

BRINGING NEW LIFE TO ENTERPRISE ZONES: CONGRESS FINALLY TAKES THE FIRST STEP WITH THE HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1987

I. INTRODUCTION

There are no easy solutions to the problems presented by America's depressed inner cities. Clearly, the traditional approach to this problem has failed. After years of federal renewal projects, inner cities remain locked in a downward spiral of decay and poverty.¹ The enterprise zone is an alternative approach. This Note examines each element of the enterprise zone concept² and describes the first federal enterprise zone act, the Housing and Community Development Act of 1987 (HCDA).³ In addition, this Note addresses the need for more comprehensive federal enterprise zone legislation.

1. "Despite Great Society intentions and years of experience with federal anti-poverty programs the condition of many inner-city areas is disastrous." Boeck, *The Enterprise Zone Debate*, 16 URB. LAW. 71, 74 (1984) (quoting *Kemp's Urban Magic*, THE NEW REPUBLIC, Aug. 23, 1980, at 5-6. See also *Enterprise Zones: Hearing Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 97th Cong., 2d Sess. 16 (1982) (statement by Rep. McKinney).

2. The enterprise zone concept is based on the employment of market forces and the reduction of government interference in distressed areas. This Note focuses solely on the use of enterprise zones in the inner cities. Rural and urban enterprise zone proposals share many similar elements. See Boeck, *supra* note 1, at 86 for a discussion of various proposals to apply enterprise zones to rural areas.

3. 42 U.S.C. §§ 11501-11505 (1988). Congress passed the HCDA on Dec. 21, 1987. President Reagan signed the Act into law on Feb. 5, 1988.

The roots of America's urban crisis are unclear. Stuart Butler of the Heritage Foundation theorizes that in post-World War II America, increased mobility coupled with high inner-city property values spurred migration of skilled and middle-income workers from the cities to the suburbs.⁴ This exodus left behind those who were unable to move — the unskilled, unemployed, and poverty stricken.⁵ Inner-city businesses soon followed their more affluent customers to the suburbs.⁶ This phenomenon, over time, severely depleted the urban tax base, reducing the urban government's ability to provide necessary services.⁷ Escalating crime rates and deteriorating infrastructure exacerbated this problem by creating an increased demand for government services.⁸ This process, according to Butler, has produced ever-expanding pockets of blight in many inner-cities.

Cities have generally responded to this problem in one of three ways: increased property taxes, redistribution of available revenues, or virtual abandonment of the worst areas in favor of the more manageable ones. Obviously, none of these "solutions" is acceptable. Increased property taxes and redistributive programs provide an incentive for the remaining inner-city property owners to leave, removing even more resources from the tax base.⁹ Writing off an area as unsalvageable dooms that

4. S. BUTLER, ENTERPRISE ZONES: GREENLINING THE INNER CITIES 7-10 (1981) (detailed discussion of the migration of population from inner cities to suburbs and its effect on the urban tax base).

5. *Id.*

6. *Id.* at 11. The departure of affluent residents has encouraged the migration of business, especially large retail businesses, out of the inner city. Smaller firms, who traditionally benefit from the spillover business of larger stores, are forced to either leave the area or close.

7. *Id.* at 14-18. Urban governments rely on residents within their jurisdiction for revenue. The urban tax base is weakened as those residents leave the jurisdiction.

8. The correlation between departure of residents and businesses and increased demand for city-provided infrastructure services is clear. Private expenditure for building maintenance drops as affluent residents and businesses leave an area. Building owners are unable to attract residential or business tenants due to the undesirability of the area. These landlords can no longer afford upkeep expenses or taxes, leading to increased abandonment. This process is self-perpetuating as more buildings fall into disrepair. Crime rates escalate as the unemployed and poverty stricken lose hope. Cities are eventually unable to meet the ever-increasing demand for infrastructure support. *Id.*

9. Affluent residents, faced with choosing between remaining in cities, which entails increased taxes, or moving to another area to avoid this burden, will generally choose the latter. K. BRADBURY, A. DOWNS, & K. SMALL, URBAN DECLINE AND THE FUTURE OF AMERICA'S CITIES 215 (1982).

area's residents to an existence of hopeless poverty.¹⁰ Acting alone, cities are powerless to reverse the downward trend of their depressed areas.¹¹

The federal government poured billions of dollars into cities to help them reverse urban decay. By 1979, almost half of the federal budget went to direct transfer payments, with nearly one quarter of the nondefense budget spent in central cities.¹² These expenditures have not only proven ineffective,¹³ they may have contributed to the problem by imposing development plans ill-suited to local needs.¹⁴

II. THE ENTERPRISE ZONE CONCEPT

The enterprise zone concept, which originated in Great Britain,¹⁵ challenges the effectiveness of direct expenditure programs.¹⁶ This concept designates blighted urban areas as eligible for federal and local tax and regulatory incentives designed to attract commercial activity.¹⁷ Proponents of enterprise zones view high taxes and cumbersome regulations as obstacles to economic growth in depressed areas.¹⁸ The concept's goal is to remove these obstacles in order to build "a climate in which people are encouraged to use the latent strengths of an area" to

10. See S. BUTLER, *supra* note 4, at 3 (writing off blighted areas would be self-defeating).

11. K. BRADBURY, *supra* note 9, at 215.

12. Boeck, *supra* note 1, at 74 (if the poor were directly given all federal anti-poverty expenditures, every American would be above the poverty level).

13. "The reality remains, however, that years of federal efforts and billions of dollars have not brought forth prosperity and full employment. . . ." S. BUTLER, *supra* note 4, at 70 (quoting U.S. Rep. Shirley Chisholm). Federal direct expenditure programs are not cost effective in part because of inefficient design and implementation. See generally *infra* note 14. The continued deterioration of the condition of the inner cities is evidence of the ineffectiveness of these programs.

14. Because the plans are designed for the country as a whole, they may be wasteful in communities whose needs are unique. Additionally, many of these programs have suffered from the political process. All too often, development grants go to politically attractive projects at the expense of truly beneficial ones. Butler, *Enterprise Zones: Pioneering in the Inner City*, in NEW TOOLS FOR ECONOMIC DEVELOPMENT: THE ENTERPRISE ZONE, DEVELOPMENT BANK, AND RFC 25 (G. Sternlieb & D. Listokin ed. 1981).

15. Boeck, *supra* note 1, at 76.

16. *Id.* at 74.

17. Callies & Tamashiro, *Enterprise Zones: The Redevelopment Sweepstakes Begins*, 15 URB. LAW. 231 (1983).

18. See S. BUTLER, *supra* note 4, at 22.

create opportunity.¹⁹

Critics of enterprise zones argue that designating limited areas for special tax treatment would simply create tax havens for large businesses without increasing local employment or welfare.²⁰ Enterprise zone proponents, however, propose the creation of new small businesses within the zone as the key element to future growth.²¹ The first priority in redeveloping distressed areas is job creation.²² Studies show that small businesses are best suited to create the kinds of jobs²³ that are needed in distressed areas.²⁴ For these reasons, the incentive package of an enterprise zone must target the development of small businesses.²⁵

A. Zone Designation

The success of an enterprise zone program largely depends on accurately identifying which areas would benefit the most as an enterprise zone.²⁶ The eligibility criteria employed, therefore, must target only

19. *Id.*

20. COMPTROLLER GENERAL, REPORT TO THE CONGRESS: REVITALIZING DISTRESSED AREAS THROUGH ENTERPRISE ZONES: MANY UNCERTAINTIES EXIST, 97th Cong., 2d Sess. 5 (1982) [hereinafter COMPTROLLER GENERAL REPORT] (tax incentives, unless tied to hiring requirements, may create few jobs); see Callies & Tamashiro, *supra* note 17, at 283 (zones would attract only large and profitable firms, providing few jobs).

21. SMALL BUSINESS ADMINISTRATION, BUSINESS IMPACTS OF STATE ENTERPRISE ZONES (Jan. 15, 1986) ("Small business is largely responsible for the success of [state] enterprise zones.").

22. See Boeck, *supra* note 1, at 77 (business must generate new jobs and provide a safety ladder for advancement).

23. "Small firms are the most effective creators of jobs in the economy." Butler, *supra* note 14, at 25; see also D. BIRCH, JOB GENERATION PROCESS 17, 20 (1979) (from 1969-1976 small business created 66% of net new jobs in the U.S.).

24. Butler, *supra* note 14, at 25 (small firms provide the type of jobs most suitable to the inner city, jobs for young, unskilled workers); see also S. BUTLER, *supra* note 4, at 83.

25. The importance of small business to urban neighborhoods is evidenced by the precipitous decline these areas suffered after the departure of small businesses. S. BUTLER, *supra* note 4, at 159 (tax incentives should be geared primarily to the problems facing small businessmen); see also Cohadas, *Urban Enterprise Zone Plan Stresses Business Tax Breaks*, 39 CONG. Q. 805 (1981).

26. In the British program the Home Secretary, upon nomination by local agencies, designates zones. See *infra* notes 102-103 and accompanying text. The American program generally follows the British pattern, in that local nomination is followed by designation by the Secretary of Housing and Urban Development (HUD). See *supra* note 3.

the most desperate areas and must accurately represent the economic condition in a potential zone.²⁷ Consequently, most American proposals base designation on an area's economic history and its potential for growth.²⁸

The most common eligibility criteria are unemployment rate, population decline, percentage of population below the poverty level, and Urban Development Action Grant (UDAG) eligibility.²⁹ Different proposals set varying eligibility levels for each of these criteria.³⁰ The criteria listed above are embodied in the Housing and Community Development Act, discussed in detail in Section IV of this Note.³¹

Designation of enterprise zones under most American proposals is a competitive process.³² Proponents of zones envision an initially limited, experimental approach.³³ Therefore, most suggested programs limit the number and duration of zones.³⁴

B. Tax Incentives

Although some critics view the tax system as an expensive and ineffective tool for spurring growth,³⁵ taxation is critical to the implementation of governmental policy.³⁶ In fact, many commentators believe that the tax system is a less expensive means of regulating activity than

27. See Boeck, *supra* note 1, at 89 (the debate over eligibility tests is not a preoccupation with trivialities).

28. *Id.* at 87-89 (discussion of various eligibility requirements embodied in bills introduced in Congress); see also Freilich, *The New Federalism, American Urban Policy in the 1980's: Trends and Directions in Urban, State and Local Government Law*, 15 URB. LAW. 159, 196-97 (1983).

29. *Id.*

30. *Id.*

31. See *infra* note 132 and accompanying text.

32. See S. BUTLER, *supra* note 4, at 131-32 (describing process whereby state and local governments present their incentive plan and the most attractive packages are designated).

33. COMPTROLLER GENERAL REPORT, *supra* note 20, at v (programs should be experimental because of uncertainty as to effectiveness and cost).

34. Callies & Tamashiro, *supra* note 17, at 237 (comparison of S. 2298 [Reagan Bill] and H.R. 3824 [Kemp Bill] limits on number and duration of zones).

35. COMPTROLLER GENERAL REPORT, *supra* note 20, at 5 (general discussion of criticisms regarding use of tax incentives to spur business growth); see also NATIONAL URBAN LEAGUE, CAN ENTERPRISE ZONES WORK FOR US? 43 (1982) (discussing the high costs of lost revenue).

36. J. JENSEN, PROPERTY TAX IN THE UNITED STATES 125 (1931) ("Tax incentives have been used to stimulate industry in America since colonial days.").

direct expenditures.³⁷ Conventional wisdom also suggests that lowering the costs of doing business will create business opportunities for more people. While the most effective combination of tax incentives remains elusive, most enterprise zone proposals share common incentives.

The biggest problem facing potential entrepreneurs is insufficient start-up capital.³⁸ Normally an entrepreneur can obtain capital funding from financial institutions, investors, or personal savings.³⁹ In blighted areas, however, these traditional sources of start-up capital are not available.⁴⁰ Effective use of the tax system can correct this problem. Almost all of the enterprise zone bills introduced in Congress since 1980 contain tax incentives designed to increase investment.⁴¹ Stuart Butler suggests the following incentives: allowing investors in small firms to establish a loss reserve; deferring capital gains taxes on investments in zone firms, so long as proceeds are reinvested within the zone; and allowing zone firms to pass on operating losses to investors.⁴² Representatives Kemp and Garcia propose elimination of the capital gains tax in enterprise zones.⁴³ The theory underlying such proposals is that increased private investment in zone businesses will create a pool of start-up capital sufficient to encourage entrepreneurship.⁴⁴

37. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973, 977 (1986) (costs of using the tax system to influence businesses may be less than the cost of implementing direct expenditure programs).

38. "Unless entrepreneurs can access this seed capital, they will be unable to get started and generate new employment." *Hearings on S. 1829 and S. 2298 Before the Subcomm. on Savings, Pensions, and Investment Policy of the Senate Comm. on Finance*, 97th Cong., 2d Sess. 201 (1982) [hereinafter *Hearings on S. 1829 and S. 2298*] (testimony of W. Norris, Control Data Corp.); see also NATIONAL URBAN LEAGUE, *supra* note 35, at 47 (availability of capital seed money is essential for small business).

39. See S. BUTLER, *supra* note 4, at 148-51 for a discussion of normal methods of start-up capital financing.

40. NATIONAL URBAN LEAGUE, *supra* note 35, at 47 (causes of scarcity of start-up capital in depressed areas include poor credit ratings, lack of personal savings, and view that investment in small businesses in depressed areas is unwise).

41. COMPTROLLER GENERAL REPORT, *supra* note 20, at 43, app. I (chart of first nine enterprise zone bills introduced in Congress, showing major provisions of each).

42. S. BUTLER, *supra* note 4, at 148-51 (giving zone firms status similar to that of subchapter S corporations).

43. See S. BUTLER, *supra* note 4, at 131-32 for a general description of the Kemp-Garcia Bill, H.R. 3824, 97th Cong., 2d Sess. (1982); see also Boeck, *supra* note 1, at 100-04 (description of various proposed investment incentives).

44. *Hearing Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 97th Cong., 2d Sess. 12-14 (1982) (testimony of

Another proposed tax code change that will benefit zones is the employer tax credit. In 1982 the Reagan Administration, as part of its enterprise zone bill, recommended that employers receive tax credits based on wages paid to employees who work primarily in the zone.⁴⁵ Variations on this proposal are present in many of the bills considered by Congress.⁴⁶ These incentives are designed to offset the high cost of employing unskilled workers in depressed areas, thereby encouraging increased employment within the zones.⁴⁷

Other suggested tax incentives include a business income tax credit for zone businesses.⁴⁸ Critics contend that this incentive would have no value to new small businesses, as they have little or no excludable income.⁴⁹ Proponents argue that the concept is more than just a package of tax incentives; it is a comprehensive attempt to remove all government burdens, and reducing taxation furthers that goal.⁵⁰

Other proposals include incentives such as employee tax credits, loss carry-overs, accelerated depreciation, and reduced social security taxes.⁵¹ Due to the novel nature of the enterprise zone concept, it remains unclear which incentives have the greatest potential for success.

Rep. Kemp) [hereinafter *Economic Stabilization Hearings*]. Representative Kemp notes that changes in the tax code created massive investment in money-market funds, "where the money just sits there." He proposes a change in the code which will make investment in zones more attractive than other types of investments. *Id.*

45. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., 2D SESS., DESCRIPTION OF S. 2298, ENTERPRISE ZONE TAX ACT OF 1982 (employers are allowed nonrefundable tax credit of 10% of wages paid to employees if 90% of the employees' services are directly related to zone business and 50% of the services are performed within the zone); see also Boeck, *supra* note 1, at 115 (description of various employer tax credits).

46. See *supra* note 41.

47. *Hearings on S. 1829 and S. 2298, supra* note 38, at 155 (testimony of John Chapoton, Assistant Secretary for Tax Policy, Dept. of the Treasury) ("There are two . . . [incentives:] payroll credits for businesses . . . designed to encourage creation of new employment . . . [and] a targeted incentive to encourage hiring . . . of disadvantaged individuals.").

48. Boeck, *supra* note 1, at 97-98 (proposals range from a flat 50% exclusion of business income to an exclusion indexed to the amount of income a business receives).

49. *Id.* at 98-99 ("Most new businesses record no profits for the first seven or eight years.").

50. Reducing income taxes in zones demonstrates a commitment by government to redevelop those areas, increasing the confidence of investors and entrepreneurs. *Hearings on S. 1829 and S. 2298, supra* note 38, at 132 (testimony of Samuel Pierce, Secretary of HUD).

51. See Boeck, *supra* note 1, at 97-122 for a detailed description of various incentive proposals.

C. Regulatory Relief

The quantity and complexity of governmental economic regulation imposes a substantial obstacle to potential entrepreneurs.⁵² Zone proponents seek to remove this barrier of prohibitive state and federal regulation, the burden of which falls "particularly heavily on the small business sector."⁵³ Stuart Butler argues that the implementation of the Regulatory Flexibility Act⁵⁴ will reduce regulatory burdens.⁵⁵ The Act allows agencies to clarify, consolidate, or simplify compliance and reporting requirements for small businesses and exempts small businesses entirely from certain rules.⁵⁶ Although critics contend the Act has been ineffective,⁵⁷ the Small Business Administration views it as potentially beneficial to smaller firms.⁵⁸

One Reagan Administration proposal allows federal agencies to waive or modify regulations only upon the request of both the state and local governments.⁵⁹ This plan exempts from waiver or modification those regulations imposed pursuant to statutory authority, as well as those whose waiver would present a risk to health or safety.⁶⁰ Other proposals include modification of the Occupational Safety and Health Act⁶¹ and Environmental Protection Agency regulations.⁶²

Proposals to reduce regulation of economic activity in enterprise zones face several criticisms. Exempting limited areas from regulation

52. Boeck, *supra* note 1, at 125-26.

53. Government regulation is especially burdensome on small business due to lack of resources and expertise. In the context of distressed areas, this burden is magnified by lack of education and, most importantly, lack of business experience. S. BUTLER, *supra* note 4, at 57-58.

54. 5 U.S.C. §§ 601-612 (1982).

55. Boeck, *supra* note 1, at 126.

56. *Id.* (citing 5 U.S.C. §§ 603(c), 610 (1982)).

57. Congress approved the Act so recently that insufficient data is available for a meaningful evaluation of its effectiveness. *Id.*

58. *Id.* at 126-27.

59. Enterprise Zone Tax Act of 1982, H.R. 6009, 97th Cong., 2d Sess. (1982); *see also* companion bill, S. 2298, 97th Cong., 2d Sess. (1982); Boeck, *supra* note 1, at 128-29.

60. *Id.*

61. 29 U.S.C. §§ 651-678 (1976).

62. Different areas suffer from widely diverse sets of problems. Flexibility is, therefore, the most logical approach to solving these problems. *See* Boeck, *supra* note 1, at 127-28 for a general discussion of proposed regulatory relief.

creates a potential equal protection challenge.⁶³ Businesses located just outside the zones might argue that the zone program unfairly benefits zone firms.⁶⁴ This criticism ignores the fact that enterprise zones, by definition, are areas where the cost of doing business is higher than in surrounding areas.⁶⁵ Rather than giving zone firms an advantage, limited regulatory relief would simply offset increased business expenses in the zone.⁶⁶

Critics contend that enterprise zones are a disguised attempt to avoid government regulation.⁶⁷ Federal deregulation, these critics argue, simply shifts the cost of protecting the public to local governments.⁶⁸ While enterprise zones do depend on substantial local and state commitments, the zone concept encourages creative and innovative experiments at all levels of government. The concept also gives state and local governments flexibility to tailor their contributions to suit local resources and needs.⁶⁹ Enterprise zoning replaces the traditional system of central federal planning with a system that is flexible enough to respond to unique local needs.⁷⁰ As economic activity gains momentum in the zones, the increased private investment and initiative would offset the higher costs initially imposed on state and local governments.⁷¹ Finally, proponents claim that enterprise zones will not replace federal urban programs,⁷² but will be implemented in

63. Enterprise zone benefits, by definition, are not distributed equally to all areas or businesses. However, this unequal treatment is rationally related to the compelling state interest in revitalizing the depressed areas. Additionally, such unequal treatment is rationally based on the dissimilar needs of different areas. *Id.* at 127.

64. Cohadas, *supra* note 25, at 806 (rules, regulations, taxes, and licensing requirements detrimental to businesses in a zone also harm competitors outside the zone, yet nonzone businesses would not get relief).

65. Butler, *supra* note 14, at 37 (if the relief is designed correctly, the result would be equality of total costs of doing business between zone and neighboring firms); *see also* COMPTROLLER GENERAL REPORT, *supra* note 20, at 8-9.

66. *Id.*

67. Callies & Tamashiro, *supra* note 17, at 247.

68. *Id.*

69. *See generally supra* note 50.

70. A flexible program, in contrast to direct expenditure plans, meets the diverse needs of different areas. *Id.*

71. *See generally Hearings on S. 1829 and S. 2298, supra* note 38, at 174 (testimony of John Brown, Governor of Kentucky) Governor Brown stated that "[t]here is little direct investment of tax dollars. Here you are making productive areas of localities that are at this point nonproductive." *Id.*

72. *See Economic Stabilization Hearings, supra* note 44, at 3 (statement of Rep. Kemp).

conjunction with programs such as infrastructure grants, public housing, and rehabilitation grants.⁷³

D. *Local Commitments*

The third element of the enterprise zone concept is commitment by local and state governments to provide their own incentives for growth. Some commentators suggest the relationship between the federal, state, and local governments is contractual⁷⁴ in that the federal government offers a package of incentives to eligible cities in exchange for the cities' promises to make certain changes at the local level.⁷⁵ In this way, "enterprise zones would not represent merely a federal incentive, but an effort by all levels of government to remove from the zones their nonessential impediments to economic activity."⁷⁶

Proponents of the enterprise zone concept identify several areas of local regulation as targets for change. One area is land use restrictions.⁷⁷ Zoning laws often prevent property owners from devoting their property to its most efficient use, resulting in misallocation of resources and reduced property values.⁷⁸ These laws replace the effect of market forces with centralized planning, perpetuating unproductive land use and waste of resources. In addition, zoning prohibits the establishment of some new businesses by restricting the number and type of activities within an area.⁷⁹ Advocates of enterprise zones, therefore, urge building code revisions. While critics argue that building codes protect the health and safety of the public, proponents believe such codes are often outdated or poorly suited to particular local needs and

73. Theoretically, if the enterprise zone successfully revitalizes blighted areas, other federal programs such as housing, infrastructure, and rehabilitation grants would no longer be necessary. *Id.*

74. S. BUTLER, *supra* note 4, at 143 ("A more productive approach would be a negotiated contract between the federal government and the city."); *see also* Butler, *supra* note 14, at 37-41.

75. *Id.*

76. Callies & Tamashiro, *supra* note 17, at 244 (quoting DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, THE ADMINISTRATION'S ENTERPRISE ZONE PROPOSAL, March 1982, at 16 (paper released with S. 2298)).

77. Callies & Tamashiro, *supra* note 17, at 244-45; *see also* Boeck, *supra* note 1, at 140.

78. *See* Callies & Tamashiro, *supra* note 17, at 245.

79. Zoning laws inherently restrict the variety of activities in certain areas and often fail to reflect the present needs of a given area. *Id.*

provide minimal protection.⁸⁰

Proponents of enterprise zones advocate changes in local taxation, including a reduction in local property taxes.⁸¹ Critics who argue that financially drained local governments cannot afford to lose this property tax revenue⁸² fail to recognize that target areas are currently non-productive and have depressed property values.⁸³ Such areas now yield little or no revenue regardless of the tax rate.⁸⁴ Consequently, reduction of property tax rates would eventually increase net revenue by generating business activity and enhancing property values.⁸⁵

Local governments would also provide increased services under many proposals.⁸⁶ The Reagan Administration suggests that more local services can be provided by "increasing local resources devoted to such services and [by] relying on the private sector to provide services."⁸⁷ In particular need of improvement are basic local infrastructure services upon which urban neighborhoods depend.⁸⁸

Private sector involvement is also a key element to the success of enterprise zones. The Reagan Administration suggests that private sector involvement will improve the quality and reduce the costs of local services⁸⁹ by introducing market competition.⁹⁰ Private firms would absorb the cost of services they provide, further lessening the

80. *Id.* Building codes thwart economic activity by imposing unnecessary costs on business and developers, while the same results could often be achieved through cheaper methods. *Id.* See also Boeck, *supra* note 1, at 141 (general discussion of the problems caused by building codes).

81. Boeck, *supra* note 1, at 141.

82. *Id.* at 131.

83. *Id.* at 133.

84. If an area does not produce revenue for the local government, the tax rate applied to that area is irrelevant. Butler, *supra* note 14, at 38.

85. S. BUTLER, *supra* note 4, at 135.

86. Boeck, *supra* note 1, at 136. The author argues that "local governments would be expected to improve the quality of other services they provide in a zone. When services are inadequate . . . the costs of doing business escalate." *Id.*

87. *Id.*; see also Callies & Tamashiro, *supra* note 17, at 243-44 (general discussion of Kemp and Reagan proposals).

88. Boeck, *supra* note 1, at 136 (services include sewers, water, public transportation, police and fire protection, road maintenance, garbage collection).

89. See *supra* note 87.

90. Boeck, *supra* note 1, at 136-37 (this proposal "will replace government monopoly with market competition, which will reduce costs and improve quality of services; will reduce the opportunity for corruption; will eliminate bureaucratic inertia").

burden on local government.⁹¹ Additionally, the Reagan Administration recommends forming neighborhood associations⁹² which could become involved in planning and directing the development of the community.⁹³

In sum, the enterprise zone concept requires the efforts of all levels of government to revitalize depressed inner cities.⁹⁴ Each element of such a program is designed to reduce the current obstacles to development in inner cities. As proposed in the United States, the enterprise zone program would supplement rather than replace existing development programs.⁹⁵

III. HISTORY OF ENTERPRISE ZONES

A. *The British Zones*

Professor Peter Hall of Great Britain created the concept of enterprise zones, using Hong Kong and Taiwan as models.⁹⁶ Professor Hall noted a correlation between the fantastic growth in these areas and the relative lack of governmental interference they enjoyed.⁹⁷ Sir Geoffrey Howe, a member of Britain's Conservative government, promoted Professor Hall's philosophy.⁹⁸

The Local Government Planning and Land Act, enacted by the British Parliament in 1980, established enterprise zones.⁹⁹ The Act authorizes the Home Secretary to designate a zone upon nomination by a local government.¹⁰⁰ Upon designation, businesses in the zone are granted various tax reductions and relaxation of regulations.¹⁰¹ The

91. *Id.* at 137.

92. *Id.*

93. *Economic Stabilization Hearings*, *supra* note 44, at 10 (testimony of Rep. Kemp); *see also* Boeck, *supra* note 1, at 143-48.

94. *See supra* note 76 and accompanying text.

95. *See supra* note 72.

96. Boeck, *supra* note 1, at 76.

97. *Id.*

98. "Within these zones . . . everything possible should be done to maximize economic freedom. Taxation should be reduced and regulation should be cut. No government plan for redevelopment should be imposed on the area." S. BUTLER, *supra* note 4, at 2 (quoting Sir Geoffrey Howe, speech to Britain's Bow Group, June 20, 1978).

99. Local Government Planning and Land Act ch. 65, § 179 (1980). The Act is a watered-down version of Professor Hall's proposal. S. BUTLER, *supra* note 4, at 126.

100. S. BUTLER, *supra* note 4, at 103-07 (the Secretary may designate zones upon local nomination).

101. *Id.* (general description of incentives offered under British plan).

British program requires local government commitments to reduce taxes and regulations.¹⁰² The national government, however, guarantees reimbursement of any loss in local governmental revenue.¹⁰³ In addition, the Act encourages the creation of free trade zones within the enterprise zones.¹⁰⁴

Reviews of the British program's effectiveness are mixed. While some areas have experienced dramatic growth, others have not.¹⁰⁵ The British experience, however, is not an accurate model for potential American enterprise zones.¹⁰⁶ The British program focuses on increased development of abandoned, underpopulated wastelands, whereas American programs would target urban areas.¹⁰⁷ In addition, the British program relies on large, established companies to develop enterprise zones. An American program would focus on the efforts of new small businesses.¹⁰⁸

B. *The American Experience*

Shortly after Britain enacted its enterprise zone program, the concept gained widespread support in the United States.¹⁰⁹ Republicans and Democrats alike supported enterprise zones, as the alliance between Representatives Jack Kemp and Robert Garcia demonstrates.¹¹⁰ The Reagan Administration also adopted enterprise zones as an integral part of its domestic economic policy.¹¹¹ Finally, from 1980 to 1984, Congress reviewed at least fourteen enterprise zone bills,¹¹² each with various combinations of tax and regulatory incentives.¹¹³ Con-

102. *Id.*

103. *Id.*

104. *Id.*

105. Boeck, *supra* note 1, at 77.

106. *Id.*

107. *Id.*

108. *Id.*

109. S. BUTLER, *supra* note 4, at 129-30; *see also* Boeck, *supra* note 1, at 84-85.

110. "An unlikely congressional partnership is coming back in the 97th Congress with a revised plan of tax breaks to encourage urban redevelopment." *Urban Enterprise Zone Plan Stresses Business Tax Breaks*, 39 CONG. Q. 805 (1981).

111. *Id.* at 806 (Reagan endorsed the enterprise zone idea during his campaign in 1980).

112. Boeck, *supra* note 1, at 73 n.1 (lists fourteen bills plus companion bills introduced in Congress through 1984).

113. COMPTROLLER GENERAL REPORT, *supra* note 20, at 43, app. I (chart showing elements of nine enterprise zone bills introduced in Congress by 1982); *see also* Boeck,

gress ultimately enacted the Housing and Community Development Act of 1987.¹¹⁴

In contrast to federal inaction, as many as forty states had enacted their own enterprise zone programs by 1985.¹¹⁵ Additionally, many local governments promulgated proposals in anticipation of future federal enterprise zone designation.¹¹⁶

In 1981 Connecticut passed the first state enterprise zone program.¹¹⁷ This program, which includes many of the elements contained in most federal proposals,¹¹⁸ received generally favorable reviews. By June 1986, Connecticut's six zones produced 627 projects, generated a total investment of 148 million dollars,¹¹⁹ created 4,961 new jobs, and preserved 4,560 others.¹²⁰ While critics contend that this growth would have occurred without enterprise zones,¹²¹ the State Economic Development Commissioner attributes most of this new economic activity to the zone program.¹²²

New Jersey's program, which is similar to Connecticut's, also met

supra note 1, at 169-72 (detailed discussion of elements of H.R. 1955, 98th Cong., 1st Sess. (1983); S. 634, 98th Cong., 1st Sess. (1983); H.R. 2375, 98th Cong., 1st Sess. (1983)).

114. *U.S. Enterprise Zones Offer Little to New York*, Crain's N. Y. Business, Jan. 18, 1988, at 7 (notes passage of Housing and Community Development Act of 1987).

115. *Hartford's Experiment with Enterprise Zones Gathering Mixed Reactions*, N.Y. Times, July 7, 1985, § 2, at 23, col. 1; see also *Cuomo's Enterprise Zone Bill Boosts a Proven Concept*, Crain's N. Y. Business, Mar. 17, 1986, at 9 ("Zones have become popular because dollar for dollar they are a bargain for cities trying to rejuvenate decayed areas.").

116. Boeck, *supra* note 1, at 150 ("Even before President Reagan's inauguration, Cleveland, Miami, Baltimore, and the South Bronx were preparing proposals for federal enterprise zone designation.").

117. *Panel Urges Housing Emphasis in Urban Zones*, N.Y. Times, Mar. 8, 1987, § 11 CN, at 1, col. 1.

118. NATIONAL URBAN LEAGUE, *supra* note 35, at 88. The Connecticut program allows a 50% reduction in corporate taxes for ten years if 30% of employees live in the zone or are CETA eligible. The plan also includes: 80% abatement of local property taxes for five years; property improvement assessments deferred for two years; special job training grants for workers living in zone; \$1,000 grant to employers for each full-time permanent job resulting from new investments. Relocating businesses are ineligible. *Id.*

119. See *supra* note 117.

120. *Id.*

121. *Id.*

122. *Id.*

with success.¹²³ Under this plan, 497 companies were certified for zone incentives, more than 160 million dollars in private investment was committed, and an estimated 6,500 permanent full-time jobs were created by the end of 1985.¹²⁴ Other states have also benefitted from enterprise zones,¹²⁵ although no data is available regarding the effectiveness of many of the newer state programs. While state programs typically contain a variety of incentives,¹²⁶ all are based on the assumption that reductions in government involvement will increase economic opportunity.

IV. THE HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1987

The Housing and Community Development Act of 1987 includes the first federal enterprise zone effort.¹²⁷ Title VII of the Act establishes a very limited enterprise zone program.¹²⁸ Under Title VII, the Secretary of Housing and Urban Development (HUD) is authorized to designate up to one hundred zones, each with a life span of twenty-five years.¹²⁹ Before designation of any zones, the Act requires HUD to publish zone regulations.¹³⁰ State and local governments must apply for zone designation and make specific commitments in furtherance of

123. *County Struggles to Match Jersey's Surging Economy*, N.Y. Times, Nov. 15, 1986, § 1, at 33, col. 2. (50% cut in sales tax in building materials; corporate income tax credits for hiring the poor; six-year tax abatement on zone buildings).

124. *The Renaissance of the Garden State*, Crain's N. Y. Business, June 30, 1986, at 11.

125. *Saving the Cities*, FORBES, Nov. 18, 1985, at 10. This article notes that Arkansas' zones have attracted \$417 million in private investments and will create 5,600 new jobs. Also, in Illinois, more than \$500 million has been invested, creating at least 3,500 jobs and saving 5,100. See also Freilich, *supra* note 28, at 196-97.

126. NATIONAL URBAN LEAGUE, *supra* note 35 (chart reflecting elements of various state programs).

127. *A Taste of Enterprise Zones*, NATIONAL JOURNAL, Jan. 9, 1988, at 101.

128. 15 Hous. & Dev. Rep. (BNA) 600, 606 (1988).

129. The Act contains a number of eligibility requirements. For example, the area must be UDAG eligible. It must have an unemployment rate at least 1.5 times the national rate, and a poverty rate of at least 20%. At least 70% of households must have incomes below 80% of the median income of surrounding areas. An area is also eligible if its population declined by at least 20% between 1970 and 1980. 42 U.S.C. § 1501(c)(3) (1988).

130. HUD must publish regulations within four months of enactment. 15 Hous. & Dev. Rep. (BNA) at 606.

the program.¹³¹ The only authorized form of federal relief is waiver or modification of HUD regulations upon the request of the state or local government.¹³² The Act contains no federal tax incentive provisions and forbids assistance to businesses relocating from other areas into the zone.¹³³ HUD is authorized to coordinate the zone program with other existing development programs.¹³⁴

V. ANALYSIS OF THE HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1987

The enterprise zone provision of the Act represents a significant step in the right direction. After seven years of debate and repeated attempts to enact legislation, Congress finally acknowledged the substantial value of the enterprise zone concept. Facially this Act provides nothing of great substance,¹³⁵ but it represents that "all-important foot in the door."¹³⁶ Without drastic expansion, however, this program will not be effective. Because enterprise zones must address a wide range of problems, token regulatory relief alone will not provide sufficient incentive to business growth.

The Title VII designation provision is the strongest aspect of the program. To be effective, the program's eligibility criteria must ensure that the areas designated are truly the most needy.¹³⁷ Although many types and combinations of criteria have been proposed,¹³⁸ the most common criteria are unemployment rate,¹³⁹ poverty rate,¹⁴⁰ population

131. 42 U.S.C. § 11501(d) (1988) (state and local actions can include reduced taxes and fees, increased services, streamlining government regulations, and involvement of public and private community groups).

132. *Id.* at § 11504.

133. *Id.* at § 11501(d)(4).

134. 15 Hous. & Dev. Rep. (BNA) at 606.

135. *U.S. Enterprise Zones Offer Little to New York*, Crain's New York Business, Jan. 18, 1988, at 7 ("State officials don't seem very impressed with the federal incentives, which will be limited at first to the waiver of some HUD issued regulations.").

136. *Id.* (quoting Richard Cowden, executive director of the American Association of Enterprise Zones). The enterprise zone provision, however, is only a small part of the Act. This is ironic because the enterprise zone is meant to reduce government involvement in distressed areas, yet the Act represents a \$30 billion commitment to continue such involvement. See 15 Hous. & Dev. Rep. (BNA) at 600-08 for a detailed description of the other provisions of the Act.

137. See generally Boeck, *supra* note 1, at 87.

138. *Id.* at 87-90 (general description of various proposed eligibility criteria).

139. *Id.* at 87 (proposed unemployment rates range from 6% for the preceding six

decline,¹⁴¹ and UDAG criteria.¹⁴² The Act's eligibility criteria should enable decisionmakers to direct the program to the neediest areas.¹⁴³

Congress should strengthen the Act's regulatory relief provisions. While the Act authorizes HUD to waive or modify its regulations,¹⁴⁴ it gives little direction regarding which regulations should be targeted for modification. Additionally, the Act does not address modification of regulations issued by agencies other than HUD.¹⁴⁵ Congress should consider applying the Regulatory Flexibility Act to enterprise zones.¹⁴⁶ The RFA lightens the regulatory burden on zone firms by giving HUD the authority to adapt federal regulations to local needs.

State and local governments play a crucial role in enterprise zones.¹⁴⁷ The Act provides for the participation of these governments by requiring them to submit specific plans detailing their commitments to furthering the program's objectives.¹⁴⁸ In addition, state and local governments must specify the type of relief they wish to receive.¹⁴⁹ By

months under the Paul Bill to 200% of the national average rate under the Kemp-Garcia Bill).

140. *Id.* at 87. Poverty rate is determined by identifying the percentage of families below the poverty level. Under the Paul Bill, any area with a 10% to 15% poverty rate would be eligible. The Reagan Bill would require a 20% poverty rate, Kemp-Garcia I, a 50% rate, and Kemp-Garcia II would follow the Census Bureau identification of poverty areas.

141. *Id.* See also H.R. 1, 99th Cong., 1st Sess. (1985) which proposes criteria of population decrease of 20% between 1970-1980. This criteria is important because rapid decreases in population create the very stresses on inner-city areas that result in blight.

142. Boeck, *supra* note 1, at 88 n.115. Boeck indicates that eligibility for UDAG is determined by six criteria: percentage of population below poverty level, percentage of housing constructed before 1940, growth of per capita income, population growth, growth in retailing and manufacturing employment, and unemployment. A city over 50,000 must meet at least three of the six criteria. *Id.*

143. One criticism of many existing direct expenditure programs is that their eligibility requirements are so broad that less-deserving areas receive assistance, while needy ones are overlooked. By basing eligibility on the economic factors that create the need, much of this problem can be avoided.

144. See *supra* note 132.

145. Agencies such as OSHA and the EPA extensively regulate economic activity. These regulations are no less burdensome than those issued by HUD. See *supra* note 62 and accompanying text.

146. See *supra* notes 43-45 and accompanying text.

147. See *supra* note 74 and accompanying text.

148. See *supra* note 131 and accompanying text.

149. See *supra* note 132 and accompanying text.

providing flexibility, this provision gives state and local governments the freedom, subject to final HUD approval, to devise the combination of incentives most suited to their particular needs.¹⁵⁰

The most glaring defect in the Act is the absence of tax incentives. Tax modification is the central feature of the enterprise zone concept.¹⁵¹ While relaxation of regulations is beneficial, a tax incentive program provides a direct financial impetus for business growth. Regulatory relief alone will do little to spur the private investment¹⁵² that is needed to redevelop depressed areas.¹⁵³

The inclusion of tax incentives is imperative to the success of enterprise zone programs. Such incentives might include a reduction in the capital gains tax, increased investment tax credits for investment in zone firms, and subchapter S status for zone firms.¹⁵⁴ Other incentives include reduced business income credits for employers who hire zone residents and credits for job training.¹⁵⁵ These provisions would encourage new small firms in the zones to employ and train zone residents and would lower the zone firms' business expenses.

The Act should also allow increased participation by volunteer neighborhood groups and should encourage state and local governments to assist such groups. In addition, the privatization of traditional governmental services¹⁵⁶ would enable small zone firms to employ zone residents to provide services such as street repair, garbage collection, and building restoration.¹⁵⁷ Such firms contribute to the success of zone programs by addressing the problems of unemployment and the inability of local government to provide these services.

150. State and local governments can create their own package of incentives, choosing from an array of regulatory modifications and possible local actions.

151. See, e.g., 39 CONG. Q. 805 (1981).

152. Such relief may have some impact on investment if investors view it as a long-term commitment by government to the area. However, such a perception would be greatly enhanced by more substantial incentives. See *supra* note 50; but cf. *Enterprise Zone Designation Seen Boosting Investment*, Daily Report for Executives (BNA), Aug. 28, 1986, at 1.

153. See *Economic Stabilization Hearings*, *supra* note 44, at 12-14.

154. See *supra* notes 38-42 and accompanying text.

155. See *supra* notes 45-48 and accompanying text.

156. See *supra* notes 88-90 and accompanying text.

157. These firms could perform these services employing relatively inexperienced and unskilled workers.

VI. CONCLUSION

The HCDA provides a solid framework for the construction of an effective enterprise zone program. Without substantial expansion, however, the Act's impact will be minimal. In light of political constraints, the prospects for the needed expansion are cloudy.

Traditionally, Congress is slow to act. Fears of losing politically valuable direct expenditure programs may slow the progress of a complete zone package. In addition, the idea of cutting tax rates, especially for businesses, is unpopular in Congress due to the federal budget deficit. Enterprise zone opponents need only raise the issue of the deficit and many members of Congress grow reluctant to consider tax reduction of any kind. For these reasons, the most likely scenario is one of Congress begrudgingly passing one element at a time. Through this process, the United States may have a complete enterprise zone program, but it will take time.

Kevin D. Bird

