

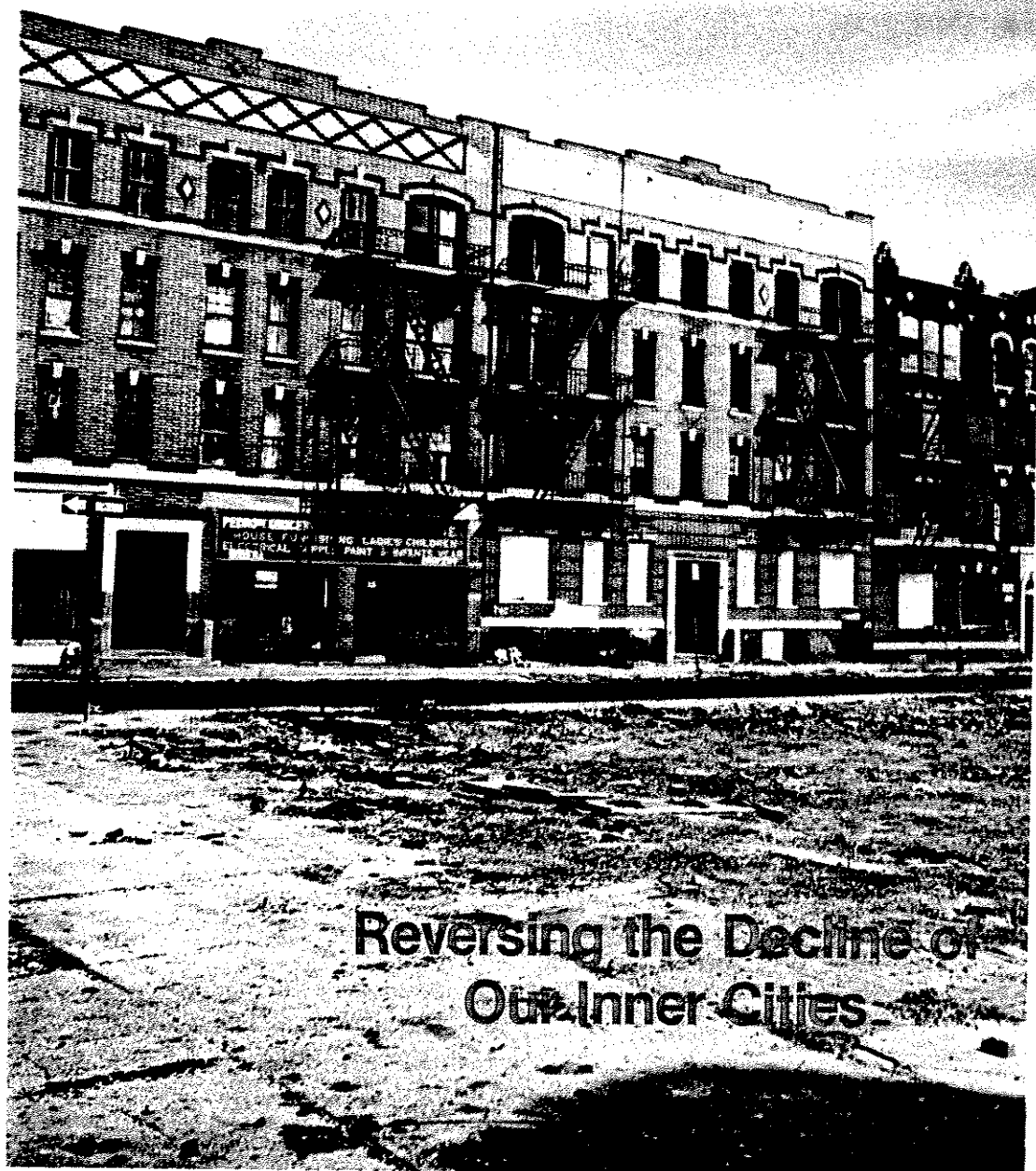
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An ICEPS Forum On:

URBAN ENTERPRISE ZONES:



Reversing the Decline of
Our Inner Cities

Economic Options for the Eighties

Session #3—January 29, 1981

URBAN ENTERPRISE ZONES

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The Heritage Foundation

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Mark Frazier
Sabre Foundation

Peter Ferrara
Cravath Swaine & Moore

With introductory remarks by
George Gilder

Participants to the Manhattan Forum on Urban Enterprise Zones included representatives from the following organizations:

Pratt Institute	New York Times
The Conference Board	NAACP
National Review	U.S. News & World Report
New School for Social Research	Time
Fortune	New York Urban Coalition
Citizens' Budget Committee	Economic Development Corporation
Citizens' Housing & Planning Council	Business Week
Vocational Foundation	Forbes
Freedom House	Department of Housing Preservation and Development
American Legislative Exchange Council	Institute for Educational Affairs
Financial World	CBS, Inc.
NBC, Inc.	Urban Institute
Venture Magazine	South Bronx Development Organization
Community Housing Improvement Program	Wall Street Journal
Dun's Review	
Foundations for Economic Education	New York Magazine

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Urban Enterprise Zones & Inner City Growth

With President Reagan proposing substantial cuts in urban programs, many have expressed grave concern over the future of the inner cities. But while most of the public focus has been on the proposed cuts, the Reagan administration has been developing an entirely new urban policy with substantial prospects for success in reversing the fortunes of declining inner city areas.

Stimulated by the intellectually charismatic Rep. Jack Kemp (R-N.Y.), the new policy calls for the designation of depressed inner city areas as "Enterprise Zones," where taxes and regulations at the federal, state and local levels would be dramatically reduced. The incentives resulting from these reductions would then hopefully spur sharply increased private investment and economic activity within the zones, leading to their redevelopment and revitalization.

The Enterprise Zone concept embraced as the centerpiece of this new Reagan urban policy is based on an entirely fresh paradigm of thought concerning urban economics. The old approach to the inner cities was based on two elements—subsidy and central planning. This involved taxing away some of the hard earned income of workers and producers to give subsidies to poor inner city residents, maintaining or increasing their economic dependence. It also involved massively bureaucratic urban renewal projects and other central planning tools aimed at redirecting existing economic activity.

The new Enterprise Zone approach is instead based on wealth creation and decentralized market processes. Instead of subsidy, it focuses on removing government barriers to wealth creation and economic growth, such as taxes and regulations. And instead of central planning, it seeks to create a general climate of open markets where entrepreneurs and economic activity could flourish. The goal is to bring the urban poor, as well as the inner city geographic areas in which they live, into the mainstream of the economy. These individuals can then create, produce and earn their own incomes and inner city revitalization can be financed through inner city economic growth.

ICEPS recently brought together a panel of experts on this new urban approach to speak to a luncheon audience of New York City academic, business, media and civic leaders. A transcript of the proceedings is reprinted below.

George Gilder—Welcome to the ICEPS series "Options for the 80s." One of the key options, as we gather, is the launching of urban enterprise zones. It's one of the major themes of policy for the new administration with relation to the cities. To chair the session, we are fortunate to have James Ramsey, who is Chairman of the Economics Department at New York University, a major theorist of econometric economics, and also an expert on energy policy, who has at the same time come to focus on the problems of specialized markets in the big cities. He also, I'm told, even teaches undergraduates. So I'd like to turn over the meeting to Professor Ramsey.

James Ramsey—Thank you. On behalf of all the guests here, as well as myself, I would like to thank George and Bill Hammett and the other members of ICEPS for this opportunity to have a delightful luncheon in elegant surroundings, even at the heavy cost of having to listen not to just one but five speakers, charming and informative as they are. Nevertheless, duty calls and the goodly turnout today is testimony to our dedication and public spiritedness. We may all

congratulate ourselves on our forswearance of alternative opportunities. The issue is important and the moment of discussion is timely.

Now, there is—and this is something for a guide for listening to five speakers with disparate backgrounds—a major central theme in the discussion by the speakers. All the speakers believe that they have learned essentially two fundamental lessons. First, a decentralized market-structured process for making decisions does in fact produce what people want when and where they want it, and—surprise, surprise—with minimal cheating.

Now, it's recognized that there are problems with markets having to do with what economists call "the concept of externalities." Pollution is the classic example, of course, but with these people who are recommending enterprise zones, there is also the recognition that in all but a few cases, market structures can be easily created which internalize the externalities and enable the market process to function in a facile manner and account for potential problems of such things as pollution. This may be of

The traditional economic policies that we have used to deal with the problems of the urban poor have not worked.

some surprise to some members of the audience. As a part of this it is recognized by the members of the panel that a decentralized market process releases enormous amounts of human energy and ingenuity, and it is this concept that has so much of the appeal to so many people who are contemplating the idea. It converts a society from one characterized by people sitting around waiting for someone else to do something to one characterized by great activity and enthusiastic innovation.

The second thing recognized by members of the panel and those who are investigating the concept of enterprise zones—which is something that still needs debate, discussion and elaboration—is that, while we all understand the deleterious effect of special interest legislation—we all understand those problems—what we are now beginning to recognize is that often well-intentioned legislation, humane legislation, kindly-meant legislation, frequently makes the situation addressed far worse. For example, legislation to be ‘fair’ to small refineries led to creating a clientele of small refineries whose sole inefficient existence was due to the enabling legislation. We all lost on that one. Legislation to aid the poor, the fatherless, homes, etc.—albeit inadvertently and not by design in terms of what people intended—often increases the poverty of the poor and adds to the number of homes abandoned by fathers.

Finally, a caveat. To avoid arguments at cross-purposes, no one here, I trust, is recommending enterprise zones on the basis of simple-minded textbook notions of pure or perfect competition, which are unrealizable, in fact, and even, indeed, in principle. We are dealing with a dirty, “nitty-gritty” world of high information costs, high transactions costs, consumer ignorance, producer mistakes, producer errors and gross incompetence. What is not being advocated is something akin to jungle warfare—nor chaos, nor irresponsibility. All concepts of enterprise zones are based on notions of orderly markets, the enforcement of contracts, and all property rights. Cheaters must be punished for cheating. All must be responsible for their actions. Markets only perform effectively, indeed, when social order prevails. It is intended that the idea of enterprise zones will lead to orderly markets. And this is a point on which there might well be some debate. Do or do not the concept of enterprise zones lead to orderly markets? So without further ado—and this is background as you go through the speeches of five different people—let us begin.

My first speaker is my good friend Al Rabushka. Al Rabushka is a Senior Fellow of the Hoover Institution, and he’s written or edited apparently a total of nine books now, including *Hong Kong: A Study in Economic Freedom* and you all know about his film. His major field of interest is British history, particularly the period of the Industrial Revolution, and so as a political scientist who, as I said, has been associated with economists for some time now, and without further ado, I now give you Alvin Rabushka of the Hoover Institution.

Alvin Rabushka—Thank you. Let me begin by telling you that the idea of enterprise zones in its more con-



Photo by Craig Terry

George Gilder, ICEPS's Program Director and author of *Wealth & Poverty*.

ceptual form is not a new one. It’s an old one. In fact, as I’ve searched back through history, I’ve tried to compile a list of examples that would be enterprise zones. The oldest one that I can find goes back to 166 B.C., which lasted for about 97 years, with an interruption, to 69 B.C. It was the island of Devos. I’m not going to go through the long and complicated history of the Eastern Mediterranean in the second century B.C., save to tell you that the island of Rhodes was the dominant commercial power and derived its revenues from a very small harbor fee were it to provide various kinds of harbor services to trading vessels in the area. And due to some wars between the Persians and the Romans, which the Romans won, the price the league of powers in the Eastern Mediterranean paid was that the island of Devos was ceded to Athens with the proviso that no taxes could be imposed on its inhabitants. In one year the revenue collections which the island of Rhodes had at approximately one million drachma fell to about 150,000 drachma, and Devos became for almost a century the dominant port in that whole part of the Mediterranean; 20,000 Italian families came and the prosperity of the place was extraordinary and remarkable. Quite a bit has been written on it. I cannot find an example of a complete, pure, real, no tax, nonregulated economy before it.

“Given the city’s ability to foul things up, would you suggest putting into the national legislation something to prevent cities from abusing the concept?”

Now, I don’t want to run you through all the other examples save to tell you that Antwerp in the 15th century was very similar. If you look into the economic structure of Antwerp you find the most prosperous city in the whole of Europe, from about the 1480s up to the Spanish pillage in 1576. I can’t guarantee these things last forever, but during their periods you do find live examples of nonregulated, lively to lowly to nontaxed areas with tremendous economic dynamism, full employment, high standards of living, goods and services available. The cur-

The assumption used to be that areas of urban blight suffered not from too little private enterprise, but from too little public enterprise and public attention.

rent examples really derive out of the British empire — places like Hong Kong and Singapore, Gibraltar, some past examples which are no longer territories of Britain like Malta, the Ionian islands, etc. — wherein the British, upon establishing them, simply declared them free ports. That is, they were areas that were simply untaxed. There were no duties, there were no import taxes, no export taxes, no income taxes. And these territories have produced the modern examples of Hong Kong and Singapore which we see as the most dynamic, full employment, high income economies in the Far East.

But, more important, and now germane, I think, to the idea of the enterprise zone, is the post-World War II phenomenon of what we can call the "free trade zone," "the export processing zone" — there is a series of labels — and they really begin in their full glory in the island of Taiwan in 1966 where the government established an export processing zone that, in effect eliminated by a stroke of the pen sales taxes, commodity taxes, all corporate income taxes for eight years, all customs barriers, all exchange controls regulations, all red tape. They only created one square mile, but the one square mile was able to generate seven percent of the country's foreign trade. The surplus on the balance of payments from that trade was equal to the entire deficit on the rest of the country's foreign trade. It created 50,000 jobs in a matter of three years — all at rapidly rising levels. This concept was so successful that they created, in fact, an exhibition hall to which people from other countries could come to learn how to set them up.

Several years ago there was an election in Sri Lanka (formerly Ceylon) in which the new government decided it had to move away from what had been the better part of 27 years of stagnation on a Socialist model. To do so, they decided to move in the direction of incentives and exemptions. So they set up an export processing zone in Sri Lanka. To ensure that capital would move in and jobs would be created, they established what I would call unprecedented tax incentives, which include, for example, 100 percent tax holiday for up to 10 years on all personal and corporate income, no limits on equity holding by any class of investor, free transfer of shares, no tax or exchange controls, no tax on dividends, no import duties, no barriers, no capital controls. It is almost the very perfect model of the purest free economy you can imagine. And it has literally contributed to turning the country around. Economic growth rates in the two years after these zones were established are double what they were before, job creation has been in the tens of thousands, the country is considering establishing two more of these zones in other parts of the country. So what you have had is a vehicle that combines economic growth with job creation — largely through the concept of a free trade zone or an enterprise zone as you would which is really applying to a part of a country an economic system that we find in places like Singapore and Hong Kong in much more full-blown form. But anyway, there's your history, and I think I've saved you some minutes.

Ramsey — Well done, Al. Are there points of clarification?

Thomas Jones, Merrill Lynch — With the idea of a free enterprise zone or a free trade zone, I think you can go through history and find all sorts of examples. It seems to me that the attributes and success of those particular examples are due to the fact that there has been concentration both politically and governmentally from a community standpoint on making these zones work and become successes. However, if you go through history you will find that practically all of them have failed at some point in time. And the key ingredients of the failure, I think, would be more revealing to us, especially if we were thinking in terms of the implementation of free enterprise zones.

Rabushka — I can answer that very briefly by just saying in the historical examples, some went through pillage, torture, the plague, shifting trade routes, etc. And there is no permanent "forever" guarantee to any given set of political or economic institutions.

Jones — Is it not true that most of the free enterprise zones or free trade zones have been based on goods that are being exported rather than on goods that are being internally absorbed?

Rabushka — In the example of countries where you'd simply draw on a geographical territory and you partitioned it off, the better part of those products are intended for export, largely because these countries were interested in earning foreign dollars and being able to use that money and also to have exports fuel economic growth. But in places like Singapore and Hong Kong where you get, in effect, country-wide enterprise zones, no distinction is made between goods for export or internal production. It doesn't have to be that way. It's simply a developmental strategy that's been invoked by a number of Third World countries.

Ramsey — Our next speaker is Stuart Butler, Policy Analyst with The Heritage Foundation, who has been, in a sense, one of the key people involved in importing what, surprisingly, was a socialist, British idea from Britain to the U.S. And without further introduction on that basis, Mr. Butler.

Butler — Well, I've rarely been accused of introducing socialist ideas into this country. If you know anything about Heritage, it's not something that we specialize in. I think one of the most interesting things about the whole concept of enterprise zones is the fact that the thinking behind it and the people advocating it span a very wide political spectrum. Now, as Alvin Rabushka introduced the idea from a historical perspective, what I'd like to do is to look at the sort of under-



Photo by Craig Terry

Peter Ferrara (L.) confers with Thomas B. Jones of Merrill Lynch & Co.

The better the environment for industrial and commercial development in the enterprise zones, the more the neighborhood residents stand to reap in terms of leasing their land.

pinnings of the concept as it has crystallized in Britain and in this country and then to look at the British case very briefly and then speculate as to some developments that might occur in this country.

Of course, the reason that we're thinking about enterprise zones is because of a broad development that is taking place both in this country and particularly in Western Europe as well, namely, a demographic change that is occurring with regard to cities. A broad, out-movement of population. Not a broad cross-section, but mainly skilled, middle and upper income people, leaving behind lower income, minorities, problem families, etc. within the inner city areas. And together with that, we see particular neighborhoods—even in growing cities—that seem to be in a spiral of decay. The enterprise zone is an attempt to deal with that specific problem. I'm talking now specifically about the enterprise zone as opposed to the broad principles of deregulation and lowering of taxes.



Photo by Craig Terry

George Roniger, Economist from Citibank in New York.

Now, it's quite clear that the traditional policies that we've used to deal with this sort of problem have not worked. We have only to look at the census statistics that are now coming out of several other studies that show that the poorer, declining cities are getting worse relative to others. The gap is not closing, it's getting wider. And whatever we have done, it has not worked. I would argue that many of the things that we have done have contributed to this situation. We've torn up the centers of many major cities and planned them. This has broken up existing communities. The flimsy community structures that are there have been totally broken down. We have segregated people into public housing—I was going to say concentration camps. That's not quite what I mean, but it almost embodies the concept. Again, breaking up communities that did exist, we've attempted to zone people out of action. We've prevented people from operating in certain areas. We've applied controls to stop people from using housing and to maintain an artificially low market for housing in these areas. We've had minimum wage which has priced people out of the market at the lower end—the very young, unskilled people that form the main basis of the population in these areas. And then we wonder why they're in a bad situation.

Well, fortunately, we've learned a few things during this process. In particular, I think we've learned a lot about the nature of job creation in cities. Very much of this is due to the work of David Birch at M.I.T. who showed very clearly that, particularly in cities, really the only job-creating segment of the population is small business—particularly businesses of less than 20 people. These provide about two-thirds of all new jobs throughout the country, and it is even more the case in the cities. The jobs that are created are not created by large corporations no matter how many cities try and pull these into their environs. These do not provide the main new jobs. Not only are these small businesses the biggest job creators, but they also create the right kind of jobs for more depressed areas. They tend to create more jobs for unskilled younger people, people that can grow with the company as it grows.

Another point that Birch makes which is of crucial importance is that, in fact, the death rate of businesses—the rate at which businesses close down—is pretty much the same throughout the country. In fact, if anything, the rate at which businesses close down is higher in growing cities than in declining cities. It is widely accepted, but a totally incorrect assumption, that the main problem in declining cities is closures. It is not. The main problem, as Birch clearly demonstrates, is that there is a great lack of new businesses starting. The birth rate of businesses is very much lower in declining cities than in growing cities. And as he also points out, the kinds of policies that we've tended to adopt have nothing to say to these small entrepreneurs that are lacking in the inner city areas or at least are not going into business. We provide all sorts of grants, the banks can provide loans, etc., but they talk to middle and bigger sized businesses. The small entrepreneur generally starts his business from his own personal savings. Sixty percent of new small businesses start with capital provided almost exclusively by their own savings or by loans from friends. Less than one percent start with government grants of any nature.

This, I think, leads you to some very important conclusions about the sorts of policies that we ought to be applying to inner cities. And this is how the enterprise zone really came about. The first is that direct support for the types of people that are going to actually create jobs for small business—direct government or other types of support—is not going to be effective because of the very type of people you're dealing with. But, if on the other hand you create a climate for these people—give them an entrepreneurial climate, reduce the restrictions, regulations and tax barriers that prevent them from going into business—using that indirect approach, you are far more likely to be successful. I think every piece of evidence shows this to be so. We can discuss this later.

Removing such regulatory barriers will encourage all sorts of experimentation—not just from a business point of view but from the point of view of local organizations trying out new ways of doing things, of meeting the problems within these areas. Also, that larger business corporations should not be seen as the main engines of revitalization of these areas. They

A decentralized market converts a society from one characterized by people sitting around waiting for someone else to do something to one characterized by great activity and enthusiastic innovation.

are important as anchors, to some extent for purely psychological reasons, and also as a link for smaller businesses. But we can deal with those on a case-by-case basis. If we're making a broad approach to the real job creators, it must be an indirect climate-creating approach.



Photo by Craig Terry

Robert Klein, Senior Editor, Money Magazine.

So broadly, what the basis of the zone concept is, then, is really to encourage experimentation and risk-taking in these areas, to try and improve the birth rate of new businesses—not to try and retain businesses within the area. And that it is also—and I think this is crucial to the idea—it is an attempt to show people within these areas that they can get on the ladder, too. To break that consensus, that rigid, underclass mentality that pervades so many depressed areas. To break that and to give people the opportunity to take the risks themselves at the lowest level. Not to import prosperity from outside. It is very much, as I sometimes call it, a “trickle up” approach rather than a “trickle down” approach. The enterprise zone tries to do this by locating a zone within a very depressed area—a relatively small area, a square mile or so—and within this area drastically reducing regulation and tax barriers, particularly as they apply to small business operations. It is not an attempt to open the door to very large corporations making very large profits out of subtle tax changes. Simplicity is of the essence in the zone idea.

Ramsey—Thank you. Points of clarification.

William Rusher, National Review—What types, typically, of small businesses are you looking for in these zones? Are these mostly service businesses?

Butler—The evidence on the types of start-ups that are taking place in cities are that they are primarily service businesses. Of course, this could be a reflection of the type of regulatory and tax situation that you have in these cities. I don't believe that they will necessarily always be such.

Rusher—I would imagine they would be service businesses and that what they would be servicing would be the employees of some large business which is not in the zone.

Butler—It would not necessarily have to be in the zone. You could, for example, say, in the South Bronx have many service businesses—and I don't mean

retail outlets—but, say, printing companies and that type of thing that would be, in fact, supplying Manhattan. It is not necessary for a major corporation to actually be in the area itself, and I think that has been one of the mistakes that has generally been made to planning in depressed urban areas. The feeling that unless you have a big company there you're not having the effect that you're seeking.

Ramsey—Points of clarification.

Peter Samuel, Australian Press—Are you saying in Britain that there's an “either-or” proposition—either the zones are directed toward large enterprises or the focus must only be placed on small businesses?

Butler—They can be complementary, but the types of changes that have been made in Britain relate much more to looking at a cleared, old industrial site and giving incentives to redevelop. In other words, to build things there. Now, most people with only a little amount of capital do not go around and build big new factories. In this country the sorts of discussion we're looking at are more in terms of using, say, an abandoned building or breaking up the use of a building—an old apartment building—using the first floor for commercial purposes, rezoning and that type of thing. In other words, using things that are already there. You can do it inexpensively—rather than clearing a site and giving big incentives to people to rebuild on it.

Ramsey—Let's move on to Peter Salins. Those of you who I cut off will have your chance back again at the end of the talk. Peter Salins, currently chairman of the Department of Urban Affairs at Hunter College, has been doing work on urban planning and analysis on urban problems for some years and is associate editor of *New York Affairs*. So with this background I welcome Peter Salins to give his talk.

Salins—Thank you. I do feel that the enterprise zone idea, even though it is novel, does embody two ideas that have been around for awhile. One of those ideas is that the poor and the unemployed are simply in the wrong place. The recent report of a presidential commission elaborated on that idea and suggested that we export our poor and unemployed to the Sun Belt. In other words, we should bring Mohammed to the mountain. The enterprise zone does have a little bit of the idea in it that you're bringing the mountain to Mohammed—that it's a locational problem we're dealing with rather than a problem related specifically to the skills and abilities and economic opportunities among the poor.

The other idea that I find the enterprise zone notion has in common with some earlier solutions is the concept of differential locational advantage. I think the enterprise zones would be unique; it would be quite different from the area surrounding it. It isn't the idea of a blanket—whereas Hong Kong and some other places would represent a blanket—reduction of taxation and a reduction of regulation and encouragement of free enterprise throughout the entire United States, but to create certain advantages in particular places in certain American cities that would be unique. In other words, to create a bunch of Hong Kongs and Singapores in the middle of various American metropolitan areas.

If we are going to give this idea a try, there is no use in being so timid about its implementation that we might lose the whole concept just because we didn't make it strong enough.

Relating the idea to New York City, I would say first of all that the South Bronx has probably been the most likely first target for the enterprise zone idea. The South Bronx has epitomized urban malaise for the entire United States recently. I think that the enterprise zone idea is apt to be a lot more effective in the South Bronx plan. I think that plans, like other forms of government intervention—I say this as an urban planner myself—plans very often compound rather than solve the problem.

I think that in terms of the way the enterprise zone would work in New York and specifically in the South Bronx it probably would be most effective as a basis for creating a lot of new housing. Everyone thinks of the enterprise zone strictly in terms of manufacturing, whether service-related manufacturing or primary manufacturing. At least in terms of some of the specific proposals that have been offered, the enterprise zone idea could be used for the construction of housing itself. I think that manufacturing in New York City does not have a very bright future. Housing does. I think that one of the most effective uses of the enterprise zone idea in the South Bronx would be to create housing.

I think that the enterprise zone if it were applied to the South Bronx would result in an upgrading of the area, but it probably would also result in some displacement of the present indigenous population. I think that intrinsic in the enterprise zone idea is the potential or the danger—if you consider it a danger—of moving the problem around. Applied to New York, I think it could result in displacement. The real question is: displacement to where? If the displacement were to other parts of New York City, probably not a great deal would be gained. If the displacement were to other parts of the United States—at least from our parochial perspective—a great deal might be gained.

Ramsey—Thank you. Once again—points of clarification.

Jamie Johnson, Esq.—Isn't the idea that a lack of jobs where people live would be the reason for the decay of an area? If we are just creating more housing, perhaps making it cheaper for builders to erect a place for people to live wouldn't solve the problem.

Salins—My own feeling is that, in terms of the New York City economy, the notion that we can sort of create a new kind of industrial infrastructure suited to the skill levels of New York City's present underclass is relatively unrealistic. I think that New York will continue to be primarily a relatively skill-oriented service center for the country. And I think that the recent pressure on the housing market indicates that there is a large, pent-up demand for new housing. The enterprise zone concept could be used to meet that demand for new housing.

George Roniger, Citibank—Given your parochial view of New York, the enterprise zone supposedly goes in low income areas, and we know that most of the poor don't live in central cities. What does that do to New York? If the enterprise zones were placed nationwide in poor areas?

Salins—What do you mean that most of the poor are not in central cities? Where are most of the poor?

Roniger—Some are in the suburbs. A lot are in the ex-

urbs and a lot are in the rural areas. They're in the South, in Vermont, in Maine.

Salins—A lot depends on how the enterprise zone legislation will be drafted. My guess is that it would be aimed at those pockets of poverty that are in central cities. You might have companion measures for rural areas. But my guess is that the first application of the enterprise zone concept is going to be in central cities.

Ramsey—Next is Mark Frazier, who is currently Director of the Sabre Foundation in Washington. He's written a number of articles but the most important thing in terms of his contribution here today is he is directing a major project aimed at trying to establish enterprise zones in various communities and is looking at some of the practical details and problems involved in implementation.

Mark Frazier—There's been a great deal of discussion in this country and in the United Kingdom about enterprise zones as economic vehicles orienting particularly toward the removal of regulations and taxes. While there's no question that these are important deterrents to the revitalization of distressed communities, there are other deterrents as well, and I think that what may set our approach to enterprise zones apart from that of the Kemp-Garcia legislation in particular is that we're looking at ways to remove deterrents that have been untouched by the legislative proposals that have surfaced to date.

If one were to ask potential entrepreneurs or industrial investors in these areas what deterrents they are concerned about most, they would answer, obviously, tax and regulation to a large degree. But there would be three other areas that they would express concern about, as well. One of them is the incidence of crime. Another is the disproportionate lack of skills and industrial habits of the work force. And a third is the lack of entrepreneurial experience—management experience—among many of the residents in the zones.

Our project represents an effort to establish relationships between the existing residents of enterprise zones and the businesses that would be operating there in order to reduce these social deterrents. The approach we've taken is one that would give residents a share of the revenues generated by enterprise zones to apply specifically to self-help efforts at the neighborhood level. What has held back neighborhood organizations and associations and the like for the most part is the problem of free-riders. If there are a group of energetic people—perhaps half a dozen or a dozen—in a neighborhood who want to start up a block patrol or undertake neighborhood improvement projects, they have the problem of financing their initiatives. The problem is that people can enjoy the benefits of their activity without having to contribute to them. This problem has been overcome in a number of cities—particularly a number of suburbs—by building into the title of property, building into deeds certain stipulations that the property owner must, in concert with his or her neighbors, undertake to provide certain levels of support for community activities. These neighborhood associations have been so good at absorbing the externalities in the free-rider problems that they've grown in number

The idea with the model cities program was to increase and intensify governmental attention in certain areas, rather than release particular areas from governmental programs and taxation.

from about 500 fifteen years ago to over 20,000 today. It's very difficult now to buy housing in a new planned unit development or cluster housing development without finding yourself a member of such an association.

"What is the difference between the enterprise zone concept and the model cities program?"

How do you develop, then, these universal membership associations in enterprise zones? There's one very attractive way to do that and that is to transfer title to city-owned properties in enterprise zones. In the case of the South Bronx it might be 50 percent of the land in the South Bronx to these contractual associations, making them landlords, as it were. The benefit of that to the residents could be immense because these lands in the South Bronx, which are now virtually worthless, could acquire a substantial value in proportion to the degree that the tax and regulatory impediments to business are removed. Those revenues could be dedicated to things such as block patrols on a sustained basis, to job training programs, to small business support services—financing services—which would address the problems. These are the social deterrents that now make many businesses reluctant to operate in these areas.

This approach has another benefit which is helping to reduce the likelihood of displacement, because as the areas prosper, the land revenues going to existing residents of the zones will increase. They should do quite well, in fact, by holding title to these areas. Our foundation has, for the past three or four years, been looking into free-trade zones internationally, and the tax and regulatory abatements are capitalized into land values—just across the board. Hong Kong, as Alvin could describe, has now got some of the most valuable real estate in the world, and that's not because it differs geographically or demographically from other cities on the South China coast. It's because it has an exceptional tax and regulatory environment.

With potentially millions of dollars being generated per block per year as enterprise zones get on their feet, that creates a chance for municipalities such as New York City to find the demand—the dependency of residents on public services—greatly reduced, which, I think, would be welcome to taxpayers everywhere in New York. If the South Bronx and other distressed communities around the country have internal sources of revenue and mechanisms which allow them to undertake self-help efforts rather than rely on the services provided by city hall or various unresponsive federal bureaucracies, they are much less likely to put as great demands as they now do on welfare and social services.

There is another way that becoming landlords can improve the lot of existing residents of enterprise zones. That is, as landlords they could make arrangements with large industries wanting to lease their land and enjoy the tax and regulatory abatements so that an IBM might negotiate an arrangement with a neigh-

borhood group that IBM would provide some tutoring services to make up for the default of the public schools in that area. Street maintenance agreements. There is just an open slate as far as what neighborhoods can negotiate with large industries that are renting their land. That has, again, the effect of reducing dependency upon public services, which, I think, taxpayers in New York City would welcome.

Ramsey—Thank you. Points of clarification?

Richard Cherry, N.Y. Urban Coalition—I was wondering whether we could get at specific examples of how this would benefit a tenant on welfare in the South Bronx.

Frazier—The benefit to residents of joining into a universal membership association—or an automatic membership association would be better—would be a share of revenues earned off of the lease of the land. And that share could be disposed of as the member wishes in voting with his neighbors. They could essentially pocket that dividend and spend it however they wish. But I think it's quite likely that many of the residents are concerned about getting mugged and robbed and worse in their neighborhoods, and so that they might be willing through this collective instrument to put a portion of that dividend into the support of anti-crime measures which would improve the quality of life for them as well as for business.

Ramsey—Thank you. Our last speaker, before we open things to more general discussion, is Mr. Peter Ferrara, Harvard Law School, currently working for Cravath, Swaine and Moore, and he has been engaged in dealing with some practical matters and details with the attempts to implement the concept of enterprise zones. Mr. Ferrara?

Peter Ferrara—I suppose it's appropriate that being the legal representative on the panel that I would be the one to inject a note of concreteness into the discussion. I will discuss some of the specific incentives which could be included in an enterprise zone bill and with the aim of presenting an overall package that would actually work. This will to some extent take into account some of the political realities, as I see them, based on my discussions with people down in Washington who are actually working on the bill. I myself would be the last one to object to the concept of removing all taxes and regulations within a zone, but I don't think that's in the cards, at least this year. I believe that to be successful, enterprise-zone legislation must contain at least some incentives from each of three categories.

The first is incentives for employers to establish businesses and create jobs in the enterprise zone areas. The second is incentives for employees—particularly the currently poor and/or unemployed—to accept jobs within the zone area and perhaps to increase their current work effort. The third are provisions that would direct at least some of the benefits from economic development of the zone to current residents of the zone. One of these would be something along the lines that Mark Frazier just discussed. Now this comprehensive approach would serve to bring the inner city poor and unemployed as well as inner city geographic areas into the mainstream of

"Does not setting up an enterprise zone with different regulatory rules both take away the incentives for general regulatory reform and also create a continued constituency for changing these regulations elsewhere?"

the economy. Without such comprehensive incentives, enterprise zones could become just another urban removal program with the poor and unemployed forced to flee to another area of the city, soon to replace the zone area as a new ghetto. The comprehensive approach also recognizes that there is a supply-side as well as a demand-side in the labor market, and that labor supply incentives may be particularly important to the poor caught in the terribly bad center structure of current poverty programs.



Photo by Craig Terry

Harry Anderson of Newsweek.

The approach also recognizes that zone residents with a stake in the development of the zone are more likely to contribute to its success and that such residents, who are likely to be poor and/or unemployed themselves, should receive at least some of the benefits from the zone's development. Now the Kemp-Garcia bill in particular does include incentives from all three categories, but I believe that the incentives in the current bill are not nearly powerful enough for the zone to succeed, and, therefore, I would like to go over a few incentives that would present an overall package that I feel is likely to be successful.

The first is the current bill, which reduces the corporate income tax rate by 15 percent across the board. I would increase this to a 50 percent across-the-board reduction. The current bill contains no analogous reduction for non-corporate proprietorships for partnerships in non-corporate businesses. Consequently, I would reduce the individual income tax on income from such proprietorships by 50 percent as well. The Kemp-Garcia bill reduces the corporate capital gains rate from 28 percent to 15 percent and increases the capital gains exclusion for non-corporate taxpayers from 60 percent to 80 percent. I would reduce the corporate capital gains rate to zero percent and increase the exclusion for non-corporate taxpayers to 100 percent. A particularly important result of this particular change is that it would encourage corporations to keep their money invested

in the zone rather than drawing it out in the form of dividends. Because if it's paid out in the form of dividends, it would be subject to the income tax; whereas if it's continuously reinvested, this would reflect itself in the increase in the capital gains in the stock of the corporation and the stockholders could take that gain tax-free by selling the stock to other individuals.

As an additional incentive to workers, I would grant an exemption from the individual income tax for the first \$10,000 of wages earned from employment within the zone. This would not only increase incentives for workers to break out of the poverty trap, but I believe it would do much to attract skilled workers to the zone, which might be essential in allowing many of the businesses to develop.

One of the greatest problems facing small businesses in the zone is obtaining the necessary working capital through loans. To ease this problem, I would recommend that the bill provide that the interest paid on all loans made to businesses within the zones be tax exempt.

Now one of the ways that the bill currently directs benefits of the bill to local residents is that it requires businesses to hire at least 25 percent of its employees from zone residents. I am told by drafters of the bill that they meant originally to make this 50 percent, but that there was a mistake in the current bill and so it actually says 25 percent. I think it is important to have something in between 25 and 50 percent, and they're thinking about somewhere in between because I think it's important to direct these benefits to the poor and unemployed individuals within the zone.

One of the possible modifications of this proposal is to use a system of job vouchers which would allow businesses to use towards this 25 percent or 50 percent requirements not only zone residents but anybody in the city area who had been unemployed for a year or had been on welfare for a year. This would, in particular, prevent the problem of businesses running out of available zone residents, and the bill as it's currently structured might put a limit on the development of businesses within the zone simply because they can't find any more zone residents to hire and therefore would not qualify for the bill's tax exemptions.

The bill, as already noted, currently does not include any federal regulatory relief. There are all kinds of ways where I think they could be provided, but I think that one is absolutely necessary—and that's relief from the minimum wage law. I would also have the bill give all federal regulatory agencies the power to grant special exemptions for the zone areas from any of their regulations, and I would give power to mayors or to specially created zone authorities to petition the federal regulatory agencies for such exemptions. I would also grant them the power to appeal to the secretary of commerce if those exemptions were not granted and give the secretary of commerce the power to grant such exemptions if he thought they were suitable.

The bill currently requires that there be a local contribution to the zone, which is a 20 percent reduction in local property taxes phased in over four years. I

On the contrary, the presence of Hong Kong and the free zones in Taiwan has been a prime reason why the entire national policies of the PRC have been moving in a market direction.

would not require this in particular because there are many problems involved in property tax reduction, including some constitutional problems in having just certain geographic areas subject to lower property tax rates than others. So I would make this one of the alternatives, and I would require the government to choose either that or the elimination of sales taxes within the zone or income tax relief from state and local income taxes analogous to the federal relief or elimination of unemployment insurance taxes on employers and funding unemployment insurance through general revenues.

I think the sales tax would be a particularly important incentive, because I could see it possibly turning these areas into booming retail discount centers which would have enormous effects in rapidly developing the areas. On the local regulatory side, I would include in the federal bill the requirement that two groups of local regulations be eliminated. One would be that zones be exempt from the state minimum-wage laws and the second is that the zones be exempt from laws controlling rent, interest, wages and all other prices.

I would then strongly recommend the following which, I suppose, would be a matter for the state and governments to include—and that would be establishment of a zone authority which would have the power to issue regulations covering zoning, building codes, health, safety, and pollution with such regulations superseding all other regulations that apply in the rest of the state. There is a bill currently proposed in Illinois which does precisely this.

Finally, the current Kemp-Garcia bill allows the zone duration to continue for ten years. I would increase this to 25 years. I think that ten years is too short. I think that businesses have a longer time horizon than that. It might take a few years for businesses to start up. The idea just might be stifled just because it hasn't had a long enough chance to be tried.

Ramsey—Thank you. Points of clarification first on Peter Ferrara's comments.

Professor Lawrence Kirschner—How would you determine the levels of incentives that you believe are sufficient to overcome the difficulties in the Kemp-Garcia bill?

Ferrara—I've had some discussions with people on the Economic Development Council, some people within the city, some people from local New York banks. It comes to a certain point where you just have to make a guess and make a stab at it. I have no magic formula by which I say it has to be 50 percent rather than 10 percent. But the feeling of everyone I talk to both from Washington and New York and elsewhere is that these incentives in the current bill are just not strong enough to make a difference and that they need to be increased dramatically. My feeling is if we're going to give this idea a try, there's no use in being so timid that we might lose the whole concept just because we didn't make it strong enough. I think that this presents a politically feasible package because I think at the national level this is going to be Ronald Reagan's urban program. It's going to be pushed very heavily, and I think that there's political

room for having something this strong. I think it ought to be tried. This is only going to be done in these little zone areas. Let's give the market a chance in these little areas.

Ramsey—We're now in the period of open discussion. When you issue your questions, please keep your questions short and succinct rather than making your own speeches at this time.

George Roniger, Citibank—I'm going to ask as many questions as I can later on because I think the legislation is a dog. You suggest reducing sales taxes and getting retail businesses started in the South Bronx, for example. Could you clarify what that would do to retail sales at small establishments in Harlem?

Ferrara—I don't think it will affect retail sales in Harlem. It may affect it to an extent, but the whole idea of the bill is to channel some of our economic development into these zone areas. Also, outside the zone areas a lot of these retail centers are apparently establishing currently economically viable areas. For example, if Bloomingdale's moved to the zone to take advantage of the sales taxes there, I'm sure someone else would seize that location. A lot of these retail things in Harlem and elsewhere are directed towards supplying the local population with food and other types of things. So I think that because these areas already are economically viable, it's not going to be a matter of one area taking away from another area but a matter of stimulating new kinds of economic developments.

Ramsey—Is there another question on this topic?

John Marlin, Council on Municipal Performance—You mentioned the property tax problem in terms of the constitutional problem. Doesn't that seem to be true in terms of equal treatment under the law of property tax that you would exempt a person who lives across the river from the income tax. Isn't there a constitutional problem?

Ferrara—There's an equal protection problem. The constitutional problems that result from this on the property tax are due to specific provisions written into the constitutions of states. And there's a federal constitution provision also that you can't discriminate from areas geographically, particularly in regard to the property tax. The equal protection theory says that when you draw distinctions in your treatment between different individuals, they have to be rationally related to some legitimate government objective. Not that you can't treat one person different than another. We have tax exemptions—just get the 1954 IRS Code, which is the one currently in force, and you have this enormous book with different exemptions and different treatment for everybody. The question is whether it's rationally related to some legitimate goal. Here the goal is the development of inner city areas and the question is: Are these kinds of tax incentives which are geared toward economic growth rationally related? I think that it is pretty clear as a legal matter that that would probably stand up. So I don't think there'd be an equal protection problem.

Ramsey—I'll take one more question on this particular topic.

Robert Moore, NAACP—The question is directed to both Mr. Ferrara and Dr. Butler. Given the city's (I

The whole rest of the city is not going to go out of business because of the tax advantages provided in this one small area.

don't know if this is a unique ability) but its ability to take an innovative tool and somehow really foul it up, would you suggest putting into the national legislation something to try to prevent the city from abusing it—or some kind of structure that would prevent what's happened to other city projects from happening to the urban zone concept?

"If small businesses are going to be attracted to the enterprise zones, what are you going to tell the employees of other firms who will be put out of work because of the shifting business?"

Butler—I think that city officials must get all their training in British universities. I tend to agree with you that I don't think that the enterprise zone is something which should be administered by a city. The one theme you hear from small businessmen, from people in neighborhood organizations, from minority groups and so forth, is: Get these people out of the way! The whole concept of an enterprise zone is to facilitate experimentation—not to start allowing cities to try some new blueprint, but to allow people in those areas to really start making a go, both from the business point of view and innovative social organizations and so forth. We're going to make mistakes. There's no doubt about that. High failure rates are a necessary concomitant to high success. And once a city starts to think that it has some specific project that ought to be throughout the whole zone, then you're going to start running into trouble. So I agree with you that one of the key things that has to be emphasized in the federal legislation is not to allow the cities to be the prime instrument in designing an enterprise zone.

Ramsey—Before we continue, I'd like to interject a note here—that if you think back very briefly over this discussion and some of the questions that have been raised, that once one starts to regulate and set up special legislation, we open a Pandora's box. You see, immediately just from this little experiment here today how legislation grows and how it becomes so much more complex. You'll notice that this is, of course, antithetical to the very initial notion of an enterprise zone where you just say: Look, here's an empty area, except for contracts to be enforced, that's it, go to it. Now, Lofts would say, rightly I think, that that is perhaps politically unfeasible at this point in time. But, never mind, we have some ideas. Now provided we're sticking to this concept for now—

Prof. E. S. Savas, Columbia University—If you're not going to deal with regulatory problems within the enterprise zone, aren't you going to dissipate a great deal of the possibilities for coalition of dealing with the regulatory problem itself? Because we have to somehow agree that the regulations that we're taking away really weren't that important. If they were really important for life and safety, we wouldn't take them away. So that, obviously, there has to be something left of the basic fire regulations, or something that's totally dangerous to life or dangerous to somebody's economic health. But what we've taken

away seems to be a possibility that we will solve these problems generally and that by releasing the safety valve over here for a particular purpose, you may have caused much, much more troubles within our economy by reason of the way the political structure is set up? Can somebody comment on that?

Mark Frazier—I was going to say that there are clearly substantive issues which are addressed by regulation which the market would have to deal with. Paris has placed building code enforcement in the hands of the insurance industry which clearly has a stake in reducing the loss of property and life due to building defects. The result is that the building codes in Paris tend to be far more responsive to innovations in technology towards the results, toward the performance, than do codes in New York City. And I think what we should look for are ways to capture the externalities through the marketplace and establish such things as has been done in Houston with zoning and in building codes in France.

Savas—I think the question there is not whether the general regulatory scheme should be changed, but does not setting up an enterprise zone with different regulatory rules both take the incentives away for general regulatory reform and also create a continued constituency for not changing it elsewhere?

Frazier—On the contrary. The presence of Hong Kong and the free zones in Taiwan—I would turn to Alvin for this—has been a prime reason why the entire national policies of the PRC have been moving in a market direction. They have had right at their doorstep an area that's got nine times higher per capita income than theirs. In Ireland they established a free zone in 1969 which had a similar effect. It was so successful in generating employment and exports that 15 years down the road the Irish government as a whole adopted national policies which now have not quite turned to a free zone, but very close to it. It's one of the reasons it's perhaps the most dynamic economy now in Europe.



Photo by Craig Terry

ICEPS's Program Director George Gilder (L.) and Lewis Beman from Business Week.

The high cost of starting up a business today is partly due to tax, but it is also due to unnecessary expenditures one has to make to overcome regulatory barriers.

Ramsey—I think there's still some interest in this topic, but there are a number of others who want to introduce new ones.

Lewis Beman, Business Week—What is the difference between this and the model cities program in that the model cities program initially was experimental without too much specific content about what it might be generally?

Salins—I was fairly actively involved in model cities right from the beginning so I'm quite familiar with it. It's sort of the mirror image of this whole thing. The diagnosis of the problems of the poverty areas was diametrically opposite. I mean that the one it shared in common was the idea of a differential advantage. I think that is the end, though, of the similarity between the enterprise zone and the model city. Because the idea there was, rather than to release the areas from involvement in governmental programs and taxation or anything else, to increase and intensify governmental attention in precisely those areas. In other words, to have more of an effort in the way of subsidized housing, more in the way of government-sponsored manpower training and those kinds of efforts. The assumption was that what those areas suffered from was not too little private enterprise but too little public enterprise and too little public attention. So that what the model cities neighborhoods were invited to do was to divide a shopping list of government programs we had available. We want more of this and more of the other. But I think it's quite a different approach than trying to remove some of these governmental interventions.

Ramsey—Now, this gentleman here has a different topic—we're introducing a new topic.

Robert Speaks, NAACP—First of all I'd like to make an observation. I thought that enterprise zones were primarily a target to reverse the economic decline in the inner city. If we're talking about the South Bronx, we're talking about Bushwick, East New York. As I've observed the complexion and composition of the group, it's very interesting that those elements that are being directly affected are not represented in the discussion. I think that it would be wise in future forums if those people who are being targeted be included. Secondly, anyone who's had any experience in dealing with problems of small businesses in the South Bronx, in Brownsville, in East New York, is aware that not only are there tax and regulatory impediments, but one of the principal impediments is the lack of equitable access to capital, both in terms of general capital and in terms of operating capital from the traditional financial institutions. And in most cases, the inability to secure capital has nothing to do with an objective evaluation of the amount of collateral that can be brought to bear into the question, but they are systemic impediments which have to do with perceptions and exclusions. For example, areas of red-lining by banks. Individuals living in those areas are going for mortgages for improvements, etc., and are finding it very difficult to secure one—not because the individual's financial situation does not permit him to meet the minimum risk requirements for that bank in terms of the loan. But because of public systemic kinds of situations that go

into the formula of determining risk, the same thing is true in terms of securing insurance.

My question is—what kind of provisos can be made or should be made in terms of putting this legislation package together that will deal with those systemic impediments that don't necessarily relate to regulations or taxation? How do you (we) provide incentives for Chase Manhattan Bank and Dime Savings Bank and the insurance companies to participate in those areas which they essentially red-line?

“Are taxes the main inhibitors to new business start-ups, or are there other inhibitors?”

Peter Ferrara—Well, I thought I had proposals directed toward that in my package, which would be to exempt from taxation the interest paid on loans made to businesses within the zone. It seems to me that that would provide a very strong incentive for the Chase Manhattan Bank to make a loan to businesses within the zone. That's a specific thing. I think on a general basis that this entire program would have the effect of “green-lining” the areas where the zone is designated because I think the financial community would begin to expect that there would be a large-scale development in those areas. Now they expect perhaps nothing to happen over the long run. They expect it to continue to deteriorate. But once this area is designated with these enormous incentives for businesses within the zone, I think the attention of the financial community would be drawn towards this area and there would be a lot of applications from this area. Loans would be perceived as more viable because if the businesses could get off the ground they would have the advantages of these tax incentives. So I think on a general area as well as a specific proposal, that would begin to overcome some of those problems.

Stuart Butler—I'd just like to make a general point about this whole question of red-lining and capital for smaller businesses. The point is that the small operations tend to be started with money from the people who are creating them, or from their friends. The money does not tend to come from banks. And the point about the enterprise zone is that what it tries to do is to reduce the necessary capital to start up businesses and to reduce the unnecessary risk and costs associated with starting up in these areas. So at that level it is trying to make it easy for people to accumulate the money to go into business. Simultaneously, of course, you can also have tax and other changes—and maybe changes in the law—to reduce restrictions on lending in these areas and to encourage bigger established banks and institutions to lend. But the prime capital in small businesses is capital that comes from savings risked by the person that actually goes into business.

Tracy Sullivan, City Council President's Office—I wonder if some of the panelists could comment on the concept of the enterprise zone in the context of the economic policy that we see likely to emerge from Washington. Some economists have suggested, for example, that the kind of across-the-board, accel-

Most people go into small business for reasons other than making a little extra money—it's being your own boss, building something yourself, and so forth.

erated depreciation that we're likely to see will have a much greater impact on cities—and a negative one—in the sense that it's going to encourage the movement of capital to outside cities where costs are lower. We're talking about a \$45-\$46 million accelerated depreciation program. This is a one billion dollar program. Is it possible that in terms of urban advocates that that's the urban policy that we've been looking at and we should be far more concerned with making sure that there is enhanced accelerated depreciation, let's say, for decline of cities and be less concerned with this relatively small program?

George Gilder—The crucial question with regard to the starting of small businesses which virtually never start with bank loans is income tax rates and, most significantly, federal income tax rates. So it's quite clear that improvement in terms of depreciation will have no particular good effect on the whole economy, and particularly in cities, unless it's accompanied by drastic cuts in personal income tax rates. Anybody who's really interested in fostering the starting of businesses across the country has to be interested in making it easier for individuals to accumulate savings, invest them themselves and gain the returns of those savings. Depreciation rules will have very little good effect, particularly if they are not accompanied by these reductions in personal income tax rates. The best example of this is that in England they have 100 percent one year depreciation of capital investments; in Sweden they have the lowest rate of capital taxation and the most rapid depreciation in Europe, next to England. Because these policies are accompanied by high personal tax rates, very little new enterprise gets begun and you have an overall stagnant system. So I think that people with an interest in the cities should focus on securing enactment of the Kemp-Roth bill and drastic reductions in the taxation of personal income.

"Why should a small businessman run to establish himself in an enterprise zone when he is only going to make \$2,000 more after taxes (money which he would have probably kept hidden from the government)?"

Ramsey—We're running out of time, so let's have very short, precisely stated questions.

Bernard Newman, *Wall Street Accountant; Chairman of the Department of Accounting, Pace University*—My question is directed to Dr. Butler. It seems to me that for small businesses—as far as tax exemption is concerned—the reductions in tax, even to the extent that Peter Ferrara outlined, are minimal. Most of these small businesses engage to a great extent in the underground economy. The difference might be a difference for a small business from a net profit of \$20,000 to \$24,000—something like that. Why small businesses are going to run to establish themselves in an area like a business enterprise zone for the individual to make only \$2,000 more after taxes—when most of what he is making is not showing in taxes anyway—is ridiculous because after taxes they're

going to get the same amount because they're going to show a little less as income, as revenue.

Stuart Butler—I knew I shouldn't have said nasty things about Wall Street the second time I spoke. But really, I think your point in many ways substantiates what I said—that if one thinks of an enterprise zone as basically playing around with tax rates, then you're not going to achieve the sorts of things I said were necessary in inner cities, and I couldn't agree more. I would point out, though, that the, say, the White House Council on Small Business, that the theme running throughout all of that was that the main problem was essentially regulation in its widest sense—actual technical, physical, red tape obstacles to people—not whether or not you could make a little bit more money in one place or another but what effort was involved. And that strikes me as being so clear with small businessmen. Many small businessmen would make a lot more money if they worked for big business, as you know. Most people who go into small business don't do it in order to make a little bit more than they could elsewhere. It's other reasons—it's being your own boss, it's building something, and so forth. And the impediments against that, of which tax is one but only one, are enormous. And that's what the enterprise zone is attempting to do—to remove those sorts of barriers that cause frustration for people and unnecessary pitfalls and failures and so forth.

Brian Summers, *Foundation for Economic Education*—What is the moral basis of, say, forcing a poor person to pay taxes when the guy down the street doesn't have to pay these taxes because he is in such a zone? What do we tell this person?

Peter Ferrara—Move into the zone. The whole idea is—you've got to start with these things somewhere.

George Gilder—I think that Brian's point is a good one, and I agree that this is a problem area.

Kelvin Stevenson, *Business Week*—I'd like to hear your comments about insurance red-lining. I studied the insurance red-lining. I studied the insurance red-lining against rent-free buildings in the city and discovered blatant cases of irrational red-lining and, also, the whole insurance industry in not stopping arson has been, I would think, a total embarrassment, and I don't think those issues will be addressed at all. In fact, that whole set of problems will not be addressed by this kind of thing. That's a statement, but I could turn it into a question.

Ramsey—I will, if you'd like, argue with you factually and evidentially at length on that issue. You have to ask the question, for example, that in the Bronx when a firm knows that it tops out at \$50, and receives say \$10 in revenues, it's going to fork out an average of \$50 in payments. You know damn well that they are regarded pure and simply as a tax to do business in the city of New York. It's ridiculous.

Stevenson—You mean small business firms?

Ramsey—I'm talking about the insurance companies. And if you want to know about the problems of red-lining, then you should know about the usury law in the city and state of New York, which was the source of the problem.

The static view which says a new business starts up only at the expense of an established business elsewhere is incorrect. We're talking about creating jobs, increasing output, and encouraging new entrepreneurial ideas.

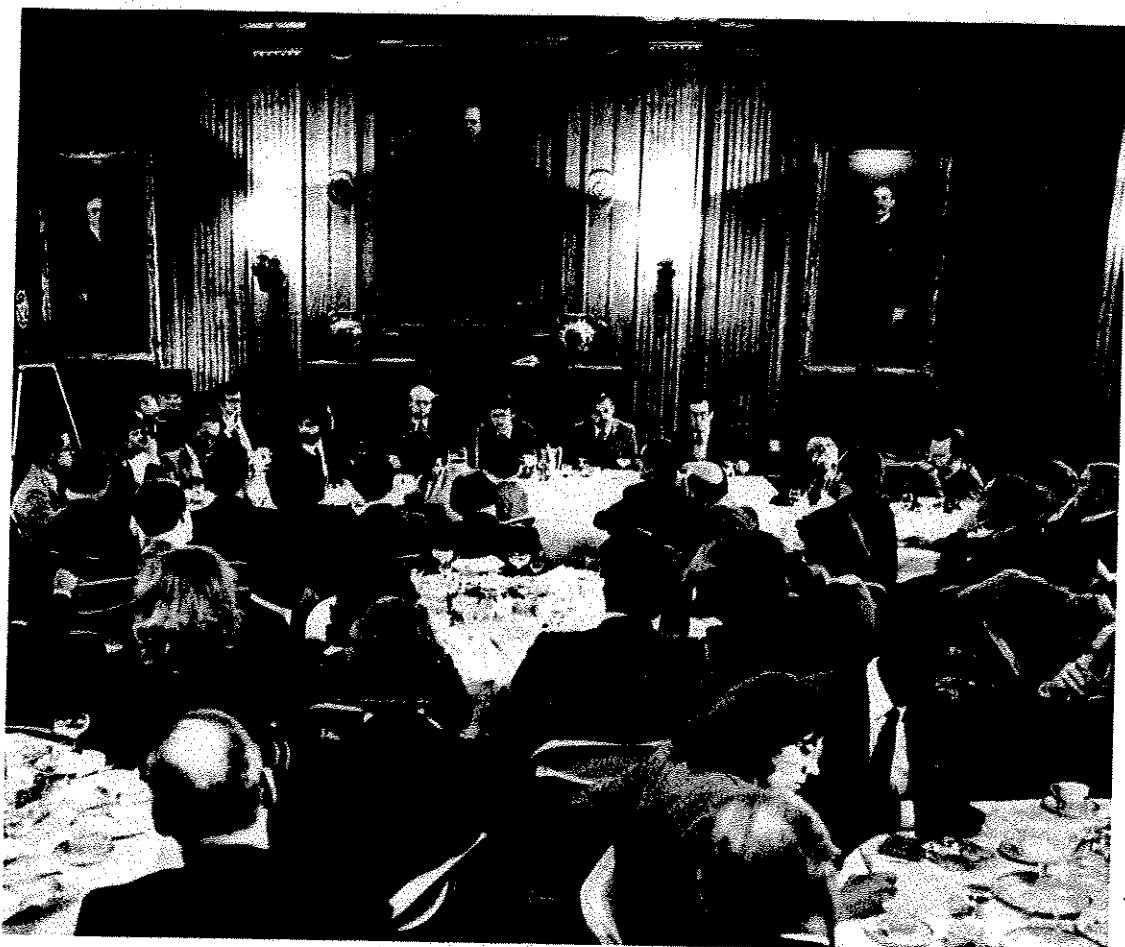


Photo by Craig Terry

ICEPS's conference on urban enterprise zones held at New York's University Club.

If you investigate very carefully what's going on, why are insurance companies so dumb as to just throw money away in the Bronx? But why did insurance companies throw money away in Detroit? They don't want to throw money away in Detroit. As a matter of fact, they managed to get out of Detroit in a massive migration. You couldn't get insurance in Detroit. So a part of the problem with the insurance companies is that they face grave difficulties in being able to enforce anti-arsonist tactics. They would love to not pay out a single dime because a building has been arsoned. You should normally suspect them of going to the other extreme and saying "Ah, ha! You know, you're not going to get the money from your building because we suspect it was arson and we don't pay for arson." All right. Now, if you said to me those cheating insurance companies won't cough up on my insurance claim because they suspect it's arson and they don't have any good evidence, I thought you'd have a much better argument. But that's a personal argument between us which we'll carry on later. I'm violating my own rules.

Stevenson—I still disagree.

George Roniger, Citibank—To focus on small business, I'm one person who thinks the Kemp-Garcia bill is a dog and I think it's because cats and chickens are getting in bed together on this. It's not a free-market system at all. We talked about small business creating jobs and apparently big business doesn't create jobs. Does anybody have any information on the average life of a new small business?

Gilder—About five years.

Butler—First of all, it's very interesting that cats and chickens getting into bed together produce dogs. Small businesses have a very high rate of failure—we all know that. But in terms of employment generation, we're talking about net new jobs. Now that's taking increases and losses within these areas.

Roniger—Are small businesses becoming the largest part of the economy of the country?

Butler—In the sense of employment, yes. The growth is in the small business sector.

Roniger—I think you're wrong.

Gilder—Small business starts in 1950 were about, I think, 93,000. The proportionate employment in small businesses has steadily grown since the 1950s.

In the proportion of private employment, there's been an expansion of public employment.

Butler—Particularly in the Northeast.

Gilder—But the proportion of private employment in small business has expanded much more rapidly than in big businesses.

Roniger—What's the definition of small businesses?

Gilder—It doesn't matter what kind of definition you want to use. You can use the companies below the Fortune 1,000. You can use companies employing less than 200 people, less than 20 people. It doesn't matter what measure you use. You find a greater growth of employment in smaller businesses than in larger businesses in the economy.

Ramsey—We will take the last question.

Sandy Greene, *State of New York* — The relocation question was, I think, supposed to have been enlightening. As long as New York City is looking for an expanding economic pie, it's in trouble. If the small businesses are going to be attracted to the enterprise zones, what will happen to the business presently in the zones? If the firms are going to be used to put other firms out of business, what are you going to tell the employees who will be put out of work by the businesses moving to the zones?

Butler—Well, your logic, which says when a new business starts, it can only do so at the expense of businesses elsewhere, is incorrect. If that were so,

there would never be economic growth at all. It's as simple as that. And specifically with smaller businesses—smaller businesses tend to be—far less mobile and so forth, and you tend to get a small localized growth if you've particularly helped smaller operations. I mean, I just don't agree with the very question or the basis of that question.

Rabushka—That's a fundamental, static view of the world and; quite frankly, the population of the world today is several times the several hundred million we had a couple of hundred years ago, and most of that increase is employed somewhere. We got most of that in periods of high rates of economic growth, and we're seeing it now largely in the Far East. We saw it here ten and twenty years ago. We saw it in Europe in the late 19th and early 20th century. And we're talking about creating jobs, output, entrepreneurial ideas. You know, somebody's going to invent a new product somewhere, and that's going to create employment. And he's not going to create unemployment by destroying somebody else's labor force. If, however, the movement of an individual to a higher paying job is going to be frustrated, we're just going to have a lower standard of living. You really have got to get off this thinking of a static view of an economy and think about a dynamic growth view—or else you will end up having a static society.

Ramsey—Ladies and gentlemen, this session is over, but it is clear that the debate has just begun.

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