Market-Based Community Economic Development

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MARKET-BASED COMMUNITY ECONOMIC DEVELOPMENT

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The Urban Markets Initiative (UMI) at the Brookings Institution Metropolitan Policy Program aims to improve the quality of the information available on urban communities and use it to unleash the full power of those markets while connecting them to the economic mainstream. Information influences investment decisions made in communities every day—whether to open a new store, to expand a warehouse, a bank's decision on personal and business loans, or a family's decision to purchase a new home. When information to make these decisions is inaccurate, unavailable, or inaccessible to urban investors, urban markets fail to thrive.

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ABSTRACT

Many urban communities have undervalued assets which offer untapped business and development opportunities. Community economic development interventions can enhance market functioning in these neighborhoods, expanding investment and wealth creation. However, enhancing market performance requires new understandings of how markets operate, of the causes of market failure or expansion, and of the levers that move markets. The paper proposes a framework for analyzing markets through examining their production, consumption and exchange functions. It then suggests ways to enhance these functions through increasing productivity, reducing transaction costs, and influencing consumer behavior, in order to enable markets to expand to include more urban assets, people and places. Finally, the paper offers a business planning tool for undertaking market-based economic development activities.

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Market-Based Community Economic Development

I. Introduction

As leading market-based development institutions such as Shorebank have demonstrated the market opportunities in inner cities, conventional business interest in these markets has increased. As a result, business and development interests in strengthening inner-city markets are converging.[1] Yet, even though businesses are looking at inner-city markets, and community developers are shifting toward market-based development, surprisingly little is known about the economics of neighborhood asset development. Why are so many inner-city assets—in the form of underemployed people, underinvested real estate, business opportunities, and consumer markets—overlooked by conventional markets? How can markets be “enhanced”[2] to better include these assets and operate more efficiently? If developers and businesses want to influence markets to expand in ways that achieve both business and community development objectives, we need a better understanding of the relation between neighborhood assets and broader economies and, in particular, of how markets work.

In an attempt to bridge the worlds of community development and economics, this discussion paper offers a preliminary theoretical framework for identifying, analyzing, and developing market opportunities in underdeveloped communities.[3] It also outlines a “business planning” process for market-based development that can help assess when a market-based approach is appropriate to the development goals of lower-income communities. It is hoped that the ideas can hint at the major business and development opportunities that could flow from bringing the expertise in these worlds together, and that each will be engaged to clarify the issues of improving market functioning in inner cities.[4]

The next section, “Why Markets?” surveys recent trends in the field of community economic development and highlights the importance of understanding markets and the opportunities arising from enabling markets to expand to include inner-city assets.

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[1] This convergence is reflected in the numerous corporate initiatives and in the success of MetroEdge, Social Compact, ICIC, and others in working with businesses seeking to profit in inner-city markets, as well as in a host of industry specific developments. See John Weiser and Simon Zadek, “Conversations with Disbelievers: Persuading Companies to Address Social Challenges” (New York: Ford Foundation, 2000). See also www.winwinpartners.com.

[2] By “enhancing markets,” we mean influencing the supply and demand of goods and services to increase market activity in inner-city neighborhoods.

[3] This is one of two discussion papers on closely related topics. The companion paper, “Using Information Resources to Enhance Urban Markets,” uses the framework presented here to analyze the role of information as a market-enhancing agent, particularly to enable markets to better serve and include underinvested communities.

[4] One of the threshold problems in writing a paper that attempts to create a framework for discussing market-based development is that the language of economists and that of development practitioners differ greatly. Words such as “assets” and “markets” carry more technical meaning to economists, and many words, such as “capital” and “investment,” have entirely different meanings for the two groups. The attempt here is to offer a less technical framework for practitioners to discuss the economic principles that underlie their work. Section 3 provides some greater clarity about key terms.

Section 3 lays out the market framework underpinning the analysis. After clarifying the role of markets in connecting neighborhood assets to broader economies, the section describes three components of markets—production, exchange, and consumption—and the factors that affect how each behaves. This description places the problem of inner-city disinvestment in the context of market structure and economic theory, offering insight into both the nature of the problems affecting disadvantaged community markets and the ways in which markets can be enhanced to address these problems.

Section 4 offers practical observations for community developers interested in applying market-based approaches to neighborhood development challenges. Examining the structure of markets, and the levers that make markets work, can help identify appropriate, focused interventions to expand market activity and investment in inner-city neighborhoods. This final section also returns to the knowledge gaps regarding the economics of community economic development, highlighting some of the opportunities and issues that would benefit from further exploration.

II. WHY MARKETS?

This paper focuses primarily on a particular type of economic development, referred to as community economic development because of its neighborhood focus and its origins in the field of community development.[5] A cursory review of the history of this field and its basic principles provides a useful context for the analysis and discussion in section 3.[6]

Community development is deeply rooted in the civil rights and political empowerment movements, and it has typically focused on deficiencies: what is wrong, missing, inequitable, or needed? Once the field identified needs, such as poor housing or high crime, it employed programmatic approaches, often based in organizing and advocacy, to develop targeted services. The strategies were primarily political and social, commensurate with the original barriers they sought to address. Even when the strategies focused on economic needs, they rarely sought to understand the local economic failure or to intervene to affect the market economy.

During the last several decades, the field has gradually added a different, asset-based approach. Addressing poverty requires creating wealth, and wealth is created in poor communities just as it is anywhere else: by identifying and investing in assets. Practitioners, therefore, shifted focus from deficiencies to assets. Strategies now focused not only on establishing a formal right to a piece of the pie (civil rights), or on taking a piece through the political process (empowerment), but also on how to make a "bigger pie" by creating new wealth in poor communities.[7] Community development practitioners thus began focusing on economic assets, giving rise to the field of community *economic* development, and particularly asset-based development.[8]

This asset-based approach offers several benefits. It focuses on the positive features of lower-income communities rather than perpetuating negative stereotypes. It recognizes that temporary services or even income, as important as they are, do not create the long-term wealth necessary to climb out of poverty that asset accumulation does. It reconnects poorer communities to the mainstream rather than creating alternative, programmatic "solutions" that further isolate and

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[5]The field of economic development, of course, has many different strands, encompassing a variety of strategies aimed at local, national, or even international levels by private, public, and nonprofit institutions. Although this paper is not directly addressed to other strands of economic development (such as chamber-based, government-based, or particular subject-focused interventions such as workforce or technology), the initial convergence across most types of economic development toward an increased focus on markets is noteworthy, as is the increasing awareness of the importance of connecting all layers of development (from neighborhood to global) to one another.

[6] For more extensive reviews, see Bruce Katz, "Neighborhoods of Choice and Connection" (Washington: Brookings Institution, 2004); see generally Robert Halpern, Rebuilding the Inner City: A History of Neighborhood Initiatives to Address Poverty in the United States (New York: Columbia University Press, 2001), chapter 4 in particular; and Ronald F. Ferguson and William T. Dickens, eds., Urban Problems and Community Development (Washington: Brookings Press, 1999).

[7] Ironically, our strategies thus expanded from "equity" (as in "fairness") to "equity" (referring to ownership).

[8] Asset-based development may be seen as broader than asset focused economic development in several respects: it defines "assets" more broadly (see discussion in section 3); and it is not exclusively focused on economics as the vehicle for asset development. See generally, John McKnight and John Kretzmann, Building Communities from the Inside Out: A Path toward Finding and Mobilizing a Community's Assets (Evanston, IL: Center for Urban Affairs and Policy Research, Northwestern University, 1993).

stigmatize them. Finally, it aligns the interests of economic development and business organizations because deploying previously underused assets also provides new opportunities for market expansion and profitable investments, increasing the overall efficiency of the economy. This alignment of business and community interests creates opportunities for new partnerships and increases business engagement.[9]

Although the focus shifted to assets, in its early stages the work often remained centered on organizing and advocacy. The field may have focused on economic assets, but it barely applied economics. Advocates for affordable housing or for better job training programs often had only limited understanding of how the economy might be tapped to achieve their objectives[10]—with good excuse: the field of economics, by and large, had little to offer, given its limited interest in inner-city development and its theoretical directions, which did not lend themselves to the analysis of economic activity across small geographies.[11]

Fortunately, a few decades of community economic development work have brought the field a long way.[12] Focusing on strengths, rather than weaknesses, of distressed neighborhoods, companies such as Shorebank and others have shown that disinvested communities do indeed offer undervalued real estate, business and human assets, and opportunities for individual, business, and community wealth creation. These companies have pioneered business and market-based approaches to identifying and investing in those assets, demonstrating both the profit opportunity and the potential for these businesses to bring jobs, business opportunity, and economic growth to inner-city neighborhoods.

As the field demonstrates the efficacy of an asset- and business-based approach to community development, its focus on economic assets (housing or employment, for example) and attracting investment in assets has increased interest in economics and, at the systemic level, in how wealth is created. Despite the anecdotal successes of varied businesses and the practices of innovative companies like Shorebank in inner-city markets, it is clear from the extent of underinvested assets that conventional markets are still not functioning well in many urban neighborhoods. Remarkably little is known, either by community development practitioners or by economists, about how neighborhood assets get connected, or not, to the broader economic systems that could fully realize their value. To understand this, we must develop a more sophisticated understanding of markets, and particularly of how they can be influenced to include

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[9] See, e.g., Jeremy Nowak, "Expanding the Scope of Community Development" (Montclair, NJ: National Housing Institute, 1998), available at www.nhi.org/online/issues/97/nowak.html.

[10] Even the phrase "neighborhood economic development" reveals the extent to which economic development has focused on assets rather than on economics. Neighborhoods, after all, do not have economies.

[11] The field of economic geography, which studies where economic activity occurs and why, has generally been overlooked by economists. The lack of spatial analysis in mainstream economics stemmed mainly from the difficulty of modeling in place-based economics. See Paul Krugman, Development, Geography, and Economic Theory (Cambridge, MA: MIT Press, 1997).

[12] For recent work bringing more market-based perspectives to community economic development practice, see Paul C. Brophy and Kim Burnett, "A Framework for Community Development in Weak Market Cities" (Denver: Community Development Partnership Network, 2003), available at www.cdpn.org/programs/weak_markets.htm.

inner-city assets. In other words, we need to put more *economics* in the practice of community economic development.

The backdrop for this article, then, while reflecting decades of hard-won experience by innumerable highly sophisticated and successful development practitioners in inner-city communities, can be summarized in a fairly straightforward syllogism:

- To address poverty, create wealth.
- Wealth is created by investing in assets.
- The economic mechanism for asset investment is the market.
- Therefore, to increase wealth in poor communities, expand market activity to the assets of those communities.

The issue, then, for market-based development is how to expand market activity in inner-city communities.[13] To answer this question, we must develop a better understanding of the ways in which markets operate and of the mechanisms that can be used to influence their operations.

[13] This question raises an additional, important issue: how to encourage market expansion to these communities in ways that benefit current residents, rather than simply triggering gentrification that results in their displacement. In other words, market-based development must address a distributional problem as well. The goal is to expand markets in ways that develop assets of inner-city residents (such as by increasing employment, savings and homeownership).

III. A Framework for Enhancing Markets for Community Economic Development

Developing strategies to "enhance markets" to better encompass neighborhood assets requires a framework for discussing the relationship of neighborhood assets to economic systems and for understanding the components of markets and how they might be influenced. This section first briefly discusses the relationship of neighborhood assets to broader economies—a relationship that occurs through markets—to more formally relate the "asset" development language in common use to a market framework. Within this framework, the section then describes the structure of markets and their components, and identifies levers for influencing each component.

A. Relationship of Neighborhood Assets to Markets and Economies

An economy can be viewed, in its broadest sense, as a collection of individuals with varied needs and desires (for example, for housing, food, health services), a set of resources (labor, capital, land, natural resources), and the process by which the resources are converted to goods and services that meet people's needs. The core problem of economics is how to most efficiently deploy and allocate the resources to match production (the use of the resources) to these consumption desires.[14]

In a market economy, the main mechanism for addressing this challenge is markets. Markets are the collection of transactions by a range of entities (individuals, firms, and intermediaries) through which all types and levels of goods and services (for example, from raw materials to finished consumer goods) are exchanged. Virtually all economic activity—which resources are developed, into which products, and for whom—relies on markets. When markets are performing well (in a perfect, theoretical model), resources are fully developed and efficiently deployed to serve the purposes most highly valued by consumers. In economic terms, supply and demand meet at an equilibrium point where all the possible gains from trade are realized.

How does this highly theoretical (and abbreviated) description of economies, markets, and resources relate to assets, as the term is used in asset-based community development practice, or to communities? This question presents two problems: (1) the multiple meanings of the word "assets," and (2) the spatial aspect of economic theory -- the geography of economies. On both issues, the discussion below provides only preliminary observations and would greatly benefit from further attention by economists.

Development practitioners use the term "assets" very broadly to encompass a wide range of circumstances that create opportunities for or embody wealth creation or other positive development outcomes. We distinguish four uses of the term (recognizing some overlap).

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[14] See Karen Eggleston, Robert Jensen, and Richard Zeckhauser, "Information and Communication Technologies, Markets, and Economic Development." In G. Kirkman and others, eds., The Global Information Technology Report: Readiness for the Networked World (New York: Oxford University Press, 2000).

- First, assets include the factors that create economic value, such as labor, land, and natural resources. These roughly correspond to what economists refer to as "factors of production."
- Second, assets represent wealth—a savings account, or homeownership. We refer to these as "ownership assets." Factors of production can be ownership assets, but this use of the phrase more often refers to individual consumer ownership of outputs, rather than inputs.
- Third, development practitioners sometimes refer to opportunities for wealth creation—an untapped consumer market, for example, or a small business opportunity—as assets of a given community. We refer to these as "market opportunities."
- Finally, in asset-based neighborhood development, some practitioners refer to other positive attributes of a neighborhood, such as parks, good schools, or other amenities, as assets. Some of these, in economic terms, might be referred to as "competitive advantages" of a particular place (such as a good transportation infrastructure). Others, although valuable to healthy neighborhoods, are not sufficiently or directly concerned with wealth creation to be the subject of economics. They may be neighborhood assets, but they would not be considered economic assets.

The first two categories are nearer the conventional, narrower economic or accounting use of the term assets, used to denote goods that provide a stream of revenue over time.[15] The factors of production (such as a new machine in a factory) are assets to the producer,[16] while ownership assets (such as a new home) are assets to the consumer. Both types of assets can affect the quantity and price of goods that are exchanged on the market; the factors of production determine costs and productivity, and thus expand or limit supply of the good. Ownership assets, on the other hand, can increase the wealth of the individual consumer, who will, in turn, be able to purchase more goods.[17]

The final two categories—market opportunities and competitive advantages—generally refer to assets at the aggregate level, given that they benefit a group or a community. Market opportunities, in particular, arise from the relationship between the aggregate supply and demand (that is, the combined output of all the producers of a given good and the combined demand of all the consumers of that good). If a latent demand is unmet by supply, the market is not capturing all the possible gains from trade and not realizing its full potential. Market opportunities can be considered assets in the broadest sense because they provide an opportunity for economic expansion and new wealth creation.

To create a framework to understand market operations, we need not fully sort out these multiple uses of the term. The key point is that, in all economic usage—whether referring to the value of assets to production, their value in the production process or product itself, or their value in

[15] Hal R. Varian, Intermediate Microeconomics (W. W. Norton, 1999).
[16] Not all factors of production are assets in formal economic or accounting terms. Labor, for example, and intangible assets may be considered factors of production but not assets. Economic and accounting usage may also differ; many intangible assets are not counted as assets by accountants because they do not meet other requirements (such as measurability), although they might be considered assets by economists.
[17] In economic terms, ownership assets shift the budget constraint of the consumer, increasing the quantity of goods he or she will demand at any given price.

the market opportunity—assets depend on market operations for their value to be realized. "Value does not inhere in some hidden essence, but is instead an *emergent* consequence of market process."[18]

In other words, assets do not have a value per se; they are passive, or idle, until they are "acted on," or leveraged by businesses and investors. Neighborhood assets become valuable only to the extent that they are deployed or incorporated in a market-based economic process. Undeveloped land, an idle factory, unemployed labor, money in the mattress, all are assets with latent value, and all are potential sources of wealth creation. None, however, is valuable in isolation. In this sense, assets embody wealth, but only in the context of a system that values and uses them—an economy. The economy, in turn, acts on assets via a market. *Markets are the primary vehicle for realizing value from assets, for wealth creation, in the economy*.

A second point to consider is the spatial issue of how markets operate across geographies.[19] The market process entails the combined activity of many individual and institutional actors, and different markets emerge for different goods and assets. The critical point is that markets are rarely, if ever, confined to neighborhood boundaries. People work outside their neighborhood in at least a regional labor market (and, ultimately, move to other regions for jobs in a national labor market). Neighborhood housing competes with real estate throughout larger markets and is affected by regional growth patterns. The scope of business networks and supply chains, firms thriving as part of regional business clusters, and retail and service markets is defined by the characteristics of the assets, actors, and institutions engaged in that particular market process. *For this reason, asset-based development must look beyond neighborhoods to understand how neighborhood assets fit as components of larger market systems.*[20]

This broader vision is particularly necessary for inner-city neighborhoods, whose assets can be isolated and excluded from the larger market systems that define the mainstream economy (see Figure 1[21]). Entrepreneurs in inner-city neighborhoods may have viable business plans, for instance,

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[18] Krugman, Development, Geography, and Economic Theory, p. 53.
[19] We discuss only a very narrow, and relatively simple, aspect of economic geography here. The relationship of economic concepts to geography generally presents a large and growing set of issues that deserve more attention. See Gordon Clark, Maryann Feldmann, and Meric Gertler, eds., The Oxford Handbook of Economic Geography (New York: Oxford University Press, 2000).
[20] A particularly useful direction for further work (also discussed at the end of the paper) would be to better understand the distinct sizes and shapes of the markets that are relevant for different neighborhood assets. It is often suggested that a primary geographic unit of economic activity these days is the metropolitan region. Regions are, in effect, considered small enough to still achieve the agglomeration effects (broadly, the benefits of shared resources) of concentrated firms, economic assets, and activities, and they are large enough to be relatively self-contained and to compete globally. See, e.g., Manuel Pastor, Jr., Peter Dreier, Eugene Grisby III, and Marta Lopez-Garza, Regions That Work: How Cities and Suburbs Can Grow Together (Minneapolis: University of Minnesota Press, 2000); Peter Calthorpe and William Fulton, The Regional City (Washington: Island Press, 2001); Janet Rothernberg Pack, Growth and Convergence in Metropolitan America (Washington: Brookings Press, 2002); Robert O. Zdenek, "Connecting People to Jobs: Capitalizing on Regional Economic Development Opportunities," Shelterforce 7-8 (1998). Understanding neighborhood assets in the context of regional economies particularly deserves attention.
[21] Figure 1 broadly illustrates the relationship between economic isolation of neighborhood assets and poverty. One way of viewing the goal of market-based community economic development is that it seeks to reconnect

but they may be unable to connect to conventional sources of start-up and operating capital. Residents have work skills but cannot find jobs because they are not part of the larger employment network. Business opportunities go untapped owing to information, access, and entry barriers. The isolation of disadvantaged communities creates market information imperfections, which increase the risks and transaction costs of identifying and investing in local assets. As a consequence of these and various other market failures, the assets that exist in inner-city communities go unrecognized, undervalued, and untapped.[22]

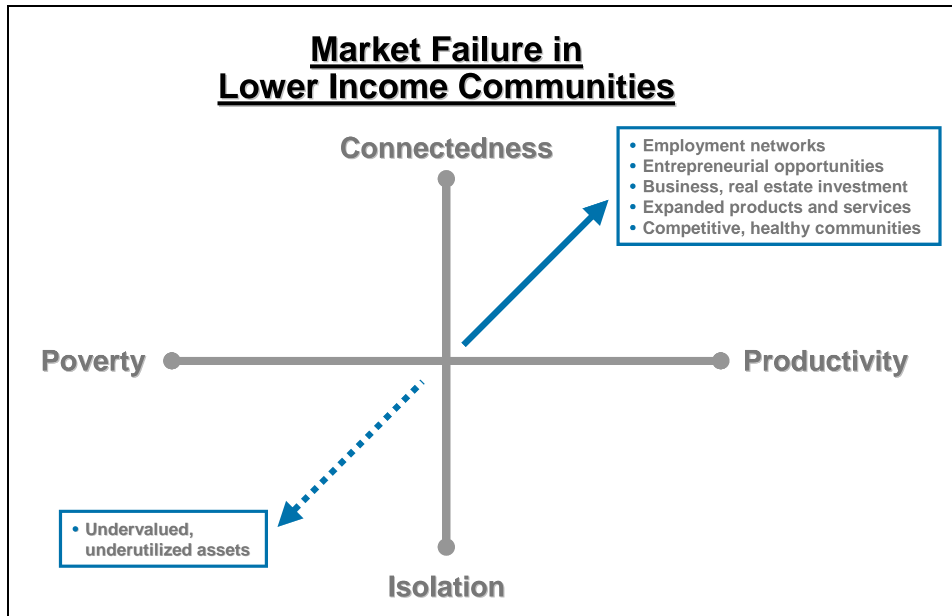

Figure 1

This market failure and oversight have two negative implications. On the one hand, inner-city neighborhoods are affected by a lack of economic activity. Lost opportunities for wealth creation translate to high poverty and poverty's related social problems. On the other hand, the larger market economies never realize their full potential because of the missed growth opportunities and the unused resources that lower-income communities could offer. Remedying these market imperfections can result in the deployment of neighborhood assets and, in turn, spur lasting and sustainable economic development in lower-income communities. The goal of asset-based community economic development is to enhance markets by including people, assets, and places that are left at the margins of the wealth creation process.

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isolated neighborhood assets to broader marketplaces as a way to make the assets more productive, and thus generate local wealth.

[22]For a detailed discussion of the information imperfections that lead to the isolation of inner-city communities, see the companion paper, "Using Information Resources to Enhance Urban Markets."

B. The Components of Markets

To see how markets can be enhanced, it is useful to have a basic understanding of their structure. The market operates through internal market forces (or "market operations") that have three essential components: production, exchange, and consumption. In addition, the market is shaped by a set of external influences, the market environment. Each of the three components as well as the market environment have distinct dynamics and levers of change that can affect what gets produced for whom and where. These dynamics and levers are the mechanisms available to community economic developers to enhance the market, widening its reach to include underserved populations and communities.

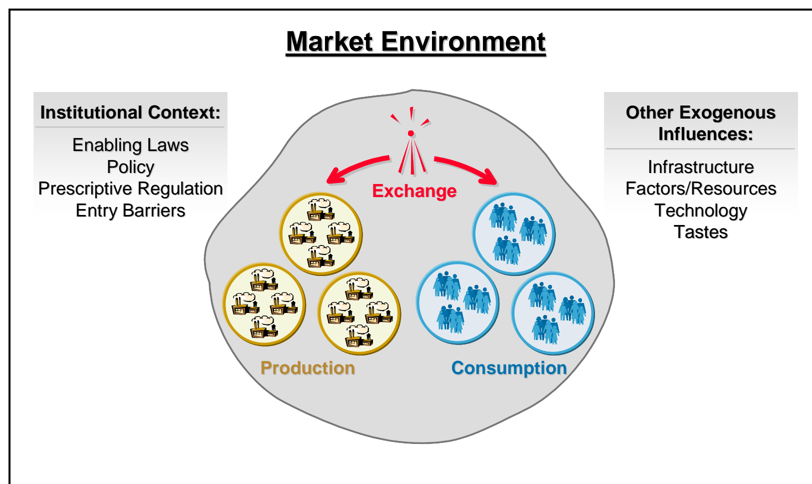

Figure 2

1. Market Environment

Markets are shaped by their environment, which includes their institutional context and extra-market influences. As illustrated in Figure 2, the institutional context primarily refers to the direct and indirect role of government in establishing and enabling the factors that allow markets to function and in shaping the mechanisms of those markets. Few markets are truly "free," in the sense of being entirely unconstrained and independent.[23] Markets exist in an institutional context of enabling laws (most fundamentally, private property rights), prescriptive regulation, and extra-market incentives. For example, markets are enabled by corporate and commercial law, constrained by laws prohibiting certain behaviors or products, and influenced by tax structure and subsidies.

In addition to its institutional context, the market environment also includes other influences that affect market behavior. Infrastructure, such as roadways, affects individual and business location decisions. The availability of natural resources, from mineral deposits to farmland, affects market location and behavior. The market environment is also shaped by influences that are

[23] See Charles Wheelan, Naked Economics (W.W. Norton, 2002).

sometimes considered external to the market itself, but other times not (depending, in part, on the particular market of interest, which models are being used, and for what purposes). Technology is particularly important to the market environment, and often accounted for as an external influence. Breakthrough technologies, such as electricity or the Internet, may not only affect internal market forces, but fundamentally reshape a particular market environment. Personal tastes also are considered part of these extra-market forces, to the extent that they change owing to factors outside the marketplace.

The market environment clearly offers major levers for changing how markets operate, and particularly to more fully include inner-city residents, assets, and places. The most familiar of these levers is public policy. The Community Reinvestment Act, for example, has played a central role in encouraging the banking market to expand lending in inner-city areas. Subsidies such as the New Markets Tax Credit are other examples of how the market environment can be altered to enable investment in areas that would otherwise be unprofitable.

2. Market Operations

As noted, a market consists of three components: production, consumption, and exchange (see Figure 3). The production, or supply, side of the market creates the products and services. A producer might be a firm making cars, a lawyer providing advice, or a person offering labor. Producers (or firms) face a set of opportunities, constraints, and preferences that determine their behavior. In the case of the firm, the costs it faces and the physical capacity of its plant determine the amount of goods or services that it is willing or able to produce. As a result, the primary levers of change for the production function are productivity and cost.[24] A manufacturer, for example, may produce more cars if the price of steel (a cost) goes down, or if new organization of production, worker training, or machinery increase the amount of output for the same cost (that is, productivity increases). A housing developer may be able to increase production, or lower price, if the costs of land go down, or if the time to identify, assemble, and acquire appropriate parcels is reduced.

[24] Technically, productivity is defined as the ratio of output over cost. However, we will refer to it here in the more popular usage, as the amount of output that can be produced at a given cost (so that increasing productivity is a distinct lever from reducing costs).

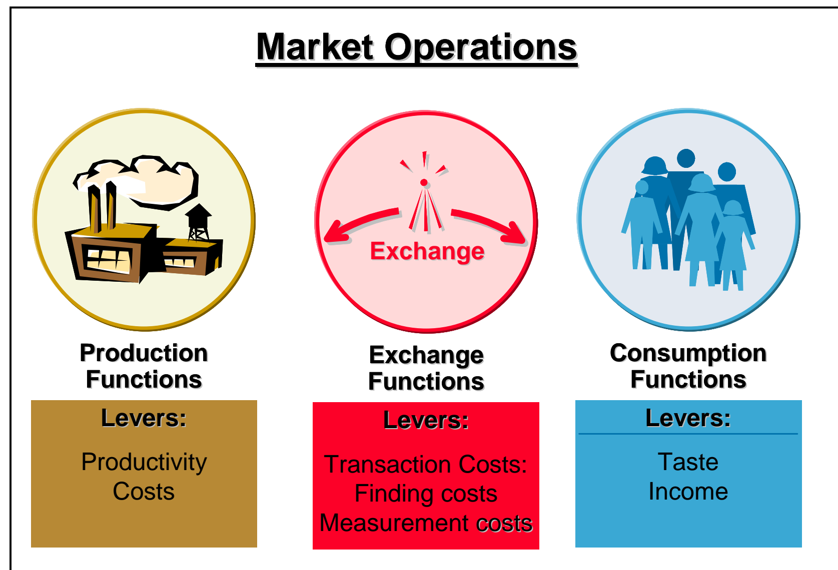

Figure 3

The consumption, or demand, side of the market would include the car buyer, client, or employer (in labor markets). Consumers, too, face a set of opportunities, constraints, and preferences that determine their behavior. In the case of the consumer, personal preferences and disposable income determine the kind and amount of goods or services that a consumer is willing or able to buy or use. The primary levers of change for consumption thus become factors that affect personal tastes or income. A factor such as "green" marketing, for example, promotes the consumption of certain goods and services based on their positive environmental characteristics, and it changes consumer preferences by adding a new dimension on which to evaluate the quality of a good. Increasing income, such as by increasing employment, also influences demand given that it affects what consumers can afford to purchase.

The existence of the market itself also relies on a trading or exchange function. Any exchange of goods and services depends on the ability of producers and consumers to find one another, offer and evaluate goods, and agree to terms of the transaction. Trade is how the producer finds the consumer, learns preferences to better tailor goods, and offers products. Trade is also how the consumer finds and chooses among competing goods.

The exchange, or trading, function is affected by transaction costs, including finding costs (for the producer and consumer to connect) and measurement costs (for each to evaluate the other or the product). An improved consumer segmentation system allows sellers to more accurately target potential customers, and as a result reduces the costs of acquiring customers. Consumer reports and product rating systems may reduce measurement costs. A job bank may reduce finding costs for employers and potential employees.

In basic classical microeconomic theory, the supply and demand functions automatically reach equilibrium without an exchange function.[25] The theory, however, assumes that producers and consumers have perfect information and that there are no transaction costs. In the real world, information is highly imperfect, which often results in prohibitive finding and measurement costs that can prevent markets from working. Indeed, information imperfections have been the subject of major recent innovations in economic theory, as discussed in the companion paper. A key lever available to community economic developers wanting to enhance markets is to influence the exchange function by improving information to reduce finding and measurement costs.[26]

C. Enhancing Markets

This description of the functional components of markets enables a more precise definition of what is meant by "enhancing markets." *Enhancing markets entails changing the conditions of production, exchange, or consumption in ways that allow market activity to include new people, assets, or places.* This, in turn, actively engages more people and assets in the market system; the factors of production will be more efficiently converted into value; individuals will be able to accumulate ownership assets that, in turn, will increase their wealth; existing market opportunities will be exploited; and new market opportunities will be created. Consequently, previously excluded groups and places will be actively involved in, contribute to, and benefit from the wealth creation process.

As we have noted, the market may be enhanced because of changes in any of its components. If productivity is increased, goods can be provided at a lower price or more goods can be provided. If the exchange process is more efficient and less costly, consumers will gain access to more and less expensive goods. Finally, if the consumer characteristics (taste and income) change, the level of goods and services demanded and offered will also change.

Consider, for example, a bank (producer) making a consumer loan to an inner-city household that is only marginally credit-worthy (consumer). If the market is left to its own devices, the bank might incur higher costs in determining the consumer's credit-worthiness, or if unable to assess credit-worthiness, the bank may face a higher risk of loan default. This higher cost or risk must be offset by a higher interest rate, or perhaps no loan will be made. As a consequence, the household might not be offered, or may be unable to afford, the loan, and no transaction will take place. One could "enhance" this market by intervening in any of its three components. Reducing the bank's cost of funds (reducing the cost of production) would enable it to make more loans or loans at a lower price. Implementing a better credit scoring system (increasing productivity) would reduce the costs

[25] Our focus on enhancing markets is primarily aimed at producers and, technically, we will often find that this exchange function can be viewed as, and often is, a cost of production. For example, ATMs allow banks to provide more access, reaching more customers less expensively, and so reduce costs of customer acquisition and service. If landlords have better information on prospective tenants, it reduces rental costs associated with screening. Credit scoring reduces costs of evaluating prospective borrowers. These each can be viewed as reduced costs of producing the products, or broken out as a special category related to the exchange function.
[26] This use of information to enhance market functioning is the primary subject of the companion paper, "Using Information Resources to Enhance Urban Markets."

of lending. Alternatively, providing the consumer with credit training, credit repair, and prescreening services would change consumer characteristics (and reduce finding costs) in a way that would increase lending. Finally, improving the quality and availability of information to determine credit-worthiness would similarly reduce costs (improving the exchange function).

IV. TOWARD PRACTICE: APPLYING THE FRAMEWORK

A. Clarity, Limitations, and Values

Confusion and controversy have arisen as the community development field moves toward economic development, particularly market-based development. Confusion has arisen because a wide range of practices claim to fall under the umbrella of market-based development. These include various forms of community finance, housing development, corporate engagement, "double bottom line," and entrepreneurship activities. Although they share a focus on using business activities, approaches, or disciplines to achieve development objectives, they are not all equally market-based or compatible with market mechanisms.

For example, a community organization approaching an insurance company that does business in its neighborhood for a charitable contribution—even though it may make sense for both the organization and the company—cannot be considered "market-based" development in the sense used here. The activity does not enhance market functioning. Approaching the same company to hire locally, although aimed more closely at improving the local (labor) market, would still not be considered market-based development. From a market or business point of view, this activity does not enhance market functioning.[27] In contrast, a community organization that uses its local expertise to develop a reliable inventory of housing conditions and works to address unsafe housing would fall under market-based development because such an inventory reduces the costs and risks of writing insurance, expanding market activity as it makes its neighborhood more insurable. These distinctions will become clearer in the next section, as we apply the framework developed above to designing market-based development interventions.

Controversy has arisen because of the limitations of market systems: in effect, if markets worked so well, why do these development problems exist in the first place? Our focus on market-based development is meant in no way to imply that it is either suitable for all kinds of development objectives or a superior approach. On the contrary, our interest in developing a clearer framework and better understanding of markets and market-based development is precisely to enable community developers to better understand where market forces can be made to work, and where they cannot. In other words, markets often cannot achieve development objectives, or they are not the best way to do so. The framework provided here is intended to help determine whether a market approach makes sense. This understanding is particularly important not only to more effectively using market-based approaches when they do apply, but also to recognizing that many of the most important problems must be otherwise addressed.[28]

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[27] The exception would be if local hiring directly made business sense for the company as an employer because, for example, the local labor force provided better (previously overlooked) value.

[28] As a result, those who mistakenly characterize essentially programmatic, organizing or advocacy work as market-based do a disservice not only to market-based approaches (by sowing confusion about or affecting credibility of market approaches), but to the very real problems these non-market approaches are trying to address (by mistakenly implying that markets can solve those problems).

This limitation is due, in part, to the fact that markets tend to move on their margins (that is, supply and demand generally move incrementally, not in leaps). Productivity and exchange costs may be altered in ways that allow more employment of the qualified, but overlooked, inner-city workforce, while the no-less-important needs of the hardest to employ must be met through non-market mechanisms. In other words, although markets can help, the problems of inner cities are not all problems of market failure, nor necessarily amenable to market solutions.[29] In fact, addressing these other problems may often be required to ensure the success of market-based approaches. For instance, crime reduction is often an important first step in implementing successful market-based strategies, but generally is not itself best achieved through market forces.

A further clarification is in order: the interest in using market *mechanisms* to achieve development objectives does not mean that market *values* -- such as broad commoditization, and unrestrained competition and profit-seeking -- should influence the goals of community change. Markets can provide a useful means, but the ends must still be defined by development goals such as addressing poverty, strengthening communities, or achieving equity. Indeed, with the ascendance of markets, a major challenge facing the development field is the declining credibility of many of the non-market institutions that traditionally produce and reinforce social and development values. This includes government, religious institutions, and community-based organizations. The focus here on using market mechanisms should not distract from the much more fundamental goal of strengthening the social institutions that continually build and define common development values.

B. Designing Market-Based Development Interventions

The framework offered above can be translated into a business planning tool for market-based development. This business planning process can help determine whether a market approach is appropriate, and which components of the market offer the most opportunity to effect change. Having identified a specific development goal (for example, to increase the availability of affordable housing), developers must address four key questions to effectively design a market-based development intervention:

1. Is there a market solution at all? What market, if any, does or could affect the development goal, and can its operations be aligned with community development interests?
2. What are the components of the market that currently prevent it from meeting the development goal?
3. What levers in each component might be altered to allow the market to achieve the development goal?
4. What products or activities are necessary to move those levers?

[29] See Amy K. Glasmeier, “Economic Geography in Practice: Local Economic Development Policy.” In Clark and others, eds., The Oxford Handbook of Economic Geography.

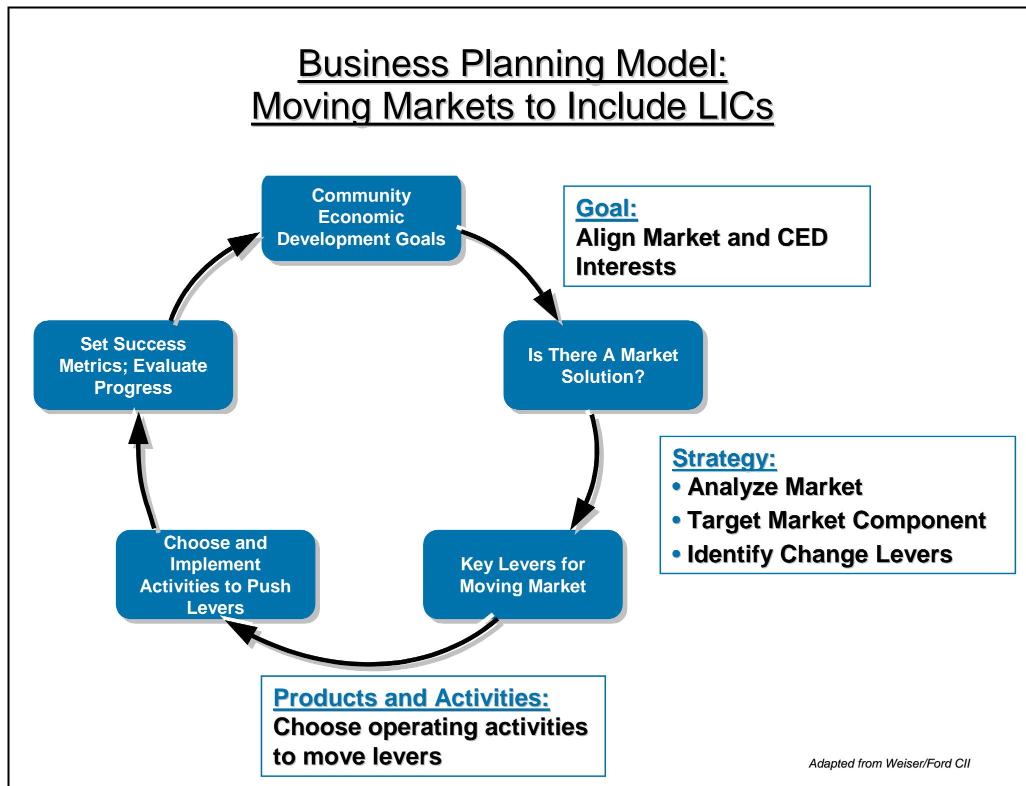

Figure 4

Figure 4 represents the process that community development, civic, or government organizations might implement to address these questions. In some cases, such as the crime example, the answers to these questions will make clear that the problem is not market-based nor best addressed with market solutions. In other cases, such as encouraging savings accounts, it may become clear that new information (for example, revealing the attractiveness of and targeting certain potential savers, thereby reducing exchange costs), new products (for example, employer payroll cards with automatic savings component, which reduce production costs), or new incentives (for example, Individual Development Accounts that provide matching funds for savings, which are subsidies that change the market environment) can enable the market to expand savings products to underserved consumers.[30]

Figure 5 focuses on the first stages of this market-based business planning process. In particular, it provides a way to determine the extent to which market and development interests are aligned, and the implications for the types of interventions needed to align them.

[30] The companion paper, "Using Information Resources to Enhance Urban Markets," provides a more detailed discussion of the role of information in enhancing the exchange function of this particular market.

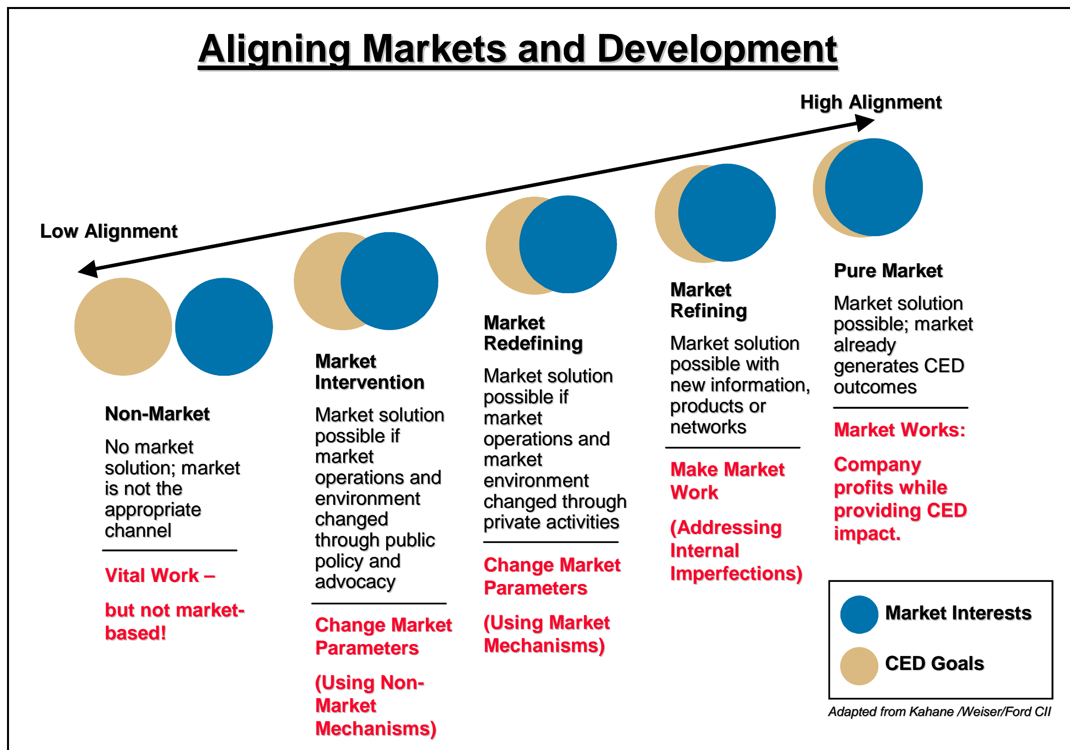

Figure 5

Figure 5 represents a continuum of the degree of alignment between market and development interests. On the right side, the market and development interests are fully aligned: successful for-profit companies are improving the economic conditions of inner-city neighborhoods, and the market is working to achieve the development goals. A profitable temporary employment agency in a previously underemployed community would fall into this category.

The column labeled "Market Refining" is the primary focus in this paper. The imperfect but potentially high alignment of market and development interests represents situations in which the market could achieve the development goal if some internal market imperfection were addressed. Enhancing markets "from within" has two advantages. First, community developers can achieve goals by leveraging market forces rather than by relying on government intervention, which can be costly, inefficient, and difficult to obtain. Second, deploying previously underused assets improves the efficiency of the market itself. In terms of the market framework developed above, improving internal market operations (that is, production, exchange, and consumption) can enable the market to expand to meet more development goals. In the case of the retail market, for instance,[31] developing more accurate sales forecasting models for inner-city neighborhoods could reveal untapped pockets of demand and bring new investments to these communities.

The next two columns represent degrees of misalignment that require interventions in the market to achieve development goals. In the center ("Market Redefining"), achieving the development objectives requires incorporating nonmarket concerns into market decision making. This strategy, well exemplified by social accountability and green marketing initiatives, differs from

[31] See companion paper, "Using Information Resources to Enhance Urban Markets," for more detailed discussion.

market refining because it leverages considerations that are not already part of the market, rather than relying purely on existing internal market considerations. Social accountability campaigns, for example, generally encourage companies to meet certain standards reflecting social values (such as overseas labor conditions or ethical relationships to governments and communities), and encourage consumers to buy products only from companies that meet the standards. A successful social accountability campaign will thus increase alignment of development and market interests by bringing into the market process previously absent concerns.

The column “Market Intervention” refers to changing the institutional parameters of the market environment. This is the realm of government intervention, influenced by public policy and advocacy. The strategies in this column may influence the market through taxes and subsidies that affect the quantity and price of the goods exchanged. Alternatively, initiatives change the market environment by modifying the laws that regulate market activity, as in the case of the Community Reinvestment Act, or by directing investment in infrastructure (influencing, for instance, the location of a new road or airport). Finally, many vital goals, such as public safety, may not lend themselves to market solutions, as represented by the last column in the chart.

Understanding the degree of alignment helps identify whether a market-based approach is appropriate, and, if so, whether to focus on the market environment or the market operations components. Once this focus is determined, it is possible to explore particular levers that affect relevant components. At a practical level, to accomplish the analysis represented in Figures 4 and 5 requires addressing a series of concrete questions:

1. Considering the development goals, or areas of intervention, are there generally private-sector firms operating in these areas? If not, the problem is unlikely to be amenable to market-based solutions.
2. If the private sector does address these goals in other neighborhoods, but not in the target community, what are its barriers to operating or being profitable in the target neighborhood?
3. If internal market barriers exist, do neighborhood market qualities create barriers to productivity and costs (production); transaction, finding, and risk assessment activities (exchange); or taste and income (consumption)? Which of these can the development organization influence?
4. Are the barriers instead (or in addition) neighborhood infrastructure, government policy or regulation, cultural taste, or other neighborhood market environmental barriers? Again, what can be influenced?
5. What organizational activities would address the identified barriers, and as a result enhance the market in the neighborhood?

This framework (summarized in Figure 6, below) emerged, in part, from work in the retail sector. Shorebank, after decades of successfully operating its banking, real estate, venture capital, and nonprofit community development subsidiaries in the South Shore neighborhood of Chicago, knew the neighborhood as a stable, largely working and middle-class, creditworthy community. It was perplexed, therefore, by the continuing lack of retail stores in the neighborhood. Clearly,

private-sector firms met retail needs in other comparable neighborhoods, why not here? The observations of developers and retailers revealed two problems. The city process for land assembly and site development approval was cumbersome and sometimes highly political, creating prohibitive costs to develop sites. This is a problem with the market environment, requiring "market intervention," working with the city to directly address some of these barriers.

More important, discussions with retailers and market analysts revealed that the available business information and models were inadequate for analyzing inner-city retail consumers and geographies. This made it difficult for companies to see or access market opportunity. As a result, the cost of identifying and serving these markets was prohibitive.[32] This is an internal market operations problem; information imperfections (particularly affecting exchange costs) prevented the retail market from functioning in the neighborhood. This problem is amenable to a "market refining" solution. In this case, Shorebank launched a new division, MetroEdge, which has developed specialized data and models to improve urban market segmentation and targeting, sales forecasting, and site selection, reducing finding costs and attracting retailers to inner-city communities.[33]

A similar analysis is common in housing markets. What type and price range of housing will the market currently support? If the goal is to produce higher-quality housing at a better price than the market currently supports, can the internal market operations be refined in ways that reduce the cost of production, such as by land banking or by identifying and supporting reliable "ma and pa" rehabbers? Would homeownership training and credit repair and screening improve the demand side (consumption) of the market? Or should the community developer go beyond market refining to seek subsidies (market intervention), for example, for affordable housing (priced well below what the market can support)? In this case, market interventions can be designed (such as the low-income housing tax credit) that change the market environment and leverage, instead of supplanting, internal market forces.

Finally, businesses can also use this framework to determine whether or how they can expand their market activity. The financial services industry has recognized that their traditional products were not well adapted to specialized urban markets, making them expensive (as a result of internal market barriers). These barriers are being addressed by new partnerships and technologies that create opportunities to better serve and include lower-income consumers. New stored value cards, transfer payment tools, employer-based services, expanded and less expensive access points (such as locations of ATMs), specialized credit scoring applications, and other practices all reduce costs and increase productivity in ways that enable the market to provide more services to previously underserved consumers.[34]

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[32] See Robert Weissbourd and Christopher Berry, "The Market Potential of Inner-City Neighborhoods: Filling the Information Gap" (Washington: Brookings Institution, 1999).
[33] For details on MetroEdge's strategies and approach, see www.metro-edge.com
[34] See Robert Weissbourd and Perpetual Motion, "Banking on Technology: Expanding Financial Markets and Economic Opportunity" (Washington: Brookings Institution, 2002); Shorebank Advisory Services, "Moving the Market: Improving the Supply of Financial Services for the Underserved" (New York: Ford Foundation, 2003).

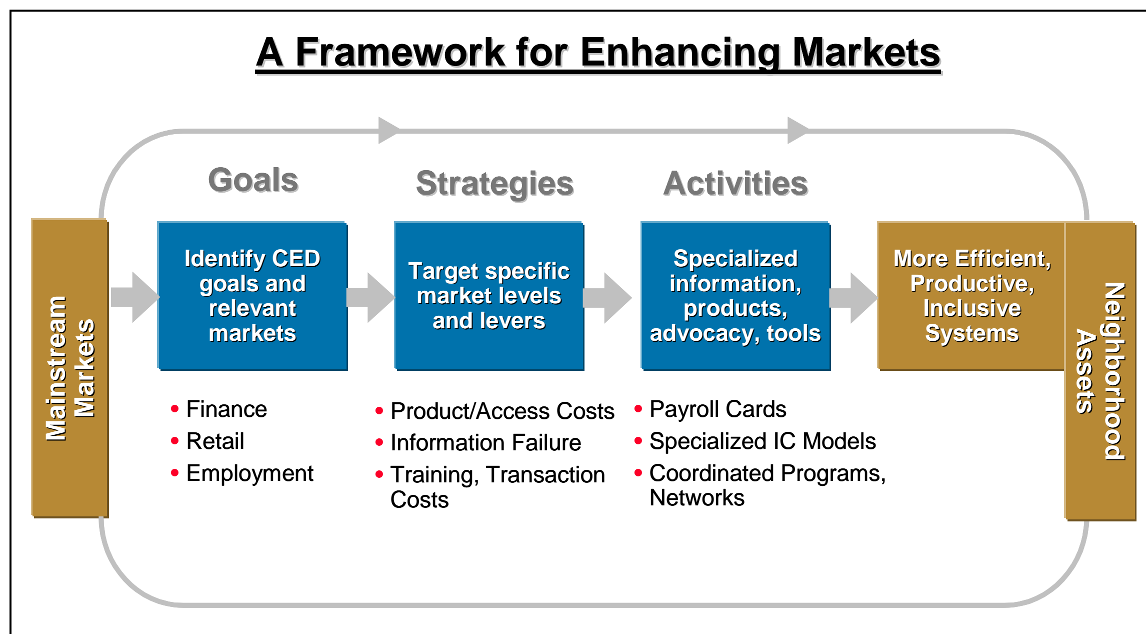

Figure 6

C. Research Implications and Next Steps

In many respects, this paper only scratches the surface of a new framework for market-based economic development. The framework suggests that highly effective development opportunities arise through better understanding of the levers that can make markets work in inner-city neighborhoods. At the same time, understanding these market dynamics requires addressing a new set of questions that emerge at the intersection of economic theory and development practice. These questions revolve around three main areas: a better understanding of markets that are particularly important to inner-city communities; a better understanding of different levers that can affect market behavior; and a better understanding of the geographic aspects of markets.

Each market, of course, has its own dynamics and may pose different barriers and opportunities to include more inner-city people and places. Much deeper market-specific analysis is needed to understand the particular levers for enhancing, for example, specific housing, retail, labor force, or financial services markets. At the same time, it would be helpful to develop more systematic "diagnostic tools" for analyzing the degree of alignment between market and development goals as a way to more routinely identify which type and focus of intervention would be most effective for each market.

Second, within any particular market, different levers can be used to influence how the market operates. Lowering the cost of production is not the same as changing consumers' preferences or remedying information imperfections that affect the exchange function. To elaborate better market enhancing strategies, then, each type of lever should be studied in more detail.

Third, different types of markets have different geographic scopes, with important implications for deploying neighborhood assets. More work is needed in the field of economic geography to understand the relationships between neighborhood assets and broader economic systems. Which markets (if any) operate at the neighborhood level? Which market operations (production, exchange, and consumption) are defined or influenced by neighborhood characteristics? More work is needed in categorizing the different types of assets and, more important, the economic relationships that determine their deployment must be better distinguished. A more detailed understanding of the mechanisms that allow neighborhood assets to be deployed in the context of the market economy would enable practitioners to identify the neighborhood assets with the highest potential, and to implement the most effective development strategies.

Finally, in common areas of market failure, it would be useful to gather and disseminate practitioner experience and guidance to demonstrate how to apply this framework to local community development needs.

V. CONCLUSION

The field of community economic development has moved from a deficiency-based to an asset-based approach in addressing the problems of disadvantaged communities. This, in turn, has led practitioners to realize that to generate wealth, assets must be leveraged and deployed in the context of economic systems. Consequently, more attention is being paid to the economics of economic development, and particularly to market-based development as the way in which neighborhood assets are incorporated into broader economic activity.

From this viewpoint, it becomes apparent that a main problem of inner-city neighborhoods is their isolation and disconnection from mainstream economic activity. This is detrimental both for these communities, which are neglected and underserved, and for the economy as a whole, which could benefit from the growth opportunities that inner-city neighborhoods present. A critical goal and opportunity for both business and economic development is thus to improve market dynamics to reconnect lower-income communities to the mainstream economy.

Accomplishing this goal requires greater understanding of the economics of community economic development. This paper outlined an initial framework for community economic development practice, which describes the structure of markets and their components and identifies the levers that can be pushed to enhance markets to better serve inner-city neighborhoods. A better understanding of the structure and the workings of markets also can contribute to a business planning tool to assess whether and how a market-based approach can help achieve the desired development outcomes.

Although these ideas suggest new opportunities and offer a framework for approaching market-based development, they also highlight how little is known about the economics of inner-city markets and their assets. The possibilities are enormous at this intersection of economic theory and development practice. The convergence of interests between businesses and community organizations—between community development and broader economic development—creates unprecedented opportunity to realize these possibilities and to dramatically enhance the business, and development, of inner-city communities.

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