

# State Tax Credits for Private Start-Up Capital: Arching Toward Urban “Entrepreneurial Redevelopment”

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## INTRODUCTION

Economic redevelopment of modern urban areas into vibrant headquarters of city culture is as intriguing to describe as it is to witness. The modern American city stands as a sheer monolith to the accumulation of history, culture, wealth, and imagination of its residents. More importantly, it represents to the local community a display of the diverse resources that were required to organize and build it and as landmark to important local traditions and endeavors. However, with the advent of suburbanization, many individuals who once knew only city living left the urban inner city for the less central and more communalized pockets of suburban America.

In the wake of the population’s departure, once-powerful downtown urban areas became economic ghost towns.<sup>1</sup> Social and economic reform programs are slow to redress the situation because of the widespread lack of resources necessary to rebuild after such a

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1. E. Scott Golden, Note, *Enterprise Zones: New Life for the Inner City*, 4 HARV. J.L. & PUB. POL’Y 243, 248-49 (1981) (quoting John F. Kain, *The Distribution and Movement of Jobs and Industry*, in THE METROPOLITAN ENIGMA: INQUIRIES INTO THE NATURE AND DIMENSIONS OF AMERICA’S “URBAN CRISES” 1, 10-15 (J. Wilson ed., 1967)).

By any measure metropolitan growth, since World War II, has been rapid but unevenly distributed. Outlying portions of metropolitan areas have been growing quickly, while the central areas have been growing very little and, in an increasing number of instances, have actually declined . . . Losses in retail sales and property values, declining profits for central city merchants, and falling tax bases have usually followed from these employment and population declines.

*Id.* at 249. See also Alan M. White, Note, *Gentrification, Tipping and the National Housing Policy*, 11 N.Y.U. REV. L. & SOC. CHANGE 255 (1982).

daunting collapse.<sup>2</sup> However, partly due to years of intensive and concentrated economic development efforts aimed at revitalizing the inner cities, the population has begun to return.<sup>3</sup> Why are people and businesses returning to the urban centers? No one simple explanation exists, and one will not be attempted here.<sup>4</sup> Most commentators agree that for both businesses and city dwellers, economic redevelopment programs continue to have at least some desirable effect on the trend of return to the cities. In Missouri, and St. Louis in particular, city residents and businesses are experiencing such an “urban renaissance.”<sup>5</sup> Not surprisingly, at the forefront of this renaissance is the small business owner.<sup>6</sup>

This Note discusses the concept of “entrepreneurial redevelopment,” a strategy implicit in modern urban economic development planning.<sup>7</sup> Entrepreneurial redevelopment is introduced

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2. See William S. Paddock, Note, *Tax and Other Legal Aspects of Business Involvement in Ghetto Development Programs*, 20 CASEW. RES. L. REV. 825, 825 (1969).

The War on Poverty has failed to provide a solution to the Nation's urban crisis. The discontent and turmoil which continue to emanate from the core areas of our cities bear witness to this failure. Conventional welfare programs based on the handout are a mere palliative for the underlying economic and social causes of chronic poverty. The dole is demeaning; it tends to promote economic dependence rather than afford the disadvantaged an opportunity for becoming productive citizens . . . . With characteristic inefficiency, the faceless bureaucracy has hindered effective implementation of existing programs, while legislative laggardness has inhibited the development of new and innovative approaches to the urban poverty problem. It is in this perspective of general governmental failure that critics have called for increased involvement of private industry in the effort to eradicate poverty and blight from the cities.

*Id.*

3. See Robin Paul Malloy, *The Political Economy of Co-Financing America's Urban Renaissance*, 40 VAND. L. REV. 67, 67 (1987).

America's urban centers are experiencing a renaissance of sorts that reflects the vitality of a renewed interest in the city. Dynamic growth and revitalization of the central city have emerged since the 1970s as key focal points for investment and development . . . . [S]ome central cities are said to be transforming into entirely new urban environments where people not only work, but live, shop, and entertain.

*Id.*

4. See *id.* at 68-69. In general, the return to urban living “involves the recognition that cities are a necessary, if not sufficient, basis for fueling long-term economic growth, job creation, and capital formation.” *Id.* at 68.

5. *Id.* at 67.

6. See *infra* Part I.

7. See *infra* Part II.

and examined here through a comparative analysis with Missouri's recently enacted Tax Credit For Investments In Missouri Small Businesses Act (the "Missouri Act").<sup>8</sup> The Missouri Act employs entrepreneurial redevelopment at the state level in the form of an outside investor incentive aimed specifically at small business investments and small business investors.<sup>9</sup> Recognizing, of course, that great business ideas often fall far away from the 'money tree,' the Missouri Act utilizes investors to create the entrepreneurial activity necessary to stimulate growth in urban areas.

Entrepreneurial redevelopment is the targeted use of investor-specific incentives to initiate and grow small and start-up businesses,<sup>10</sup> thereby initiating sustainable economic growth in an economically depressed urban city. Entrepreneurial redevelopment manifests itself in the form of direct and indirect assistance and incentives to investors in order to support small and start-up businesses in the early years of new business activity. Entrepreneurial redevelopment exclusively uses local entrepreneurs to begin redeveloping the economic and business base of a depressed urban city. The focus of entrepreneurial redevelopment is specific and narrowly limited to initiating small and start-up businesses. Once a viable economic base is established and supported by sustained entrepreneurial activity, additional economic development programs and tax incentives are better able to provide larger-scale, even manufacturing-level, urban development.

Entrepreneurial redevelopment is not an effort to subsidize already-failing larger and mid-sized businesses or to encourage a start-up business to relocate to a different location from outside of the urban region.<sup>11</sup> Entrepreneurial redevelopment is an effort to start *additional* businesses within the region, using the flexibility and

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8. MO. REV. STAT. §§ 135.400-430 (Supp. 1999).

9. See *infra* Part I.

10. 'Small business', 'start-up business', and 'Missouri small business' are used interchangeably and for the purposes of this Note have similar meanings. 'Start-up business' is used in certain contexts where it is more appropriate to denote the very early phase of growth of the business.

11. Such programs to attract businesses to locate in another area are commonly known as "location incentives." See, e.g., Andrew Kolesar, Note, *Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development?*, 44 TAX LAW. 285 (1990).

agility of small business organizations to take advantage of the remaining, but scarce viable resources and opportunities in depressed urban areas.

This genesis is not a novel concept; rather, entrepreneurial redevelopment is a concept implicit in other redevelopment strategies.<sup>12</sup> Current economic stimulus projects already use small businesses and start-ups as catalysts for growth.<sup>13</sup> Entrepreneurial redevelopment to date has neither been employed on a large or unrestricted scale, nor monitored as a specific and purposeful development strategy itself. In the urban economic development context, entrepreneurial redevelopment typically precedes other successfully implemented redevelopment strategies and responds to community and small business needs.

Part I of this Note introduces Missouri's innovative response to the challenge of urban redevelopment.<sup>14</sup> Part I will describe the Missouri Act in detail, first on a functional level and then on a policy level. Next, Part II will introduce the Enterprise Zone and provide an overview of the Missouri Act's problematic operational and policy effects by way of comparison to Enterprise Zones.<sup>15</sup> Part III describes the conflicting statutory enactments and policy objectives between Enterprise Zones and the Missouri Act. Part III also discusses the pivotal "fixed pool" assumption, as embodied in the Missouri Act, and explores and details this assumption as it affects Missouri's implemented redevelopment strategy.<sup>16</sup> Part III then presents arguments for rejecting the "fixed pool" assumption in the Missouri Act.<sup>17</sup> In conclusion, this Note recommends a less restrictive 'free-market' clause to fully initialize entrepreneurial redevelopment,

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12. See *infra* notes 87-94 and accompanying text.

13. See *infra* Part II.

14. See *supra* note 7.

15. Part II specifically addresses Enterprise Zones and does not address other redevelopment programs. The programs that are not addressed include the following: "sales and use tax exemptions, a wage credit for job creation, an employer income tax credit, a credit for hiring certain disadvantaged workers, property tax reduction or abatement, . . . investment credit for real improvements, . . . venture capital funds, tax increment financing, direct state loans, regulatory relief, and infrastructure improvement assistance." David Williams, II, *The Enterprise Zone Concept at the Federal Level: Are Proposed Tax Incentives the Needed Ingredient?*, 9 VA. TAX REV. 711, 720-21 (1990).

16. See *infra* Part III.

17. See *infra* Part III.

reversing the current 'fixed-pool' statutory assumption and its stifling ramifications.<sup>18</sup>

### I. THE MISSOURI ACT: AN INNOVATIVE FIRST STEP ON THE ROAD TO ENTREPRENEURIAL REDEVELOPMENT

Commentators note that there is a renewed interest in the revitalization and redevelopment of urban areas in the United States.<sup>19</sup> While suburban areas continue to grow with the population rate, the recent growth in many urban downtown areas has been attributed primarily to a demand for newer urban environments and urban living.<sup>20</sup> The plethora of start-up opportunities for entrepreneurs and small business owners in these downtown urban areas partly causes this urban economic "phenomenon."<sup>21</sup> Urban areas are typically rich in raw business resources and provide a supportive environment to develop small and start-up businesses.<sup>22</sup> Thus, the recent drive to resurrect many of the country's downtown areas presents a clear opportunity for entrepreneurs and small start-up business owners to act as catalysts and leaders in the resurgence of these important regions.<sup>23</sup>

Missouri's efforts to develop its flagging downtown urban cities culminated with an unusually progressive tax expenditure: the State of Missouri Tax Credit for Investments In Missouri Small Businesses

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18. See also, e.g., Part II.

19. Malloy, *supra* note 3, at 67-68. See also, e.g., JANE JACOBS, CITIES AND THE WEALTH OF NATIONS (1984).

20. Malloy, *supra* note 3, at 68 ("Cities provide the closely knit environment necessary for the incubation of many small business enterprises."). "The economic strength of urban centers and the extended regions that surround them is essential, not only for improving the local standard of living, but for improving regional and national economic prospects as well." *Id.*

21. See Stuart M. Butler, *Enterprise Zones: Pioneering in the Inner City*, in NEW TOOLS FOR ECONOMIC DEVELOPMENT: THE ENTERPRISE ZONE, DEVELOPMENT BANK, AND RFC 25 (George Sternlieb & David Listokin eds., 1981). Small businesses are able to use local resources more efficiently and "[s]mall firms are the most effective creators of jobs in the economy, and provide the type of jobs most suitable to the inner city." *Id.*

22. Malloy, *supra* note 3, at 68 (noting that "[o]nly in the womb of the urban environment can the small business enterprise . . . have access to extensive sources of capital, flexible use of technology, [and] close relationships with other similarly innovative firms").

23. *Id.* at 67-68.

Act,<sup>24</sup> made effective January 1, 1993.<sup>25</sup> The Missouri Act represents an effort to stimulate additional small business activity within the state with targeted tax expenditures aimed specifically at the early stages of a start-up business' life cycle.<sup>26</sup> The Missouri Act provides that a "qualified investment"<sup>27</sup> into a "Missouri small business"<sup>28</sup> entitles any investor<sup>29</sup> to a state tax credit equal to forty percent of the gross amount of cash invested by the taxpayer.<sup>30</sup> For the small business investor, the Missouri Act provides an attractive risk-reduction incentive to seriously consider adding a local small business in Missouri to a diversified investment portfolio.<sup>31</sup> For the

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24. MO. REV. STAT. §§ 135.400-.430 (Supp. 1999).

25. *Id.*

26. John A. Granda, *An Overview of Missouri's New Seed Capital Tax Credit Legislation*, 49 J. MO. BAR 263, 263 (1993). Generally, as the small business begins to operate and demand more working capital than the owners and their families have available to contribute, some sort of secondary financing will be acquired, if it has not already been acquired. The Missouri Act focuses on this stage of capital financing of the business concern. *Id.* at 265-67.

27. *See infra* notes 32-37 and accompanying text.

28. § 135.400(8) (Supp. 1999). The Missouri Act broadly defines a "Missouri small business" as "an independently owned and operated business . . . which is headquartered in Missouri and which employs at least eighty percent of its employees in Missouri . . . involved in interstate or intrastate commerce." *Id.* The small business must be engaged in one of the specifically enumerated industries in order to qualify for the credit. *Id.* *See infra* notes 45-49 and accompanying text. However, there is no requirement that the business be in a particular form, i.e., partnership, corporation, limited liability company, or sole proprietorship.

29. The Missouri Act defines an "investor" to include "an individual, partnership, financial institution, trust or corporation" subject to certain requirements which are not germane to this discussion. §135.400(7) (Supp. 1999). Although the Missouri Act explicitly lists corporations as qualified investors able to receive the tax credit, if an investing corporation acquires over fifty percent of the ownership of the small business, the corporation will become a "principal owner" and will not be eligible for the credit. §135.414 (Supp. 1999). The Missouri Act explicitly excludes from qualified investor status the principal owner, their spouse, and relatives within the third degree of consanguinity or affinity. §135.414 (Supp. 1999).

30. § 135.403 (Supp. 1999). The Missouri Act also provides a sixty percent tax credit for qualified investments into a "Missouri small business in a distressed community," as that term is defined in section 135.530. Further, if the qualified investment is in a "community bank or community development corporation," the tax credit is equal to fifty percent of the amount of the investment. *Id.* "The tax credit may be used to offset the Missouri state income tax liability of the investor [or] the Missouri state corporation franchise tax liability of any corporate investor [and] . . . [e]xcess credits may be carried forward for ten years." Granda, *supra* note 26, at 263.

31. In its simplest form, investors may view the amount of state income tax credited to them as a cash payment equal to the above-market risk the investor assumed by investing in a small business with no proven track record. Granada, *supra* note 26, at 263 ("In view of the higher risk of loss from investing during the early phases of a small business, it was also

entrepreneur seeking a much-needed capital investment into their start-up business from investors, the Missouri Act places start-up investments on equal footing with less risky, but potentially less profitable, investment ventures.<sup>32</sup> In essence, the investor assumes real additional underlying risk in her investment while simultaneously lowering the comparative risk of her investment opportunity as compared with other, potentially less profitable, ventures.

The Missouri Act requires the start-up business investor to make a “qualified investment”<sup>33</sup> in the business in order to be eligible for the tax credit.<sup>34</sup> For the purpose of the Missouri Act, “qualified investments” are basically unsecured cash investments,<sup>35</sup> consisting of equity or debt securities.<sup>36</sup> Unsecured investments are especially

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recognized that the additional stimulus provided by tax credits for such investments was needed to compensate for that risk.”). *Id.*

32. *Id.*

33. MO. REV. STAT. § 135.408 (1994). This section broadly authorizes the small business to use the investment dollars for “capital improvements, plant, equipment, research and development, or working capital for the business or such business activity as may be approved by the department.” *Id.* The Missouri Act does not define “working capital,” and for the purposes of this Note it is assumed to incorporate its common usage and meaning. *See id.* Thus, the Missouri Act purportedly authorizes the invested dollars to be spent on wages, leases, and incorporation fees such as accountants, attorneys, and insurance agents. *Id.*

34. § 135.403 (Supp. 1999). This requirement and others discussed in this Section are enforced through a certificate that is issued from the Missouri Department of Economic Development specifying the amount of the tax credit to be given to a particular investor. § 135.426 (1994). The certificate is an important part of the implementation of the Missouri Act as it encourages investor/entrepreneur contact in the investigation of the venture and assures that the state will have an effective means of tracking the expenditure. *See id.*

35. The Missouri Act specifies only that the “investment” must be “a transaction in which a Missouri small business . . . receives a monetary benefit from an investor pursuant to the provisions of sections 135.403 to 135.414.” §135.400(6) (Supp. 1999). Although this Note assumes that cash is the primary investment made into start-up businesses, this does not serve to undermine the proposition that equipment, plant, real property, and other cash equivalent investments may be the subject of the investor’s contribution and still fall within the gamut of the Missouri Act. To the author’s knowledge, this proposition, to date, is untested in the Missouri courts.

36. § 135.408 (1994). Unsecured loans are also a method of financing eligible for the Missouri Act’s tax credit. *See id.* The Missouri Act further provides that following their investment, the investors “must collectively own less than fifty percent of a business after their investments are made . . . [and] investments . . . must be expended for capital improvements, plant, equipment, research and development, or working capital . . .” *Id.* The Missouri Act requires that the investments either must be registered or exempt securities, both of which have implications as to the total amount of the proceeds from the offering to be used within the state. § 135.416 (1994). However, these implications are beyond the scope of this Note.

desirable for a small business because secured lenders often secure a large portion of the new business' property with liens early in the business' life.<sup>37</sup> Conversely, in the case of service-related or high-tech and software-related businesses, the start-up may have accumulated little in tangible inventory or capital assets, making securitization for a loan nearly impossible.<sup>38</sup> Thus, the Missouri Act provides that the small business with little or no unencumbered collateral may be eligible for outside venture capital financing.<sup>39</sup>

Moreover, the Missouri Act has the desirable side effect of requiring local investors to investigate their business investment prospects more intently.<sup>40</sup> As small and start-up businesses may not make large-scale share offerings, information dissemination will be much less widespread and the information often exists in an inaccessible form. Consequently, a sound investment may require personal communication. The risky nature of an unsecured equity or debt interest further fosters the opportunity for information exchange, which encourages a heightened owner/investor understanding of the business risks involved.<sup>41</sup> The Missouri Act mandates a five-year

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37. Granda, *supra* note 26, at 266. The Missouri Act protects any assets that are not already encumbered by requiring unsecured investments. *See infra* note 39.

In order to preserve those assets, and any assets obtained with the proceeds of the seed capital raised through the tax credits, for use as collateral to obtain debt or other second-round financing, these conditions prevent the small business from having to bargain away that right because of its lack of negotiating leverage.

Granda, *supra* note 26, at 266.

38. *See infra* note 39 and accompanying text.

39. The capital investments sought for the tax credit are investments that must be "[a]t risk, that is, the repayment thereof must be entirely dependent upon the success of the business operations." Granda, *supra* note 26, at 266. Guidelines promulgated from the committee who authored the Missouri Act provide:

that no collateral of the business or other entity related to the business or its owners will be allowed to be held by the investor as security for the permitted investment, including personal or corporate guarantees of the principal owners or related persons. These requirements recognize that small businesses at this stage of development typically have few, if any, tangible assets available to secure payment of or return on seed capital.

*Id.*

40. *See, e.g.*, § 135.411 (1994).

41. The relationship between investor and owner can have a significant impact on the operation of the business concern, as well as the potential for further investments in the future. The relationship that can develop between such investors and owners is "not a pure agency

minimum period for the investment, and failure to meet this minimum leads to repayment of the tax credit.<sup>42</sup> Thus, the minimum period provides even greater incentive for the development of an understanding between owner and investor.<sup>43</sup> In the case of urban redevelopment, where crucial business synergies are still in their infancy,<sup>44</sup> these understandings can play an important role in the formation and culturing of the new business community.<sup>45</sup>

The Missouri Act strictly limits eligibility for the tax credit to those investments in “Missouri small businesses.”<sup>46</sup> The Missouri Act requires a “Missouri small business” to be independently owned, operated, and located within the state with a maximum of one

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relationship, but rather a more complex interaction characterized by give-and-take on both sides” and “more akin to a partnership than to the shareholders-manager relationship in a modern public corporation.” D. Gordon Smith, *Venture Capital Contracting in the Information Age*, 2 J. SMALL & EMERGING BUS. L. 133, 139 (1998). The opposite relationship that may evolve when the source of investment is the more traditional investor-owner arrangement is aptly described in the context of “moral hazard”:

The directors of such ... companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

*Id.* at 137 n.11 (quoting ADAM SMITH, *THE WEALTH OF NATIONS* 700 (1776)).

42. § 135.411 (1994).

43. *See id.* The Missouri Act effectively creates a five-year relationship between the investor and the entrepreneur of co-ownership, as opposed to more generic relationship of creditor and debtor. *See supra* note 19.

44. *See, e.g.*, Ed Mickens, *The City Fights Back—Downtowns on the Rebound*, 45 URB. LAND, May, 1986, at 11.

45. *Id.*

46. § 135.403 (Supp. 1999). Although the requirements are flexible enough to provide funding to most typical start-ups, eventually the business will grow to make subsequent investments ineligible for tax credits under the Act. For some businesses, commentators and economists speculate that the ‘notch problem,’ the point at which the small business outgrows the Missouri Act's eligibility requirements, will discourage growth beyond a certain point. Jane G. Gravelle, *What Can Private Investment Incentives Accomplish? The Case of the Investment Tax Credit*, 46 NAT'L TAX J. 275, 286 (1993). However, this concern ignores the presence of other redevelopment plans and programs that may better address the intermediate growth needs of the business. Further, if the ‘notch problem’ proves serious, legislators may choose to phase out eligibility for the credit over time as opposed to an immediate cut-off once business reaches a pre-set level of income. *See id.*

hundred employees.<sup>47</sup> Under the Missouri Act, a “Missouri small business” must be involved in manufacturing, processing, or assembling products, or conducting research and development.<sup>48</sup> The Missouri Act explicitly excludes all retail, real estate, insurance, and professional service organizations.<sup>49</sup> The industry exclusion effectively denies the tax credit and investment incentives otherwise provided by the Missouri Act to all restaurants, retail consumer stores, and professional consulting services including accountants, business consultants, and other professional service-based businesses<sup>50</sup> in Missouri.<sup>51</sup> By narrowing the scope of the tax credit, the industry restriction prevents entrepreneurial redevelopment from taking root on the ground plowed by the Missouri Act.<sup>52</sup>

Missouri specifies the total amount of tax credits available in a given year.<sup>53</sup> This approach fully utilizes the flexibility and accountability inherent in the tax expenditure<sup>54</sup> mechanism.<sup>55</sup>

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47. § 135.400(8) (Supp. 1999). The Missouri Act also requires that the business have annual revenues of \$2 million or less and the principal owner or owners generally must be engaged in the operation of the business on a full-time basis. § 135.414. Although the statute’s definition of a “Missouri small business” cites federal legislation, the guidelines in the Missouri Act offer clearer guidance on the eligibility of the business. § 135.400(8). The Missouri Act also requires that the start-up employ at least eighty percent of its employees in Missouri, which proves a fairly easy stipulation given the size limitations on businesses to be eligible for the credit. *Id.*

48. § 135.400(8) (Supp. 1999).

49. *Id.*

50. The apparent rationale for such a broad exclusion is discussed in detail *infra* in Part II. One commentator noted, quite accurately, that under the Missouri Act:

Businesses engaged in retail, real estate, or insurance activities or in rendering professional services such as accounting and legal services are excluded from the permissible scope of activities. The goal of these exclusions is to eliminate certain types of business which do not produce a multiplier effect on economic development as large as manufacturing or high-tech jobs. Partial justification for these exclusions is based on the recognition that some of these businesses can utilize hard-assets as collateral (such as real estate development) or are not as capital intensive (such as professional services).

Granda, *supra* note 26, at 265.

51. § 135.400(8) (Supp. 1999).

52. The Missouri Act’s industry restriction is examined *infra* in Part III. For now, it is sufficient to note its general effect on the overall operation of the statutory scheme.

53. § 135.403 (Supp. 1999). As of 1999, the total tax expenditure was capped at \$13 million. Since the enactment of the Missouri Act there have been several upward adjustments of the funding ceiling. *Id.*

54. A tax expenditure, in contrast with a direct grant of taxing revenue for a government

Missouri also limits the total amount of tax credit eligibility for individual investors although the ceiling does not restrict the total amount of investment that can be made in the small business.<sup>56</sup> The Missouri Act's tax expenditure is relatively straightforward to employ and administer, and it safeguards against abuse.<sup>57</sup>

The social and economic justifications for this government-spending tool make this device especially formidable in the arena of economic development.<sup>58</sup> Although other strategies stimulate market

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purpose, is defined generally as an exclusion, deduction, or credit that "reduce[s] the tax liability otherwise applicable by adopting a special exclusion, deduction, or the like for the favored activity or group." STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 3 (1985). "[A] general reduction of tax rates would not be a tax expenditure—though it would be relief from taxes." *Id.* at 4. Tax expenditures, although viewed sometimes as 'tax loopholes' and 'tax preferences', are really government 'spending programs.'" *Id.* at 25-26. *See, e.g.,* Koelsar, *supra* note 11, at 295-96 (noting that "tax incentives are tantamount to a spending program" and "tax incentives are politically expedient because they appear to be less costly than other spending programs.").

55. Although relevant to the effectiveness of the Missouri Act, this Note will not address the constitutional aspects of tax expenditures to promote business within a state. The main issue, of course, is the "race to the bottom" competition effect that may result when one state inspires economic growth seemingly at the cost of another state. *See, e.g.,* Peter D. Enrich, *Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 380 (1996); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984); *Boston Stock Exch. v. State Tax Comm'r*, 429 U.S. 318 (1977); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 n.9 (1994).

56. § 135.405 (Supp. 1999). The ceiling would only come into effect as a limit on the amount of investment that was eligible for the tax credit. However, that would not make the remainder of the investment above the cap unauthorized in terms of an investment in the business. One can still invest; however, the investment may not be eligible for the tax credit under the Missouri Act. Another effect of exceeding the cap is the potential to rise above fifty percent beneficial ownership of the small business, thus making all funds invested ineligible for the credit. *Id.*

57. § 135.403 (Supp. 1999).

The tax credit shall be evidenced by a tax credit certificate in accordance with the provisions of sections 135.400 to 135.430 and may be used to satisfy the state tax liability of the owner of the certificate that becomes due in the tax year in which the qualified investment is made, or in any of the ten tax years thereafter . . . . No investor may receive a tax credit . . . unless that person presents a tax credit certificate to the department of revenue for payment of such state tax liability. The department of revenue shall grant tax credits . . . [and] certificates of tax credit issued in accordance with these sections may be transferred, sold or assigned by notarized endorsement thereof which names the transferee.

*Id.* The goal of the tax expenditure is not affected by the alienability of the tax credit. *See generally* this section.

58. The social justification of using a tax expenditure as opposed to other forms of government resource allocation is framed in the context of "public perceptions." Peter J.

and economic growth over the long term, the Missouri Act's tax expenditure particularly benefits the short-term goal of immediate economic stimulus.<sup>59</sup> Additionally, the long-term implications, not discussed here, may bear on the governments' choice of redevelopment tools.<sup>60</sup>

A combination of two very visible factors embrace the legislative advantages of using the Missouri Act's tax expenditure over a direct spending program.<sup>61</sup> First, the importance of both an environment and a perception of free market development is crucial to sustained economic growth. An environment of free market growth significantly affects investor confidence and encourages the most efficient use of resources.<sup>62</sup> Moreover, the apparent lack of government dependence could bolster the entrepreneur's credibility in the eyes of potential investors. Secondly, the Missouri Act's tax

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Wiedenbeck, *Paternalism and Income Tax Reform*, 33 U. KAN. L. REV. 675, 679 (1985). Professor Wiedenbeck argues, effectively, that some important social goals cannot be achieved through direct spending as effectively as through a tax expenditure for four reasons:

First . . . most taxpayers do not consider a tax allowance available to people at their income level to be a *subsidy*. Instead of seeing special tax allowances . . . as implicit expenditures of *public* funds, most taxpayers view such allowances as *reduced government confiscation*. Second, it is not understood generally that the long-term consequences of such selective tax reduction for one's income peers is a higher tax burden for those who do not qualify for the allowance. Third, taxpayers understand that, absent cutbacks in other areas, their taxes must be raised in order to finance an explicit spending program. Fourth, an explicit subsidy designed to counteract the underuse of specific goods or services is likely to be viewed as a "give away" to the consumers of such goods and services, rather than as an expenditure which indirectly promotes the general welfare.

*Id.*

59. The Missouri legislature's ability to amend the statute to reflect the current level of desired spending under the Missouri Act and the ability to track the dollars spent via the issued certificates help to immediately assess the Missouri Act's success. See MO. REV. STAT. § 135.403 (Supp. 1999).

60. See, e.g., NEW TOOLS FOR ECONOMIC DEVELOPMENT: THE ENTERPRISE ZONE, DEVELOPMENT BANK, AND RFC (George Sternlieb & David Listokin eds., 1981).

61. A direct-spending program is a government budget line-item that is funded by a direct or indirect cash payment of tax revenue generated dollars. This is the more popularized and traditional way for Congress to exercise its taxing and spending power. See, e.g., SURREY & MCDANIEL, *supra* note 54.

62. See David M. Maloney, *A Critical Analysis of the 'Enterprise Zone' Concept and its Application*, 34 TAX NOTES 261, 274 n.58 (1987) (noting that "[a] given economic arrangement is efficient if there can be no rearrangement which will leave someone better off without worsening the position of others . . . . If . . . such a change is possible, then the prevailing arrangement is inefficient and an efficiency gain can be had by making the change.").

expenditure provides reduced-risk capital targeted at the most important financing party in the start-up of a small business—the local investor. Whereas a direct spending program provides its funds directly to the small business, a tax expenditure can promote opportunistically the direction of resulting benefits to the investor, adding a powerful incentive to invest in the start-up. Because investments in small businesses are more akin to long-term partnerships than public stock investing, the difference in approach comes down to one question: Who, as a small business owner, would you like as a long-term partner, your community or your government?

Notably, the Missouri Act's tax credit, made available to investors, differs from other state tax credits which are made available directly to the small business as an organization.<sup>63</sup> The Missouri Act tax credit represents an instant return on the investor's capital, without regard to the type or extent of risk to which the investor is exposed. Of course, business risk and other investment-related factors remain dominant considerations. Nonetheless, the Missouri Act gives the investor an additional incentive to consider the additional risk assumed in small and start-up business investing.<sup>64</sup> Thus, in terms of encouraging growth, a tax incentive aimed at encouraging the investors, who control the direction and allocation of

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63. The Missouri Act provides the investor, in addition to the small business, the additional incentive to promote development. Strategically, as compared with a start-up tax credit for the small business, a tax credit for the investor can provide overall tax savings earlier. See WILLIAM HAMILTON ET AL., *INDUSTRIAL INCENTIVES: PUBLIC PROMOTION OF PRIVATE ENTERPRISE* 118 (1985).

In contrast to exemptions and deductions, which diminish the tax base for the company, credits may be subtracted from the tax due in reducing the actual tax payment. Credits, if large enough, may offset the total tax liability for the year, and under some state codes, may be carried forward and/or backward to be applied to income from other tax years.

The administration of tax credits, particularly income tax credits, presents a challenge to the state where it wishes to promote entrepreneurial activity, product development and the growth of small businesses in general. Credits are beneficial to a firm only if there is income to be offset by the credits. Many small companies that are in the start-up phases . . . do not generate significant net income, if any. To deliver incentive benefits to such firms from income tax credits the state must consider [other] options.

*Id.*

64. See *supra* notes 28-31 and accompanying text.

capital, arguably drives the redevelopment process more rapidly and efficiently.<sup>65</sup>

It is insightful to briefly discuss implementation when considering state or local policies like the Missouri Act.<sup>66</sup> A major criticism levied on several government redevelopment activities is the extent of the government's role in guiding or implementing the new activity.<sup>67</sup> Perhaps an equally persuasive criticism is the skepticism in state or federal government officials' ability to adequately predict and shape market development, especially given that the urban region's economic base is currently in disrepair.<sup>68</sup> The relationship between the investor's and entrepreneur's skepticism and the strong and active hand of government in private business affairs is further amplified in the context of the capital and investment markets. The Missouri Act, however, reaches a reasonable compromise between the state's objective, and market demands. Missouri's use of a tax expenditure to effectively purchase risk away from local investors creates the atmosphere of free market mechanics and allows increased entrepreneur and investor control in matters concerning the small business.<sup>69</sup> In substance, the Missouri Act attracts capital to small businesses with the most subtle of lures, all of which are directed at

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65. Golden, *supra* note 1, at 246. Planners have used tax incentives:

as a means of persuading private citizens and enterprises to invest in desired ways at desired times, and in desired locations. To encourage long-term investment, we tax capital gains at a ceiling of twenty-five percent. To encourage charitable contributions, we allow them to be deducted from current income. To encourage oil and mineral production, we offer depletion allowances. To encourage the building of grain storage facilities and defense plants, we have offered faster-than-normal depreciation rates. To encourage investment in capital goods, as opposed to inventory or consumption, we have allowed tax credits for such investment; suspended that credit when we wished to slow investment down; and reinstated it in order to speed investment up again.

*Id.* at 246-47 (quoting R. KENNEDY, TO SEEK A NEWER WORLD 42-43 (1967)).

66. See, e.g., TIMOTHY J. BARTIK, WHO BENEFITS FROM STATE AND LOCAL ECONOMIC DEVELOPMENT POLICIES? (1991).

67. *Id.* at 26-62.

68. One commentator posed the concern; "in the context of a dynamic, multiurban national economy, can local politicians and urban planners be expected to select and promote the best revitalization plans on a project-by-project, neighborhood-by-neighborhood basis . . . ?" Malloy, *supra* note 3, at 74.

69. If framed as "are revitalization efforts best realized by creating a foundation for market-directed revitalization based on an enhanced free flow of capital, technology, labor, and ideas?", the answer would be in the affirmative. *Id.*

the investors. The Missouri Act accomplishes a balance between an environment of free-market economics and the Missouri legislature's efforts to focus exclusively on small businesses in depressed urban cities.

## II. THE ENTERPRISE ZONE; FREE-MARKET MECHANICS SET FREE

Before turning a critical eye toward the Missouri Act, it is useful to describe, in overview, the concept of the Enterprise Zone. Thirty states have enacted Enterprise Zone legislation as part of urban redevelopment efforts.<sup>70</sup> Generally, the Enterprise Zone is an attempt to initiate economic growth in a legislatively-controlled business environment.<sup>71</sup> The Enterprise Zone aims to initiate self-sustaining business and commerce development.<sup>72</sup> Fierce debates surround the question of the success of Enterprise Zones in America and even the

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70. Maloney, *supra* note 62, at 267.

71. David Boeck, *The Enterprise Zone Debate*, 16 URB. LAW. 71, 74-85 (1984).

There is a consensus that federal urban programs have not achieved promised goals, and that a radically different approach to urban problems must be taken. Proponents believe it is difficult to argue effectively against an enterprise zone program, since enterprise zones are proposed to supplement existing federal programs, not to replace them. The concept involves building on the effective elements of existing programs, rather than scrapping them and starting from nothing.

Proponents view taxation and government regulation as burdens that hinder entrepreneurship and stifle the innovative spirit. . . . The program is intended to create paradise in the inner city for the venturesome, free enterprise capitalist.

*Id.* at 74-75.

72. *Id.* at 75. Enterprise Zone programs are designed for several specific reasons:

[To] benefit . . . the low-income, unskilled, uneducated residents of inner cities by making them entrepreneurs. The concept requires confidence that there is considerable potential for economic development in the most depressed neighborhoods and that "apparently unsophisticated people" can succeed as entrepreneurs when given the appropriate incentives. The incentive is profit, made more readily available by removing governmental burden . . . .

The enterprise zone is not intended to guarantee success to each of these entrepreneurs, but to reduce unnecessary causes or failure . . . .

Enterprise zone objectives are several. Most importantly is a significant reduction of inner-city unemployment. The primary supplier of jobs will be small business. Local private enterprise will be encouraged and new jobs will come from an economic expansion.

*Id.* See Madsen Pirie, *A Short History of Enterprise Zones*, NAT'L REV., Jan. 23, 1981, at 26; *see, e.g.*, STUART M. BUTLER, ENTERPRISE ZONES GREENLINING THE INNER CITIES (1981).

standards for benchmarking the success of the programs.<sup>73</sup> However, despite the great difficulty in identifying the success of the programs, it is not generally disputed that states employ Enterprise Zones with at least some success in cities around the country and even around the world.<sup>74</sup>

In an effort to stimulate economic growth in depressed urban centers, economists, sociologists, and urbanologists collaborated to develop the concept of the Enterprise Zone.<sup>75</sup> The Enterprise Zone concept, originally tested in England,<sup>76</sup> quickly spread throughout the western hemisphere.<sup>77</sup> The United States implemented Enterprise Zones in depressed urban cities in an effort to foster economic growth with limited affirmative government stimulus.<sup>78</sup> Essentially, an Enterprise Zone is a geographic area<sup>79</sup> in a depressed urban center singled out by local or federal officials to receive special consideration.<sup>80</sup> This consideration typically is offered in the form of relaxed minimum wage laws, housing codes, building codes, reduction or elimination of state or federal income or capital gains tax, and a general lessening of burdensome and expensive municipal 'red tape.'<sup>81</sup>

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73. BARTIK, *supra* note 66, at 205-08. See, e.g., David L. Callies & Gail M. Tamashiro, *Enterprise Zones: The Redevelopment Sweepstakes Begins*, 15 URB. LAW. 231 (1983).

74. BARTIK, *supra* note 66, at 207.

75. See, e.g., Williams, *supra* note 15, at 712-22. President Ronald Reagan aptly summed up the goal of the Enterprise Zone in his 1982 State of the Union Address: "A broad range of special economic incentives in the [Enterprise] zones will help attract new business, new jobs, new opportunity to America's inner cities .... Some will say our mission is to save free enterprise. Well, I say we must free enterprise so that, together, we can save America." Ronald Reagan, Address Before a Joint Session of the Congress Reporting on the State of the Union (Jan. 26, 1982), reprinted in 1 PUBLIC PAPERS OF THE PRESIDENTS 72, 76 (1982).

76. Butler, *supra* note 21, at 26-29. Peter Hall originally formulated the first formal Enterprise Zone plan in an outline entitled "Freeport." *Id.* at 26. He designed the concept specifically for the inner cities. *Id.* at 26.

77. *Id.*

78. Maloney, *supra* note 62, at 262-63.

79. Enterprise Zones are defined by geographical boundaries, typically because the level of economic incentive is so burdensome to the state. Although the Missouri Act is a statewide initiative, Enterprise Zones remain valid comparisons.

80. *Id.* at 262-64.

81. Williams, *supra* note 15, at 720-22. At the state level, common incentives include: sales and use tax exemptions, a wage credit for job creation, an employer income tax credit, a credit for hiring certain disadvantaged workers, property tax reduction or abatement, and investment credit for real improvements. Other incentives include

The goal of an Enterprise Zone is to provide a geographically focused area where capital investment and community resources economically flourish amid reduced government interference.<sup>82</sup> By removing regulatory obstacles, small businesses avoid the high cost and bureaucratic confusion often associated with start-up businesses.<sup>83</sup> In a regulation-free climate, small businesses have a better chance for growth and survival.<sup>84</sup> The key to both the Enterprise Zone and the concept of entrepreneurial redevelopment, and, more pointedly, the critical missing element in the Missouri Act, is supported free-market enterprise and development.<sup>85</sup> The Enterprise Zone does not dictate product or process type or industry requirements for start-up businesses in the Zone; rather, it lays an attractive foundation for a self-selecting variety of small businesses, inviting self-directed and independently sustainable economic growth.<sup>86</sup>

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availability of venture capital funds, tax increment financing, direct state loans, regulatory relief, . . . infrastructure improvement assistance . . . [and] small business incubators.

*Id.* at 720-21.

82. Butler, *supra* note 21, at 35 (finding that “[r]educ[ed] to its essential foundations, the Enterprise Zone aims to stimulate businesses—especially small enterprises—in depressed central-city neighborhoods, by encouraging entrepreneurs to take the risk of setting up a business by removing unnecessary obstacles and reducing taxes.”).

83. *Id.*

84. *Id.* at 40.

85. *See supra* notes 73-74 and accompanying text.

86. Malloy, *supra* note 3, at 73-75. The policy question is succinctly posed as:

in the context of a dynamic, multiurban national economy, can local politicians and urban planners be expected to select and promote the best revitalization plans on a project-by-project, neighborhood-by-neighborhood basis, or are revitalization efforts best realized by creating a foundation for market-directed revitalization based on an enhanced free flow of capital, technology, labor, and ideas?

*Id.* at 73. Most importantly, the Enterprise Zone is:

a recognition both that at least part of the urban crisis is due to government, and that success is more likely if the residents of a community are given a real chance to rebuild the commerce and housing of their neighborhood with a minimum of taxes and red tape. The Enterprise Zone imposes no blueprint and stifles no local idea. What it does do is to declare the blighted inner cities open neighborhoods, devoid of as many regulations and tax costs as possible, and to invite what may be called Urban Pioneering—the same kind of local projects and enterprise that once built countless successful communities across the continent.

Butler, *supra* note 21, at 41.

Enterprise Zones specifically target small business growth as the primary catalyst for economic turnaround in depressed urban business areas.<sup>87</sup> It is axiomatic that more traditional redevelopment plans focus on attracting large corporations to depressed areas, while economic growth continues to stem mainly from small businesses.<sup>88</sup> By focusing on the creation and growth of small and start-up businesses, the Enterprise Zone revitalizes existing, but dormant local assets in an attempt to stimulate free-market forces.<sup>89</sup> Much of the basic business infrastructure in an Enterprise Zone is in disarray, and small businesses are better equipped to make efficient use of confused, indigenous resources.<sup>90</sup> Furthermore, small businesses are able to take advantage of resources and talent on a small scale more quickly and less expensively than large companies.<sup>91</sup> Because small businesses are not capital *intensive* but are extremely capital *sensitive*, they use dollars available for investment more efficiently

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87. Butler, *supra* note 21, at 25. *See also* Golden, *supra* note 1, at 265 (concluding that “[t]he important factor in employment decline is not whether large businesses can be induced to move into the central city, but whether new businesses can be induced to begin operations there.”). One commentator aptly noted:

The greatest economic problem of the inner city is the poor birthrate of businesses-and especially small businesses . . . . The best way of encouraging this sector is thus to remove obstacles in the path of the entrepreneur in the cities and to give these individuals the kind of business climate that will provide the incentive to take risks.

Butler, *supra* note 21, at 25.

88. Golden, *supra* note 1, at 265. This commentator correctly observes that:

The job generating firm tends to be small. It tends to be dynamic (or unstable, depending on your viewpoint)—the kind of firm than banks feel uncomfortable about. It tends to be young. In short, the firms that can and do generate the most [new] jobs are the ones most difficult to reach through conventional policy initiatives . . . .

The very spirit that gives them their vitality and job-creating powers is the same spirit that makes them unpromising partners for the development administrator.

*Id.* *See* Maloney, *supra* note 62, at 265.

89. Maloney, *supra* note 62, at 263.

90. *Id.* The basic premise is “that local residents are better able than outsiders to relieve local social and economic maladies, if given the opportunity.” *Id.*

91. Butler, *supra* note 21, at 25.

Neighborhood residents have shown themselves eager to put their own time, effort, and limited resources into housing rehabilitation if given genuine encouragement to do so. Rather than funding new projects, governments would achieve more if they created a climate in which essentially self-help projects would be more likely to succeed.

*Id.*

than larger businesses. Small businesses utilize more of the untrained urban workforce due to the lower skill requirements for many positions, and more efficiently produce jobs as growth ensues.<sup>92</sup> An Enterprise Zone is, at its core, a highly subsidized form of entrepreneurial redevelopment.<sup>93</sup> However, as compared with the Missouri Act, the economic incentive for entrepreneurial redevelopment emphasizes an immediate return to the investor, as well as an environment of increased free-flowing capital to the small business.<sup>94</sup>

### III. THE ENTERPRISE ZONE MEETS THE MISSOURI ACT: “WHERE IS YOUR ENTREPRENEURIAL REDEVELOPMENT?”

Like the Enterprise Zone, the Missouri Act recognizes the fundamental importance of small businesses in urban redevelopment.<sup>95</sup> Enterprise Zones primarily depend on the job-producing attributes of small businesses. The Missouri Act targets only those businesses still in their infancy, and thus, in this respect, the Missouri Act mirrors Enterprise Zones because it recognizes the important and indispensable role that start-up businesses play in local economic redevelopment.

In fact, the Missouri Act seeks to create a type of state-wide Enterprise Zone, albeit with only one financial incentive, by way of the most important growth catalyst for small businesses—early, long-term capital investment.<sup>96</sup> The most obvious difference between

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92. Butler, *supra* note 21, at 25. Butler notes that small businesses “bring together local entrepreneurial talent and the young, unskilled workforce, and they play a crucial social role in the community.” *Id.* Maloney, *supra* note 62, at 286.

93. *See supra* notes 6-10 and accompanying text.

94. *See supra* note 7-11 and accompanying text.

95. The exclusively local nature of the small business is stressed heavily throughout the requirements of the Missouri Act. *See, e.g.*, MO. REV. STAT. § 135.400(8) (Supp. 1999) (defining a “Missouri small business” as an “independently owned and operated business . . . which is headquartered in Missouri and which employs at least eighty percent of its employees in Missouri . . .”).

96. Although Missouri legislative history does not reveal a legislative intent to create an Enterprise Zone, it is instructive to note several provisions in the Missouri Act that pertain to additional tax credits for investments in to a “target area.” § 135.403 (Supp. 1999). A “target area” is defined in the Missouri Act as “a group of blocks or a self-defined neighborhood where the rate of poverty in the area is greater than twice the national poverty rate . . .” § 135.400(13) (Supp. 1999). Investments in a “target area” provide the investor with a fifty percent tax credit.

Missouri's approach and the Enterprise Zone is the financial incentive which attracts the investment to the business.<sup>97</sup> The focus in an Enterprise Zone is on providing financial incentives to the small business *owner*; the Missouri Act places a preponderance of the financial incentives on the small business *investor*. Thus, the demand for tax-favored investment is on both sides of the transaction, as opposed to only on the entrepreneur's side in an Enterprise Zone. In other words, investors will push capital investments into small businesses for the immediate return, in the form of a tax break, while entrepreneurs are pulling these investors and their capital investment by offering the tax break as a risk-reducing incentive to invest.<sup>98</sup>

On the surface, the Missouri Act seems a distant cousin to the Enterprise Zone, at least in terms of the basic policy underpinnings like development incentives and deployment of small businesses. However, in one fatally flawed respect the Missouri Act is directly contradictory to the Enterprise Zone concept—the explicit industry restriction. By this restriction, the Missouri Act hinders the entrepreneurial redevelopment scheme clearly engendered in Enterprise Zones. The Missouri Act's explicit industry restriction<sup>99</sup> is perverse to the scheme of stimulating a revitalized free-market environment because the restriction ignores the Enterprise Zone's most basic proposition—to encourage free-market, self-sustaining economic growth.<sup>100</sup>

The Missouri Act premises its industry restriction clause on what is known as the “fixed pool” assumption.<sup>101</sup> The fixed pool assumption, a common premise of modern economic redevelopment theory, engenders the notion that the number of new small and start-up businesses to emerge in any given year is fixed.<sup>102</sup> Essentially, the

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MO. REV. STAT. § 135.403 (Supp. 1999). At least implicitly, one can glean from the text of the statute an intent that the credit be used in the urban areas most needy.

97. See *supra* notes 24-27 and accompanying text.

98. See *supra* notes 26-30 and accompanying text.

99. See *supra* notes 45-49 and accompanying text.

100. Butler, *supra* note 21, at 35.

101. Entrepreneurial redevelopment and programs such as Enterprise Zones are “not designed to create a zero sum game, where existing businesses move to the inner city leaving abandoned workers behind.” Boeck, *supra* note 71, at 75.

102. The ‘fixed-pool’ assumption leads policy makers to examine competing states in a ‘race for the bottom’—an effort where states compete to attract start-up companies for other

assumption posits, economic and business market conditions in the United States will only produce a limited and predictable number of new start-up businesses in any given year.<sup>103</sup> The fixed pool assumption often leads policy makers and local governments to face redevelopment problems with strategies to attract more of these annual small businesses from outside their respective geographic area—basically to affect a favorable redistribution of business activity.<sup>104</sup> Redevelopment programs that partially, or completely, ignore the importance of stimulating of new small business from within their borders, like the Missouri Act,<sup>105</sup> premise their strategies on this assumption.<sup>106</sup>

Because of the “fixed pool” assumption, many current redevelopment programs focus solely on the entrepreneurs that will undoubtedly launch small businesses<sup>107</sup> from outside the region or state.<sup>108</sup> Neither this focus nor the assumption behind it rests squarely

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states with more favorable economic incentives. Enrich, *supra* note 55, at 400. “[A]rguments for state business incentives focus almost universally on incentives’ ability to influence the location of economic activity, not on their ability to affect the overall level of investment; incentives aim to redivide the pie, not to make it larger.” *Id.* at 398 n.110. Approaching economic redevelopment as a finite resource, to be divided among programs as a “pie,” may be where other economic redevelopment efforts fall short. *Id.*

103. Enrich, *supra* note 55, at 399. Consistent with this line of reasoning, states engage in massive attempts to attract businesses from other states in an effort to increase their own economic base. The effect on the states is:

far worse than zero sum. For, although the states can expect to achieve no overall gain in business activity or jobs, they do incur a very substantial loss of tax revenues. Even a tax break that succeeds in attracting a business investment to a state will represent a net loss for the states collectively, as long as that investment . . . would have occurred in some state in the absence of the incentive.

*Id.* at 398-99.

104. *Id.*

105. *Id.* “In short, continuing interstate competition over incentives for businesses has reduced state taxation of mobile capital and has intensified the rivalry among the states for a finite pool of businesses and jobs, all without an appreciable effect on the interstate distribution of economic activity.” *Id.* at 401.

106. See, e.g., DAVID OSBORNE & TED GAEBLER, *REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR* (1992).

107. *Id.* at 190-201.

108. Based on the “fixed pool” assumption, policy makers embark on strategies to draw businesses of all types and sizes to a state for the purpose of increasing the state’s tax base. These “location incentives” speak to a finite pool of resources, an assumption that Enterprise Zones clearly reject. The use of these “location incentives” to attract new business is beyond the scope of this article. *But see, e.g.,* Kolesar, *supra* note 11, at 285.

on prevalent redevelopment theory or economic reality.<sup>109</sup> In its defense, this erroneous premise makes for accurate economic comparisons that can easily sum up the benefits derived from the program simply by watching tax revenues.<sup>110</sup> However, from an economic redevelopment perspective and as evidenced in the Missouri Act, the ‘fixed pool’ assumption is limiting and may lead to the wrong political, sociological, and economic result.<sup>111</sup>

The “fixed pool” assumption implicit in the Missouri Act’s industry restriction leads to results that ignore some of the economic realities of urban redevelopment. The industry restriction assumes those sustainable firms in the product assembly and research and development industries will be first to “re-locate” to a depressed urban area in response to financial incentive.<sup>112</sup> However, because the

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[T]he majority of commentators in this field have concluded that these contributions, especially when in the form of tax incentives, constitute such a minor role in the location decision, that they are essentially unnecessary expenditures that deplete government revenue sources and erode the level of government services, such as infrastructure improvement and education, factors acknowledged by most as playing a major role in the location decision.

*Id.*

109. Theorists rest their conclusions on the “zero sum game” argument against economic development policy. BARTIK, *supra* note 66, at 187. The argument posits “that development policies only redistribute jobs among state or local areas ... [and] [t]he gains of the unemployed in one local area are offset by the losses of the unemployed in other local areas.” *Id.* However, the argument is easily questioned when the assumption of the fixed pool of ventures is rejected. The issue then becomes one of encouraging entrepreneurial productivity, which is not a “zero sum game.” *Id.* at 188.

110. Much of the important research necessary to validate any particular economic development project is missing. Maloney, *supra* note 62, at 274. However, “[t]he data and research relating to this issue appears to support the EZ [Enterprise Zone] concept, although the results are not overwhelming.” *Id.*

111. *Id.* It is important to clarify on what rational grounds this premise is so vehemently rejected. Some studies show that the number of start-up companies each year can be relatively constant from year to year. See, e.g., Small Business Association, *Executive Summary: ACE-Net (Angel Capital Electronic Network)*, at <http://www.sba.gov/advo/acenet/report.html> (last visited Jan. 12, 2001) (“The total number of entrepreneurial companies receiving investment from institutional venture capital funds remains fairly small and relatively constant. In 1987, the NVCA venture funds invested in 1,737 companies; in 1991 the total was 791 companies; in 1993 it was 938 companies; and in 1995 it was 1,090 companies.”). But this is not evidence that the pool of ‘potential’ start-ups is fixed; rather, it serves only to indicate how the current entrepreneurial financial system effectively maintains the number receiving investment constant each year.

112. It is doubtful that the Missouri Act intended anything other than an attempt to attract smaller, heavy manufacturing and production companies from outside the region. See Maloney,

area is already depressed, it is probably void of successful industry counterparts, suppliers, support services, qualified staff, and amenities.<sup>113</sup> Further, as evidenced in Enterprise Zones, sustainable high-tech and manufacturing intensive firms are not the small businesses initially to seek out a depressed urban area.<sup>114</sup> In this manner, the Missouri Act's industry restriction exemplifies putting the cart before the horse. While small professional service, retail, and other consulting-type businesses that can more ably take advantage of the limited resources in a flagging urban area are targeted by Enterprise Zones,<sup>115</sup> these industries do not qualify for the Missouri Act's incentives as the result of the industry restriction.<sup>116</sup> The premise of the Missouri Act's industry restriction is the fixed pool assumption, and therefore it focuses almost exclusively on attracting business. As such, the Missouri Act does not aim to generate additional small businesses,<sup>117</sup> but rather attempts to attract small manufacturing-intensive firms from outside the state to relocate in an intra-state depressed urban region.

This argument is not to imply that the Missouri Act is completely noneffectual. However, the Missouri Act does not lend itself to developing a sustainable free-market environment in which small businesses can develop independent of additional subsidies at inception. The success of providing incentives to relocate businesses is doubtful at best and, certainly from a practical standpoint, much more difficult for local residents to rally behind and finance.<sup>118</sup>

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*supra* note 62, at 262-65.

113. That is not to say that the area is desolate. Rather, the area contains resources that only certain businesses are in a position to take advantage of. Heavy manufacturing and high-tech internet start-ups are not in such a position. *Id.* at 274 (discussing Pareto efficiency at the service business level).

114. *Id.* at 264-65.

115. *Id.*

116. See *supra* notes 43-49 and accompanying text.

117. See, e.g., Maloney, *supra* note 62, at 270-71.

118. See generally this part.

## CONCLUSION

The “fixed pool” assumption that led to the industry restriction in the Missouri Act is self-defeating and prevents entrepreneurial redevelopment. However, if policy makers reject the “fixed pool” assumption, as argued for here, then they properly may reject the industry restriction in the Missouri Act as well. A more appropriate “free-market” clause, allowing investors to pour much-needed capital into any small or start-up business in the urban region that meets the size and capitalization requirements of the Missouri Act should replace the industry restriction.

This change would result in an economic development program in Missouri that uses entrepreneurial redevelopment on a statewide level, targeting numerous urban areas and producing growth under free-market conditions in a sustainable manner.<sup>119</sup> Once freed of the restrictive nature of industry requirements, local economies could focus on creating new entrepreneurial opportunities by opening channels to outside equity investments, lured by risk-reduced investing and the instant return inherent in a tax credit. Armed with the Missouri Act, investors in the state of Missouri could team with entrepreneurs to produce sustainable businesses that take full advantage of existing resources in resurgent urban areas.

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119. “Many . . . programs do not assist start-up businesses with one of their most pressing needs, that of start up capital.” Maloney, *supra* note 62, at 272.





