Issues and Policy Options 2

The United States is in the midst of a technological revolution that is leading to an ever more spatially dispersed and locationally footloose economy and, as a consequence, is reshaping America's metropolitan areas (see chapters 4 through 8). Under these conditions, many older, higher-cost metropolitan areas, central cities and inner suburbs are experiencing job loss and disinvestment. Moreover, the existing skills mix of urban, suburban and rural economies is changing. Goods production, transportation and distribution jobs, and routinized service jobs are decentralizing to metropolitan peripheries and to middle-size and smaller metros. In contrast, higher-skill professional and managerial jobs are more likely to remain in urban cores and suburbs of larger metropolitan areas.

These changes create benefits and opportunities, including greater efficiency (as industry locates in the lowest-cost locations), increased opportunities for people to live in the suburbs, and potentially decreased commuting times.[1] However, the new development patterns pose challenges that have important public policy implications. First, the changes are likely to bring about ever-larger, more sprawling, and less densely populated metropolitan areas, creating problems of inadequate transportation, added infrastructure costs, and poor environmental quality. Second, some places will not successfully adapt, and will continue to suffer disinvestment and job loss leading to underutilization of the built environment, reduced central city agglomeration benefits for industry, and increased poverty, ghettoization, and fiscal

[1] Moreover, this wave of information technologies has the potential to lead to significant improvements in productivity, particularly in the services sector.

problems for local governments. Moreover, the combination of the higher skills needed in the new economy in the suburbs, and the large, growing population of lower-skilled and often minority residents in urban cores is likely to exacerbate economic and social problems. Overall, rapid technological change reinforces uneven development patterns, both between and within metropolitan areas.

Federal urban policy has been built on a number of assumptions since World War II, including a strong federal role, the idea of a mass-production metropolis with most employment concentrated in the core, a focus on remedying market imperfections through direct government action, and an emphasis on housing, social services, and physical redevelopment. Based on these assumptions, the federal role in addressing the problems of the industrial metropolis has largely been devoted to operating programs to provide funds.

In the era of the post-industrial metropolis, federal urban policy needs to become smarter and more strategic, focusing on shaping the institutional, regulatory, and fiscal environment influencing uneven growth patterns. Especially in an era of reduced federal resources, increased capacities at the state, local, and private (non-profit and profit) levels, and increased variation and diversity between places, federal policy needs to focus less on simply providing funding to a large number of places through grant and other programs, and more on intervening strategically in the metropolitan development system. Federal funding is still needed, in part because it can provide important levers to shape the behavior of other institutions. The federal role, however, needs to encompass several critical functions not now being performed:

- providing incentives for other players (e.g., states, suburban governments, core city governments, non-profits, and business) to strategically devote their own resources to solving problems of uneven development between and within metropolitan areas;
- assessing how other non-urban federal policies (e.g., environmental regulation, tax policies, telecommunications policies) contribute to uneven development and, if feasible, working to minimize their negative impacts;
- assessing how non-urban federal programs (e.g., manufacturing modernization programs, business finance programs) could be better targeted to support more even development;
- supporting new innovative institutions, including in the private sector, that promote urban economic development; and
- increasing efforts devoted to evaluation, demonstration, and technical assistance so that the state-of-the art of federal, state, and local urban economic and community development efforts is continually advanced.

The chapter discusses three new approaches to federal urban policy (see table 2-1). The first emphasizes new approaches to economic development in urban core areas (including central cities and inner suburbs). As discussed below, past federal policy has not emphasized job creation and enterprise development in urban areas as a solution to disinvestment, poverty, and the fiscal problems of urban governments. If this current wave of technological change were leading to increased centralization of economic activities, there would be little need to try to stimulate economic growth in these areas. However, because technology is leading in the opposite direction, it may be an appropriate federal role to assist affected cities and suburban communities, in large part to give them the time to adjust to these changes and reduce the transition costs (for people, industries and governments) of moving from the old mass production metropolis to the post-industrial metropolis (see chapter 3). One important avenue toward this is to ensure that a broad range of federal economic development policies focus on these areas. Moreover, it will be important that federal policies recognize the latest and most innovative economic development approaches and not only encourage communities to adopt these, but also modify their rules and regulations to allow communities to do so.

Second, while economic development will be important in urban cores, both to provide breath-

TABLE 2–1: Policy C

		Impact on federal $	Change in federal role	Change in state/ local role
	IMPROVING ECONOMIC AND COMMUNITY DEVELOPMENT EFFORTS			
1	Increase funding for economic and community development	M-L	N	N
2	Target more funds to distressed cities and suburbs.			
	▪ require that EDA spend more of its funds in urban areas	N	M	N
	▪ tighten CDBG funding formulas	N	M	M
3	Increase targeting of SBA loan programs to minority-owned businesses and businesses in distressed urban core areas.	N	s	s
4	Require cities to spend an increased share of federal funds in distressed neighborhoods	N	s	M
5	Provide incentives for cities and states to focus programs on distressed places and disadvantaged persons.	N	s	M
6	Base state and local funding on performance:			
	▪ allocate a share of block grant funds based on selected performance measures of the grantee	N	M	M
	▪ create a competitive, challenge-grant program combining all federal economic and community development funds.	N	L	M
7	Encourage EDA or HUD to do more to support innovative efforts, perhaps funding an office of strategic economic development	S	M	s
8	Consolidate existing urban economic and community development programs into one program into one agency or institution.			
	▪ move more toward consolidated block grants.	N	L	M
	▪ create a competitive, challenge-grant program combining all federal economic and community development funds.	N	L	M
9	Target a greater share of federal funding to more comprehensive, innovative economic development organizations.			
	▪ encourage HUD to fund more innovative economic development institutions, perhaps through funds distributed on a performance basis.	N	s	M
	▪ broaden the applicability of activities under Title 1 in EDA to allow funding for innovative economic development programs or activities.	N	s	M
10	Increase support for Community Development Corporations (CDCs) and other similar comprehensive, locally-based development organizations.			
	▪ Increase funding for HUD's National Community Development Initiative	M	s	M
	▪ establish a quasi-public corporation to fund community-based development Organizations.	M	L	M
11	Target a greater share of NIST's manufacturing outreach efforts urban areas.	N	M	s

(continued)

TABLE 2-1: Poli

		Impact federal $	Change in federal role	Change in state/local role
	DEVELOPING PARTNERSHIPS AND METROPOLITAN LINKAGES			
12	**Encourage federal policymakers to work with trade associations, large corporations, and other business organizations** to catalyze efforts to revitalize distressed urban economies	s	M	M
13	Provide incentives for local governments in a metropolitan area to cooperate.			
	▪ encourage the Administration to review existing federal programs as to the extent to which they hinder or encourage regional cooperation at the metropolitan level.	N	s	M
	▪ require that states and cities receiving federal funds in areas such as transportation, economic development, and housing establish metropolitan-wide development councils that work to minimize uneven development .	N	M	L
14	Encourage the formation of metropolitan-wide organizations to manage federally-funded efforts.	N	M	L
15	Increase support for mobility to work programs.			
	▪ fund the “Bridges to Work” program, and based on its findings, expand the program to more cities and more participants.	M	s	M
	• provide tax incentives to suburban employers who provide van pools or other transportation for disadvantaged urban core residents.	M	s	s
	REDUCING SUBSIDIES TO PERIPHERAL DEVELOPMENT			
16	**Require that HUD assess the extent** to which public policies subsidize suburban and exurban development, particularly at low densities.	L	N	N
17	Develop policies to reduce state and local industrial incentive bidding wars.			
	▪ prohibit executive branch agencies from entering incentive bidding contests for the attraction of federal facilities.	S	s	N
	▪ apply anti-pirating provisions to all federal economic development programs.	N	s	M
	▪ encourage the Secretary of Commerce to convene a meeting of state economic development directors to try to reach an agreement to stop, or at least significantly curb the practice.	N	s	M
	▪ require city and state recipients of federal economic and community development funds to report all subsidies given to relocating firms	N	M	L
	▪ reduce federal funds to states and communities for economic development in proportion to recruitment incentives offered	N	M	L
	▪ subject state and local incentives to federal taxation.	+	s	M
18	Foster cleanup and redevelopment of urban brown fields:			
	▪ establish programs to fund brownfield assessment and cleanup.	M	M	s
	• establish a “Brown field IRA” that would allow small and medium-sized companies to put aside tax free money that must be spent for cleanup	M	s	s

N= none; S= small; M= moderate; L= large; + = increased revenue flow ing room during this transition and to capitalize on the opportunities provided by technological change, relying only on economic revitalization of the core is unlikely to be successful. In most places the strongest parts of the post-industrial metropolis are selected outer suburbs, and even exurban areas. Linking these growing and buoyant economies with urban core economies will be particularly important. One avenue involves increasing regional planning, cooperation, and linkages in metropolitan areas. One critical strategy will be to increase the ability of urban core residents, particularly disadvantaged residents, to get jobs in the growing suburbs.

Finally, while the first two policy approaches work to provide additional assistance to places where market forces may not be producing socially desirable outcomes, it is important that market prices themselves give the right signals for development, so that they do not lead to a bias against development in more dense inner suburbs and central cities. Though only preliminary empirical research has been done, it does appear that development on the edge of metropolitan areas, particularly sprawl development, does not fully pay for itself, and is instead subsidized by others (e.g., local taxpayers in cores of large, sprawling cities; consumers in the region; and state and federal governments). Several important subsidies include the provision of incentives by local and state governments to businesses locating in prosperous suburbs, the cleanup costs borne by developers of contaminated lands in urban cores (brownfields), and the underpricing of physical development (e.g., roads, sewers, etc.) in low-density, peripheral development. Although the magnitude of these subsidies or the impact of their elimination on metropolitan growth patterns is not known, moving to reduce or eliminate these subsidies and institute full-cost pricing policies for peripheral development appears to be a step in the right direction.

This chapter first discusses the rationale for why federal policymakers should be concerned with metropolitan areas, and in particular, uneven development patterns within and between them. It then discusses a range of broad guiding principles or approaches that could guide federal urban policy. Next, it examines urban economic development policies and offers a number of options for improvement, including increased targeting, greater incentives for better performance, more effective coordination at both the federal and local level, and increased efforts at business development. Policies to link urban core economics with growing suburbs are then discussed. Finally, the last section examines policies to reduce or eliminate subsidies to suburban and exurban growth, particularly low-density growth.

THE BASIS OF CONCERN WITH UNEVEN DEVELOPMENT

Before examining policy options for metropolitan areas, we ask why policymakers at the national level should care about metropolitan development patterns. There are at least three reasons for concern: 1) the efficiency of the national economy; 2) the economic and social hardships experienced by some people in some urban economies; and 3) the nature of the federalist system, which results in some cities and states not adequately addressing urban decline, especially poverty.

Uneven development at the regional level means some metropolitan areas (metros) grow very fast while others stagnate or lose jobs and population. Uneven development at the metropolitan level means growth, prosperity, and congestion in some parts of the metropolitan area, and decline, poverty, and underutilization in other parts. For many metropolitan economies, particularly those that have not successfully made the transformation to the dispersed city, their growth is characterized by uneven development. Technological change is likely to further exacerbate uneven development patterns.

Uneven development can reduce the efficiency of the national economy because some places are declining and have excess capacity, while others are growing and spending to add new capacity. When some metropolitan areas or parts of a metropolitan area suffer dislocation and decline, some factors of production are moved and can be used elsewhere. Some firms may relocate, either to other metros, or to other parts of the metropolitan area, taking their capital, expertise, and even their machinery with them. Some workers may do the same. However, firms cannot move their buildings, nor can workers move their homes. Public and quasi-public infrastructure, such as hospitals, utility networks, schools, roads, sewers, and bridges, is likewise immobile. As a result, when all or part of a metropolitan area undergoes economic dislocation leading to out-migration, many houses, factories, and offices and land remain vacant or underused, and public infrastructure is underused. This premature writedown or less than full use of public and private resources imposes costs and reduces the efficiency not only of the declining area, but also of the U.S. economy as a whole. No one argues that all inefficiencies can be squeezed out of a dynamic economy. However, some inefficiencies are self-correcting, or easily corrected, and others are not. Metropolitan economic decline may lead to inefficiencies of the latter kind, even at the national level.

With urban decline, local spending on social services usually increases and, because of a smaller tax base, tax rates often increase, leading to fiscal difficulties that are today evident in many central city and inner suburban governments. A reduced tax base in the medium term means that less is spent on city services, including infrastructure, transportation, police protection, and education. This can in turn lead to increases in congestion, crime, and other negative externalities, while reducing educational levels and some of the benefits to firms of agglomeration economies. As a result, further rounds of outmigration occur, threatening to create a downward cycle, one Myrdal has characterized as cumulative causation.[2]

If the departing industries or workers move to areas that are growing—either outer suburbs or other metropolitan areas—the growing community either has to incur costs to pay for new infrastructure (e.g., bigger hospitals, widened roads), or put further strains on already overextended resources, thereby causing increased transportation congestion and delays, overcrowded schools, and other inadequacies in public services. Private resources are strained as well, increasing the price of land, housing, labor, and offices.[3] Businesses competing in international markets bear some of these increased costs. Moreover, uneven utilization of resources limits the ability of the Federal Reserve Board to lower interest rates and otherwise stimulate the economy as much as it might, because growing places threaten to overheat the economy. The less uneven development, the faster the U.S. economy as a whole can grow.

Urban economic decline imposes social, psychological, and physical distress as well as economic costs. Such stress can weaken the community fabric so that redevelopment becomes more difficult. Moreover, urban decline has led in many places to expanded ghettoes and increased poverty, making advancement even harder for those living in these areas[4] (see chapter 3). The health of the residents can suffer, and crime and other social disorders can increase. Moreover, increased costs (e.g., health insurance, prisons) can be borne by all consumers and taxpayers.

Finally, assuming that public policy action to respond to urban economic distress is desirable, the question remains as to whether this is necessarily a federal responsibility rather than solely a state or local one. One byproduct of the federalist system in the United States is that states and cities

[2] The theory of cumulative causation, first proposed by Gunnar Myrdal, suggests that economic decline is not always self-correcting. *Rich Lands and Poor* (New York, NY: Harper and Row, 1957).

[3] One study of 103 Massachusetts communities found that local per-capita expenditures were highest in both rapidly declining cities and rapidly growing cities. One reason local public expenditures increase with growth is that the cost of providing services for new households is often higher than the revenues they provide. Helen Ladd, "Municipal Expenditures and the Rate of Population Change," in R. Burchell and D. Listokin, (eds.), *Cities Under Stress* (Rutgers, NJ: Center for Urban Policy Research, 1981) pp. 351-68.

[4] William J. Wilson, *The Truly Disadvantaged* (Chicago, IL: University of Chicago Press, 1987).

compete for jobs and residents, and so must keep taxes low, especially when revenues are targeted for redistribution to distressed cities or parts of cities. As a result, many states are reluctant to spend much money to address urban problems, because doing so runs the risk of raising taxes. Cities and suburban communities that want to address problems of uneven development within their borders may not have the revenue to do so, since increasing taxes for this purpose runs the risk of exacerbating business and middle-class flight. Even states and cities that have the fiscal capacity to help rebuild urban economies may not have the political will to do so. In many state legislatures, the power of urban constituencies is weak, making it difficult for states to help cities.[5] In addition, Governors often respond to more influential suburban or rural constituencies. Similarly, many mayors and local elected officials emphasize services and economic development assistance for prospering areas of the city, particularly the downtown, in part because the political costs of not helping distressed areas are low, and in part because they perceive this as the most effective strategy for improving the tax base.[6]

A federal role appears to be appropriate on two grounds. First, there is inter-state and inter-city competition to keep expenditures low. Second, in many cases city or state governments would like to do more to help distressed local economies or parts of economies but cannot justify these actions politically. Being able to point to the federal government as requiring these actions or providing matching funds for them can establish needed, and sometimes welcome, political cover. An appropriate federal urban policy provides incentives and motivation for states and localities to address these issues and provide a framework for viable partnerships, not only between all levels of government, but most importantly involving the private sector, non-profit organizations, and citizens.

URBAN POLICY APPROACHES

People or Places

There is an historical debate about whether urban and regional policy should target people directly or instead target distressed places.[7] People policies focus on helping people regardless of where they live, and include, for example, welfare reform, helping people move to get jobs, and portable housing vouchers. In contrast, place policies focus on helping people in particular places, and include, for example, enterprise zones, health clinics in poor areas, and publicly assisted housing. The people vs. place choice has, unfortunately, usually been stated in stark terms, with policymakers expected to choose one or the other. A more effective approach appears to be to combine the best elements of place- and people-oriented policies into a coherent approach to address the problems of distressed urban places and their residents.

There are at least three broadly defined ways to address the problem of economically disadvantaged places and persons in urban areas, with the first focusing on people, the second on both, and the last on place: 1) assist people in moving out of depressed local urban economies; 2) help local residents gain access to jobs in suburbs; and 3) revitalize depressed local urban economies. All three approaches are premised on the notion that geography matters in terms of economic opportunity.

Clearly some people move from declining metros to growing ones, and from declining neighborhoods to more prosperous ones, and early evidence suggests that these strategies can in-

[5] For example, in the small-city Community Development Block Grant (CDBG) program administered by states, there was significant variation among states in terms of degree of targeting on the most distressed places, and a majority of states did less well at targeting CDBG funds than did the federal government. Michael Rich, *Federal Policymaking and the Poor* (Princeton, NJ: Princeton University Press, 1993).

[6] Phyllis A. Furdell, “Poverty and Economic Development: Views from City Hall” (Washington, DC: National League of Cities, July 1994).

[7] Robert Wood, “People Versus Places: The Dream Will Never Die,” *Economic Development Quarterly*, vol 5, No. 2, May 1991, pp. 99-103.

crease the economic and social well-being of the movers.[8] However, not all people can or will avail themselves of this option. The poor may not be able to afford housing in the suburbs and they face other barriers. Even for people who can afford to move, many long-time residents are committed to their neighborhoods and communities and do not want to move.

The second approach focuses on helping people in distressed areas get jobs in the growing suburbs. Usually, mobility-for-work programs train residents of disadvantaged areas for jobs in the suburbs, help them become aware of job openings, and facilitate transportation to the jobs. The major advantage of this approach is that it focuses on where most of the new jobs are. (They are usually growing fastest in the suburbs.) A limitation is that it is not clear that urban residents will be able to get enough of these jobs. Moreover, commuting long distances to the suburbs can be costly and time consuming.

The third approach is place-based and focuses on revitalizing depressed local urban core economies through, for example, empowerment zones, business development programs, and provision of infrastructure to urban core areas. The pros and cons of this approach form the subject of the first half of this chapter.

Any discussion of revitalizing urban core economies must acknowledge there are many factors that contribute to the problems of the urban poor, including a lack of good jobs, discrimination, a culture of poverty, drug abuse, crime, and low education levels and poor schools. As technology restructures urban core economies to become more service oriented and more highly skilled, increasing the skills and education levels of urban residents will be increasingly important. To compete and continue to provide jobs for residents, cities will have to do a better job of preparing their young people for employment. Thus, one important public policy for central city areas is improving central city public schools.

Although these social factors are important elements of the economic and social decline in some of these places, there is widespread agreement that factors related to economic decline and restructuring also play a significant role.[9] Since this report concentrates on how technologies are reshaping the geography of metropolitan economies, the emphasis is on place-based economic development policies.

Moreover, any attempt to formulate urban policy options must recognize that it is not reasonable to expect any one option to be the complete solution. In many cases, advocates tout their own particular policy solution (e.g., moving to opportunity, enterprise zones) as **the** solution to the problem and criticize all other options. A more realistic view is that no one policy option will provide the answer. Rather, a wide range of policy options and approaches, each contributing something to making cities better and their residents better off, has a better chance of success. This does not mean that some approaches don't work better than others, but rather that the solution to a multifaceted problem must itself be multifaceted.

Major Approaches to Urban Policy

Place-specific policies offer Congress a number of overlapping choices on how to address uneven development between and within metropolitan areas.

Reduce Funding and Ensure That Accurate Price Signals Are Sent

Congress could significantly reduce funding of current programs and hope that existing market

[8] For example, the Gautreaux project in Chicago, where a random sample of public housing residents was relocated to suburban locations, is cited as having led to economic and social advancement for the participants. Mary Lou Gallagher, "HUD's Geography of Opportunity," *Planning*, July 1994, p. 12.

[9] Wilson, op. cit., footnote 4.

forces will send the right price signals at the right strength. Such a course has several advantages. First, it minimizes federal expenditures. Second, it is consistent with market forces that may by themselves yield solutions. As urban areas decline and suburban and exurban growth increase, cost differentials between the core and the edge will decline. Land costs will decline in the core and increase on the edge. Commuting will become more difficult on the edge and easier in the core. Densities will decline in the core, perhaps with some abandoned areas of cities devoted to open space, while densities on the edge will increase.

However, for three reasons, market adjustments alone are not likely to produce economic recovery in all metros or parts of metros in the near future. First, it can take a long time for prices to fall far enough to put adjustment into motion. Moreover, unlike consumers who may readily shift to lower-priced items, most firms will not necessarily move to declining areas to take advantage of lower costs, not only because the costs of relocating are substantial, but because other non-economic factors (e.g., crime, blighted environment) reduce the attractiveness of the area. In addition, workers have non-economic ties to neighborhoods and localities that make it hard for them to move when local economies decline. Other factors may make it difficult for urban residents, particularly minorities, to move to suburban locations.

Second, economic decline may never be self-correcting. When it is sustained and significant it can create a vicious circle that makes a city progressively less competitive. As financial, human, and civic resources shrink, investment in public and private infrastructure falls. Reduced spending on education and training, transportation, and other public infrastructure makes the city less attractive to new investment, in turn causing further economic decline. Caught in a downward spiral, it may be impossible for a community ever to regain its former level of prosperity and quality of life unless it gets help.

Third, there are many tax, regulatory, and policy factors that hinder accurate price signals from being sent. These distortions appear to systematically tilt development toward suburban and rural areas (see chapter 8). Part of the problem arises from the conventional practices of subsidizing (directly and indirectly) new development in lower-density outer suburban and exurban areas. For example, the cost of providing phone service to fringe, low-density suburban development is higher than providing phone service to the central business district, yet monthly rates are set the same by regulation. In addition, part of the problem is that there is no effective system for allocating the external costs to the people and businesses that generate them. These externalities, including increased expenditures on infrastructure, increased traffic congestion, pollution, reduced open space, and abandonment of property in central cities and older suburbs, are not usually borne by those who choose dispersed development.

Policies that reduce subsidies (e.g., changes in telecommunications pricing policies) or internalize externalities (e.g., Clean Air Act Trip Reduction Programs) to greenfield development might be profitably employed. Prices would rise if low-density areas were forced to pay the real marginal costs of these services.[10] Similarly, limiting the ability of suburban and state governments to provide subsidies to attract industry from urban core areas would not only help retain industry in cities, it would save cities money. These policies have the advantage of not costing the federal government much.

Economic Incentives

Congress could rely on economic incentives to encourage residents and businesses to locate in weaker inner suburbs and central cities. For exam-

[10] United States Congress, Office of Technology Assessment, *Technology and the American Economic Transition: Choices for the Future* (Washington, DC: U.S. Government Printing Office, 1988).

ple, some have proposed significantly reducing federal income taxes on residents of central cities. Similarly, empowerment zone and enterprise community programs rely in part on tax exemptions and credits to make distressed parts of cities more attractive. Such mechanisms have several advantages. First, they can pump significant resources into older central cities and inner suburbs; moreover, as residents or industries prosper, they will spend more, multiplying the jobs and investment in the city. Second, these mechanisms let individuals and businesses make decisions on how, where, and when they will relocate.

However, these approaches suffer from three principal drawbacks. First, they can be expensive and difficult to target. For example, reducing federal income taxes on the residents of central cities by 10 percent would cost the Treasury tens of billions of dollars. Likewise, the empowerment zone program has made $2.5 billion in tax incentives available to firms locating in the six zones. Moreover, in many central cities, particularly more prosperous ones and ones that have grown significantly through annexation (many Sunbelt cities, and some northern cities such as Indianapolis and Columbus), the portion of the city or its residents who are distressed can be quite small, leading to a diffusion of benefits to areas or people that do not need it. Moreover, the benefits go not only to residents or industries that move to the area because of the incentives, but also to those already there or who would have moved there without the benefits.

Second, in many places incentives may not be enough to overcome problems in the business and residential environment, including crime, inadequate infrastructure, poor education, minimal urban services, and regulatory barriers (including Superfund regulations regarding reuse of contaminated land; see chapter 9). It is likely that firms or individuals will locate in distressed places with a large enough incentive, but that amount may be very high in some places. In fact, the amount may be larger than the firm's or resident's entire tax bill, so that forgiving all the taxes may not be sufficient to induce location in the targeted places.

Third, even if incentives attract residents and industry, it does not necessarily follow that disadvantaged people will be helped. For example, though empowerment zone job creation tax credits are tied to zone residents, disadvantaged residents of the zone may not be hired in them, especially if they lack skills or other qualifications.

Continue the Status Quo

Congress could continue current programs, either at current or reduced levels. However, many of these programs were built up and designed to respond to problems of the mass production metropolis, when most of the jobs in the metro were in the core. Technology is transforming this pattern, and as a result, new policies should reflect this new reality. Moreover, urban policy has focused on providing adequate housing, social services, and in some cases community infrastructure. However, if information technology is weakening core economies, responding to the needs of people in these places will require either widespread outmigration to more economically healthy places, or increased economic development. Moreover, while current programs do help cities and their residents, the problems of poor housing, poor neighborhoods, and poor urban services stem in part from the low incomes of disadvantaged urban residents.

Sharpen the Focus on Economic and Community Development

Congress could sharpen the focus on community and economic development as a way to revitalize lagging metros and parts of metropolitan areas and provide jobs for low- and moderate-income residents. Urban economic development refers to the attraction, creation, or expansion of businesses within metropolitan areas. As discussed in chapter 4, technological change is reducing some of the competitive advantage central cities once held. In addition, it appears to be moving blue collar jobs away from urban cores and contributing to the increase in skills required by many urban jobs. Reduced economic activity is leading to underutilization of the built environment in many cities and to increased local government fiscal stress. Moreover, many low- and moderate-income residents without the education needed for many urban jobs are finding it difficult to advance economically.

Economic development in urban core areas could lead to several benefits. First, as more industry is attracted, created, or expanded in core areas, land and building use will rise. Second, increased industry and commerce will help urban residents advance economically. Finally, economic development can improve the tax base and fiscal health of urban governments, which in turn could improve services, including schools, public safety, and public housing.

The place-oriented, economic development policy approach has been criticized on a number of grounds. The first criticism is that as jobs are decentralizing to the suburbs, a policy of job creation in urban core areas swims against an inexorable tide. Similarly, people are moving out to the suburbs in search of opportunity. Expanding urban policy to include access by central city residents to suburban jobs is an important component of any effective policy effort. (However, not all residents or businesses can leave core areas, nor do they want to.) But many core areas are losing jobs, particularly lower skilled jobs, and this is often occurring for reasons that are amenable to public policy, such as labor force skills, tax rates, regulatory structure, and land availability. Moreover, as the current of decentralization of people and jobs flows on, there are hundreds of efforts to foster economic development in America's cities that are based on a strategic look at the new environment and the strengths and weaknesses of the community to determine the best role it can play in the new metropolitan economy.

Second, many believe the federal government has tried to promote urban economic development in the past and has failed, and therefore current efforts are doomed to fail. However, historically, the dominant focus of U.S. urban policy has been on redistributive measures to provide economically disadvantaged urban residents with services (e.g., income support, social services) or to provide housing and build infrastructure. Much less was spent on economic development. Moreover, that spending has declined over the last 15 years.

Third, much criticism is based on the view that government does not create jobs or know how to promote economic development effectively. In fact, it does appear that many efforts at economic development have been poorly conceived or targeted. However, the field of economic development has evolved significantly in the last decade, largely through innovative efforts at the local and state level. These efforts have developed and tested a wide range of new approaches on a limited basis, but they are not yet widely deployed.[11] Many of the approaches rely on private organizations and industry to carry out economic development, with the public sector playing a catalytic and supportive role.

Fourth, some argue that helping distressed core economies is a zero sum game that does little to help the overall economy, because jobs are simply shifted from one area to another. For example, many criticize empowerment zones for generating jobs at the expense of other areas. This criticism is valid when economically strong communities (either growing metropolitan areas or healthy suburbs) use inducements to recruit industry, particularly from distressed areas. In these cases not only are no new jobs created, but congested places get more congested and costs go up, and distressed places suffer even more. In contrast, as Bartik has shown, when distressed places attract industry, it helps the U.S. economy by evening out differences in regional economic capacities and allowing the national economy to grow at a faster rate with less fear of inflation.[12] The national un-

[11] Robert D. Atkinson, "The Next Wave in Economic Development," *Economic Development Commentary*, Spring 1993.

[12] Tim Bartik, *Who Benefits From State and Local Economic Development Policies* (Kalamazoo, MI: Upjohn Institute for Employment Research, 1993).

employment rate of 5.5 percent (March 1995) masks significant regional differences with rates of 2.7 percent in Raleigh-Durham, and 8.5 percent in New York City.[13] Such differences in regional capacity utilization mean that national economic policymakers are constrained in boosting U.S. growth for fear of inflation in places with low unemployment. Moreover, creation of jobs in depressed areas generates increased demand for goods and services produced outside the areas, creating new jobs throughout the economy.

Federal Economic and Community Development Initiatives

There is a common perception that, since the 1960s, federal urban development policies have focused largely on economic development, particularly of distressed communities within cities, and that these efforts have failed.[14] Yet, few if any urban development programs since the 1960s have explicitly targeted economic development, and overall, policy has made only limited efforts to implement economic development in the inner city.[15] Yet, urban core areas of many metropolitan areas are increasingly at risk of economic decline as information technologies allow an increasing share of the economy to operate at distance and become more footloose. As a result, urban policy may need to take economic factors more into consideration and build up the productive component of the inner city. A key to this strategy would be to focus on developing the locational advantages of the inner city for businesses and enable the private sector to play a more active role.

Historically, the nature, perception, and response to urban problems has differed. From 1948 to the early 1960s, the federal response to urban problems was primarily to provide housing and to clear and assemble land through the Urban Renewal Program. In the late 1960s to early 1970s, HUD's Model Cities program focused on distressed places within metropolitan areas. But funding was limited (in 1972 it was equivalent to approximately $1.5 billion in 1995 dollars), widely dispersed (to 150 cities) and mostly spent on education, housing, health, social services, and infrastructure in poverty neighborhoods, with only a small share going for economic development.[16] In 1974, the Community Development Block Grant program (CDBG) was created to consolidate a number of housing and community development grant programs. Today, it is the major federal community development program. Outlays peaked in 1981 at $4.042 billion and in 1994 were $3.651 billion.

The Urban Development Action Grant program was established in 1977 to make direct grants to cities, in part because of the difficulty in using CDBG funds for economic development, particularly large-scale physical development projects. During its 12 years of operation (1978-1989) it awarded $4.6 billion to assist about 3,000 economic development projects in more than 1,200 cities.[17] UDAG mostly provided financial incentives (usually loans) for larger-scale projects, usually involving development or redevelopment of offices or retail stores; most communities did not (or could not) fund such projects with CDBG funds, which were used more for neighborhood renewal. Funding peaked at $675 million in FY 1981. Over 90 percent of UDAG funds went to central cities (with half of that going

[13] Unemployment rates are even higher in some small metropolitan areas such as Fresno, CA (15.4 percent) and McAllen, Texas (17.1 percent). U.S. Department of Labor, Bureau of Labor Statistics, *Employment and Earnings*, vol. 42, No. 5, May 1995.

[14] Nicholas Lemann, "The Myth of Community Development," *New York Times Magazine*, Jan. 9, 1994, pp. 26-31; 50; 54; 60.

[15] Michael Porter, "The Competitive Advantage of the Inner City," *Harvard Business Review*, May/June 1995, pp. 55-71.

[16] Morton Schussheim, *The Modest Commitment to Cities* (Lexington, MA: Lexington Books, 1974).

[17] Michael J. Rich, "UDAG, Economic Development and the Death and Life of American Cities," *Economic Development Quarterly*, vol. 6, No. 2, May 1992, pp. 150-172.

to downtown projects), and most went to places with high levels of economic distress.[18] UDAG was praised for its ability to target money to distressed places, to strengthen public-private partnerships, and for contributing to a large number of development projects. Critics of UDAG believed that the program subsidized large developers and firms, such as large hotel chains, who did not need the subsidy. In addition, some criticized the program for building large-scale real estate development projects, often in the central business district. These projects provided economic activity, but they may not have directly addressed the economic needs of urban core residents.[19]

Today, four departments or agencies provide assistance for urban economic development: HUD, the Economic Development Administration (EDA) in the Department of Commerce, the Small Business Administration, and the Treasury Department.

HUD

HUD operates two major programs for urban economic and community development, the Community Development Block Grant program (CDBG), and the Empowerment Zone and Enterprise Communities Program. In addition, they operate several smaller programs.[20]

- The CDBG program allocates grants on a formula basis to entitlement communities (cities with more than 50,000 population and selected urban counties) and to states for distribution to non-entitlement communities on a discretionary basis. Funds can be used for a variety of purposes, including housing rehabilitation, energy conservation, public services and facilities, infrastructure, business financing, and commercial revitalization. In 1995, funding was approximately $4.6 billion.

CDBG has long been criticized by local and state government officials for being difficult to use for economic development because of overly restrictive rules and regulations governing use of funds. CDBG rules have recently been relaxed, making it somewhat easier to use for economic development.[21] However, funding is still tied to job creation and retention, which can make it hard to fund activities such as industrial service organizations, because establishing a direct link to job creation is difficult. Moreover, according to some city officials, the new rules have not gone nearly far enough in removing the impediments to putting in place flexible and innovative economic development efforts.

In 1994, HUD established its Economic Development Initiative (EDI) to encourage CDBG recipient cities to undertake more economic development activities. The program provides grants that can be used as a match for the Section 108 Loan Guarantee program. Under Section 108, communities can obtain loan guarantees from HUD to finance economic development and large-scale physical development projects that create jobs for low- and moderate-income people. Communities can

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[18] Ibid.

[19] Bernard Friedan, "Who Gets the Jobs in the New Downtown," *The Future of National Urban Policy*, Marshall Kaplan and Franklin James (eds). (Durham, NC: Duke University Press, 1990).

[20] Two smaller HUD programs also target community development. In 1994, HUD committed $20 million to the National Community Development Initiative to leverage $120 million from a consortium of foundations and a private insurance company, with the funds going to community-based nonprofit groups working to revitalize distressed communities, largely through provision of housing. The John Heinz Neighborhood Development Program provides grants to community organizations to create jobs; develop, rehabilitate or manage housing; and deliver services. In 1994, HUD awarded $4.8 million to 75 organizations, an average of $64, 000 per organization.

[21] On January 5, 1995, HUD published new rules in the Federal Register detailing these changes. For example, a worker a company hires is now presumed to qualify as having a low or moderate income if he or she lived in a census tract in which at least 70 percent of the residents have low or moderate incomes. Moreover, upon development of a neighborhood revitalization strategy through the consolidated Plan, communities gain further flexibility in use of CDBG funds for economic development.

borrow up to five times their annual CDBG allocation. However, because many communities are hesitant to pledge CDBG funds as collateral, partly because of the risk involved, but also because of the regulatory difficulties in using CDBG for economic development, HUD created EDI. Under the EDI program the Department awards grants to communities to use as collateral for loans. In FY94, HUD awarded 70 grants for just under $50 million dollars (an average of $714,000 per grant), and in conjunction with these grants HUD will provide these communities with nearly $413 million in loan guarantees. In FY1995, approximately $300 million was allocated, with most of it going to the supplemental empowerment zones (Los Angeles—$125 million; Cleveland—$87 million). So far, there have been no defaults to banks through use of the 108 program, largely because the communities' CDBG funds are used as collateral. However, HUD does not know the rate of project default. To date, funds are used largely for capitalizing revolving loan funds or for financing commercial and industrial rehabilitation projects. HUD also recently proposed a "Leveraging Investments for Tomorrow" (LIFT) program, which would have been targeted as project gap financing for community-based economic development real estate projects. However, the program was not funded.

- Empowerment zones, borrowed from an earlier British initiative and similar state government programs, assist local governments in attracting new business and investment to inner cities by providing tax incentives to firms locating in a designated zone and by providing funds for employment and other social programs within the zone.[22]

The Omnibus Budget Reconciliation Act of 1993 (Title XIII, Chapter 1) established the Empowerment Zone/Enterprise Communities program. The zone area or combination of areas meeting certain population, size, and poverty criteria required joint nomination by the local government and state(s) in which it is located. These areas can be characterized as having pervasive poverty, unemployment, and general distress. The legislation allowed the Administration to designate six urban and three rural communities as empowerment zones (EZs), and up to 100 as smaller enterprise communities (ECs). From over 500 rural and urban applications, the Administration selected 105 awardees in 1994. Six cities (Atlanta, Baltimore, Chicago, Detroit, New York, Philadelphia/Camden) were designated as EZs (with Los Angeles and Cleveland being designated as supplemental EZs) and 60 urban ECs were selected. Each urban EZ is slated to receive $100 million, and each EC is to receive $2.95 million through the Social Services Block Grants administered by the Department of Health and Human Services. These grants can be used to fund a variety of economic, social, and community development activities as determined by community residents. In addition, the Treasury Department will administer $2.5 billion in tax credits to EZs. Businesses that qualify and operate in EZs will be eligible for employer wage credits of up to 20 percent on the first $15,000 of wages paid to certain zone employees, increased deductions for plant and equipment (section 179), and new tax-exempt bond financing.[23] Businesses that qualify and operate in ECs will be eligible only for the tax-exempt bond financing incentive. Because programs have only recently been established, it is

[22] Barry M. Rubin and Craig M. Richards, "A Transatlantic Comparison of Enterprise Zone Impacts: The British and American Experience," *Economic Development Quarterly*, vol. 6, No. 4, November 1992, pp. 431-443. See also Stuart Butler, *Enterprise Zones: Greenlining the Inner Cities* (New York: Universe Books, 1981).

[23] Bruce K. Mulock, "Empowerment Zone/Enterprise Communities Program: Background and Analysis of Economic Issues," Congressional Research Service, Apr. 12, 1995.

too early to evaluate results. However, many of the principles underlying the EZ/EC program, including thinking strategically, developing integrated solutions across programs, crafting regional partnerships, and connecting planning with implementation, are consistent with what many experts believe are the foundations of solid urban economic development efforts.

Economic Development Administration

The Economic Development Administration (EDA) in the Department of Commerce was established in 1965 to aid economically distressed regions, and soon became the flagship federal agency for regional economic development. EDA principally funds local public works construction projects (e.g., industrial parks, access roads, sewer lines), in large part to enable communities to attract new industry. EDA also provides grants to communities facing sudden economic distress, increasingly to respond to military base closures, and funds technical assistance and economic research. Current grant funding of $379 million is down from $900 million (1995 dollars) in 1980.[24] Historically, about 70 percent of EDA funds have been spent in rural areas and small cities, while 30 percent has been spent in larger metropolitan areas; even less has been spent in distressed central cities or inner suburbs. In 1994 EDA did propose, but did not implement, a Competitive Communities program to support high-growth industries in distressed urban communities.

The Small Business Administration

SBA provides financing and technical assistance to small businesses, some of them minority-owned, and some located in urban core areas. The agency's primary financing program, the 7(a) loan guarantee program, guaranteed more than 36,000 loans in FY94 for a total of more than $8.1 billion. However, the program is generally targeted neither to urban areas nor to minority businesses in distressed areas.[25] Moreover, SBA programs have focused on small-scale "mom and pop" retail and personal service industries, which do little to revitalize urban economies as a whole or to create significant numbers of jobs.[26]

SBA's 504 program is a fixed-asset financing program for existing businesses, providing long-term, fixed, below-market rates. SBA will fund up to 40 percent of a loan, with a bank or other financial institution providing 50 percent, and the borrower 10 percent. SBA requires that one job be created or retained for every $35,000 of SBA funds. The loans are packaged and administered by approximately 280 SBA-certified Certified Development Companies around the country. In FY95, approximately 4,000 loans, for a total of $1.5 billion, will have been made.

The Community Development Finance Initiative

Administered by the Treasury Department, CDFI was established by Congress in September 1994 to provide capital to either existing financial institutions that specialize in community development lending, or to seed new organizations that are proposing to do this type of work. In contrast to traditional lenders, the express purpose of community-oriented financial institutions is to make loans and other investments to individuals and businesses located in economically distressed places, usually, but not exclusively, in cities. CDFI was modeled in part on the successful experience of the South Shore Bank in Chicago, a community development bank and development organization that has worked for over 20 years to help revitalize the South Side of Chicago. While South Shore was seen as a successful model, it has not been widely duplicated across the country, in

[24] Fiscal Year 1995 funds include $194 million for public works, $37 million for planning and technical assistance, and $105 million for defense conversion activities.

[25] Daniel Immergluck, "Moving to Economic Development: A New Goal for SBA Loan Programs" (Chicago: Woodstock Institute, 1995).

[26] Porter, op. cit., footnote 15.

part because though it does not lose money, its rate of return is not high enough to attract money from traditional equity capital markets. Yet, because the activities involved (community development in distressed places) provide benefits beyond those accruing to the borrower or bank alone, there may be some economic justification for government support of these activities. As a result, CDFI was created to help stimulate more community development lending organizations.

In addition to South Shore, there are a number of other models of community-oriented lending. For example, the Community Capital Bank in New York City is an insured bank that is oriented to making loans in low-income communities in New York. Community Development Credit Unions, of which there are several hundred, serve low-income neighborhoods. In addition, there are also community development loan funds focused on business development, micro-enterprise loan funds, and community development venture capital funds. Finally, for-profit and not-for-profit multi-bank CDCs are usually formed and invested in by a number of conventional banks as part of their Community Reinvestment Act (CRA) obligations.[27]

CDFI is a competitive program authorized to provide a variety of assistance, including grants, equity investments, loans, deposits (to insured institutions), and technical assistance to community-oriented financial institutions. Though the program received funding in FY 1995 of $125 million, $75 million was rescinded. The program plans to announce its first round of funding availability in mid-October 1995. Of the $50 million, two-thirds will go to CDFI. Recognizing that all communities have different needs, the program will fund a variety of different types of institutions. However, given the proclivity of community development finance institutions, including South Shore, to focus largely on housing and personal finance, it is not clear that these organizations will focus extensively on business development financing.

The other one-third of the funds will go to the Bank Enterprise Award program that provides incentives to traditional banks and lenders to invest in community development finance activities. Banks propose a set of activities during an assessment period, and if this exceeds their similar lending during a prior baseline period, they may be eligible for grants. One advantage of this program is that it may get banks more oriented and used to community development lending, encouraging this practice after the grant period is over. However, the program also runs the risk of providing subsidies for activities the banks would have done through their Community Reinvestment Act (CRA) obligations. Moreover, because the grants are likely to be small, they may simply reinforce what banks were already doing, as opposed to encouraging them to engage in new types of activities.

IMPROVING ECONOMIC AND COMMUNITY DEVELOPMENT EFFORTS

Federal support for economic and community development appears to play an important role in helping urban communities design and carry out strategies to address poverty, abandonment, and economic distress. However, there is considerable room for improvement. There are several problems with current federally supported economic and community development initiatives:

- Though the number of distressed places has increased in the last 15 years, federal funding has decreased.
- Reduced funds could be better targeted to distressed areas.
- Funding formulas for many programs provide few incentives for improving local grantee performance.
- Efforts are piecemeal and uncoordinated.

[27] John Sower and Beverly L. Milkman, "The Bank Community Development Corporation: An Economic Development Tool for the Nineties," *Economic Development Quarterly*, vol. 5, No. 1, February 1991, pp. 3-8.

- Most economic and community development funds are either for physical revitalization projects (e.g., housing and infrastructure), or for financial assistance to individual firms. There is no strategy to build up private and non-profit institutions to promote economic and community development in distressed inner suburbs and central cities.
- Even when business and managerial assistance is provided to firms, many organizations are not well suited to operate programs that provide services to industry.

To address these shortcomings, a number of policy options are listed in the following sections of this chapter.

■ Federal Funding Levels for Economic and Community Development

Federal funds for economic development have declined in real dollars over the last 15 years. For example, HUD outlays for community development (including Urban Development Action Grants) fell from $4.13 billion in 1980 to $3.68 billion in 1994, a decline of over 45 percent in inflation-adjusted dollars.[28] At the same time, the needs of cities and inner suburban communities grew. For example, between 1969 and 1989, the poverty rate of CDBG grantees in a sample that accounted for 80 percent of funds allocated in 1989, increased from 14.1 to 17.8 percent.[29] Moreover, the current wave of technological change is likely to further reduce the competitive advantage of many of these places over the next 20 years.

OPTION 1: *Congress could increase funding for economic and community development targeted to distressed urban places.*

■ Targeting Federal Economic Development Funds

Given the reduced federal resources for economic and community development, it becomes even more important that the remaining resources be targeted to areas that are actually distressed. Though increased targeting to a fewer number of more distressed places risks losing widespread political support for programs, shotgun approaches to federal economic and community development not only diffuse the resources too broadly, but also risk subsidizing development in prosperous places at the expense of distressed places.

Targeting to the Most Distressed Places

A not insignificant share of CDBG and other economic development funds is spent on places with relatively low levels of distress and need (such as relatively well-off suburbs) and projects that have few benefits for low- and moderate-income people. For example, between 1975 and 1989 the share of CDBG funds going to the most distressed cities declined from about 50 percent to about 36 percent, while the share going to cities that were best off doubled (to about 11 percent).[30]

Similarly, SBA programs appear to be poorly targeted to firms in distressed places or to minority-owned firms. For example, the SBA 504 program provides some extra benefits to firms in distressed areas. Firms located in labor surplus areas (as defined by the Department of Labor), redevelopment areas (usually rural or small metropolitan areas defined by the Economic Development Administration), or state or federal enterprise/empowerment zones must create one job for every $43,000 (instead of $35,000) of SBA

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[28] Budget of the United States Government: Fiscal Year 1996 (Washington, DC: U.S. Government Printing Office, 1995), table 12.3.

[29] The Urban Institute, "Federal Funds, Local choices: An Evaluation of The Community Development Block Grant program'" (Washington, DC: HUD Office of Policy Development and Research, 1995).

[30] Michael J. Rich, "Targeting Federal Grants: The Community Development Experience," in Community and Economic Development: Rethinking the Federal Role, Congressional Research Service, May 6, 1992.

funds, and the SBA loan limit of $750,000 can be increased by 25 percent. Yet, these bonuses appear to do little to actually target funds to firms located in more distressed areas.

The SBA 7(a) program appears to be even less targeted. For example, a recent study of the program conducted in San Antonio, Texas, found that lending was generally neither targeted to minorities businesses or to businesses located in distressed areas.[31] According to the study, non-manufacturing firms in lower-income zip code areas received 43 percent of the 7(a) funds, despite these zip codes having 54 percent of the metro area sales and receipts. Moreover, according to the study, after the recent introduction of the SBA Low Documentation program (LowDoc) that allowed an increased number of loans to be made for under $100,000, lending patterns favored firms in well-off areas even more. For example, while lending to firms in lower income areas increased 44 percent after the introduction of the LowDoc program, it increased by 110 percent in upper income areas.[32]

It is difficult to justify the public purpose of SBA loans that are not targeted sectorally, spatially, or demographically. SBA and other publicly assisted business finance programs are often justified for their job creation benefit. However, it is not clear that providing funds to any and all business serves that goal. For example, providing funds to a local serving business (e.g., restaurant, retail store) located in an economically growing community may result in the firm creating jobs, but the net job creation in the community and the nation is likely to be zero, as the expansion will simply take business away from firms that would have expanded after receiving private financing at less favorable rates. Moreover, with an unemployment rate of below 6 percent in 1995, and Federal Reserve Bank policies that appear to resist letting this rate decline any further, such job creation policies appear to be a poor use of public funds. A more effective use would be to target these funds for explicit public purposes. Though there appear to be several possible public purposes for SBA loans, including boosting productivity, increasing international competitiveness of firms, and assisting disadvantaged individuals or distressed places, the current system of simply providing loans to any and all firms that apply (provided they create jobs and are financially viable), diffuses the effectiveness of the program.

Targeting Distressed Neighborhoods and Disadvantaged Persons

Targeting needy communities is important to make federal economic and community development expenditures more effective, but results will be diminished if the money is not spent on the poor areas of the community and the poor residents. Some cities have been able to target their efforts at relatively distressed neighborhoods and disadvantaged areas. However, many city governments appear to spread federal funding, including CDBG funds, out to a wider range of neighborhoods, including those with low levels of distress. Moreover, cities are pressured to spend federal grants on regular functions of local government, including those in higher-income areas.[33] For example, Michael Rich, in a study of Chicago, documented that when restrictions on neighborhood targeting of CDBG funds were relaxed in the early 1980s, most of the increased CDBG funds went to middle and high income neighborhoods.[34] In contrast, targeting to the most distressed areas did increase significantly when Harold Washington

31 Daniel Immergluck, op. cit., footnote 25.

32 Because this study focused on just one metropolitan area, further research is needed to analyze lending patterns in other areas.

33 Peggy L. Cuciti, "A Nonurban Policy: Recent Public Policy Shifts Affecting Cities," *The Future of National Urban Policy,* Marshall Kaplan and Franklin James, (eds.) (Durham, NC: Duke University Press, 1990).

34 Rich, op. cit., footnote 5.

became mayor, suggesting that local politics can affect significantly the degree of targeting.[35] Community development officials from several large cities that OTA visited discussed the political pressures that led them to disperse funds throughout the city instead of spending them on the most distressed areas. In addition, even when cities spend federal money in distressed areas, they often reduce general fund expenditures there; thus federal funds substitute for local funds rather than augment them.

Currently 50 percent of the beneficiaries of each CDBG project must be low- and moderate-income persons (defined as households with incomes less than 120 percent of median income in the region). Moreover, 70 percent of projects must meet this criterion. If a project benefits a majority of low- and moderate-income residents, then all of that money is counted as benefiting low- and moderate-income people, even though higher-income people also benefit. This all or nothing method of accounting for benefits leads to an overestimation of targeting to needy people. Theoretically, as high as 65 percent ((100 percent minus (50 percent times 70 percent)) of the beneficiaries of a community's CDBG allocation could be higher-income people. Moreover, many communities, particularly suburban, spend HUD funds on what HUD calls special populations, particularly the elderly and the handicapped, to qualify. One argument against targeting to the neediest persons is that cities want to attract the middle class back into cities, and overly strict targeting provisions would hinder their efforts.

Encouraging Cities to Target Their Own Funds

Some cities with strong economies have been able to focus economic development policies on enhancing opportunity. For example, the city of Charlotte, North Carolina, focuses its economic development programs on alleviating poverty. However, most cities' economic development programs do not strongly target distressed areas.[36] For example, even though half the elected officials in one survey reported that poverty is a serious problem in their city, most reported that economic development activities are not directed specifically toward reducing poverty.[37] For example, the economic development programs in one large, fast-growing southwestern city are directed almost entirely toward recruiting new industry to the region, and the lion's share of these jobs went to outlying areas far from the large disadvantaged, mostly Hispanic, community. In another big northeastern city, economic development programs are crafted largely to boost economic growth in the region, with little or no thought given to how the benefits of that growth could be used to enhance economic opportunity for disadvantaged residents.

Many cities do not target their economic development programs on needy places or people, in part because the most vocal and organized constituency for economic development is the segment of the local business community that benefits most directly from growth—the businesses that strongly depend on sales within the metropolitan area (e.g., local media, retail stores, utilities, and local banks). For example, a survey of elected officials of 188 large cities by the National League of Cities found that 48 percent of officials thought that promoting economic development was more important to their chances of getting reelected than reducing poverty, while 2.9 percent felt the opposite, and 49 percent viewed them as equal.[38] When areas are already growing, promoting economic development, especially by attracting

[35] Ibid.

[36] Furdell, op. cit., footnote 6.

[37] In two surveys of local officials on local economic development goals, addressing issues of poverty ranked lowest. Ibid, and Ann Bowman, "The Visible Hand: Major Issues in City Economic Policy," (Washington, DC: National League of Cities, 1987).

[38] Furdell, op. cit., footnote 36.

firms from other areas, is inefficient from the national perspective and can increase congestion, raise housing and land costs, and increase costs to businesses, especially to those exporting products outside the region.[39] Appropriate development policies depend on strong involvement by local residents and businesses negatively affected by growth, but political factors often limit such involvement.

As a result, the degree of targeting that is appropriate depends on the condition of the local and regional economy. In cities that are losing jobs, increasing employment benefits all groups, including low- and moderate-income residents, even if the jobs are not specifically targeted to them. In contrast, in cities that are growing, there is less rationale for not targeting jobs specifically to low- and moderate-income persons and distressed neighborhoods.

There are several measures Congress could take if it wanted to increase targeting.

OPTION 2: *Change funding formulas so that a greater share of funds go to distressed cities and suburbs. Congress could:*

- Require that EDA spend more of its funds in urban areas. Currently approximately 80 percent go to rural areas and small cities. However, as discussed in chapters 4-7, technological change is not likely to lead to significant enhancement of rural economic prospects, so diverting economic development funds from rural areas may not be appropriate.
- Tighten the formula for allocation of CDBG funds so that fewer funds go to well-off and growing jurisdictions.

OPTION 3: *Increase the targeting of SBA loan programs (both 7(a) and 504), so that a greater percentage of loans serve minority-owned businesses (see below) and businesses in distressed urban core areas. Congress could:*

- Require SBA to develop better definitions of distressed places used in the 504 program, since the use of unemployment rates in counties does not adequately provide incentives for targeting problems of uneven development within metropolitan areas. One way to improve this would be for poverty census tracts to be used as one indicator of location in distressed area. Firms located in such areas would be given greater priority for SBA funding, provided that they meet normal SBA financial standards.
- Encourage SBA to make greater efforts to target funds to distressed areas or minority-owned businesses. Funding or guarantees for banks, Certified Development Corporations, and other institutions relying on SBA funds could be based in part on how well they target funds. SBA regional offices that approve loans could be required to establish targets for funding minority-owned firms and firms in distressed places.

OPTION 4: *Tighten criteria so that cities receiving federal aid spend more of it on distressed neighborhoods and disadvantaged persons. Congress could:*

- Change the CDBG criteria to focus more on low- and moderate-income people, perhaps lowering the definition of low- and moderate-income persons to households below 100 percent of median income and/or requiring that 80 percent of projects have over 60 percent of benefits going to low- and moderate-income persons. If Congress does not want to apply these stricter standards to all places, it could vary the percentage targets depending on the unemployment rate in the metropolitan area—the healthier the economy, the higher the percentages could be.

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[39] Tim Bartik, *Does Local Economic Development Work* (Kalamazoo, MI: Upjohn Institute, 1993).

OPTION 5: *Federal funding could be used as incentives for cities and states to focus their economic development programs on distressed places and disadvantaged persons. Congress could:*

- Encourage HUD to develop performance indicators on which to allocate additional block grant funds. One indicator could be the degree to which cities and states demonstrate a commitment to target their own programs.

Performance-Based Funding

Many federal urban programs (including job training, housing, and economic development) provide formula-based block grants to city or state governments, regardless of the performance of the grantee. Inmost cases, performance varies significantly between cities or states, with some cities using federal funds to craft and implement strategic and efficient actions, and others failing to plan or target, and then operating mediocre programs. Yet, for both the best performers and the worst, block grants provide the same amount of money. Without some kind of market-based competition, there is less incentive for poor performers to improve.

Currently, some federal programs are based on competition, including the Empowerment Zone and Enterprise Community programs and EDA funding. However, EZ/EC funding is based on the quality of the grantee's initial application, and further funding is not based on performance. Political and institutional obstacles in some cities may result in less than fully effective efforts. Anecdotal evidence from several cities receiving EZ designation suggests that local performance may vary significantly, with at least some programs getting bogged down in politics and bureaucracy. Moreover, in some instances, federal agency delay and unresponsiveness have not helped matters. The legislation to establish the program did create an Enterprise Zone Board headed by the Vice President to coordinate efforts within the federal government and to act as a means by which communities could seek help in resolving differences with federal agencies.

HUD has taken some steps in the direction of building performance incentives into CDBG. As part of Secretary Cisneros' HUD reinvention plan, "From Blueprint to Action," HUD has proposed consolidating 60 major programs into three flexible, performance-based funds: a Community Opportunity Fund (COF); an Affordable Housing Fund; and a Housing Certificate Fund. HUD also proposed that a percentage of program funds be retained for later distribution to reward those jurisdictions deemed good performers. The funds would be targeted for job creation and brownfield cleanup (see chapter 9).

However, HUD has made little effort to define meaningful performance-based standards. For example, some have suggested that one performance standard be whether communities have spent all of their CDBG allocation. However, this criteria would simply reward communities that spend money, even if the money is spent unwisely. Developing meaningful performance standards can be quite difficult. Standards must be able to control for the influence of factors, such as regional recessions, beyond the control of local officials. Moreover, while standards must be related to outcomes, they must not penalize communities with fewer resources and expertise, or lead to creaming by organizations receiving funds. For example, one complaint leveled against many job training programs is that they tend to enroll people who are relatively easy to employ, in order to pump up their placement rates.[40] Similarly, many locally operated public business finance programs fund relatively safe deals for fear of having too high a default rate, although strict federal oversight also makes cities hesitant to fund more risky deals. This criticism has also been leveled at SBA financing programs. Such creaming increases the

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[40] United States Congress, Office of Technology Assessment, After the Cold War: Living With Lower Defense Spending, OTA-ITE-524 (Washington, DC: U.S. Government printing Office, 1992).

risk that public resources are simply substituting for private.

One reason why performance standards are difficult to develop is because there has been so little evaluation of local efforts .4] Careful and rigorous evaluations of urban development efforts are needed, in particular, evaluation of different strategies (e.g., loan funds, infrastructure, technical assistance) and approaches (e.g., government run programs, vouchers, networks). Better evaluation would lead to a more sophisticated set of indicators, which could help judge performance and make funding decisions.

Finally, an additional weakness of the current funding system is that though federal agencies concentrate on closely monitoring the grantees to ensure they do not violate procedures or accounting rules, much less is done to help communities identify and implement the most effective economic and community development strategies. In short, federal economic and community development programs try to ensure funds are spent efficiently, but not necessarily that they are spent effective y.

There are several drawbacks to this skewed priority. First, local grantee flexibility is often severely restricted as the grantees try to comply with a myriad of federal regulations. Because they are often second guessed by federal oversight officials, communities often choose safe projects that may not yield the most economic benefits, but are assured of getting approved. Moreover, the paperwork faced by local governments in managing these grants diverts resources from the real work. For example, there is a risk that the Empowerment Zone program, while initially designed as a flexible program, could become more rule bound, limiting local flexibility and initiative. Second, relying on rules enforced from Washington to secure objectives in distant communities is difficult. Communities can find a myriad of ways to bend the rules to allow them to do what they want.

OPTION 6: *In spite of the difficulties in developing effective performance indicators, there are several steps Congress could take. Congress could:*

- Modify existing block grant programs so that communities would receive a minimum amount based on need (perhaps 50 to 75 percent of current levels). The remainder of the money would be allocated across all the communities and states based on performance measures (e.g., quality of strategies, percent of funds meeting national objectives, degree of matching funds, degree of comprehensiveness, and measurements of outcomes). Outcome indicators could include such things as reduction in percentage in poverty (relative to the metro area), increases in employment, and increases in first-time housing purchases.
- Create a competitive, challenge-grant program combining all federal economic and community development funds (see box 2-l). Such grants would be based in part on need and in part on performance. One advantage of this would be that it would maximize federal ability to promote national objectives. However, a drawback, especially if the grants are based on responding to grant proposals, is that the more disadvantaged communities may not have the resources to design as effective programs or craft as effective proposals. As a result, such a system could have built into it provisions that reward performance in part on the level of improvement shown by a jurisdiction.

OPTION 7: *Finally Congress might want to ensure that federal economic development and community development agencies, in particular HUD and EDA, place greater emphasis on technical assistance and evaluation. Congress might:*

- Encourage EDA or HUD to do more to support innovative efforts, perhaps by providing funding (or reallocating funding) for an office of

[41] Bartik, op. cit., footnote [39].

BOX 2-1: Reinventing Federal Urban Economic and Community Development

Although the particular limitations of federally-supported economic and community development efforts can be addressed individually (e.g., institute new procedures for targeting, develop performance standards as part of block grants), one option for Congress would be to create a new approach that addresses all the limitations simultaneously. Such an approach would have several characteristics, it would:

- provide increased funding targeted to distressed urban core areas;
- be comprehensive and avoid piecemeal approaches;
- be flexible enough for localities to easily and imaginatively use the funds in ways they see as important, yet would ensure that valid federal objectives would be met;
- provide incentives for states and communities to change their behavior to better meet incentive requirements.

To do this, Congress could create a consolidated urban development initiative. This could be in one department, such as HUD or the Economic Development Administration. Or, to give the initiative more flexibility and a fresh new start, it could be housed in a newly created quasi-public National Urban Economic Development Corporation. This corporation could have a board of directors appointed by the President and Congress, representing industry, academia, CDCs, community-oriented banks; and, most importantly, state and local government.

Either entity would operate comprehensive, performance-based, flexible urban development programs Either would house all current federal urban economic and community development programs, Including EDA and CDBG. Other programs that it might include are the Minority Business Development Agency and some SBA programs such as the 504 loan program.

The organization's main role would be to make competitive challenge grants to states and cities (perhaps with a share of the funds going to states and a share directly to cities). States and cities would compete for grants for a multi-year period, with funding being renewed each year based on performance. Funding could be for a wide array of projects, activities, or organizations. Moreover, a portion of the city funds could be allocated on a metropolitan basis in order to promote regional cooperation and develop regional solutions. Some of the allocation could be based on need, while the rest could be based on performance. By basing funding on performance, the federal government could not only use market forces to drive performance improvement among grantees, but could also create incentives for Inducing state and local grantees to meet federal objectives.

Performance standards could include: 1) demonstrated commitment by the states and cities not only to leverage their own funds, but also to target the funds to distressed places and disadvantaged people; 2) efforts of states and cities to promote regional cooperation and initiatives to solve urban core problems; 3) extent to which states and cities refrain from recruiting firms from outside through financial incentives, particularly to prosperous, growing areas; 4) degree to which funds are focused on innovative activities, especially non-financial business assistance; 5) degree to which grantees provide services in a comprehensive, as opposed to piecemeal, manner.

In particular, such an organization might make competitive grants supporting locally based, fully integrated, one-stop service centers. These quasi-public centers would provide a wide array of services (e.g., training, technology, export assistance and management assistance) to help firms in central cities and inner suburbs expand and compete.

(continued)

BOX 2-1: Reinventing Federal Urban Economic and Community Development (Cont'd.)

In order to ensure that grantees are meeting the performance standards and yet avoid onerous rules and regulations, awarding and management of grants could be based on negotiated agreements between the organization and the states and localities. For example, the organization could assign one person to serve as a program officer for a small number of states (5 to 10) and metros (10 to 25, depending on the size) to work cooperatively with the cities and states, in part to help develop ongoing strategic economic development plans These officers would be able to focus on assuring that funding is spent to solve local problems effectively, not just on complying with rules, In part, DOD's Office of Economic Adjustment plays a similar role in helping regions deal with the economic impacts from defense cuts

The organization would also provide technical assistance and evaluate what works, It could employ a small cadre of the leading economic and community development experts to study best practices in economic development, to support demonstration and rigorous evaluation, to examine trends and changes in economic conditions that affect regional and local development, and finally, to effectively disseminate this knowledge to states and localities, Moreover, this group could help lagging performers improve their performance so as to qualify for increased funding,

Finally, the organization would play a catalytic role to stimulate the development of other urban initiatives, particularly in partnership with foundations and the private sector.

strategic economic development, whose job would be to learn from best-practice economic development efforts around the country and to diffuse that knowledge to economic development organizations throughout the nation.

Coordination of Federal Economic Development

There is considerable agreement that comprehensive approaches to community development are more effective than piecemeal ones.[42] Yet, historically, federal economic and community development policy has been the province of a number of different agencies and within each, a large number of individual programs. According to GAO, the federal government assists distressed urban communities and their residents through at least 12 federal departments and agencies.[43] The Departments of Labor and Health and Human Services help people enter the labor market by providing training and human services. The Small Business Administration (SBA) and the Minority Business Development Agency in the Department of Commerce both try to promote minority business. Twenty-four programs provide technical assistance to business.[44] At least six Departments provide economic development assistance.

This proliferation of programs causes a number of problems. First, because these agencies rarely work together, their programs cannot reinforce one another. Second, organizations at the local level must deal with a plethora of programs and agencies, making it difficult for localities to obtain assistance. Third, the crafting of comprehensive, integrated solutions at the local level is difficult, because each federally funded program

[42] U.S. Congress, General Accounting Office, *Community Development: Comprehensive Approaches Address Multiple Needs but Are Challenging to Implement,* GAO/RCED/HEHS-95-69 (Gaithersburg: MD: U.S. General Accounting Office, February 1995).

[43] Ibid.

[44] U.S. Congress, General Accounting Office, U.S. *Government Aid to Business,* GAO/GGD-95-3FS, (Gaithersburg: MD: U.S. General Accounting Office, October 1994).

has its own rules, eligibility requirements, and boundaries. Moreover, the overlap, specialization, and duplication at the federal level fosters similar conditions in most metropolitan areas.

As a result, efforts to improve the economic prospects of distressed urban areas and the lives of disadvantaged people in cities are an amalgam of separate subsystems, usually with very little overlap, cooperation, or coordination.[45] These subsystems include:

- **Economic development**. These efforts are usually run by city governments or private sector coalitions and are typically focused on specific enterprises, and in some cities are directed at the revitalizing the CBD. Their major goal is usually economic growth of the region, even if the region is growing rapidly, as opposed to overcoming uneven development within the region.
- **Community development**. These efforts, often run by housing activists and community development corporations, and supported by banks and foundations, usually focus on housing, some small-scale retail development, and community services. Often these efforts revolve around CDBG funds.
- **Job training**. The mission of these programs is to train and place disadvantaged residents; funding is by the Department of Labor.
- **Transportation**. The efforts to use transportation to promote economic development (e.g., by such means as providing transit services to assist disadvantaged inner city residents to commute to suburban jobs) are often run by regional or local transportation officials and supported by Department of Transportation Funds.
- **Health and social services**. These programs, often supported with HHS funds, provide direct services to people who are in poverty.
- **City services**. Cities provide basic services, including police, fire, water, and garbage, as well as investments in infrastructure.

Unfortunately, each of the subsystems is driven by different funding sources, different definitions of the customer, and different organizational and political imperatives. Because of this, in most cities, these parties usually work in isolation from one another, each addressing a part of the problem, but seldom in a synergistic manner.[46] Public programs rarely operate as full-service, one-stop shops. This smorgasbord makes it difficult to craft comprehensive strategies with mutually reinforcing components. As a result, an important function for federal urban policy in the post-industrial metropolis will be to enable and encourage local delivery organizations to craft integrated and strategic economic development solutions that link business development, job training, community development, transportation, and human services into a holistic framework.[47]

HUD has taken some steps to coordinate and consolidate its efforts, and has increased funding for comprehensive community-based organizations. It has proposed that its current community development programs be merged into a Community Opportunity Performance (COP) Funds program. COP funds would provide localities and states with flexible, formula-based funding for economic revitalization (including housing) and renewal of distressed communities. In addition, its Consolidated Plan allows communities to produce just one plan and one application for HUD's

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[45] William Schweke and Carol Conway, *Proceedings of the Macarthur Roundtable: Reinventing Urban Development Delivery* (Washington, DC: Corporation for Enterprise Development, Sept. 26, 1994).

[46] Corporation for Enterprise Development, *1995 Entrepreneurial Economy Review: The Path Toward Urban Revival*, (Washington, DC: CfED, 1995).

[47] Marc Bendick and Mary Lou Egan, "Linking Business Development and Community Development in Inner Cities," *Journal of Planning Literature*, vol. 8, August 1993, pp. 3-19.

major formula community development programs, including CDBG and several housing programs. One goal of the Consolidated Plan is to encourage local departments and agencies to become more strategic and to communicate and cooperate. However, it is not clear how successful the Plan will be in this respect, as some cities may view the plan as a pro forma exercise required before obtaining federal funds.

EZ and EC winners also had to demonstrate how they would coordinate efforts among various organizations in the cities. The creation of local empowerment zone boards to oversee efforts is one attempt to bring some coordination to the process. However, there is a risk that such boards may become too top heavy and actually impede effective action. For example, Detroit has proposed that its Empowerment Zone Development Corporation board be made up of 50 members.

OPTION 8: *Consolidate existing urban economic and community development programs into one program into one agency or institution. Congress could:*

- Move more toward consolidated block grants. Existing fragmented block grant and categorical grant programs could be consolidated and provided to states and cities. For example, instead of the current project-specific funding in EDA, Congress could put EDA funds into two block grant programs-one for states and the other for cities. The advantage of this approach is that it provides maximum flexibility to state and local governments. However, it provides few incentives for state and local government to improve performance or meet national objectives.
- Consolidation of programs into an urban development block grant program administered by the states could be a transitory measure to an operating regime where states assume full responsibility, including funding responsibility, for what are now federally-operated urban programs. Such a system would provide maximum flexibility to the states and could lead them to spend more to address uneven development. However, it is not clear, given the added fiscal responsibilities they are likely to face, that states would place significant priority on these problems.
- Create a competitive, challenge-grant program combining all federal economic and community development funds. This could be in one department, such as HUD or the Economic Development Administration. Or, to give the initiative more flexibility and a whole new start, it could be housed in a newly created quasi-public National Urban Economic Development Corporation (see box 2-1). One drawback of such an approach is that it may divert attention and energies from other important issues such as targeting, fostering local flexibility, and promotion of more innovative approaches.

New Institutions for Economic and Community Development

At the local level, one institutional solution to piecemeal, uncoordinated efforts is to increase support going to organizations that provide more comprehensive approaches to community and economic development.

In the area of community development, one method to boost coordination is to increase funding of Community and Local Development Corporations (CDCs).[48] These locally based, private non-profit organizations, governed by a board consisting primarily of neighborhood residents and business leaders, generally focus on revitalizing distressed areas. They are usually engaged in one or more types of community development, including affordable housing, commercial and industrial development, and small-scale business development. In addition to project specific work, many CDCs often conduct other activities to

48 Corporation for Economic Development, Rebuilding Inner-City Communities: A New Approach to the Nation's Urban Crisis (Washington, DC: CED, 1995).

benefit local areas, including providing social services.

Initially begun in the late 1960s, in part as an alternative to the federal Community Action Program, these programs focused less on advocacy and community action, and more on community and physical development.[49] The number of CDCs has grown significantly, to approximately 2,000, although not all of these serve urban areas, and many are not very large. According to one survey of over 1,100 CDCs, 88 percent create affordable housing.[50] In contrast, only about 25 percent are involved in economic development, and they are often engaged in commercial and industrial real estate activities. Some also operate revolving loan funds for business development, although usually on the micro-enterprise scale, since almost 75 percent of loans are under $25,000. Many CDCs, particularly the larger ones, also provide other services, such as job training and placement, child care, health care, youth programs, and anti-crime activities.

Funding comes in part from federal (largely through CDBG), state, and local governments. However, private foundations, as well as intermediary organizations, such as the Local Initiatives Support Corporation (initiated by the Ford Foundation) and the Enterprise Foundation (initiated by James Rouse), provide significant financing. In addition, some banks (in part through financing that allows them to fulfill CRA requirements) and other private companies invest in CDCs, particularly in housing projects.

CDCs, particularly the better and more established ones, offer several advantages.[51] First, because many are neighborhood based, they are able to craft more comprehensive solutions that try to solve an array of problems.[52] Second, in the midst of poverty and despair, many CDCs represent a hope and enthusiasm that is all too often missing in distressed urban areas. Because they do more than just provide housing or jobs in isolation, and instead also build "social capital," these organizations can help strengthen the community fabric, thereby facilitating development.[53] In many of these communities, it is not simply traditional business location factors (e.g., cost of land, availability of skilled labor) that hinder development, it is the lack of local leadership and institutions to create a coherent community that can support and foster development by the private sector.[54] In this respect, the maturation and expansion of CDCs in the 1980s has been an important institutional development that can serve as a foundation for the next steps in urban policy.[55]

Notwithstanding these strengths, the current organization of CDCs suffers from several weaknesses. First, in the face of large problems, their efforts remain small. In many places, CDCs have only marginal impact. For example, in the late 1980s, the average CDC created approximately 15 units of housing per year.[56] However, some of the

[49] Mitchell Svirdoff, "The Seeds of Urban Revival," *The Public Interest*, Winter, 1994.

[50] National Congress for Community Economic Development, *Changing the Odds: The Achievements of Community-Based Development Corporations* (Washington, DC: NCCED, 1991).

[51] See Avis Vidal, *Rebuilding Communities: A National Study of Urban Community Development Corporations* (New York: New School for Social Research, 1992).

[52] Bennett Harrison, Marcus Weiss, and John Gant, *Building Bridges: CDC's and the World of Employment Training* (New York: Ford Foundation, 1995).

[53] Mitchell Svirdoff, op. cit., footnote 49, pp. 82-103.

[54] For a discussion of this as it relates to rural communities hard hit by plant closings, see Michael Hibbard "When the Going Gets Tough: Economic Reality and the Cultural Myth of Small Town America," *Journal of the American Planning Association*, vol. 52, No. 4, 1986.

[55] Corporation for Economic Development, op. cit., footnote 48.

[56] National Congress for Community Economic Development, op. cit., footnote 50.

more successful CDCs are much larger, and with more resources, CDCs could certainly do more. Second, in contrast to much of the rhetoric of the community development movement, much of their work has been focused on housing revitalization and construction, and much less on economic development.[57] In part, this has been because funding by government (through the Federal Low Income Housing Tax Credit and HUD) and foundations has been predominately for housing. However, economic development by CDCs is growing, although largely oriented to commercial and retail revitalization. As more and more jobs move to the suburbs, and unemployment and underemployment rises in distressed areas in core cities, everyone agrees that job creation is important. Foundations are increasingly supporting economic development, especially commercial revitalization.

While CDCs can play an important role in community development, they appear to be less well suited for economic development, especially business development beyond local commercial revitalization. Yet, other economic development organizations are also sometimes poorly suited. Urban economic development programs are often run by organizations, including city governments, that are not familiar with industry. As a result, business development programs are often too bureaucratic, too focused on general information rather than on real services (e.g., training, access to technology, management assistance), generally passive in orientation, and do not develop working relationships with firms.[58] Most public agencies have little contact with or knowledge of business needs. The best programs are customer oriented, focused on ongoing interaction with the business client, provide customized services, and are flexible. Non-governmental (private or quasi-public) organizations often do this best.

These problems are exacerbated by the fact that economic development programs take a "shotgun" approach to economic development, serving a wide variety of firms. The lack of sectoral specialization severely hinders service providers from developing in-depth, comprehensive knowledge about particular industries.[59] In many cases, providers are expected to give assistance to all industries while knowing little beyond the most general information about market structure, technology needs, and worker skill requirements. The generalist approach may serve novice entrepreneurs attempting to open up retail stores, but it falls far short when it comes to working with firms operating in intensively competitive and complex markets. To be competitive, firms need services that help them address pressing problems. General business development programs are not likely to provide this type and level of service.

As a result, federal policies could increasingly support organizations that have closer ties with industry and can provide real services to them. Such institutions can help small and medium-sized manufacturing and producer service firms improve quality, product design, productivity, and market savvy, and thus help them be more competitive. These organizations can also play a role in bringing key players together and marshaling the resources of the private sector. This kind of social and economic organization cannot be legislated or mandated: these efforts must emerge from particular places and particular actors, including residents, business leaders, universities, federal laboratories, and local government. However, the federal government can provide matching funds, can publicize success stories and other models, and can provide technical assistance.

Interest in these approaches in part reflects learning from sub-national European experiences.

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[57] Robert O. Zdenek, "Investing in Distressed Communities," *Economic Development Commentary*, Winter 1993, pp. 17-24.

[58] Office of Technology Assessment, op. cit., footnote 40.

[59] Mt. Auburn Associates, *Jobs and the Poor: Defining and Assessing Sector Economic Development Efforts by the Public Sector,* prepared for the Ford Foundation and Mott Foundation, forthcoming , 1995.

For example, in the United Kingdom the central government has played a direct facilitating role, not just financially for enterprise zones, but by providing managerial expertise and creating new organizational structures, in part by establishing and funding locally independent urban development corporations.

In Copenhagen, the Technology Institute (one of 31 technology services centers in Denmark) was established to help small and medium-sized industrial firms use advanced technologies. The Institute not only conducts applications-oriented R&D, but also provides a wide range of services to its clients. These include market research, assessment and consultancy on technical and management problems, demonstration of new technologies, financial consulting and referral. Over two-thirds of the Institute's budget comes from the firms it serves.[60]

Similarly, in Bologna, the Centro Ceramico, a research/industrial services center funded by the 500 ceramics firms in the Bologna area, works one-on-one with member firms to solve technical problems, including reducing environmental emissions, developing new materials and products, and putting in place more efficient production processes.[61]

There are similar programs in the United States. Although most are not targeted to distressed urban areas, the model holds significant promise for such areas. Oregon's Wood Products Competitiveness Corporation provides a wide range of services to Oregon secondary wood products producers, including marketing, training of workers and managers, manufacturing modernization, research and development, financing and promotion of cooperative industrial networks. In Pennsylvania, seven Industrial Resource Centers provide an array of services to small and medium-sized manufacturers. Originally established in 1988 as a manufacturing extension program, this effort has evolved and now offers a wider range of services. In New York City, the Garment Industry Development Corporation, funded in part by city government, unions, and industry, helps garment firms both to become more competitive and to hire low- and moderate-income New York residents.

Though a number of states and cities have tried to apply the new models of economic development,[62] few have focused on revitalizing distressed urban core economies. There are a number of reasons for this, but most of them come down to not knowing how to apply the new models to the particular case of distressed areas. Moreover, little or no technical assistance is available for this application. Finally, and perhaps most importantly, it is difficult to fund such efforts through some Federal programs. For example, the CDBG program focuses on projects with specific outputs (e.g., rehabilitating a building, giving a business a loan), rather than on creating and sustaining organizations that can foster business development. Moreover, historically HUD area and regional office interpretations of rules and documentation and other administrative requirements have been so time consuming and difficult to manage, that for many communities, housing rehabilitation and infrastructure was the path of least resistance and least likely to raise HUD office concerns. The structure and culture of EDA also constrains it from funding these types of economic develop-

[60] Office of Technology Assessment, op. cit., footnote 40.

[61] U.S. Congress, Office of Technology Assessment, *Industry, Technology and the Environment: Competitive Threats and Business Opportunities*, OTA-ITE-586 (Washington, DC: U.S. Government Printing Office, 1994).

[62] R. Scott Fosler, "State Economic Policy: The Emerging Paradigm," *Economic Development Quarterly*, vol. 6, no. 1, February 1992, pp. 3-13.

ment organizations. Moreover, because much of EDA's funds are in Title 1, which principally funds infrastructure, it is difficult for EDA to fund non-infrastructure efforts.

OPTION 9: *Target a greater share of federal funding to more comprehensive, innovative economic development organizations. Congress might:*

- Encourage HUD to fund more innovative economic development institutions, perhaps through funds distributed on a performance basis.
- Broaden the applicability of activities under Title 1 in EDA to allow funding for economic development programs or activities. Another option would be to reduce or eliminate Title 1 funding, and allocate the funds to the more flexible Title IX. Congress might then broaden the definition of economic adjustment in Title IX to allow funding for long-term distressed areas, not just for areas suffering sudden and severe economic distress. If Title 1 were eliminated, appropriate infrastructure projects could be funded under Title IX. In addition, require EDA to open up its funding process to support the most effective organizations.

OPTION 10: *Increase support for Community Development Corporations (CDCs) and other similar comprehensive, locally based development organizations. Congress could:*

- Increase funding for HUD's $20 million National Community Development Initiative, which, in conjunction with foundations, funds community-based non-profit groups.
- Establish a separate quasi-public corporation to make grants for economic and community development to community-based organizations.[63]

Focus Efforts on Business Development

In part because of the potential of new information technologies to weaken and restructure the economies of the urban core, a new kind of urban policy effort may be needed, one focused explicitly on economic development, and specifically on business development. For example, Michael Porter argues that the cornerstone of a new model of urban economic development should be to identify the potential competitive advantage of inner city-based companies and thus understand the basis for sustainable market positions.64 The major thrust of the new urban economic development should be to build up the capacity and competitiveness of business in the central city and inner suburbs, relying less on tax incentives, low interest loans, and provision of buildings and infrastructure and more on improving the management and financial skills of small- and medium-sized business owners and managers.

Yet, historically, urban community development efforts have been organized around programs to supply housing, infrastructure, and social services. When economic development has been the focus, federal funds have often been used to provide subsidies (e.g., low-interest loans, free land, developed infrastructure) to corporations to induce them to locate or build a facility in the city. For example, two-thirds of CDBG economic development funds are for assistance to individual firms, and 78 percent of these funds provide low-interest loans to help business develop and expand.[65] Similarly, tax incentives are a major component of the empowerment zone program.

In a study of CDBG economic development funds, only 4 percent of assisted businesses re-

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[63] In 1991, Congress proposed the National Community Economic Partnership Act, which would have provided $250 million over three years in a competitive process for CDCS to do community economic development projects. As originally proposed, the funds would be administered by a quasi-public corporation. However, in the final legislation it was housed within the Office of Community Services at HHS. The program was included in the urban aid bill vetoed by President Bush and included, but not appropriated, in the Crime Bill.

[64] Porter, op. cit., footnote 15

[65] The Urban Institute, op. cit., footnote 29.

ported receiving technical assistance, while 98 percent received either grants or loans.[66] Providing direct loans in a retail manner to industry may not make much sense.[67] First, it is not clear that capital is the major need of many of these firms. In many cases, firms need managerial or technical assistance to prepare business plans, keep their books properly, and develop marketing strategies. After these are in place, finding private financing becomes much easier. Second, a dedicated direct loan program is a costly way to provide capital to industry. An alternative method would be to have banks make the loans, but provide a processing fee to help cover the costs of processing small-scale loans, or provide a loan loss reserve pool to encourage banks to make more risky loans. Finally, by making direct loans or grants, many of these programs can help only a few firms a year.

While incentives and business financing can play a role, urban economic development should do much more than recruit industry from outside through large one-time incentives. Building partnerships with industry, community organizations and others is probably more important. Moreover, the nonprofit sectors in these areas need to be stronger and better linked to industry. The following factors will be important for an urban economic development initiative.

Urban Blue Collar Industry Initiative

Low- and moderate-income urban residents are experiencing increased economic difficulty partly because of the movement of blue collar jobs out of urban cores. While it is not realistic to expect to replace all the jobs that have been lost, employment in these sectors might be stabilized or increased slightly. Industries such as manufacturing, freight, distribution, and recycling can thrive in urban cores, particularly if they adopt flexible technologies and seek market niches (see chapter 6). Therefore, federal assistance might help firms in these industries become more competitive, particularly through application of advanced technology. Currently, some, but not all of the 44 Manufacturing Outreach Centers supported by DOC's National Institute of Standards and Technology's Manufacturing Extension Partnership target manufacturing firms in central cities and inner suburbs. For example, the Chicago Manufacturing Center has focused a share of its efforts on helping the city's manufacturers, many located in distressed areas, become more competitive (see box 2-2). And the Center itself is located in the Empowerment Zone.

OPTION 11: *Target a greater share of federal assistance to modernize manufacturing to manufacturers in urban areas. Congress could:*

- Encourage NIST to provide guidance to NIST's Manufacturing Outreach Centers (MOCs) to establish urban manufacturing initiatives.
- Provide increased funds for MOCs ($73 million in FY 1995) and require that some of the money be spent to create centers that focus at least in significant part on serving manufacturers in distressed urban areas. Centers need not necessarily be located in these places, but would have to serve firms located there. Section 103 of S17, The New Urban Agenda Act, introduced in 1995 by Senators Arlen Specter and Carol Moseley-Braun, requires the Secretary of Commerce to give preference for awarding funds to manufacturing centers located in empowerment zones and other distressed areas. In addition, Congress could broaden the range of industries able to be served to include other blue collar industries, including wholesaling and freight transportation.

Minority Entrepreneurship

Evidence suggests that minority-owned firms are more likely to hire minorities, even if they are not

[66] Ibid, p. 3-30.

[67] Doug Ross and Robert Friedman, "The Emerging Third Wave: New Economic Development Strategies of the '90s,'" The Entrepreneur/al Economy Review, vol. 9, No. 1, Autumn 1990.

located in places with high levels of minority residents.[68] Bates found that most white-owned small businesses in non-minority neighborhoods employ no minority workers and that roughly one-third of these businesses in minority areas employ no minorities. In contrast, 97 percent of black employers in minority areas hired minority workers, (in most cases minorities made up over 75 percent of their workforce) and black-owned firms outside minority neighborhoods employ a large proportion of minorities.[69] Therefore, policies to encourage minority entrepreneurship are one way to create jobs for minority urban residents. As discussed above, targeting a greater share of SBA loan funds to minorities is one way to do this.

Bates also documents that black-owned firms in urban minority areas had lower levels of capitalization, were smaller, had owners with less education, and had higher chances of failure.[70] Many of these firms were small local-serving businesses (e.g., retail, personal services, construction) and had little prospects for expansion, in part because they depend on the low spending power of the local areas. In contrast, stronger black-owned firms tended not to be located in urban minority areas, and were in industries (e.g., manufacturing, producer services) that generated income from wider markets. This suggests that policies that target minority business focus more (but not exclusively) on businesses that exhibit growth potential and sound business fundamentals, and less on local-serving businesses with little potential to expand.[71] As noted below, many minority-owned firms are in suburban locations, but they are still likely to hire minority workers. Thus, they can provide employment opportunities for central cities minorities. And if these firms employ central city residents, their employees will also support central city local-serving businesses.

Urban Neighborhood Networks

Many successful immigrant areas within formerly declining or stagnant parts of U.S. cities have vibrant cooperative business networks. For example, in Los Angeles, the Chinese community relies heavily on networked relations, both formal and informal, to boost economic activity. They have formed banks, accounting firms, and other business service companies. These ethnic firms have extremely high levels of intra-community purchasing, outsourcing and hiring. As a result, money is recycled within the community many times before it leaves, creating more jobs and wealth.[72] One approach would be to fund programs that help local organizations to identify and promote local, import-substituting market niches, and foster ethnic and area commercial networks.

Urban Technology Initiative

There are a number of technological innovations and applications, which, if diffused to urban settings, could improve economic prospects. For example, Argonne National Laboratories outside of Chicago is working with several CDCs, in areas such as energy-efficient housing rehabs, setting up recycling facilities, developing small-scale and inexpensive remediation and assessment technologies for small brownfield sites, and writing software to map urban land use (see box 2-2).

In addition, a number of communities, including Los Angeles and Durham, North Carolina, are exploring how access to the Internet and other information and communication technologies can help create jobs in inner city neighborhoods. For example, in Los Angeles, black residents from the

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[68] Timothy Bates, *Banking on Black Business* (Washington, DC: Joint Center for Political and Economic Studies, 1993).

[69] Ibid.

[70] Timothy Bates, "Small Business Viability in the Urban Ghetto," *Journal of Regional Science*, vol. 29, No. 4, 1989, pp. 625-643.

[71] Bendick and Egan, op. cit., footnote 47.

[72] Ibid.

BOX 2-2: Applying Federal Laboratory Expertise to Solving Urban Problems

Argonne National Laboratory (ANL), located outside of Chicago, and Bethel New Life, Inc. (BNL), a community development corporation (CDC) in West Garfield Park (on the near west site of Chicago) have formed a "Towards a Healthy, Sustainable Community" project, a community economic development initiative focused on recycling, environment and energy. The two-year-old partnership brings together Argonne's technologies and Bethel's expertise in community economic development to create new liveable wage jobs in new industry as the foundation for a healthy, sustainable community.

Staff at Argonne and Bethel have identified five main areas of endeavor that make use of Argonne's expertise in energy and the environment, as well as Bethel's track record in community economic development.

Industrial Site Reclamation and Retention

More than 40 vacant or abandoned industrial buildings are clustered in the vicinity of the Bethel headquarters alone, and many more are scattered throughout the area. The ANL-BNL partnership is developing a process for analyzing abandoned buildings and land formerly used for industrial purposes buildings, with the aim of:

- Developing cost-effective methods of assessing and cleaning-up contaminated sites in order to use this process in the area and offer it to other community development groups throughout the nation.
- Bringing industrial properties located in the community to a condition in which prospective new owners and tenants will be assured of compliance with pertinent environmental regulations.

In its first project, completed in late 1994, Argonne served as the site characterization technical advisor to a small minority-owned, female-headed business specializing in environmental services The two completed Phase 1 assessment of a six-acre site, which Bethel is now in the process of selling to a company that makes fiberboard from waste wood.

Promoting Manufacturing Jobs Through Partnerships

West Garfield Park is home to approximately 40 small- to medium-size manufacturers. Bethel has formed a partnership with Argonne and the Chicago Manufacturing Center (CMC) (a Manufacturing Outreach Center supported in part by the National Institute of Standards and Technology) to help firms modernize, become more competitive, and retain or create jobs. For example, BNL developed onsite training programs for employees who want to upgrade their skills. The CMC augments Bethel's program by offering a variety of services to improve firm performance. "Benchmarking," for example, enables a company to compare its performance with that of similar companies.

Recycling Spin-offs

Bethel has also focused on environmentally based community economic development. In 1992, Bethel opened a $1 4-million Material Recovery Facility (MRF) providing employment for community residents while handling 45 tons of recyclable daily. Bethel realized that for the project to achieve its full potential, they need to encourage scrap-based manufacturers to use the end products of the MRF. Argonne has been conducting research and development, in collaboration with industry, to make recycling of a wide variety of waste streams technically feasible and economically attractive.

Affordable, Energy-Efficient Housing Rehabilitation

Another Bethel-Argonne project involves the development of a collaborative team which will incorporate energy conservation measures in a large set of multi-family dwellings in the community. In addition to Bethel and Argonne, the project will bring together the resources of local utilities, Chicago Department of Housing, and the Illinois Department of Energy and Natural Resources. The team is

(continued)

BOX 2-2: Applying Federal Laboratory Expertise to Solving Urban Problems (Cont'd.)

investigating cost effective opportunities to include energy conservation measures in moderate rehabs. In addition, they hope to help others use the process to include energy efficiency in large scale residential rehabilitation projects such as those being proposed under the Empowerment Zone initiative

Education and Training

Education and training are key components of the Argonne-Bethel partnership. All of the earlier projects require a trained work force and engineers who can be a part of developing and refining the technology for problem solving and appropriate industrial applications. The partnership is also developing three specific projects

- Short-term certification training for environmental technician and hazardous waste handler, with pathways for further training in specific waste materials, assessment technology, and self-employment.
- A training program for residents on how to catalog solid waste streams at Argonne. This training will be useful to the residents as they return to West Garfield Park with the experience to assist the community in establishing additional recycling activities.
- The Urban Engineering Program is being developed to help prepare academically and economically disadvantaged children (grades 4-1 2) for careers in science and engineering.

Watts area telecommute to downtown and suburban jobs from local satellite offices of Business Services Etc., Inc. The company employs graduates of the Urban League job training program to provide remote computer and word processing services to business clients.

In other places, organizations are helping urban residents become better prepared to cope with a technologically advanced work place. For example, in Detroit, Focus Hope, a non-profit community development organization, trains disadvantaged residents to use advanced technologies related to the automobile industry. Their Center for Advanced Technology trains community residents in advanced automobile engineering methods. In addition, predominately minority two-year colleges can play important roles in training minorities for technology-based jobs, particularly in manufacturing.[73] Urban policy efforts might profitably focus on helping local organizations apply advanced technology solutions to urban problems and helping urban residents, particularly minorities prepare for these jobs.

DEVELOPING PARTNERSHIPS AND METROPOLITAN LINKAGES

In an era of reduced federal resources, increased capacities at the state, local, and private (non-profit and profit) levels, and increased variation and diversity between places, federal policy needs to focus less on simply providing funding to a large number of places through grant and other programs, and more on intervening strategically in the metropolitan development system. As a result, it will be important to encourage state governments and industry to be proactively a part of the solution to urban problems. A second component will be to establish linkages between all parts of the metropolitan economy. This is even more important, now that one of the defining features of the post-industrial metropolis is that it is not a collection of small, nearly self-sufficient economies, but is a truly metropolitan-wide economy (see chapter 3). As a result, federal policy should encourage efforts to link opportunities and policies in the growing outer suburbs to the needs and efforts in the urban core.

[73] Stuart Rosenfeld and Marcia E. Kingslow, *Advanced Opportunity for Manu facturing: The Potential of Predominantly Minority Two-year Colleges,* (Chapel Hill, NC: Regional Technology Strategies, Inc., 1995).

■ Tapping Into Industry's Role

In addition to providing greater support to more innovative efforts, federal agencies and programs could do more to develop new partnerships between industry, government and communities. Urban policy has often meant creation of specific programs or mandates for action that have failed to adequately involve the private sector. In addition, even with adequate federal funds, these efforts would be less than fully successful unless they tapped into the expertise and creativity of the private sector.

There are a number of partnerships that suggest productive avenues. For example, the city of Birmingham, Alabama, in an effort to award more contracts to black-owned building and contracting firms without using set-asides, established a mentoring program in which successful contractors provide technical and business assistance to struggling minority contractors. In Chicago, the Sears Merchandise Group recently announced a $250,000 grant to help establish a training center for minority entrepreneurs. In Boston, the Harvard Business School, under the direction of Michael Porter, is sending its MBA students to inner-city businesses to provide technical assistance and management training. Other business schools, including Columbia and MIT, are doing the same. The Initiative for A Competitive Inner City was formed in Brooklyn, New York, to help graduates and alumni of business schools provide management assistance to inner city firms.

Similarly, a national program by the Food Marketing Institute is working with its members, large grocery store chains, to promote expansion into under-served inner city areas. On a similar program, the Local Initiatives Support Corporation, a non-profit corporation created by the Ford Foundation that funds CDCs and other urban development efforts, has organized a consortium of 10 large financial institutions, who have put up $24 million to be invested in inner-city supermarkets and shopping centers.[74] Increasing the number and quality of retail and service stores in underserved inner-city areas would increase employment in these areas by keeping more of the local dollars circulating in the community.

In addition, there is potential to connect inner-city businesses with markets and strengths in the greater region. A number of places, including Baltimore and Columbus, included such options in their applications for Empowerment Zone designation. In some cases this might mean fostering mentoring programs, while in others it could mean the development of cooperative industrial networks where urban and suburban firms cooperate to address common concerns (e.g., purchasing, marketing, training).[75]

OPTION 12: *One important role for the federal government is to catalyze these partnership efforts, partly by documenting what is going on and then publicizing what can be learned from them. Congress could:*

- Encourage federal policymakers to consider working with trade associations, large corporations, and other business organizations to explore the extent to which efforts that firms find profitable also help revitalize urban economies, and to help catalyze such efforts.

■ Metropolitan Cooperation

First, the federal government can provide incentives for municipalities in a metropolitan area to work together. The Intermodal Surface Transportation Efficiency Act (ISTEA) and the Clean Air Act Amendments are precedents for this approach. However, it is not clear how effective ISTEA has been to date in bringing about regional cooperation. Effective regional planning will also

[74] Neil R. pierce, "A New Way to Bring Home the Bacon," *National Journal,* Oct. 8, 1994, p. 2359.

[75] Gregg A. Lichtenstein, *A Catalogue of U.S. Manufacturing Networks* (Gaithersburg, MD: National Institute of Standards and Technology, State Technology Extension Program, 1992); also Brian Bosworth and Stuart Rosenfeld, *Significant Others: Exploring the Potential of Manufacturing Networks* (Chapel Hill, NC: Regional Technology Strategies, Inc., 1992).

help to overcome the fragmentation of land use planning in American metropolitan areas.

OPTION 13: *Federal policies and programs can provide incentives for local governments in a metropolitan area to cooperate. Congress could:*

- Encourage the Administration to review, perhaps through the National Economic Council, existing federal programs as to the extent to which they hinder or encourage regional cooperation at the metropolitan level.
- Require that states and cities receiving federal funds for applications such as transportation, economic development, and housing, establish metropolitan-wide development councils to work to minimize uneven development.

Establish Metropolitan-Wide Organizations

Many federal and state-funded programs are operated by separate organizations in suburban and central city areas. For example, the Job Training Partnership Act (JTPA), the major source of federal training funds, is usually organized into multiple Service Delivery Areas (SDAs) with the central city SDA being separate from suburban ones.[76] For example, in the Chicago metropolitan region there are five SDAs that receive funds from the Department of Labor. Some suburban county and central county SDAs work cooperatively together, at least informally. But most do not. As a result, in many metropolitan areas, suburban SDAs do not market job openings to urban residents, even though most new jobs are in the suburbs. Likewise, many central city SDAs do not fund organizations to place people in suburban jobs. The lack of a regional structure makes it difficult to craft metropolitan-wide training, placement, and transportation solutions for employment. Even in places where there is interest in consolidating the numerous SDAs into a metropolitan-wide entity, local political factors can hinder it. In at least one case, a large city mayor successfully opposed such a move because he felt the city would not get adequate funding under such an arrangement. The result, however, was that urban residents who needed the jobs were effectively separated from where the jobs were located and growing.

OPTION 14: *In addition, instead of providing services through federally funded organizations now set up at the county or city level, Congress could:*

- Encourage the formation of metropolitan-wide organizations to manage or at least coordinate efforts. Specifically, Congress could provide incentives under the JTPA program for Service Delivery Areas (SDAs) to cooperate across SDA boundaries. More proactively, Congress could consider requiring that SDAS be consolidated to the metropolitan level. Congress, however, would need to be careful to avoid arrangements that may allow outer suburban jurisdictions to unfairly capture a larger share of resources than prior arrangements.

Linking Urban Residents with Suburban Jobs

While economic development in the core appears to be able to provide some jobs in the core, dispersion of jobs will nonetheless continue because of the technological changes described in this report. As a result, urban core residents need access to jobs throughout the metropolitan economy. This was not a problem when the poor and unemployed lived near large concentrations of jobs, either in the downtown or in core city industrial areas, and the metropolitan labor market was by and large synonymous with the central city. However, as jobs decentralize, particularly jobs that provide opportunity for people with less education, policies that recognize the metropolitan nature of the economy are needed. Anecdotal evidence suggests that many urban residents do not even consider suburban job openings, particularly those in the outer suburbs, in part because they never

[76] Gary Orfield and Carole Ashkinaze, *The Closing Door* (Chicago, IL: University of Chicago Press, 1991).

become aware of them. Thus, one strategy for economic development is to overcome isolation by developing and maintaining connections to growing suburban labor markets (see box 2-3).

There are three main components of metropolitan-wide employment accessibility policy.[77] First, people in central city areas may need job training to prepare them for suburban jobs in back office operations, light manufacturing, or retail. The gap between present skills and needed skills can be enormous for the higher-end service jobs concentrated in many CBDs. The gap is much smaller for blue collar and back office employment, which has decentralized to the suburban periphery. As a result, central city training systems need to train for jobs regardless of where the jobs are within the metropolitan area. Moreover, the largest training needs seem to be in basic areas, such as reading skills, positive work habits, and problem solving.

Second, effective job information systems are needed to match city workers with job openings in the suburbs. Regional job information programs, including those operated by employment services

BOX 2-3: Improving Access to Transportation and Distribution Jobs: Columbus Seeks to Create New Links

During the past three years, local officials in Columbus, Ohio, estimate that air cargo and related distribution operations at Rickenbacker International Airport and the adjacent industrial park have generated about 5,000 new jobs. And they expect transportation and distribution employment in the area to grow by an additional 25,000 jobs by the year 2010.

Rickenbacker is located at the edge of the greater Columbus area, about 15 miles from downtown. Businesses on and around the airport draw most of their employees from the city and three adjoining counties. Jobs in the Rickenbacker area are generally accessible only by auto; there is currently no public transportation to the airport or the industrial park. Says William Honey of the Greater Columbus Chamber of Commerce:

"This is a real concern for us. Columbus has a low unemployment rate--in fact, we're at virtually full employment. We already have companies telling us that they can't find workers. But we also have a high poverty rate; in fact, Columbus has more people living below the poverty level than a number of larger cities--Philadelphia, for example. Entry-level jobs in transportation and distribution typically pay about $7.00 an hour in this area, which ought to provide an attractive alternative to public assistance. But the low-income population is concentrated in the center of the city, and most of the growth is on the periphery."

Local officials and the business community have proposed to address this spatial mismatch by extending public transit from the city to outlying areas. The proposed new services would be part of a package of metropolitan transportation improvements that would be financed in part by a new half-cent sales tax surcharge, which will be submitted for voter approval in November 1995.

The city and the Chamber of Commerce are also exploring ways to encourage some growing distribution businesses to locate in older industrial areas, closer to the inner city, rather than in outlying areas. Strategies they are considering include tax incentives, encouraging re-use of abandoned land under the state's new voluntary-clean-up law, and assistance in the development of day care services for local residents.

[77] Mark Alan Hughes, "Employment Decentralization and Accessibility: A Strategy for Stimulating Regional Mobility," *APA Journal,* vol. 57, No. 3, Summer 1991, pp. 288-298.

and the Job Training Partnership Act Private Industry Councils (PICs) can help make these linkages. In addition, less formal systems, based on building networks between suburban employers and city residents can help.

Finally, central city workers need transportation to suburban jobs (see chapter 9), and they are often dependent upon car pooling or public transportation. In some cases, transit routes can be more effectively organized to facilitate reverse commuting. For example, SEPTA, the transit authority in the Philadelphia region, has successfully implemented some reverse transit routes. Similarly, the Milwaukee transit authority, partly at the urging of the local PIC and suburban employers, has established new routes to help urban workers commute to the suburbs. In other cases, specially organized van pools or buses can be set up. In Chicago, for example, Suburban Job Link operates buses every day to transport largely minority residents of Chicago's near west side to suburban jobs.

There have been limited federal efforts in this area. The JOBLINKS Employment Transportation Initiative, created by the Federal Transit Administration, is a demonstration project on how transportation may improve employment outcomes of participants in the Department of Health and Human Services Job Opportunities and Basic Skills (JOBS) program. However, it is of short duration (one year), limited funding ($83,000 for each of 12 sites) and is largely rural.[78]

HUD's "Bridges to Work" program is an antipoverty strategy to link unemployed and underemployed in central cities to jobs in the suburbs. The program was initially funded mostly by five private foundations that put up $1.2 million. HUD and DOT contributed an additional $250,000 between them. The first phase of the project involved planning in nine communities. As a result, six cities, Baltimore, Chicago, Denver, Milwaukee, Philadelphia, and St. Louis, were chosen for a four-year demonstration project to begin at the end of 1995. The cities were selected in part because they developed a plan and collaborative relationships among job providers, job training organizations, transit providers, and social services organizations. The four-year demonstration project will include a control group and an experimental group in four of the cities to rigorously test its effectiveness. Total funding will be $25 million over the four years. Currently, HUD is working with HHS, DOL, and DOT to negotiate funding shares. Funding is coming from internal department funds. Congress has not explicitly appropriated money for this purpose.

OPTION 15: *Increase support for mobility to work programs. Congress could:*

- Fund the "Bridges to Work" program and, based on its findings, expand the program to more cities and more participants. Senator Bill Bradley recently introduced Mobility for Work Legislation that would provide federal funds for a similar program.
- Provide tax incentives to suburban employers who provide van pools or other transportation for disadvantaged urban core residents. Possible incentives could include tax credits for van service to and from existing transit or bus lines, and accelerated depreciation of the vehicles.

REDUCING SUBSIDIES TO PERIPHERAL DEVELOPMENT

Since the earliest years of the Republic, localities and regions have competed with each other to attract investment, and to some extent to attract certain types of residents. However, in the last 20 years, competition for industry and people has intensified significantly, resulting in widespread industrial recruiting and increased efforts at exclusionary zoning to restrict the entry of low-income residents. Cities compete with each other to attract industries that provide jobs, and high-in-

[78] Mark Alan Hughes, "Changing the Geography of Work," a report to the Ford Foundation, March 1994.

come residents, who pay more in taxes than they consume in services.[79] There are several reasons why these practices have increased. First, before the 1970s, when the economy was growing rapidly and regional dislocations were minimal, jurisdictions had less need to compete for a share of the economic pie because the pie was growing. Second, the decline in federal support to cities over the last two decades has made them much more dependent upon the health of their local economies and the prosperity of their residents for revenues. As a result, they are more active in trying to get a favorable mix of industry and residents. Third, the rise of metropolitan-wide economies, in part facilitated by technological change, means that business has more locational freedom and that jurisdictions are competing more fiercely to attract and retain industry.

The system of 50 states and thousands of local governments has a number of advantages. The system widens jurisdictional choices for industry and individuals. Moreover, private enterprise and state and local governments must compete to attract people and industry, and this competition exerts pressure on them to keep taxes low and to operate efficient government services. States and cities cannot become complacent about the quality or cost of the services they offer.

Despite these advantages, aspects of this jurisdictional fragmentation weaken the competitive position of urban core jurisdictions. Outlying and often more fiscally healthy jurisdictions offer incentives to attract industry, often at the expense of core jurisdictions (see chapter 8). Competition among local governments exacerbates the fragmentation of land use planning, which in the era of the post-industrial metropolis often has deleterious results.[80] Finally, there is some evidence to suggest that greenfield development in outer suburbs and exurban areas does not pay its own way. For a number of areas, including infrastructure and transportation, places with lower densities of development often cost more to serve, yet pricing policies often do not reflect these differences. Federal tax policy also appears to favor suburban as opposed to core areas. In sum, the actions of the public sector, including the federal government, distort the locational decisions of the market.

In this case, the failure of market prices to reflect full costs, including externalities, means that price signals are being given that further stimulate urban sprawl and dispersed development. Dispersed development is cheaper than it would be if it paid its full costs, and core development is more expensive. Moreover, such development patterns appear to systematically weaken the development prospects of the urban core.

Dispersed development weakens the economic prospects of the core and possibly creates inefficiencies at the metropolitan level. Yet, unduly restricting development in the outer suburbs or exurban locations through such mechanisms as growth controls may also be economically inefficient. However, an array of mechanisms, including marginal cost pricing, development levies, and full-cost recovery regulations, have the advantage of using the market's own signal mechanism—price—to adjust land uses and to encourage a more cost-effective pattern of urban development. But these are in themselves incomplete because they address only localized and direct costs, not the region-wide social, economic, and environmental costs of excessive suburbanization and inner city decline. For that to occur, mechanisms that internalize the external costs of development are also needed.

The private sector and the market may ultimately address part of this imbalance if the rent gap and cost differentials between city and suburban land development become smaller. But it is the public sector's role to review the nature of, and biases inherent in, the tax and regulatory environments, and to address the social, economic and environmental consequences of uneven urban

[79] Peter D. Salins, "Cities, Suburbs, and the Urban Crisis," The Public Interest, No. 113, Fall 1993, pp. 91-104.

[80] Anthony Downs, *New Visions for Metropolitan America* (Washington, DC: The Brookings Institution, 1994).

growth and change. In some cases, government policies (subsidies) or lack of policies (e.g., to price negative externalities) appear to allow new development, particularly low-density development on the periphery of metropolitan areas, to not pay its own way. It is not clear how large these subsidies and externalities are, nor whether requiring dispersed development to pay its full share would significantly impact urban growth patterns. However, efforts in that direction have the potential to not only increase economic efficiency, but also to strengthen the development prospects of the core. A number of policies could move in this direction.

Marginal Cost Pricing of Urban Services and Infrastructure

Pricing policies for most utilities (public and private, including telecommunications, power, cable TV, postal service) do not generally reflect the differences in costs of serving areas that differ in density (see chapter 8). For example, the cost of serving rural telephone users is generally most expensive (and is subsidized by non-rural users), followed by dispersed suburban users, with densely populated (usually urban core areas) the cheapest to serve. Yet, telephone regulation limits the extent to which telephone service providers can charge prices that reflect the true cost of providing services to business and residents in different density locations. Encouraging pricing of services to reflect these differences at least in part could increase costs in outer and exurban locations and reduce costs in central city locations. Clearly, the major motivations for any deregulation of utility, telephone, and mail services will be for other reasons, including attempts to increase overall efficiency. In addition, average cost pricing does promote the goal of universal service. However, as discussed in chapter 8, moving to marginal cost pricing in rural areas, at least, is estimated to have only a minimal impact on phone penetration rates. Overall, these changes could also have a beneficial effect on urban cores.

Full Cost Pricing

Policies to internalize externalities could help reduce the cost advantage outer suburbs and exurban sites currently enjoy. For example, efforts to enforce the Clean Air Act provisions on trip reduction in non-attainment metropolitan areas are likely to benefit the urban core because transit access is greater there. Similarly, efforts to have drivers pay the full cost of driving are likely to benefit urban cores. Likewise, congestion pricing for driving would require automobile drivers to bear the costs they impose on other drivers in the form of increased traffic congestion. To be most efficient, the price charged a motorist for driving should account for the costs imposed on all motorists as a result of the additional delay caused by that motorist's entry into the system. Various forms of traditional toll barriers could partially do this, but would not necessarily account for regional mileage traveled. More importantly, they would impose high transaction costs (toll infrastructure, labor, and delays imposed by the tolling process) to accomplish the policy objective.

Some systems developed in the Intelligent Transportation Systems program could enable real-time congestion pricing to be implemented. Congestion pricing uses tolls on highway use at peak periods. Technological innovations now make it possible to impose such tolls with low transaction costs. To date, few places have experimented with congestion pricing despite widespread interest. The lack of experience with congestion pricing hampers assessment of its impact on metropolitan form. Given the importance of context, the handful of congestion pricing-like schemes provides an uncertain base on which to speculate about its impact on U.S. metropolitan form.

Although the effect of congestion pricing on urban form is difficult to predict, it is possible that congestion pricing can help major centers and the CBD by providing greater access. On the other hand, congestion pricing is also likely to lead to increased pressures for development at the periphcry, particularly among higher-income households who put a high value on their time. In contrast, policies to make users pay the full cost of using a particular road, through such mechanisms as tolls, could have the effect of increasing the cost of travel in more dispersed settings, leading to more concentrated residential and commercial development pattems.[81]

OPTION 16: *Without further and more definitive information, it is not clear how important subsidies are to encouraging peripheral development. Therefore, Congress could:*

- Require that HUD undertake a major study to assess the nature and extent to which public policies at all levels of government inadvertently subsidize suburban and exurban development, particularly at low densities, and what policy steps could be taken to reduce or eliminate these subsidies.

Reining in Business Location Incentives

It is one thing for companies to leave the center city to move to the outer suburbs because land costs or rents are cheaper. Market forces are operating well here. However, it is quite another thing when financially well-off suburban jurisdictions provide financial incentives (e.g., free land, reduced taxes) to induce companies to move out of the city. Clearly, there are many cases where companies would have moved even without incentives. Yet, there are others where the incentives tip the balance. For example, Brooks Sausage, a minority-owned and largely minority-employee firm, formerly located in the South Side of Chicago, was offered significant incentives to relocate its facility to a smaller city in Wisconsin; it moved, and laid off its Chicago workforce. Similarly, the Securities and Exchange Commission located in Washington, D. C., has been offered millions in incentives by Maryland and a suburban jurisdiction to move out of the District. Moreover, state incentive policies exacerbate this pattern. Virtually no states use incentives to target new investment to distressed areas, particularly in cities. In contrast, usually states provide funds for companies in suburban or smaller city locations, in large part because they are responding to locational preferences by industry. Central cities and inner suburbs are often at a disadvantage in attracting investments, and state incentive programs only exacerbate this. For example, the state of Virginia and the city of Manassas are providing close to $100 million to a joint venture by IBM and Toshiba to establish a semiconductor fabrication plant in Mannassas, an outer suburb of Washington, D.C. In some cases, states even fund companies that are moving out of the central city to the outer suburbs. For example, the state of Illinois provided Sears with $110 million to move out of the downtown, where a large share of its workforce were central city residents, to Hoffman Estates, a suburb 40 miles from the downtown, with little public transportation access for potential workers from the central city.[82]

Unfortunately, because of the weakened fiscal conditions of most urban jurisdictions, they either cannot match these incentives, or if they do, they must reduce funding on other important urban services. Moreover, in some cases, cities use federal funds, including CDBG funds, to lure firms to their communities.

OPTION 17: *Finding policies to curb incentives is difficult. However, because of the nature of competition between states or between cities, only higher levels of government can control such giveaways, in this case*

[81] Just as Intelligent Transportation Systems enable realtime congestion pricing systems to be implemented, in part th
ment systems, they could also enable greatly expanded use of toll systems.

[82] Sears had threatened to relocate to North Carolina.

the federal government. [83] *To end or reduce bidding wars, Congress could:*

- Prohibit executive branch agencies from entering incentive bidding contests for the attraction of federal facilities. For example, a number of states bid for the Superconducting Super Collider, and many bid for other federal facilities, such as the Department of Defense accounting centers. However, with reduced federal budgets, the monies for such incentives may be more important to federal agencies than they were in the past.
- Ensure that federal programs and practices do not further bidding wars. While most federal economic development programs prohibit using the money to encourage firms to move, the CDBG program does not. As a result, one option would be to apply such anti-pirating provisions to all federal economic development programs. Recent legislation in the House (HR 463) and Senate (S192) would prohibit the use of CDBG funds for this purpose. Because states and cities are still likely to find ways to use federal funds to recruit industry or to substitute their own funds in incentive deals, more fundamental measures to restrict incentives may be needed.
- Encourage the Secretary of Commerce to convene a meeting of state economic development directors to try to reach an agreement to stop, or at least significantly curb the practice. If an initial agreement could be reached, it would be in the interest of states to keep it, since all would benefit.[84]
- Require city and state recipients of federal economic and community development funds (including tax breaks and tax-free financing—e.g., Industrial Development Bonds) to report all subsidies given to relocating firms (over a certain minimum amount, such as $1 million) to HUD. This information could be reported electronically and be accessible through the Internet to anyone in the nation. As a result, watchdog efforts by other communities or states could help ensure that communities and states reported all the incentives they are providing.
- Reduce federal funds for economic development in proportion to industrial recruitment incentives offered. Congress could encourage compliance with an agreement to curb bidding wars by directing the Administration to reduce funds from those budget categories in proportion to the dollar value of incentives provided by cities and states to attract new business. States that spend money on incentives for relocating firms could have the amount of federal economic development funding reduced by some proportion, depending perhaps on the degree to which they provide more incentives than other states.
- Make state and local incentives subject to federal taxation. Congress could modify federal tax law so that tax abatements provided by states and localities to businesses would be treated as part of corporate income for federal tax purpose. In order to make the system manageable, Congress may want to set a minimum amount of incentives above which businesses must report (for example, $500,000 or $1 million). The IRS could also be required to report this information to the designated federal agency overseeing incentives.

Federal Telecommuting Programs

Although telecommuting may have environmental and transportation benefits, it also appears to foster residential decentralization (see chapter 7). Federal policy should realize this. For example, the federal government, through the General Services Administration, pays for telecommuting centers that exurban commuters travel to one to

[83] Samuel Nunn, "Regulating Local Tax Abatement politics," *Policy Studies Journal, vol. 22, No. 4, 1994,* pp. 574-588.

[84] Collectively states would benefit from incentive curbs because the same level of development would occur in the United States without the incentives, and states would have to pay much less to attain it.

three days a week. However, the large majority of these federal commuters still have offices in the core which the federal government must also pay for, in addition to the cost of their telecommuting office space. The rationale for such subsidies is that the workers are not driving as much, thereby reducing congestion and air pollution. However, being able to telecommute a few days a week from a center, and not paying any of the costs, makes it easier for these workers to live in exurban locations. Workers living closer in receive no such subsidy. Congress could consider requiring users of telecommuting centers to pay at least part of the net costs of supporting these centers.

Brownfield Redevelopment

More so than outer suburbs, inner suburbs and central cities (or new firms locating there) are burdened with cleanup costs on contaminated land because in many cases, the industries responsible for the contamination cannot or will not pay. A number of problems attend the reuse of brownfields, including cost, liability concerns, and delays and uncertainty; all discourage development of these sites. Though removal of these impediments would not solve all redevelopment problems at brownfield sites, it would improve their development prospects. There are a number of federal policies that could encourage reuse of these sites, including modification or clarification of liability issues, funding for cleanup, and EPA delegation of authority to states.

Brownfields are currently receiving a lot of attention from all levels of government in the United States.[85] In particular, state authorities and organized stakeholder groups are promoting legislative and administrative changes in the way that many of these properties are handled. During 1994-1995, nine states passed legislation creating voluntary cleanup programs.[86] Though many of these changes are directed toward improving the prospects for brownfield cleanup and redevelopment, some expand the scope beyond brownfields to all hazardous waste sites including cleanups pursued through enforcement driven programs, such as state superfunds and property transfer laws. Legislation designed to change state policy on such factors as cleanup standards and liability at a site will impact all hazardous waste cleanups in a state. However, it is uncertain whether state programs will be able to provide enforcement immunity to particular parties, since liability assurances are limited and extend protection only from state enforcement actions, leaving liability under federal law or third-party actions in place. As a result, state assurances may not go far enough for some stakeholders to promote further brownfield cleanups and redevelopment.

As states rethink their policies toward hazardous waste site cleanups, many are taking a more comprehensive approach to the law, easing some of the constraints considered barriers to brownfield activity. States are making an effort to clarify cleanup standards and processes, clarify liability at brownfield sites to include some level of government oversight without slowing the process unnecessarily, and to offer financial incentives to promote cleanups. However, considerable variation is still evident in some important elements.

In addition to brownfield activity at the state level, EPA and Congress are addressing the problem at the federal level. EPA's Brownfields Action Agenda works to remove identified barriers to cleanup and redevelopment. Congress is currently addressing brownfield issues in Superfund reauthorization and in separate bills on lender and fiduciary liability for cleanups. Addressing the issue of liability under federal law will be important to facilitate brownfield redevelopment.

A second important issue is who should pay for cleanup and redevelopment, and if there is a federal role, what form should it take? Some have advo-

[85] U.S. Congress, Office of Technology Assessment, *The State of the State of Brownfields* (Washington, DC: OTA, June 1995).

[86] These states are Nebraska, Wisconsin, Colorado, Tennessee, Connecticut, Ohio, North Carolina, California, and Virginia. Stateside Associates, personal communication, May 1995.

cated large new programs to fund not only brownfield cleanup but also redevelopment. There are three potential drawbacks to such programs. First, it is not clear that market forces would not adjust the price of privately owned sites to reflect expected cleanup costs, especially if there has been a site assessment. Second, under the polluter pays principle, it is not clear that private companies responsible for the pollution at sites they still own should receive cleanup subsidies. But providing assistance for orphan sites, where there is no identifiable owner may make sense. Third, while federal cleanup funds may be needed, the rationale becomes weaker for government assistance for redevelopment. Many of these sites have good redevelopment prospects that should attract investors as long as environmental uncertainties and problems do not overwhelm the calculation.

OPTION 18: *In some places and at some sites, federal financial assistance may be appropriate to help stimulate brownfield development. As a result, Congress could:*

- Establish programs to fund brownfield assessment and cleanup. Several bills have been introduced addressing financing of brownfield assessment and cleanup. For example, HR2178, introduced in August 1995, would provide federal assistance for brownfield cleanup. Under the bill, the Environmental Protection Agency would make grants to applicants to pay for site characterization and assessment. In addition, EPA would be authorized to make loans for site cleanup. In making the awards, one of the criteria for approval is the extent to which the assessment or cleanup is linked to redevelopment. Such provisions are important, since there is a risk that a brownfield finance program could result in sites with little development potential being cleaned up.
- Establish a "Brownfield IRA" that would allow small and medium-sized companies to put aside tax free a certain amount of money per year up to some limit (perhaps $250,000) that must be spent for cleanup or be subject to taxes and penalty. The brownfield problem can be particularly onerous for small and medium-sized firms faced with transferring ownership of a site, and therefore fall under state property transfer or brownfield laws. As a result, such a mechanism might be particularly helpful to firms where the owner is planning to sell and knows ahead of time that cleanup will be an issue.