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Lessons and Limits:
Tax Incentives and Rebuilding the Gulf Coast after Katrina

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"Though many studies have been done to evaluate the effectiveness of federal and state tax-based efforts to redevelop distressed areas, none of that learning has been reflected in policy debates about the Katrina recovery effort."

In the wake of the devastation wrought by Hurricane Katrina, Congress enacted legislation creating Gulf Opportunity Zones (GO Zones) in localities in Alabama, Louisiana, and Mississippi that suffered the most extensive storm damage. Special tax incentives created in these areas are designed to encourage investment, job creation, and economic growth. While many studies have been done to evaluate the effectiveness of federal and state tax-based efforts to redevelop distressed areas, none of the learning has been reflected in policy debates about the Katrina recovery effort. The evidence suggests that tax incentives alone are not enough—they work better when combined with good planning, local capacity-building, and good governance across sectors. This paper will summarize the purpose of the Gulf Opportunity Zone tax program and explain how this latest endeavor reflects the 25-year evolution of federal efforts to use tax incentives as a core tool for revitalizing distressed areas.

Introduction

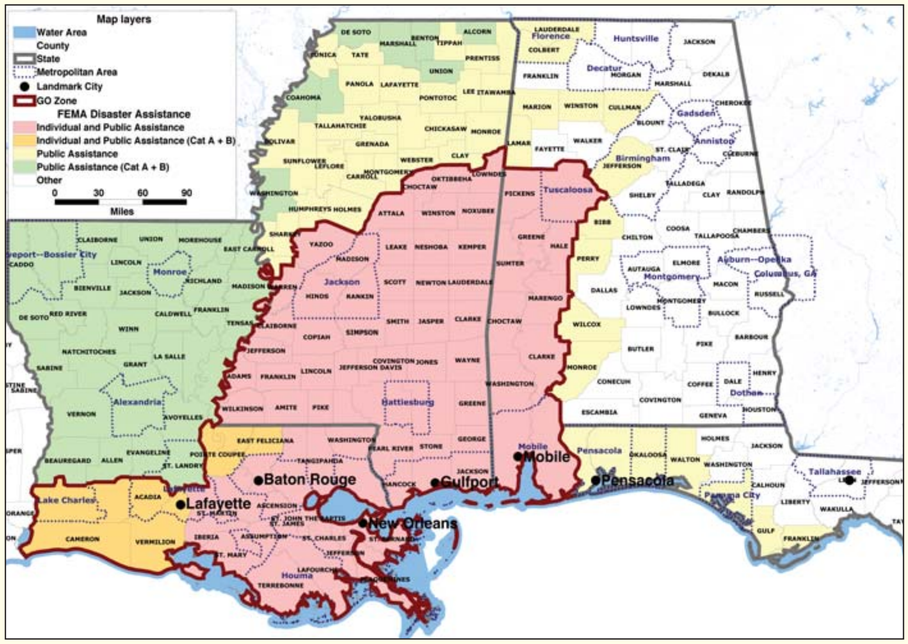
Hurricane Katrina damaged thousands of homes and businesses, wrecked public infrastructure, and displaced hundreds of thousands of Gulf Coast residents. In the aftermath of the storm, the nation was shocked by the privation and distress it witnessed in New Orleans as flooding made large portions of the city uninhabitable. For several days, thousands of people, most of whom were poor and black, were stranded in desperate need of assistance. Indeed, a recent study by sociologist John Logan based on Federal Emergency Management Agency storm damage data confirmed that Katrina's effects were "disproportionately borne by the region's African-American community, by people who rented their homes, and by the poor and unemployed."[2]

The federal government is providing direct aid to individuals who suffered uninsured property losses due to the storm and grants to state and local governments to restore and rebuild local infrastructure such as roads, levies, bridges, and schools. In addition, Congress has enacted legislation to provide tax relief to storm victims and to create Gulf Opportunity Zones (or GO Zones). The Katrina GO Zone is composed of the localities in Alabama, Louisiana, and Mississippi that suffered the most severe and extensive storm damage. Special tax incentives have been created in these areas to encourage investment, job creation, and economic growth.

Although the scope of Katrina's destruction makes rebuilding Gulf Coast communities a challenging national problem, the federal government has significant experience in redeveloping distressed communities. Despite this experience, little is known about the effectiveness of past federal efforts and what is known has not been reflected in policy debates about the Katrina recovery effort. Several past programs, including state enterprise zone programs, the National Rural Development Partnership, and urban and rural Empowerment Zones, offer valuable lessons about the potential and limitations of encouraging economic revitalization through tax incentives. The evidence suggests that tax incentives alone are not enough—they work better when combined with additional policy tools that are managed by an effective process of cross-sector, collaborative governance. Effective governance is especially important to assure that needy residents benefit from redevelopment efforts. The combination of tax incentives and effective governance has been demonstrated to be a robust strategy to encourage economic growth and job creation.

This paper will summarize the purpose of the Gulf Opportunity Zone tax program and explain how this latest endeavor reflects the 25-year evolution of federal efforts to use tax incentives as a core tool for revitalizing distressed areas. It will then review the academic literature about the impact of similar federal and state economic development programs, such as state enterprise zones and the federal empowerment zone program, to extract lessons that can be applied to the ongoing efforts to rebuild the Gulf Coast region. The paper will then close with a proposed strategy to enhance Gulf Coast redevelopment efforts.

Figure 1. Gulf Opportunity Zone



Source: U.S. Government

A Daunting Challenge in the Gulf Coast

Three factors heighten the challenge of economic redevelopment in the wake of Hurricane Katrina. First, as Figure 1 shows, the scale of the damage is vast, as the storm created widespread destruction in Alabama, Louisiana, and Mississippi. Second, many residents were displaced from their homes, and in particular pockets where the damage was quite severe (such as low-lying areas in New Orleans) few have been able to return.[3] Third, the economic health of Gulf Coast communities varied significantly before the storm, suggesting that the challenges of creating economic vitality in communities that were already distressed should be distinguished from the efforts to restore economic vitality in communities that were previously robust.

New Orleans is one place where Katrina exposed social and economic problems that existed long before the storm.[4] Census Bureau estimates show that in 2004 large numbers of New Orleans residents were already struggling to cope with poverty and idleness. Many residents were not working: 37.2 percent of the population over age sixteen was not in the labor force and the unemployment rate among those in the civilian labor force was 11.8 percent. Low educational achievement or lack of transportation were likely barriers to work, as 17.7 percent of people over age twenty-five had not completed high school and 21.2 percent of households had no vehicle for transportation. Median household income in New Orleans was only $31,369 and 23.2 percent of residents lived in poverty, a number that climbed to 41.1 percent among female-headed households with children. Finally, only 46.8 percent of New Orleans residents owned their home.[5]

By contrast, the 2004 Census profile of the Metropolitan Statistical Area (MSA) composed of Biloxi, Gulfport, and Pascagoula, Mississippi is far more positive, owing in part to the fact that it is a combination of urban areas and more affluent suburban areas. Although 18.9 percent of residents over the age of sixteen had not completed high school and 35.6 percent were not in the labor force, median family income was $43,979, only 4.4 percent of households had no vehicle for transportation, and 67 percent of homes were owner-occupied. Unemployment in the Biloxi-Gulfport-

Pascagoula MSA was 8 percent and 16.1 percent of residents were poor. Among female-headed households with children, the poverty rate was 28.6 percent. Compared to New Orleans, in the Biloxi-Gulfport-Pascagoula MSA, household income was 17.4 percent higher and the home ownership rate was 43 percent higher, while poverty was 31 percent lower and unemployment was 32 percent lower.

Despite the wide social and economic differences that existed between communities hard hit by the hurricane, the federal government responded by establishing GO Zone tax relief that treats all of the impacted communities in the same way. Specifically, GO Zones offer the same set of tax incentives to encourage redevelopment regardless of the local conditions that existed before the storm. In addition, because GO Zones in their present form rely exclusively on tax incentives, they limit the tools available to encourage economic development; they do not provide a mechanism for coordination within or across local jurisdictions (e.g., between Orleans Parish and St. Bernard Parish); and they make no provisions for the participation of displaced residents in the recovery process.

The Recovery Strategy: Gulf Opportunity Zones

President Bush presented his proposal to rebuild the Gulf Coast in a nationally televised speech from Jackson Square in New Orleans on September 15. The president sounded popular objectives: create jobs and opportunity, break the cycle of poverty, foster minority business ownership, and encourage homeownership.[6] He proposed three programs. The first would target business growth and job creation through tax incentives and loans or loan guarantees. The second would help workers to participate and compete in the job market by providing up to $5,000 in support for education and training or childcare. The third was an "Urban Homesteading" program that would assist and encourage low-income homeownership by donating federal lands to be used as building sites. Since then, Congress has passed legislation to provide tax relief for storm victims and has created GO Zones, but has not yet acted on the President's other proposals.

President Bush proposed a federal, state, and local partnership to rebuild public infrastructure and anticipated the need to revise zoning laws and building codes in the wake of the storm. However, when it came to the redevelopment of the region's economic vitality, the president emphasized the role of entrepreneurs, not government: "It is entrepreneurship that creates jobs and opportunity; it is entrepreneurship that helps break the cycle of poverty; and we will take the side of entrepreneurs as they lead the economic revival of the Gulf region."

After the president's speech, Congress enacted two laws to structure the redevelopment effort. First, the "Katrina Emergency Tax Relief Act of 2005" was enacted (on September 21) to provide tax relief for storm victims and to put into place some pieces of the redevelopment effort. Subsequently, Congress passed the "Gulf Opportunity Zone Act of 2005" (on December 16) to create GO Zones and provide tax incentives for the redevelopment of the Gulf Coast region. Although 453 counties in five states (Alabama, Florida, Louisiana, Mississippi, and Texas) are eligible for federal disaster assistance because of Hurricanes Katrina, Rita, and Wilma, the Katrina Gulf Opportunity Zone is composed of a subset of that area affected by Hurricane Katrina that President Bush specifically designated as eligible for individual or individual and public assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Figure 1). The legislation also created GO Zones for similar areas affected by Hurricanes Rita and Wilma.

The "Katrina Emergency Tax Relief Act of 2005" provides a variety of tax benefits to encourage the economic recovery of the Gulf Coast.[7] First, the Work Opportunity Tax Credit and an employee retention tax credit (targeting small- and medium-sized firms) provide tax benefits of as much as $2,400 per year per employee to businesses in the core disaster area. Second, capital gains taxes are reduced through an extension of the non-recognition period from two to five years on the "involuntary" conversion of property.[8] Third, limitations on charitable giving by corporations are lifted to encourage charity and reduce business taxes. Fourth, personal income taxes are reduced by special rules for withdrawals and loans from retirement accounts, suspension of limitations on charitable giving, creation of a special $500 exemption for persons displaced by the storm, exclusion from income of charitable mileage reimbursement, exclusion of cancelled debts from gross income, and suspension of limits on Personal Casualty Loss. In addition, some means-tested personal income tax benefits are subject to special look-back rules that allow the use of the prior year's income as the basis for calculating the Earned Income Tax Credit and the Refundable Child Credit. Finally, rules governing tax-exempt bonds are liberalized; several existing restrictions on Mortgage Revenue Bonds are waived; states are authorized to use GO Zone bonds for "private activities;" and Alabama, Louisiana, and Mississippi are permitted to make advance refunds on state-issued bonds.[9]

The "Gulf Opportunity Zone Act of 2005" created Gulf Opportunity Zones, expanded and codified selected provisions of the "Katrina Emergency Tax Relief Act of 2005," and added additional tax benefits to encourage Gulf Coast redevelopment.[10] The areas that have been designated as GO Zones represent about half of the total area affected by Hurricane Katrina and contain more than sixty thousand square miles of territory in eighty-nine counties and three states (Alabama, Louisiana, and Mississippi), with an estimated population (in 2003) of more than 5.7 million people. (For additional information about the GO Zone, see the Appendix). The employee retention credit provided by the "Katrina Emergency Tax Relief Act of 2005" is expanded to include all firms, regardless of size. Business taxes are reduced by a variety of special rules that allow 50 percent of the cost of new equipment to be expensed in the first year; double small business expensing limits to as much as $200,000 annually; expand the net operating loss carry-back from two to five years; allow 50 percent of demolition and clean-up costs from storm damage to be expensed; allow expensing of brownfields and petroleum contamination clean-up costs; and allow increased expensing of some reforestation costs. The act also increases the normal allocation of Low-Income Housing Tax Credits within GO Zones by a factor of three. One billion dollars in New Markets Tax Credits are made available to nonprofit firms that are involved in the rebuilding efforts within the GO Zones. And, personal income taxes are reduced by a provision that shields GO Zone bond income from the Alternative Minimum Tax.

Looking Back: A History of Tax Incentives as an Economic Development Tool

President Bush's proposal to create Gulf Opportunity Zones reflects the belief that open, competitive markets—and the use of incentives to motivate market actors—are the most effective means of stimulating targeted economic development. This idea has deep roots, reflecting policy trends employed in the United States as far back as the early 1980s. Since then, tax-oriented tools have become a popular form of federal assistance to distressed communities, emerging first as a common feature of state enterprise zone programs and later as a core component of the federal empowerment zone and renewal communities programs.

Enterprise Zones

The idea to use tax incentives to spur targeted economic development originated in Great Britain in the late 1970s. Sir Geoffrey Howe—a leading member of the Conservative opposition in Great Britain—proposed the creation of "enterprise zones" to combat blight in British cities. He argued that what was needed was not another governmental program, but rather, the removal of as much government as possible, and predicted that jobs and investment would flourish in distressed urban areas if taxes and government regulations were eliminated.[11] Howe translated his ideas into policy during his service as Chancellor of the Exchequer under Prime Minister Margaret Thatcher, and two dozen enterprise zones were created throughout England during the 1980s.

Howe's ideas were soon transported across the Atlantic. In 1979, the Heritage Foundation published a report that called for the adoption of similar policies in the United States.[12] In 1980, Congressman Jack Kemp (R-NY) introduced legislation detailing an American version of enterprise zones and Ronald Reagan embraced the concept during his presidential campaign. The British envisioned enterprise zones as a strategy to redevelop vacant and abandoned industrial areas. In contrast, the United States recast enterprise zones as a community development tool to revitalize depressed inner-city neighborhoods. Enterprise zones were promoted as an alternative to conventional government programs—e.g., urban renewal, Model Cities, Community Development Block Grants, and Urban Development Action Grants—that sought to revive inner-city neighborhoods through the investment of public funds. Reflecting Howe's ideas about governments and markets, these proposals were intended to get government out of the way in order to allow markets to flourish. It was expected that tax and regulatory relief would reduce business costs and increase profits, thereby attracting investment and creating jobs in distressed urban areas.

Although the Reagan administration vigorously promoted the idea, support in Congress for enterprise zones was lacking, particularly among House Democrats. Three objections to the idea were raised. First, opponents argued that the location and expansion decisions of business firms depended on a variety of factors other than tax incentives. Consequently, revitalizing distressed areas required a broader strategy that also included additional tools to create infrastructure, improve public safety, and enhance human capital. Second, opponents were concerned that low- and moderate-income zone residents might not benefit from tax incentives and regulatory relief. Thus, enterprise zone opponents believed government's role needed to be enhanced, not eliminated. Third, opponents were concerned that enacting federal enterprise zones might jeopardize existing federal urban programs for distressed communities.

While Washington remained deadlocked, the idea was gaining popularity in the states. By 1983, nearly half of the states had established enterprise zones; 10 years later, forty states and the District of Columbia had designated more than 3,000 zones. However, the state programs deviated from what had been proposed originally at the national level. According to Michael Wolf, "the paradigm derived from Butler, Kemp-Garcia, and Reagan comprised a *federal, supply-side, antiregulatory, conservative-Republican* program to attract new, small businesses to the inner city." However, as enterprise zones moved from theory to practice, a new paradigm emerged: "Zones at their most effective are *state and local, public-private, reregulatory* partnerships, passed and endorsed by *liberals, moderates,* and conservatives of both parties, designed not only to attract small, *moderate*, and *larger* employers, but also to *retain existing* businesses in urban, *rural*, and *suburban* areas."[13] Rather than viewing enterprise zones as free market sectors, the states viewed tax and regulatory relief as two tools within a larger kit to encourage economic redevelopment through public-private partnerships.

Today, state enterprise zone programs vary widely in terms of geographic scope and the tax incentives and other inducements offered. In Arkansas, for example, the entire state is designated as an enterprise zone. By contrast, Connecticut, the first state to establish enterprise zones in the United States, presently has seventeen separate zones spread across the state. Connecticut designates areas as enterprise zones on the basis of high poverty, high unemployment, and receipt of public assistance. Although most of the incentives offered through state enterprise zone programs involve tax abatements or credits for various state and local taxes such as property taxes, corporate income taxes, sales taxes, and a variety of excise and licensing taxes, some states also include wage tax credits for employers, and a handful of states have extended tax credits to individuals employed by enterprise zone firms.[14] Many state programs also include capital financing (direct loans, venture capital funds, and capital made available through industrial development authorities and/or tax increment financing districts). About half of the states offer some type of regulatory relief for zone firms. And a few states also provide funds for infrastructure improvements, job training, and technical assistance.[15]

Despite these differences, Roy Green and Michael Brintnall conclude that the one common feature of state enterprise zone programs is "the partnership of public and private enterprise to engineer growth." They add that this theme "has raised a world of confusion in analysis of enterprise zones, because some 'pure' models have presumed the program would operate with no public intervention at all, and because some proponents have asserted that the 'government-free' nature of zones is one of its greatest virtues."[16] However, "the degree and style of this government engagement with the program appears to make a difference in the performance of zones."[17]

From Enterprise to Empowerment

It wasn't until the early 1990s that Howe's idea to encourage business and job growth in distressed communities through tax incentives and regulatory relief gained real traction at the federal level.

By 1989, many key state and local government organizations, including the U.S. Conference of Mayors, the National League of Cities, the National Association of Counties, the National Governors Association, and the National Conference of State Legislatures had endorsed the concept of a federal enterprise zones program. However, these groups called for a more expansive program to revitalize distressed communities that would complement—not replace—existing federal efforts. The U.S. Conference of Mayors, for example, supported the concept of enterprise zones, but also called for a variety of social programs such as job training, adult education, childcare, school improvements, public safety, and anti-drug initiatives as part of the overall zone package.[18]

Despite the endorsement of state and local leaders, efforts to create a federal enterprise zone initiative continued to stall out in Washington over the next few years, as Democrats and Republicans could not reach agreement on the mixture of policy tools to include and the level of funding to support the effort. While the riots that erupted in South-Central Los Angeles in April 1992 kept the conversation over enterprise zones alive, key sticking points remained. When President George H. W. Bush announced a six-point proposal to respond to the needs of Los Angeles and other distressed inner city areas—the centerpiece of which was the enactment of a federal enterprise zones program—Democratic leaders in the Congress countered that the proposal was nothing more than a warmed-over version of policy ideas that had been proposed before and called for nearly $9 billion in new spending for a wide variety of existing federal programs.

Although administration and congressional leaders pledged to work together to reach consensus on an urban aid bill, partisan differences, fiscal stress, and posturing for strategic advantage for the 1992 presidential election proved to be too many obstacles to overcome. No urban aid package was enacted. While Congress passed an Urban Aid Tax bill in October 1992 that provided $2.6 billion over five years for the creation of 50 enterprise zones—as well as authorized $2.5 billion over five years for new spending for job training, education, health, housing, and law enforcement programs in the zones—President Bush vetoed the bill the day after he lost the election to Bill Clinton. Since Congress had adjourned, there was no possibility to override the president's veto.[19]

Six months later, in May, 1993, President Clinton unveiled a proposal that revisited and expanded the concept of enterprise zones, calling for the creation of ten empowerment zones and 100 enterprise communities. Under this plan, about two-thirds of the zones would be located in urban areas and all of the zones would receive tax incentives and priority consideration for funding for federal assistance for community development banks, community policing, employment and training programs, and education reform.

Though Republicans initially opposed Clinton's proposed initiative and Democratic support for it was weak, the administration did find one important ally in Congress, Representative Charles Rangel (D-NY), whose district included Harlem, a severely distressed area in New York City.[20] Rangel, who was one of the House budget conferees, not only insisted that provisions to create empowerment zones and enterprise communities be included in the final budget bill, he also succeeded in getting the conferees to agree to a $1 billion line item for direct federal outlays for communities participating in the program; this funding was to be provided through the Title XX Social Services Block Grant (SSBG) program administered by the Department of Health and Human Services. The conference report was cleared by the narrowest of margins: the House of Representatives passed the report by one vote and Vice President Gore cast the decisive, tie-breaking vote in the Senate. President Clinton signed the legislation (PL 103-66) on August 10, 1993.

Thus, after more than a decade of debate and deliberation, a federal enterprise zone program was finally created. The final form of the legislation was a compromise: While the initiative contained many features similar to those in the Kemp-Garcia bill (tax incentives earmarked for a limited number of distressed areas), it also met the demands raised by many Democrats that an enterprise zone approach must go beyond tax incentives to include direct federal assistance for community development and social programs. Many of the initiative's details also reflected the influence of existing programs in localities such as Atlanta, Baltimore, Boston, Cleveland, and Oakland, where comprehensive community building programs were already underway.

Federal officials who spoke during the regional workshops conducted in 1994 to promote the new Empowerment Zones and Enterprise Community (EZ/EC) initiative continually emphasized that it "is not a typical federal program." The intellectual framework for the EZ/EC initiative was based on four key principles: economic opportunity, sustainable community development, community-based partnerships, and strategic vision for change. These principles also served as the key criteria that were to be used in evaluating applications. According to the application guide, "the first priority in revitalizing distressed communities is to create economic opportunities—jobs and work—for all residents," a goal consistent with previous enterprise zone proposals.[21] But the EZ/EC initiative's second principle, sustainable community development, pushed this idea further, maintaining that economic development efforts can only be successful when they are grounded in a broader revitalization strategy that coordinates efforts in the areas of economic, physical, environmental, community, and human development. In addition, the EZ/EC initiative recognized—as reflected in its third principal—that successful community revitalization must be driven by broad participation from all segments of the community, including federal, state, and local government, the private sector, nonprofit agencies, community-based organizations, and residents. The fourth element of the EZ/EC initiative was the creation of a community-based strategic plan that not only articulated a vision but also included goals and benchmarks to measure progress.

The type and level of benefits of designation depended upon whether a community was selected as an Empowerment Zone (EZ) or an Enterprise Community (EC). The six cities designated as urban EZ communities—Atlanta, Baltimore, Chicago, Detroit, New York, and Philadelphia/Camden—each received a $100 million Social Services Block Grant (SSBG). These funds could be used over a ten-year period to support a broader range of activities than was normally permitted under the Title XX SSBG program and were designed to help communities carry out activities identified in their strategic plans. EZ communities also received $150 million in federal tax credits. EC designees received $3 million in block grant funds, but no tax credits. Both EZ and EC cities were eligible to apply for new federal tax-exempt private facility bonds and for waivers of federal regulations and program requirements. Both types of communities were also to receive special consideration for any pending or subsequent applications for federal aid tied to an EZ/EC activity.

From Empowerment Zones to GO Zones

In the years since the original federal EZ/EC initiative was launched, federal initiatives designed to revitalized distressed communities have increasingly relied on tax-oriented tools, while the deployment of grants and loans has declined.

As noted above, each of the Round I EZ communities received intergovernmental grants that could be used over the ten-year designation period. The block grant was an essential part of EZ program design, funding local activities such as governance, planning, community mobilization, and the administration of EZ activities, as well as economic development programs to encourage business growth and job creation. EZ block grant resources could also be used to fund activities that support economic development, such as community policing, affordable housing, literacy training, human services, and public works and facilities. The combination of block grant funding with tax-oriented tools was a distinctive feature of the Round I EZ program.

The allocation of intergovernmental

Table 1. The Evolution of Policy Components in Tax-Based Federal Economic Revitalization Programs

	Before Katrina				After Katrina	
Policy Tools	Round 1 Empowerment Zones	Round II Empowerment Zones	Round III Empowerment Zones	Renewal Communities	Katrina Tax Relief Act	Gulf Opportunity Zone Act
Intergovernmental Grants	X	X				
Employment Tax Credits	X	X	X	X	X	
EZ Facility Bonds	X	X	X			
Capital Gains Tax Reductions	X	X	X	X	X	
Business Tax Reductions	X	X	X	X		X
Bonds for private use and home repair						X
Increased funding for low-income housing tax credits						X
Funding for New Markets Tax Credits						X
Personal income tax reductions						X
Special rules for means-tested Personal income tax programs						X

grants as a tool to assist distressed communities declined in subsequent rounds of EZ designation, however. Although Round II EZs—designated in 1998—were authorized to receive as much as $100 million in grant support, the funding was to come from HUD, rather than SSBG grants, and it was subjected to the annual appropriations process, rather than authorized in one bill.[22] While Round II urban EZs anticipated grants of $10 million per year throughout their 10 year designation period, the actual amount appropriated was far less, with each EZ receiving only about $24 million between 1999 and 2003.[23]

By Round III—authorized in 2000—EZ designees did not receive any grant funding as part of the package of zone benefits. Nor did the new Renewal Communities (RCs), established the same year. Like EZs, RCs were provided with employment tax credits, capital gains tax cuts, and business tax breaks. The benefits differ however: The employment credits available to RCs have only half the value of the credits provided to EZs, while the capital gains tax credits are more generous.[24]

Five years later, the federal government continues to focus on tax breaks as a means for community revitalization, with intergovernmental grant funds conspicuously absent from the GO Zone legislation. Although Congress provided grants for infrastructure redevelopment and housing reconstruction, and authorized more flexible uses for supplemental Community Development Block Grant (CDBG) funding for disaster assistance, these grants were not coordinated with the GO Zone economic redevelopment effort. GO Zones will offer a substantial array of tax incentives, however. Businesses and residents located in GO Zones will be able to take advantage of many of the same, or similar, benefits available to EZs and/or RCs, including employment tax credits (the value of which falls between that provided to EZs and RCs); tax-exempt bond financing (which, in addition to financing business development, can be used for home repairs); and increased Section 179 deductions that allow investments in new equipment to be deducted more quickly.[25] GO Zones also feature a variety of other business tax reductions—including the extension of tax deductions for cleanup and restoration of storm damage—that reflect federal policymakers faith in this tool. Finally, the Katrina Emergency Tax Relief Act reduced capital gains taxes by extending the non-recognition period on converted property in the areas designated as "Hurricane Katrina disaster areas" by President Bush.

In addition, GO Zones increase the allocation of Low-Income Housing Tax Credits and New Markets tax credits. Although EZs and RCs also were eligible for these credits, Congress created additional benefits specifically for GO Zones to combat the unique and widespread challenges there. People residing in GO Zones, as well as people residing in the larger disaster area affected by Hurricane Katrina, are also eligible for a variety of personal income tax reductions, which were not part of the federal package provided to EZs or RCs.

In sum, as federal policy moved from Empowerment Zones to Renewal Communities, intergovernmental grants were dropped from the federal tool kit. And like in RCs, Congress is relying solely on tax incentives to encourage economic revitalization in GO Zones. These changes have several important implications. First, the EZ block grants required preparation of a comprehensive strategic plan outlining the proposed uses of federal and other leveraged funds and provided modest financial support for local planning and program administration. As block grants were dropped in favor of tax incentives, local planning and administration were de-emphasized. Second, the EZ/EC program required community participation in the planning and implementation of the programs intended to renew distressed communities and EZ block grant funds could be used to support a variety of community mobilization activities. Without such directives and funding community participation is less likely. Finally, block grants funded the creation of a variety of different economic development tools that local communities could tailor to meet their needs. The reliance of GO Zones on tax incentives implies a "one size fits all" orientation in which local communities are given the same limited set of tools to encourage economic development regardless of local conditions.

Lessons Learned

Gulf Opportunity Zones reflect the latest incarnation of the belief that distressed economies can be jumpstarted by tax incentives. But this belief is not necessarily supported by evidence from earlier programs in which tax incentives were offered as a means to promote economic revitalization. This section summarizes several key lessons that emerge from a wide-ranging set of studies that evaluate state enterprise zone programs, from U.S. Department of Housing and Urban Development (HUD) and General Accounting Office (GAO) reports on the federal EZ program, and from a recent evaluation of federal efforts to spur rural development. These lessons imply three primary conclusions.

- Tax incentives alone are unlikely to be an effective means to attract investment, create jobs, and assist disadvantaged workers
- Effective revitalization of distressed communities requires a broad array of policy tools that induce firms to locate (or expand) in targeted neighborhoods and also provide programs to improve the business environment (such as programs to reduce crime, eliminate blight, and improve the skills of potential workers)
- Although government participation is no panacea, an effective process of cross-sector, collaborative governance can enhance the effectiveness of tax incentives and improve the prospects for economic growth and job creation

Lesson 1: Tax incentives are unlikely to promote economic investment or create jobs because few businesses utilize them.

The use of tax incentives to spur economic growth and create jobs implies that governments can influence the location and expansion decisions firms make with financial incentives that lower the firm's costs of operating in particular communities, such as those designated as enterprise zones. However, if firms are not aware that these incentives exist, or if they perceive they are unlikely to affect their cost of doing business, the effect of the incentives on business growth and employment is likely to be negligible.

The empirical evidence after nearly five decades of research on the effects of tax incentives on business location decisions is inconclusive. Several reviews of this literature note that there is scant proof of a statistically significant effect of public policies that provide tax and fiscal incentives to encourage job growth. Though the conventional wisdom that taxes are not a very important determinant of business location decisions has been challenged by some recent studies, most reviews conclude that public policies that lower tax rates to encourage business investment or provide firms with a tax abatement end up subsidizing employment that would have occurred even in the absence of the subsidies.[26] As Alan Peters and Peter Fisher concluded in a recent review of the literature, "the most fundamental problem is that many public officials appear to believe that they can influence the course of their state or local economies through incentives and subsidies to a degree far beyond anything supported by even the most optimistic evidence."[27]

One possible explanation for the lack of evidence regarding tax incentives on economic growth is that there is little variation in tax burdens across the states. Indeed, one of the arguments made in favor of federal enterprise zones legislation during the early 1980s was that the federal tax incentives would significantly ratchet up the value of business incentives available to firms that opt to locate in federally designated zones, thus differentiating these zones from other areas. Though the federal government never did enact a federal enterprise zones program, the EZ/EC initiative marked the first time the federal government authorized a package of federal tax incentives to encourage investment in distressed communities.

As part of their interim assessment of the EZ/EC initiative, Abt Associates conducted a survey of business establishments in the six communities designated in the Round I urban EZs. Approximately 1,800 businesses were surveyed—300 firms per zone— during two waves, one in late 1997 and the second in 2000. The surveys found that business awareness of EZ tax incentives was low and that few establishments actually utilized the incentives. Overall, utilization of the EZ Wage Tax Credit increased from nine percent of zone businesses in 1997 to 11 percent in 2000; utilization of the Work Opportunity Tax Credit remained flat at three percent; and the percentage of zone businesses utilizing the Section 179 special expensing provisions actually declined by half, from eight percent to four percent from 1997 to 2000.[28] Despite efforts by many EZ cities to inform businesses about the tax incentives, awareness remained low. According to the Abt study, "Almost half (49 percent) of establishments were unaware of the EZ Wage Tax Credit, while fully 69 percent were unaware of the Section 179 Expensing Provision and 71 percent were unaware of the Work Opportunity Tax Credit."[29]

The findings of the Abt study were consistent with a 1999 GAO report on the uses of EZ tax incentives, which also found that few businesses claimed the tax breaks. This report was based on the results of a mail survey of 2,400 large (50 employees or more) and small businesses in the nine original EZs (the six urban and three rural zones designated in Round I). The purpose of the survey was to gather information about these businesses' use of three tax incentives—the employment credit, enhanced depreciation for business property, and tax-exempt facility bonds. Generally, the report concluded that small urban businesses were the least likely type of business to claim any one of the three tax credits. Among all types of businesses, the employment credit was the one used most frequently. However, the employment credit was most often used by rural and large urban businesses: 42 percent of large urban businesses and 32 percent of rural businesses claimed this credit, while only 6 percent of small urban businesses did so. The enhanced depreciation for investments was used by only 9 percent of large urban business, 4 percent of small urban businesses, and 8 percent of rural businesses. And only ten businesses reported the use of the tax-exempt facility bonds.[30]

The GAO report also tried to explain why businesses did not claim the tax benefits that were available to them. Most of the respondents that did not use the employment credit explained that they were not eligible for the credit because their employees lived outside the zone or they did not know about the credit. Most of the respondents that did not take advantage of the enhanced deductions for business investments said they did not know about it or they had not made any qualifying investments. The overwhelming reason businesses did not use the tax-exempt bonds was that they did not know about them.

A subsequent GAO report noted that the number of corporate returns claiming the EZ Wage Credit (and the dollar volume of credits claimed) increased steadily between 1995 and 2001. The GAO estimated that corporations and individuals claimed a total of $251 million in EZ Wage Tax Credits during this period. The report also pointed out that state and local governments between 1995 and 2001 issued a total of $315 million in tax-exempt EZ facility bonds. But the study also noted that the obstacles to the utilization of EZ tax incentives reported by zones businesses in their earlier report—lack of awareness, complicated requirements, ineligibility, not having a federal tax liability—remained, particularly among smaller businesses.[31]

Lesson 2: Tax incentives have not been an effective means to attract firms to start-up or relocate in state enterprise zones.

The original motivation in Great Britain for enterprise zones was to spur job growth in distressed industrial areas. Evaluations of the British experience with enterprise zones have reached two broad conclusions. First, there was a large gap between the composition of enterprise zones in theory and in practice. Many key provisions of the original proposal, such as administrative relief, regulatory relief, and certain fiscal incentives, were not included in the zones as implemented. Second, the British zones produced "relatively small numbers of really new jobs, and at appreciable—but perhaps not excessive—cost." As Peter Hall concludes, "this doubtless, lay behind the decision of the Thatcher government not to extend the experiment."[32] Marilyn Rubin, in her review of the evaluations of the British zones, concluded, "the lesson for the United States from the British experiment is that free-market incentives by themselves should not be expected to revitalize urban communities."[33]

Evaluations of the effectiveness of tax incentives in state economic development programs in the U.S. have been largely inconclusive. This is especially so for evaluations of state enterprise zone programs, where wide variations in their design have exposed methodological challenges and a general absence of reliable data. Although many of the early studies found positive results regarding the effects of state enterprise zone incentives on business growth and employment,[34] in a recent review of the literature, Alan Peters and Peter Fisher write "the conclusions of the extant literature do point in quite contrary directions; however, the vast majority of the recent literature suggest that enterprise zones have little or no positive impact on growth."[35]

In 2002, Peters and Fisher evaluated 75 state enterprise zones in thirteen states and found that tax incentives were unlikely to be an effective means to promote economic growth and job creation. They developed a simulation and statistical models to estimate the value of zone incentives to individual firms, focusing primarily on firms in the manufactur-

> *"Tax incentives alone are unlikely to be an effective means to attract investment, create jobs, and assist disadvantaged workers."*

ing sector. They concluded that tax incentives are unlikely to attract many firms or create many jobs because the value of the tax incentives was equivalent to only about a 1.6 to 7.1 percent reduction in wages, an incentive that could easily be offset by a small wage premium. They found "no evidence of a strong positive impact of enterprise zone incentives on growth: zones offering larger incentives (or a lower net tax rate) for firms in a given sector did not attract significantly more births and in-migrations of establishments in that sector than zones with a less attractive tax and incentive regime." As a result, they expect tax incentives to be insufficient to create economic growth. Peters and Fisher attribute the ineffectiveness of zone incentives to "the fact that many zones are in older, distressed, inner-city neighborhoods. Such places suffer from a number of important locational deterrents—high levels of crime, poor infrastructure, poorly skilled workers and so on —and it is unlikely that tax incentives alone, small as they usually are, will make up for these negatives."[36]

Lesson 3: Tax incentives are more likely to benefit new rather than existing firms.

Research has shown that state enterprise zone tax incentives are generally more useful to new, as opposed to existing, businesses. A 2004 study by Robert Greenbaum and John Engberg analyzed the impact of enterprise zones on manufacturing activity in six states and concluded that the programs had little effect, on average, on several economic indicators, including employment, the number of business establishments, the value of goods shipped, payroll, and capital spending. However, establishment level data they analyzed indicated that the effects of state enterprise zones had a positive effect on new establishments and a negative effect on existing establishments. Their evidence, in conjunction with their analysis of state enterprise zone benefits, suggests that such programs may be inherently biased toward assisting new businesses.[37]

The results Greenbaum and Engberg report are consistent with the theory underlying the use of tax credits to spur economic growth. Investment tax credits or accelerated depreciation of the value of new equipment are likely to be more valuable to new firms because they require capital investment in order to create the means of production. By definition, established firms already have a physical plant required to produce goods or services. Consequently, established firms are less likely to utilize tax incentives; they may not need additional equipment because they have unused capacity or because the existing equipment is sufficient to meets their needs. When tax incentives are designed to reduce the costs of capital investments, it stands to reason that new firms are likely to enjoy greater benefits than established firms.

Wage tax credits are also more likely to benefit new firms. Established firms have an existing workforce, while new firms are recruiting and hiring new employees. As a result, new firms can more easily take advantage of wage tax credits, for two reasons. First, they can organize their recruitment efforts to target potential employees who are eligible for the credit. In many cases, employer eligibility to receive the wage tax credit is contingent upon recruiting disadvantaged workers or people who live in designated areas. Second, many wage tax credits are limited to "new hires" to avoid the "windfall" that employers would receive (a tax credit for no net gain in employment) in the absence of such provisions. Consequently, wage tax credits are also more likely to benefit new rather than existing firms.

Lesson 4: The net benefits of state enterprise programs for state and local governments may be small or may not always exceed costs.

Several studies have assessed whether

state enterprise zones are cost effective, with mixed results. Marilyn Rubin studied 976 firms in urban enterprise zones in New Jersey and concluded that zone benefits exceeded the costs. When she examined only the 315 firms that stated that the program's incentives were the primary reason for expanding or locating in the zone, the local tax benefit was seventy cents per dollar of program cost. However, when the multiplier effect of job creation was considered, Rubin estimated benefits of $1.90 per dollar of program costs.[38] Kala Sridhar also argued that state enterprise zones are cost effective. Sridhar compared the net benefits and costs from jobs created or relocated as a result of state enterprise zones in Illinois and concluded that the benefits of the program outweigh the costs, suggesting that targeted development incentives are beneficial for the localities that adopt them.[39]

But Peters and Fisher also assessed the cost-effectiveness of state enterprise zone programs and arrived at a different conclusion: "T]he direct revenue effects of enterprise zone incentives on state and local government combined are very likely to be negative, and rather strongly so."[40] This result follows from their estimate that the jobs that can be attributed to the enterprise zone incentives result in a net present value to state and local governments of $7,200 over twenty years. However, many more jobs are also subsidized by zone incentives than would have been created even in the absence of the incentives. They estimate that state and local governments lose about $3,200 for each such job. The net result of this tradeoff is an estimated loss of $7,130 to state and local government per job created by the zone's incentives.

Lesson 5: Good governance enhances the effectiveness of tax incentives and overall economic revitalization efforts.

Effective governance is built upon collaboration among residents, community-based and nonprofit organizations, the public sector, and local businesses. As Robert Chaskin and Sunil Garg explain, "governance entails the creation or adoption of mechanisms and processes to guide planning, decision making, and implementation as well as to identify and organize accountability and responsibility for action undertaken. Thus governance is both process and structure."[41] The form and process of governance are important considerations when trying to enhance the prospects for economic development.

Effective governance contributes to economic development in two ways.

First, a collaborative, cross-sector system of governance can help put into place a comprehensive plan for economic development. Many different state, local, and regional actors control resources that are vital to economic development. For example, a recent study by the Initiative for a Competitive Inner City noted, "in 1996, the Federal government spent approximately $16 billion on programs that affect urban business development, roughly $9 billion of which affected inner cities." These funds were distributed through more than 90 programs administered by 14 different federal departments and agencies and 75 percent of these federal funds initially flowed through state and local government agencies. In addition, the report pointed out that nonprofit and for-profit intermediaries such as community development corporations play a critical role in service delivery and in determining how federal resources are used. In Boston, for example, more than 130 intermediaries—including 59 nonprofits, 38 for-profits, 27 academic institutions, and 5 trade organizations—were involved in the implementation of federally-funded business development programs in 1996.[42]

Governing arrangements can bring these participants together, coordinate their actions, and create and sustain support for a revitalization plan. The ICIC report maintains, "a coordinated strategy both at the Federal and local levels as well as across the for-profit and nonprofit sectors needs to be in place to maximize the impact of existing Federal investments." Among the report's recommendations is a call for the federal government to "provide grants and incentives to catalyze local government efforts that engage leaders from across public and private sectors to coordinate local inner-city economic development initiatives."[43]

Second, effective governance can make various aspects of the economic development program work better. Governance systems can coordinate programs, increase the number of redevelopment tools available to stimulate business and job growth, enhance services, inform businesses about redevelopment incentives, solve collective action problems, and address market failures, all in a context tailored to reflect the distinctive needs and opportunities that exist within local communities.

A look at evidence of job growth and anti-poverty effectiveness among the Round I urban EZs helps illustrate how good governance affects program outcomes. (Table 2) Three of six zones (in Atlanta, Chicago, and New York) did not experience positive job growth between 1996 and 2004. However, the other three zones (in Baltimore, Detroit, and Philadelphia) experienced growth in total employment that outpaced growth achieved in the comparison census tracts and citywide.[44] Based on several economic measures, Baltimore's EZ was clearly the most successful of the six zones. Baltimore's EZ recorded employment growth of 18.1 percent between 1996 and 2004 while the comparison census tracts and the city overall experienced substantial employment declines. In addition, from 1990 to 2000, unemployment in the zone declined by 18.1 percent and median family income increased by 67.5 percent.[45]

A comparison of Atlanta and Baltimore, cities that occupy the opposite ends of the performance continuum for program effectiveness, provides insights into the ways in which Baltimore combined tax incentives and good governance to make its EZ program more effective. Baltimore succeeded and Atlanta did not because of differences in the process of cross-sector collaboration and the capacity and performance of the institutions each city had to draw upon in undertaking the task of revitalizing distressed inner-city neighborhoods.

Baltimore's zone leaders placed emphasis on local governance and capacity building. The zone enjoyed a stable, experienced leadership that was armed with a clear vision—to create job opportunities within the zone and to prepare zone residents for those opportunities. Empower Baltimore Management Corporation (EBMC), the zone-wide, quasi-public, nonprofit organization that coordinated Baltimore's EZ initiative, integrated the efforts of Baltimore's business, civic, philanthropic, nonprofit, and government leaders in support of that vision. EBMC had a culture of accountability that emphasized financial integrity and effectiveness: EZ programs were carefully developed and evaluated and resources were shifted away from ineffective programs to increase the funds available for effective programs. In addition, EBMC devoted considerable time and resources to the creation of organizational capacity in the community-based nonprofits they sponsored, called Village Centers, and gave significant planning and program implementation responsibilities to them in order to integrate them into the policymaking process.

By contrast, Atlanta had frequent changes in leadership. Local elites and zone residents never reached consensus on what the EZ was supposed to accomplish nor the means by which those goals would be obtained. As a result, the implementation of the EZ initiative in Atlanta was mired in deadlock and delay.

Lesson 6: Effective local governance can ensure that existing residents in the zone can benefit from the tax incentives and revitalization efforts.

Peters and Fisher contend that commuters often occupy the majority of the jobs that are created in enterprise zones. On the basis of preliminary evidence, they conclude: "creating local growth may not, in and of itself, be good enough" to extend the benefits of enterprise zones to disadvantaged zone residents.[46]

Effective governance can enhance the benefits zone residents receive in a number of different ways. For example, in his speech outlining his redevelopment proposal for the Gulf Coast, President Bush proposed $5,000 grants to individuals for job training and work supports. The President's proposal appeals to symbolic values such as flexibility and choice because it empowers individuals as consumers to use the grants in the manner they choose. However, consumers may make poor choices about how to spend their grants. In this case, effective local governance could help connect residents or workers to better information about the job training programs and connect them to such programs or job opportunities. In Baltimore, venders for such employment training services in the EZ were prescreened by EBMC staff in order to assure that funds were spent on reputable, high quality programs.

Although the idea of empowering individuals to select the type of job training they prefer has appeal, the training program that was deemed most effective by leaders in Baltimore's EZ was "customized training," a program that trained workers for specific job opportunities in the zone. Thus, rather than providing blanket training funds to workers, a "customized" approach would ensure that funds go directly to programs that are

Table 2. Anti-Poverty Effectiveness of Empowerment Zone Programs

Anti-poverty indicator by city (1990-2000 percent change, except as noted)	Empowerment Zone tracts	Comparison tracts	Non-EZ high poverty tracts	City-wide
Atlanta				
-Total employment*	-13.8	-73.4	-41.5	-19.8
-People unemployed	41.5	-9.4	226.0	69.1
-Median family income	84.8	99.6	87.6	47.9
-People in poverty	-24.2	-27.3	-20.7	-6.5
Baltimore				
-Total employment*	18.1	-27.4	-37.0	6.0
-People unemployed	-18.1	-10.5	-13.4	-3.6
-Median family income	67.5	19.1	44.5	25.6
-People in poverty	-36.7	-26.1	-32.3	-8.2
Chicago				
-Total employment*	-2.4	3.9	-8.3	-0.2
-People unemployed	-26.5	-23.6	-14.1	-10.9
-Median family income	93.5	73.1	75.0	39.1
-People in poverty	-29.6	-22.1	-25.6	-6.0
Detroit				
-Total employment*	1.2	-18.8	-27.5	-9.2
-People unemployed	-35.3	-44.7	-43.8	-35.3
-Median family income	48.3	68.5	71.8	50.0
-People in poverty	-34.9	-37.4	-36.0	-26.0
New York				
-Total employment*	-9.3	-8.3	0.9	0.4
-People unemployed	21.5	14.7	10.7	7.6
-Median family income	40.3	56.9	55.0	21.9
-People in poverty	-2.2	1.5	-2.3	20.5
Philadelphia				
-Total employment*	3.4	-59.0	-25.5	-0.2
-People unemployed	-34.8	-12.4	0.1	2.3
-Median family income	64.9	44.6	52.6	22.9
-People in poverty	-30.8	-11.9	-18.5	7.3

**Percent change from 1996 to 2004*

Sources: for total employment, Claritas Inc., Business Facts, 1996 and 2004; all other data are from the U.S. Census Bureau, 1990 and 2000 Census.

tied to emerging employment opportunities in the zone. This is different from President Bush's proposal in two important ways. First, trainees were assured that the skills developed through training would lead to a local job opportunity. Second, it was possible to offer customized training as one part of a larger package of economic incentives to attract business investment for employment growth. Empower Baltimore could offer low-interest loans to businesses in exchange for employment guarantees that were conditioned on the ability EBMC enjoyed to recruit and train zone residents. The Village Centers were vital partners in this initiative because they conducted outreach programs and pre-screened applicants to assure that they were viable trainees.

Lesson 7: The combination of cross-sector, collaborative governance and tax incentives also work to create jobs and encourage economic growth in larger, more diffuse rural settings.

Federal initiatives have promoted regional business development and job creation in distressed rural areas for more than forty years.[47] Regional development initiatives have increased access to capital to attract and retain

"First and foremost, federal policymakers must recognize that the constraints and opportunities that exist for economic redevelopment vary from one Gulf Coast community to another."

investment, provided infrastructure funding, and more recently, engaged in strategic planning to encourage collaborative, cross-sector approaches to rural economic development.

The rural component of the EZ/EC initiative illustrates the significance of collaborative governance in a setting that more accurately represents the challenge of governance facing many rural Gulf Coast communities in the wake of Hurricane Katrina. Whereas urban EZs and ECs were confined to selected neighborhoods in an individual city, rural zones were often composed of multi-county consortia. In their report on rural EZs and ECs, Norman Reid and Karen Savoie Murray acknowledged that governance featuring cross-sector collaboration is a critical element of successful community revitalization programs. Their analysis of fifty-seven rural EZs and ECs found that comprehensive community revitalization: "calls for special approaches and methods…especially critical is a strong base of on-the-ground support by community development specialists who are able to provide technical assistance in community processes, leadership and project management skills, and the transfer of best practices from other communities to meet individual, local needs."[48] Reid and Murray conclude that "a simple drop of money or tax credits that are outside of local community management and accountability quickly become a wasteful use of public funds…The amazing accomplishments of the Champion Communities, which are implementing their strategic plans without EZ/EC grants, prove the point that clear focus, community support, and effective leadership are worth their weight in gold."[49] However, they also observe that collaborative, cross-sector community building does not come naturally to most communities; to the contrary, collaboration requires significant training, technical assistance, and capacity building.

Additional evidence suggesting that collaborative approaches to regional and rural economic development are effective is found in a recent evaluation of the Appalachian Regional Commission (ARC). The ARC, created in 1965 to foster a comprehensive economic development strategy for the Appalachian region, serves an area that includes about four hundred counties in thirteen states with a population of 22.9 million people (according to the 2000 Census). According to Andrew Isserman and Terance Rephann, "the ARC brings together federal stature and dollars, state governors, and local development districts. It supplies federal funds in coordination with state priorities; it helps to build local capacity; and it provides a forum for articulating state and local preferences at the national level."[50] Using a matched control group design to compare Appalachian counties to counties with similar economic structures and growth patterns outside of Appalachia, they found that between 1965 and 1991, "the Appalachian counties grew significantly faster than their twins did." Moreover, these positive findings held when a variety of demographic and income indicators were included in multivariate analysis. Although Isserman and Rephann were not able to attribute these results to specific ARC programs, their findings do suggest that the region has benefited from the initiative.

Policy Implications

The lessons from state, federal, and even rural-oriented, economic development programs show that there are limitations to relying on tax incentives alone to revitalize economically distressed areas. The vast, interconnected social and economic challenges faced by businesses, workers, and families in distressed areas make placing high hopes on market incentives alone an imprudent policy. The literature reviewed in this paper serves as a critical reminder that a combination of grants and tax incentives, matched by a working partnership between the public, private, and nonprofit sectors, is a more effective strategy to revitalize distressed areas.

There are several things the federal government can do to encourage effective, collaborative governance that can complement the tax incentives that have already been provided to stimulate Gulf Coast redevelopment. First and foremost, federal policymakers must recognize that the constraints and opportunities that exist for economic redevelopment vary from one Gulf Coast community to another. Effective policymaking requires the creation of governance entities that reflect that variation.

1. Designate Gulf Enhanced Opportunity Zones (GEO Zones) within the Katrina GO Zone to promote local planning and effective program implementation.

In order promote better coordination, planning, and governance in Gulf communities, the federal government should establish GEO Zones, smaller, coherent areas within existing GO Zones. In cooperation with state governments, GEO Zones would receive federal block grant funding to enhance the capacity of local governance systems and broaden the array of policy tools that are available to promote community revitalization and economic growth.

State and local governments would nominate areas for GEO Zone designation because they are best qualified to identify those communities that require additional assistance in the recovery effort. Following procedures similar to those developed for the original EZ/EC initiative, local nominees would be required to engage various key local constituencies in the development of a strategic plan. The federal government would then review the applications and select GEO Zone designees. The competition for designation would spur localities to develop thoughtful plans that comply with federal guidelines.

A financing mechanism already is in place for GEO Zones. The Department of Defense Appropriations Act (DODAA, enacted on December 30, 2005) appropriated $11.5 billion in CDBG funds for disaster relief, long-term recovery, and infrastructure improvements related to the damage caused by hurricanes Katrina, Rita, and Wilma (including more than $6.2 billion for Louisiana and more than $5.0 billion for Mississippi).[51] The HUD Secretary is authorized to specify alternate uses for these funds and could use this authority to create GEO Zones. If HUD Secretary Jackson is not inclined to specify this use of CDBG funds, Governors in the affected states could initiate the creation of GEO Zones through waiver requests.

Regulations HUD developed to implement the DODAA recommend that states consider the creation of a governance entity similar to the Lower Manhattan Development Corporation (LDMC), a joint state-city corporation that was created in the aftermath of the September 11 terrorist attacks to assist in the planning, coordination, and revitalization of the neighborhoods most directly affected by the destruction of the World Trade Center. According to the LMDC's web site, the LMDC directed a collaborative, cross-sector, strategic planning process that defined a vision for revitalizing Lower Manhattan, created specific initiatives to improve the quality of life in Lower Manhattan, and leveraged the resources and investments needed to achieve that vision.[52]

Despite HUD's recommendation, the LMDC may be a poor model of collaborative governance. Several entries in a recent volume edited by John Mollenkopf that chronicles the politics of recovery in New York following the September 11 attacks conclude that public involvement and influence in the rebuilding effort was far more symbolic than real.[53] On the positive side, the Mollenkopf volume notes that while the LMDC was significantly constrained in directing the redevelopment of the World Trade Center site, it was able to influence public opinion and participation in the planning process to achieve a number of concessions that were more in line with what the public desired (e.g., less commercial space, more cultural and recreational amenities) than what the Port Authority (who controlled the site) and its lease holder sought. Nonetheless, several contributors to the volume note that the LMDC and the public were relatively powerless to alter the fundamental elements of what the principal decision makers sought to achieve in the rebuilding effort (i.e., to maximize the amount of commercial space that would be rebuilt on the site).

The major lesson from the New York City case is that rebuilding efforts that blend market and government are likely to yield outcomes that are more closely aligned with public interests than rebuilding efforts that rely solely on market forces. But it also clearly illustrates that the crafting and control of governance entities are critical concerns that influence public participation in such efforts and how the public interest is articulated and incorporated into the decision making process.

Unlike the strategic planning and citizen participation requirements that were part of the EZ/EC initiative, neither the GO Zones legislation nor the provisions accompanying HUD's supplemental CDBG funds provide significant requirements for local governance, planning, and community participation. Although the CDBG disaster recovery regulations provide a GEO Zone funding mechanism and seem to acknowledge the importance of local planning and targeting resources to "the most impacted and distressed areas," many other regulatory provisions seem to be pushing in the opposite direction. First, the regulations waive the standing provision that 70 percent of CDBG funds must be used to benefit low- and moderate-income persons. Second, citizen participation requirements are waived to "permit a more streamlined public process."[54] Finally, the regulations endorse and encourage "direct" grant administration by states (e.g., states may use grants "to carry out state-administered activities") because of concerns about waste, fraud, and abuse. Rather than encouraging local planning and program development that will enhance the opportunities for displaced, low-income citizens to have a voice in disaster relief and economic recovery programs, these provisions encourage state administration that inevitably will reflect a more distant perspective on the recovery and rebuilding effort. By taking this path, states are likely to miss important opportunities for coordinating available recovery resources for a more holistic community building effort, and may end up targeting less-distressed communities as well as diluting citizen participation requirements.

Without federal guidance and leadership the creation of effective local governance structures is likely to be uneven. For example, examination of the Action Plans filed by the three states affected by Hurricane Katrina detailing their proposed uses of the supplemental CDBG funds provided for disaster recovery and rebuilding show wide variation in the extent of community-based strategic planning and the engagement of local communities. Among the three states, Louisiana has taken the most comprehensive and coordinated approach to recovery and rebuilding. The Louisiana Recovery Authority (LRA), created by the Governor and the Louisiana legislature to oversee the rebuilding effort, is charged with developing policy and priorities for the use of CDBG disaster assistance funds and other federal and state resources available for the recovery effort. A cornerstone of that effort was the launch of "Louisiana Speaks," a multifaceted, multilevel planning process designed to "develop a sustainable, long-term vision for the Southern region in the wake of the destruction caused by Hurricanes Katrina and Rita."[55] According to the LRA, the plans developed locally (Parish Recovery Plans, neighborhood improvement plans) will be eligible for CDBG disaster funds to support their implementation. In addition to support for homeowners, the Louisiana Action Plan earmarks funding for workforce and affordable rental housing programs, homeless housing programs, developer incentives and code enforcement, economic development, and infrastructure.

The action plans submitted by Alabama and Mississippi, by contrast, take a less comprehensive approach. In Alabama, supplemental CDBG funds have been targeted primarily to restore basic infrastructure (repair or replacement of water and sewer systems, repair of damaged roads and drainage systems). In Mississippi, all of the state's phase I supplemental CDBG funds ($3 billion) have been allocated for a homeowner grant assistance program, with one-time grant payments of up to $150,000 to eligible homeowners who suffered flood damage to their primary residence as a result of Hurricane Katrina.

GEO Zones could use block grant funding to establish the same sort of governance system that worked so effectively in Baltimore's empowerment zone. Such funding would provide several benefits. First, it could be used to help bring government, non-profits, business and community representatives, and displaced residents into a process in which their actions can be coordinated, while providing a vital communications link to help national representatives understand problems on the ground. Second, the block grants could finance a variety of different economic development tools to compose a comprehensive program to coordinate job training and placement with strategic investment, infrastructure improvements, and business and community development initiatives. The GEO Zone governance structure could also coordinate the uses of other federal assistance that is flowing into the GO Zone to assure that it is targeted strategically and spent wisely. Third, grants would provide GEO Zone representatives the resources needed to conduct outreach efforts to inform local business people about GO Zone tax incentives. Finally, by providing multi-year funding, Congress can assure that the extensive planning that is currently taking place will not be lost in the implementation process. It is vitally important that a governance structure is put in place to build and sustain momentum for the many years that rebuilding the Gulf Coast will require.

The states would also be key partners in the development and operation of GEO Zones. States should target GEO Zones for tax breaks and other forms of assistance such as business and housing loans and workforce development initiatives. In addition, state governments should participate in local governance and provide technical assistance to help assure program integrity.

2. To encourage rural economic vitality, the National Rural Development Partnership should be extended to more Gulf Coast communities within the Katrina GO Zone.

One model of cross-sector collaboration for rural Gulf Coast communities is the National Rural Development Partnership. The foundation of this partnership is President George H.W. Bush's Rural Development Initiative, an initiative that eventually led to the creation of forty State Rural Development Councils. However, of the three states with GO Zones, only Mississippi has created a Rural Development Council. The 2002 Farm Bill provided $10 million for each of fiscal years 2003 through 2007 to support the Councils. A portion of those funds could be combined with other federal funds (e.g., supplemental CDBG funds) to establish and support councils in Alabama and Louisiana and to bolster support for the existing Council in Mississippi as a means for fostering greater federal/state/local coordination for the re-building effort.

The primary functions of the State Rural Development Councils are to facilitate coordination and collaboration among the various rural development stakeholders (federal, state, local, and tribal governments, as well as for-profit and nonprofit organizations), to promote the dissemination and exchange of information on publicly and privately funded programs, both horizontally (on a state level) and vertically (federal-state-local), and to monitor, report, and comment on policies that address (or fail to address) the needs of rural communities.[56] These councils bring together a diverse set of rural development stakeholders to address important community concerns and to craft strategies to respond to new opportunities.

An analysis of the National Rural Development Partnership noted that while it is too early to draw definitive conclusions about the effects of the

"As previous programs have demonstrated, tax incentives work best when paired with grants that finance other economic development tools, support infrastructure, and enhance community development and other social needs within a system of cross-sector, collaborative governance."

initiative on rural communities, "one of the most surprising aspects of the Partnership was its ability to deal with the extraordinary diversity found within rural America…The eclectic approach to rural development, embracing both economic and community development aspects of the area, gave states enough discretion and autonomy to shape the program in their own image. Yet at the same time, the initiative was clearly a national effort with an identity that transcended the individual activities within the states." However, despite the early promise of the National Rural Development Partnership, the partnership's 2004 annual report to Congress points out that "the NRDP structure has never been fully implemented and only limited funds have been provided to support its work. Today, more than two years after the enactment of the 2002 Farm Bill, the question arises: do Congress and the Executive Branch have the will and determination to act on this great vision?"[57] Rural redevelopment within GO Zones affords an ideal opportunity to realize this vision in response to an important national priority.

Conclusion

In sum, this paper provides a cautionary tale for state and federal leaders about the limitations of relying primarily on tax incentives for revitalizing economically distressed areas. As previous programs have demonstrated, tax incentives work best when paired with grants that finance other economic development tools, support infrastructure, and enhance community development and other social needs within a system of cross-sector, collaborative governance.

The economic recovery of communities like New Orleans and St. Bernard Parish in Louisiana and Gulfport and Biloxi in Mississippi, will take many years. Building strong institutions to complement existing tax incentives provided by the Gulf Opportunity Zone and other investments in the region will be difficult. However, experience from past federal efforts to promote economic development in distressed communities demonstrates that the rewards will be well worth the effort.

Appendix. Selected Characteristics of GO Zone Communities by State.

	Alabama	Louisiana	Mississippi	Total
Square Miles	11,620	20,272	29,974	61,866
Jurisdictions				
Counties	11	31	47	89
Cities	29	42	70	141
Greater than 100,000	1	3	1	5
50,000–99,999	1	2	2	5
25,000–49,999	1	3	5	9
10,000–24,999	4	14	16	34
Less than 10,000	22	20	46	88
Population, 2003 estimate				
Total	863,941	2,958,271	1,954,252	5,776,464
Metropolitan	718,024	2,463,906	938,570	4,120,500
Percent	83.1	83.3	48.0	71.3
Nonmetropolitan	145,917	494,365	1,015,682	1,655,964
Percent	16.9	16.7	52.0	28.7
Poverty, 2003 estimate				
Number	144,012	508,406	351,718	1,004,136
Mean percent (counties)	19.2	17.2	20.1	19.0
Median Household Income, 2003 estimate				
Mean (counties)	29,113	35,183	29,039	31,141
Unemployment, 2004 annual average				
Number	23,715	74,395	53,428	151,538
Rate	6.0	5.4	5.9	5.6
Mean rate (counties)	7.4	6.2	6.9	6.7
Employment, 2003				
Total	295,094	1,080,763	630,384	2,006,241
Percent manufacturing	13.9	9.0	15.4	11.9
Percent retail trade	15.3	14.0	15.4	14.8
Percent services	52.5	55.3	55.4	55.7
Percent total employment change, 1998-2003	-1.3	0.6	-1.2	-0.3

Sources: U.S. Bureau of the Census, Population Estimates Program, Vintage 2003; U.S. Bureau of the Census, Small Area Income and Poverty Estimates, 2003; Bureau of Labor Statistics, Local Area Unemployment Statistics, 2004; and U.S. Bureau of the Census, County Business Patterns 2003.

Endnotes

1. Robert Stoker is Associate Professor of Political Science and a member of the faculty of the School of Public Policy and Public Administration at George Washington University. He recently published a book with the Brookings Institution Press, co-authored with Laura Wilson, entitled *When Work is Not Enough: State and Federal Policies to Support Needy Workers.* Michael J. Rich is Associate Professor of Political Science and Director of the Office of University-Community Partnerships at Emory University. He is the author of several publications on federal urban policy, including *Federal Policymaking and the Poor.* His current research focuses on the effects of comprehensive revitalization strategies on urban neighborhoods.

2. John R. Logan, "The Impact of Katrina: Race and Class in Storm-Damaged Neighborhoods" (Brown University, 2006), available at **www.s4.brown.edu/Katrina/report.pdf** Logan found that "the population of damaged areas was nearly half black (45.8 percent compared to 26.4 percent black in the rest of the region), living in rental housing (45.7 percent compared to 30.9 percent), and disproportionately below the poverty line (20.9 percent compared to 15.3 percent) and unemployed (7.6 percent compared to 6.0 percent)," p. 7.

3. Logan's analysis suggests that New Orleans may lose as much as 80 percent of its black population if residents cannot return to flooded neighborhoods.

4. See, for example, "New Orleans After the Storm: Lessons from the Past, a Plan for the Future" (Washington: Brookings Institution, 2005).

5. Figures for New Orleans and the Biloxi-Gulfport-Pascagoula MSA are from the U.S. Census Bureau, American FactFinder, 2004 American Community Survey. For comparison: 34.1 percent of all U.S residents over 16 are not in the labor force; unemployment among the U.S. civilian labor force is 7.2 percent; 16.1 percent of the U.S. population over 25 has not completed high school; 8.8 percent of U.S. households don't have a vehicle for transportation; the U.S. median household income is $44,684; the U.S. poverty rate is 13.1 percent; the U.S. percent of female-headed households living in poverty is 37.6 percent; and 68 percent of Americans own their own home.

6. The text of President Bush's speech can be found on the White House website, **www.whitehouse.gov/news/releases/2005/09/20050915-8.html**

7. For a description and explanation of these provisions, see the report prepared by the Joint Committee on Taxation, Technical Explanation of H.R. 3768, the "Katrina Emergency Tax Relief Act of 2005," as Passed by the House and the Senate on September 21, 2005, (JCX-69-05), September 22, 2005.

8. A conversion is the disposition of property as a sale for cash or for other consideration (such as a cash settlement from insurance or an exchange for another property). This provision permits someone who realizes a capital gain as a consequence of the involuntary conversion of property in the Katrina disaster area to wait five years before recognizing (or declaring) the gain and paying the tax. An involuntary disposition occurs when a property is condemned. For example, if George owned a rental property that was destroyed by wind damage from Katrina, the insurance settlement he receives may create a capital gain if the amount of the settlement exceeds his basis in the property (normally the basis is the purchase price plus the value of improvements less depreciation). If the property suffered such severe damage that it was condemned, the conversion would be "involuntary." In that case, George would not have to acknowledge his tax liability for the capital gain for a five-year period.

9. The significance of designating private activity uses for GO Zone bonds is that under normal rules, income earned from the bonds would be taxable. The exception granted by the legislation makes this income tax-exempt, providing a subsidy to bond holders by foregoing federal tax revenue. The advance refund provisions allow the states to take advantage of opportunities to refinance their existing debt on more favorable terms. For more information on tax-exempt bonds, see Dennis Zimmerman, "Tax-exempt Bonds." In Joseph Cordes, Robert Ebel, and Jane Granvelle, ed., *The Encyclopedia of Taxation & Tax Policy* (Washington: The Urban Institute Press, 2005).

10. For a description and explanation of the legislation, see the report by the Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of H.R. 4440, the "Gulf Opportunity Zone Act of 2005," as Passed by the House of Representatives and the Senate,* (JCX-88-05), December 16, 2005. This act extends many of the benefits conferred on victims of Katrina to victims of Hurricanes Rita and Wilma.

11. See Stuart M. Butler, "The Conceptual Evolution of Enterprise Zones." In Roy Green, ed., *Enterprise Zones: New Directions in Economic Development* (Newbury Park, CA: Sage Publications, 1991).

12. Stuart M. Butler, "Enterprise Zones: Pioneering in the Inner City" (Washington: The Heritage Foundation, 1980).

13. Michael Wolf, "Enterprise Zones: A Decade of Diversity," *Economic Development Quarterly* 4 (1990). (Emphasis in original quote.)

14. A recent survey of state financial incentives in the United States found that 40 percent of the 940 state economic development programs active in 1997—including Enterprise Zones—provided some type of tax incentive and the average value of tax incentives was about $13 million. See Kenneth E. Poole, George A. Erickcek, Donald T. Iannone, Nancy McCrea, and Pofen Salem, *Evaluating Business Development Incentives,* prepared for U.S. Department of Commerce, Economic Development Administration, August 1999.

15. See U.S. Department of Housing and Urban Development, "Enterprise Zones Update" (Washington: Office of Policy Development and Research, 1997).

16. Roy Green and Michael Brintnall, "Conclusions and Lessons Learned." In Roy Green, ed., *Enterprise Zones: New Directions in Economic Development* (Newbury Park, CA: Sage Publications, 1991).

17. Ibid.

18. Enid Beaumont, "Enterprise Zones and Federalism" In Roy Green, ed., *Enterprise Zones: New Directions in Economic Development* (Newbury Park, CA: Sage Publications, 1991).

19. See Michael J. Rich, "Riot and Reason: Crafting an Urban Policy Response," *Publius: The Journal of Federalism,* 23 (Summer 1993): 115–134.

20. For a review of the legislative history of the EZ/EC initiative see Sarah F. Liebschutz, "Empowerment Zones and Enterprise Communities: Reinventing Federalism for Distressed Communities," *Publius: The Journal of Federalism* 25: 3 (Summer 1995): 117–132.

21. The President's Community Enterprise Board, "Building Communities Together: Empowerment Zones and Enterprise Communities Application Guide" (Washington: U.S. Department of Housing and Urban Development, 1994).

22. John Burton, "The GO Zone Won't Go: Lessons for Gulf Opportunity Zones" (Washington: Center for American Progress, 2005).

23. U.S. General Accounting Office, "Community Development: Federal Revitalization Programs are Being Implemented, but Data on the Use of Tax Benefits Are Limited," Report GAO-04-306, March 2004.

24. The capital gains tax benefits available to all three rounds of empowerment zone designees—which included the partial exclusion of capital gains on stocks and restricted non-recognition of capital gains on assets—were replaced in RCs with a broad exclusion from the capital gains tax.

25. Renewal Communities are eligible to receive Qualified Zone Academy Bonds to fund educational improvements. However, this is not included as a benefit in this discussion because this benefit is not exclusive to Empowerment Zones, Renewal Communities, or GO Zones.

26. See, for example, Peter Eisinger, The Rise of the Entrepreneurial State (Madison: University of Wisconsin Press, 1988); Robert J. Newman and Dennis H. Sullivan, "Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know and How Do We Know It?" Journal of Urban Economics 23 (2) (1988): 215-234; Timothy Bartik, *Who Benefits from State and Local Economic Development Policies?* (Kalamazoo: W.E. Upjohn Institute for Employment Research, 1991); Timothy J. Bartik, "The Effects of State and Local Taxes on Economic Development: A Review of Recent Research, *Economic Development Quarterly* 6 (1) (1992): 102-110; and Michael J. Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review,* 5 (2) (1997): 37-52.

27. Alan Peters and Peter Fisher, "The Failures of Economic Development Incentives," *Journal of the American Planning Association,* 70, (1) (2004): 27-37.

28. Scott Hebert, Avis Vidal, Greg Mills, Franklin James, and Debbie Gruenstein, "Interim Assessment of the Empowerment Zones and Enterprise Communities (EZ/EC) Program: A Progress Report," Report prepared for U.S. Department of Housing and Urban Development, 2001.

29. Ibid.

30. U.S. General Accounting Office, "Community Development: Businesses' Use of Empowerment Zone Tax Incentives" (1999).

31. U.S. General Accounting Office, "Community Development: Federal Revitalization Programs Are Being Implemented, but Data on the Use of Tax Benefits Are Limited" (2004).

32. Peter Hall, "The British Enterprise Zones." In Roy Green, ed., *Enterprise Zones: New Directions in Economic Development* (Newbury Park, CA: Sage Publications, 1991).

33. Marilyn Marks Rubin, "Can Reorchestration of Historical Themes Reinvent Government? A Case Study of the Empowerment Zones and Enterprise Communities Act of 1993," *Public Administration Review* 54 (1994): 161-169.

34. See, for example, Marilyn Marks Rubin; "Urban Enterprise Zones in New Jersey: Have They Made a Difference? In Roy Green, ed., *Enterprise Zones: New Directions in Economic Development* (Newbury Park, CA: Sage Publications, 1991); Barry Rubin and Margaret Wilder, "Urban Enterprise Zones: Employment Impacts and Fiscal Incentives," *Journal of the American Planning Association* 55 (1989): 418-431; and Rodney Erickson and Susan Friedman, "Enterprise Zones 2: A Comparative Analysis of Zone Performance and State Government Policies," *Environment and Planning C: Government and Policy* 8 (4): 363-378.

35. Alan H. Peters and Peter S. Fisher, *State Enterprise Zone Programs: Have They Worked?* (Kalamazoo: W.E. Upjohn Institute for Employment Research, 2002).

36. Ibid.

37. Robert Greenbaum and John Engberg, "The Impact of State Enterprise Zones on Urban Manufacturing Establishments," *Journal of Policy Analysis and Management* 23 (2) (2004): 315-339.

38. Marilyn Rubin, 1990. "Urban Enterprise Zones: Do They Work? Evidence from New Jersey," Public *Budgeting and Finance* 10 (4) (1990): 3-17.

39. Kala Sridhar, "Tax Costs and Employment Benefits of Enterprise Zones," *Economic Development Quarterly* 10 (1) (1996): 69-90.

40. Peters and Fisher, *State Enterprise Zone Programs: Have They Worked?*

41. Robert J. Chaskin and Sunil Garg, "The Issue of Governance in Neighborhood-Based Initiatives," Urban Affairs Review 32 (1997).

42. Initiative for a Competitive Inner City, "Inner-City Business Development: Benchmarking Federal Spending and Guidelines for Action," (1999).

43. Ibid.

44. Research conducted by the authors, using data originally gathered by Abt Associates for the HUD-sponsored "Interim Outcome Assessment" of the empowerment zone initiative, suggests that knowledge and use of tax incentives are related to employment outcomes. See Michael Rich and Robert Stoker, "Urban Regimes and Community Empowerment: Lessons from the Empowerment Zones in Atlanta and Baltimore" (2004). Contact the authors to access this paper.

45. Although unemployment declines in Detroit and Philadelphia outpaced what was achieved in Baltimore, the income gains in Detroit and Philadelphia lagged behind Baltimore and in Detroit the gains lagged behind its comparison Census tracts. In addition, the number of poor people residing in Baltimore's EZ declined by 36.7 percent between 1990 and 2000, a decline that exceeded what was achieved in Detroit and Philadelphia.

46. Peters and Fisher, *State Enterprise Zone Programs: Have They Worked?*

47. Examples include the Area Redevelopment Agency and its successor, the Economic Development Administration, the Appalachian Regional Commission, and the Tennessee Valley Authority.

48. J. Norman Reid and Karen Savoie Murray, "Empowering Rural Communities: A Perspective at the Five-Year Point," Paper presented at the annual meeting of the Rural Sociological Society, 2000.

49. In 1994 more than 220 rural communities submitted applications for designation as a Round I Empowerment Zone or Enterprise Community. To encourage implementation of the strategic plans in communities that were not selected, the U.S. Department of Agriculture (USDA) designated all applicant communities as "Champion Communities" and provided assistance to them. Several of these communities were designated as EZ or EC communities in subsequent rounds. Since 1995, the USDA has provided more than $450 million in community development funding to nearly 100 Champion Communities.

50. Andrew Isserman and Terance Rephann, "The Economic Effects of the Appalachian Regional Commission," *Journal of the American Planning Association* 61 (1995): 347.

51. See the *Federal Register,* Vol. 71, No. 29, Part IV, Department of Housing and Urban Development, Monday, February 13, 2006, 7666:7672.

52. Lower Manhattan Development Corporation, "Progress Report, 2001-2004." Available at www.RenewNYC.com.

53. *Contentious City: The Politics of Recovery in New York City,* John Mollenkopf, ed., (New York: Russell Sage Foundation, 2005).

54. "The streamlined requirements do not mandate public hearings at either the state or local government level, but do require providing a reasonable opportunity for citizen comment and ongoing citizen access to information about the use of grant funds." U.S. Department of Housing

and Urban Development, "Allocations and Common Application and Reporting Waivers Granted to and Alternative Requirements for CDBG Disaster Recovery Grantees Under the Department of Defense Appropriations Act, 2006; Notice," Federal Register 13 February 2006, Part IV, p. 7668.

55. Louisiana Recovery Authority, "The Road Home Housing Programs: Action Plan for the Use of Disaster Recovery Funds" (2006).

56. Farm Security and Rural Investment Act of 2002, Public Law 107–171.

57. National Rural Development Partnership, "Report to Congress" (2004).

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