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S. William Green

Nancy W. Hunt

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Member of Congress (18th Cong. District, New York) A.B., magna cum laude, 1950, J.D., magna cum laude, 1953, Harvard University. Member, House Committee on Appropriations and the Subcommittee on HUD and Independent Agencies. Staff Economist to Congressman Green. B.A., 1968, Smith College. M.B.A., 1979, New York University

FEDERAL FINANCING OF URBAN ECONOMIC DEVELOPMENT

*S. William Green**
*Nancy W. Hunt***

I. Introduction

The federal government's role in financing urban economic development has evolved in a patchwork fashion during the past fifty years. In response to changing urban problems and needs, the federal government has formulated a broad range of assistance programs including categorical,[1] block,[2] and unrestricted grants,[3]

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* Member of Congress (18th Cong. District, New York) A.B., *magna cum laude*, 1950, J.D., *magna cum laude*, 1953, Harvard University. Member, House Committee on Appropriations and the Subcommittee on HUD and Independent Agencies.

** Staff Economist to Congressman Green. B.A., 1968, Smith College. M.B.A., 1979, New York University.

1. Categorical grants exchange federal resources needed by local governments for acceptance of national minimum standards for a specific purpose. *See* K. BEA, CONG. RESEARCH SERV., THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM: QUESTIONS AND ANSWERS 2 (1980) [hereinafter cited as THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM].

The categorical grant programs replaced by community development block grants included urban renewal, 42 U.S.C. §§ 1450-1469c (1976) (terminated 1975); Model Cities, Pub. L. No. 89-754, tit. I, 80 Stat. 1255 (1966) (terminated 1979); water and sewer facilities, 42 U.S.C. § 3102 (1976) (terminated 1975); neighborhood facilities, 42 U.S.C. § 3103 (1976) (terminated 1975); public facility loans, 42 U.S.C. §§ 1491-1497 (1976) (terminated 1975); and open space land, 42 U.S.C. §§ 1500-1500d-1 (1976) (terminated 1975).

One urban analyst has stated that "categorical programs, properly simplified and stripped of unnecessarily detailed review and red tape, are the most appropriate methods for achieving specific, high-priority national objectives — such as improving slum conditions and relieving other urgent problems of the inner city." M. McFARLAND, FEDERAL GOVERNMENT AND URBAN PROBLEMS — HUD: SUCCESSES, FAILURES, AND THE FATE OF OUR CITIES (1978). An opposing argument is that local governments should be able to choose their own priorities, which they understand better than do Washington bureaucrats. *See* 126 CONG. REC. S10385 (daily ed. July 31, 1980) (1980 Republican Party National Platform).

2. Block grants have the following traits:

1. Federal aid is authorized for a wide range of activities within a broadly defined functional area.
2. Recipients have substantial discretion in identifying problems, designing programs to deal with them, and allocating resources.
3. Administrative, fiscal reporting, planning, and other federally imposed requirements are kept to the minimum amount necessary to ensure that national goals are being accomplished.
4. Federal aid is distributed on the basis of a statutory formula, which has the effect of narrowing federal administrators' discretion and providing a sense of fiscal certainty to recipients.

which have consisted of direct aid to locations with the intent of indirectly assisting the people in those locations. Despite the number of programs in operation, however, the debate over the federal government's role in urban economic development continues unresolved. A continuing question in the debate is whether the federal government should focus on solving the nation's macroeconomic problems in the hope that they would serve to increase local economic activity, or alternatively, should it focus its attention directly on localities that are in social, economic or fiscal distress. If the latter approach is chosen, the question then becomes should the localities in distress receive assistance intended to benefit the residents indirectly or should the aid be given directly to people to enable them to move to where there are jobs. Direct aid to people may mean that deteriorating urban areas might be assisted only to help them shrink gracefully.

Whether programs focus on people or places, several other problems arise. In the past, when it has been proposed that aid be targeted geographically, the proposals have encountered political difficulties. In addition, the federal government (or perhaps state and local governments) must decide whether to aid the most needy — the worst of the worst — or those needy people most likely to respond — the best of the worst. Finally, the government must

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> 5. Eligibility provisions are statutorily specified and favor general purpose governmental units as recipients and elected officials and administrative generalists as decisionmakers.

THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM, *supra* note 1, at 4.

Block grant programs with these characteristics include Comprehensive Health Planning and Public Health Services Amendments of 1966, 42 U.S.C. §§ 242g, 243, 244 (1976); Omnibus Crime Control and Safe Streets Act of 1968, 42 U.S.C. §§ 3721-3726, 3731-3739, 3741-3747, 3750-3750d (1976 & Supp. III 1979); Comprehensive Employment and Training Act, 29 U.S.C. §§ 801-929 (1976 & Supp. III 1979); Social Services Amendments of 1974, 42 U.S.C. §§ 303, 602, 603, 604, 622, 651-660, 1203, 1308, 1315, 1397-1397f (1976 & Supp. 1979); and Housing and Community Development Act of 1974, Pub. L. No. 93-383, tit. I, 88 Stat. 633 (1974).

3. Local governments receive unrestricted grants under the rubric of general revenue sharing. The State and Local Assistance Act of 1972, 31 U.S.C. §§ 1221-1228 (1976), entitled local governments to use shared revenues in the following "public expenditure categories:" public safety, environmental protection, public transportation, health, recreation, libraries, social services for the poor, and financial administration. In addition, they could use the shared revenue for "any ordinary and necessary capital expenditure authorized by state and local law." *See* OFFICE OF REVENUE SHARING, DEP'T OF TREASURY, WHAT IS GENERAL REVENUE SHARING? (1973).

choose among available financing tools such as loans, loan guarantees,[4] grants,[5] equity financing[6] and changes in tax laws.[7] All these forms of aid have been used, but each has its advantages and disadvantages.

II. The Macroeconomic Approach

Many federal programs that provide economic development assistance to urban areas can trace their roots to the Reconstruction Finance Corporation[8] ("RFC"), even though the RFC's goal was

4. Loan and loan guarantee programs have been created to assist in funding public works and services, 42 U.S.C. §§ 3141-3144 (1976) and to aid small businesses, 15 U.S.C. § 636 (1976).

5. For example, under the Public Works and Economic Development Act, 42 U.S.C. § 3131 (1976), the federal government made direct grants "for the acquisition or development of land and improvements for public works, public service, or development facility usage, and the acquisition, construction, rehabilitation, alteration, expansion or improvement of such facilities." *Id. See* Note, *New Urban Economic Development Initiatives: History, Problems and Potential*, 16 HARV. J. LEGIS. 811, 813-14 (1979) [hereinafter cited as *New Urban Economic Development Initiatives*].

6. Aware of the limitations on the usefulness of traditional debt financing to small and new business concerns, the federal government, as well as a few enlightened states, have turned to equity financing, which serves to free struggling companies from the burden of debt service while injecting new capital in return for a share of future growth. *See* L. LITVAK AND B. DANIELS, INNOVATIONS IN DEVELOPMENT FINANCE 110-11 (1979) [hereinafter cited as INNOVATIONS IN DEVELOPMENT FINANCE]. For examples of equity financing programs, *see* Public Works and Economic Development Act, 42 U.S.C. §§ 3241-3245 (1976); Alaska Renewable Resources Corporation, ALASKA STAT. §§ 37.12.010-.080 (Supp. 1980); Massachusetts Community Development Finance Corporation, MASS. ANN. LAWS ch. 40F, §§ 1-5 (Michie Supp. 1981), Massachusetts Technology Development Corporation, MASS. ANN. LAWS ch. 40G, §§ 1-10 (Michie Supp. 1981).

7. The latest and most serious attempt to affect local economic development through changes in tax laws is the enterprise zone concept in which tax abatements are offered as incentives to business and industry to relocate in an economically distressed area. Two New York congressmen recently offered an enterprise zone bill in the House of Representatives. H.R. 7563, 96th Cong., 2d Sess. (1980). *See* Comment, *The Kemp-Garcia Enterprise Zone Bill: A New, Less Costly Approach to Urban Redevelopment*, 9 FORDHAM URB. L.J. 659 (1981) [hereinafter cited as *Kemp-Garcia Bill*]. Other more limited attempts to use changes in tax laws for development purposes include, I.R.C. § 481(1)-(5) (investment credits for energy conservation) and CAL. REV. & TAX CODE § 23601.5 (West Supp. 1979) (tax credits for solar energy systems). *See also* Murphy, *State and Local Tax Incentives for Urban Growth: A Concept Whose Time Never Was?*, 6 FORDHAM URB. L.J. 457 (1978) (tax incentives are of limited usefulness because the costs involved counterbalance the benefits received).

8. Reconstruction Finance Corporation Act, ch. 8, 47 Stat. 5 (1932) (repealed 1957). *See* Reconstruction Fin. Corp. v. Central Republic Trust Co., 17 F. Supp. 263 (N.D. Ill. 1936), *cert. denied*, 308 U.S. 558 (1939) (upholding constitutionality of the RFC); Baltimore Nat'l Bank v. State Tax Comm'n, 297 U.S. 209 (1936) (shares in bank held by RFC are taxable by

economic stabilization rather than urban economic development. The RFC was the federal government's response to the macroeconomic development of the 1930's — the Great Depression. In the late 1920's and early 1930's, aggregate demand decline was accompanied by sharply rising unemployment, deteriorating international trade, and declining gross national product. The overall economic crisis, including the stock market crash[9] of October, 1929 and the ensuing widespread collapse of banks,[10] caused sharp contractions in credit availability. After an attempt to establish a private credit pool to assist commercial banks,[11] the federal government turned to its own resources in an effort to restore economic stability. In 1932, President Herbert Hoover signed the Reconstruction Finance Corporation Act stating that "its purpose is to stop deflation in agriculture and industry and thus to increase employment by restoration of men to their normal jobs."[12] If commercial availability of credit could be reestablished, it was argued that the economy would be restimulated and unemployment would decline. To accomplish this, the RFC was initially mandated to provide loans to financial institutions[13] and purchase preferred and

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a state). To counteract the effect of *Baltimore National Bank*, Congress exempted stock held by the RFC from state taxation. 49 Stat. 1185 (1936). For a discussion of the creation and purpose of the RFC, *see generally* Pinney, *The Reconstruction Finance Corporation*, 8 BROOKLYN L. REV. 158 (1938).

9. On October 24, 1929, a date which came to be known as Black Thursday, 12,894,650 shares were traded on the New York Stock Exchange, causing economic panic and heralding the onslaught of the Great Depression. N.Y. Times, Oct. 25, 1929, at 1, col. 5. The average price of 404 stocks traded on the Exchange fell approximately 40% from September to December. For an economic history of the depression period, see B. MITCHELL, DEPRESSION DECADE: FROM NEW ERA THROUGH NEW DEAL: 1929-1941 28 (1947). For a detailed discussion of the causes and ramifications of the stock market crash, see J. GALBRAITH, THE GREAT DEPRESSION (1955).

10. By 1929, 7,000 banks had closed their doors in the United States. G. MOWRY, THE URBAN NATION: 1920-1960 91 (1965). During 1932, banks closed at the rate of forty a day until on the day of the inauguration of Franklin Delano Roosevelt, March 3, 1933, more than half of the nation's financial institutions were closed. *Id.* at 92.

11. J. BICKLEY, CONG. RESEARCH SERV., AN EVALUATION OF THE RECONSTRUCTION FINANCE CORPORATION WITH IMPLICATIONS FOR CURRENT CAPITAL NEEDS OF THE STEEL INDUSTRY 29 (1980) [hereinafter cited as EVALUATION OF THE RFC]. The National Credit Corporation was organized as a private $500 million credit pool. Its maintenance of stringent loan requirements, however, doomed it to failure. *Id.*

12. *Id.* at 4 (quoting SECRETARY OF THE TREASURY, FINAL REPORT OF THE RECONSTRUCTION FINANCE CORPORATION 1 (1959)).

13. Ch. 8, § 5, 47 Stat. 5 (1932).

capital stock of business and industry.[14] By 1934, the RFC also allocated resources to federal, state and municipal public works projects.[15] During World War II, the financing efforts were directed toward defense related activities[16] and about twenty percent of the lending went directly to business enterprises.[17] Although the RFC was allegedly fraught with political favoritism and corruption,[18] it is nonetheless generally credited with cushioning further economic decline during the 1930's.[19]

With the success of the RFC and the current congressional interest in revitalization of industry, particularly steel and auto corporations, proposals to reactivate the RFC have emerged.[20] The Reagan Administration, however, appears more intent on pursuing an even broader macroeconomic approach to economic revitalization. The Administration will apparently promote general tax reductions geared toward increasing business activity rather than additional aid packages to foster urban economic development on the premise that improving the nation's economy will improve the condition of the cities as well. It is not at all clear, however, that general tax cuts will benefit all geographic regions equally. The impact of the tax cuts will depend on the region's economic age, income distribution, and industry mix.[21] In general, central cities receive a smaller share of the benefit from a cut in personal income tax rates because of the lower per-capita income level. Conversely, an across the board reduction in personal income tax rates will favor regions with higher than national average per-capita income, particularly the Northeast and West Coast.[22] Another argument against general

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14. EVALUATION OF THE RFC, *supra* note 11, at 7.
15. Ch. 653, § 14, 48 Stat. 1112 (1934).
16. Ch. 190, § 4, 55 Stat. 248 (1941).
17. EVALUATION OF THE RFC, *supra* note 11, at 7.
18. *Id.* at 13.
19. *Id.* at 11.
20. At a symposium of business and labor leaders, Charls E. Walker, a former Deputy Secretary of the Treasury, called for "a modern 'tough-minded' Reconstruction Finance Corporation." Silk, *A "Dissensus" on U.S. Policy,* N.Y. Times, Mar. 25, 1981, at D2, col. 4. Another proponent of a modern RFC is Felix Rohatyn, Chairman of the Municipal Assistance Corporation. N.Y. Times, Apr. 21, 1981, at B10, col. 3.
21. B. DANIELS & M. KIESCHNICK, THEORY AND PRACTICE IN THE DESIGN OF DEVELOPMENT FINANCE INNOVATIONS 29-31 (1978) (working papers prepared for the Council of State Planning Agencies).
22. R. VAUGHN, 2 THE URBAN IMPACTS OF FEDERAL POLICIES: ECONOMIC DEVELOPMENT 92 (1977).

corporate tax cuts is regional capacity. If the area's use of resources is at or near full capacity, stimulating investment will be inflationary. The regions with older, declining economies, however, probably have excess capacity and investment could be stimulated without adding to inflation.[23]

A. Aiding Places

Although some consideration has been given to overall economic growth as an approach to urban economic development, programs to aid localities and regions directly, often for specific projects, have dominated federal efforts to aid urban areas. Enactment of the Housing Act of 1937,[24] which authorized a public housing program,[25] demonstrated that the federal government's involvement in urban economic development was basically a shelter program intended to promote redevelopment of urban areas through housing solutions. Under the original 1937 public housing legislation, one slum unit was torn down for each public housing unit built,[26] but the Housing Act of 1949,[27] introducing the concept of urban renewal, broadened the basic concept of public housing and slum clearance to allow the federal government to put up two-thirds of the cost of land clearance.[28] By allowing the federal government to pay two-thirds of the loss of value of the property that resulted from slum demolition, the 1949 Act recognized that slums had economic value.

The Housing Act of 1954[29] constituted the first attempt to coordinate community development under a plan that included housing and non-housing elements. The legislation authorized the use

23. *Id.* at 87.

24. Ch. 896, 50 Stat. 888 (1937), *as amended by* 42 U.S.C. § 1401 (1952). The Housing Act of 1937 placed responsibility for project design and administration in independent local public housing authorities. This approach was designed to insulate the program from the influence of local political corruption and to avoid municipal debt limitations. *See* Comment, *Government Housing Assistance to the Poor*, 76 YALE L.J. 508-09 (1967).

25. Ch. 896, 50 Stat. 888 (1937), *as amended by* 42 U.S.C. § 1401 (1952).

26. *Id.*

27. Pub. L. No. 81-171, 63 Stat. 413 (1949). The Act had as its stated goal "the elimination of substandard and other inadequate housing through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and suitable living environment for every American family."

28. *Id.* § 104.

29. Pub. L. No. 83-560, 68 Stat. 590 (1954).

of ten percent of the capital grant fund for non-residential purposes, specifically, for commercial and industrial development, even though its stated purpose remained the prevention and containment of urban blight.

Like urban renewal, the Urban Development Action Grant ("UDAG") program[30] is place oriented, but the basic approach differed because of its acceptance of the fact that the federal government alone can not solve urban problems. Partnerships of public and private efforts are necessary. The UDAG program is "a highly flexible economic development tool which seeks to create partnerships among the government, community and private industry to overcome problems of development."[31] The UDAG program was intended to revitalize local urban economies, reclaim declining neighborhoods, and create jobs by leveraging public with private capital. UDAG eligible projects include industrial, commercial and neighborhood projects. For example, a major company that would otherwise leave the area may obtain UDAG funding for land expansion, or demolition of a site may be funded if a commitment for new housing is executed.[32]

Other federal government programs designed to aid places include the Area Redevelopment Act ("ARA"),[33] the Appalachian Regional Act,[34] and the Urban Mass Transportation Act.[35] In the early 1960's, the concept of aiding particular regions that were economically distressed became popular. The ARA[36] provided loans and grants for public, commercial and industrial facilities in redevelopment areas which had high unemployment.[37] Through this

30. 42 U.S.C. § 5318 (Supp. III 1979). *See* Comment, *Urban Development Action Grants: A Housing-Linked Strategy for Economic Revitalization of Depressed Urban Areas*, 26 WAYNE L. REV. 1469 (1980).

31. U.S. DEP'T OF HOUSING AND URBAN DEVELOPMENT, THE ACTION GRANT INFORMATION BOOK (1980). In 1980, $675 million was authorized for the UDAG program, with 25% targeted for small communities. *Id.*

32. U.S. DEP'T OF HOUSING AND URBAN DEVELOPMENT, URBAN DEVELOPMENT ACTION GRANT PROGRAM, FIRST ANNUAL REPORT 7 (1979).

33. Pub. L. No. 87-27, 75 Stat. 47 (1961) (repealed 1965).

34. Pub. L. No. 89-4, 79 Stat. 5 (1965).

35. 49 U.S.C. §§ 1601-1618 (1976 & Supp. III 1979).

36. *See* note 33 *supra* and accompanying text.

37. Pub. L. No. 87-27, § 5, 75 Stat. 47 (1961) (repealed 1965). "Redevelopment areas" were designated as those areas with at least six percent unemployment and where the average annual rate of unemployment was either 1) 50% above the national average for three of the preceding four years; 2) 75% above the national average for two of the preceding three

aid, the Area Redevelopment Administrator[38] was to attack structural problems in distressed areas and thus provide a long-term solution to economic problems.[39] The ARA was quickly followed by President John F. Kennedy's Appalachian Regional Commission ("ARC").[40] The Commission recommended that efforts should be made to promote economic development in the economically depressed areas of Appalachia and to close the gap in regional economic performance and income distribution. Although the focus of the ARC was rural, it became the prototype for subsequent regional commissions which eventualy encompassed urban as well as rural areas.

The Public Works and Economic Development Act of 1965 ("PWEDA")[41] created a "depressed area agency with a largely rural focus . . . and a supply side orientation [which was] aimed at reducing costs to potential investors as a means of attracting industry and creating jobs."[42] The PWEDA, which was the basic authorizing legislation for the Economic Development Administration ("EDA"),[43] focused its attention on primarily rural places and looked to long-term solutions to high unemployment and underemployment in contrast to cyclical economic aid. In fact, it is interesting to note that of the rationale behind the ARC and the PWEDA was that the "trickle down philosophy" of overall economic revitalization was rejected.[44] The area aid concept was based on the belief that promoting general economic recovery did not benefit all areas equally and did not diminish regional income distribution disparities. In 1976, the PWEDA was amended to include assistance for metropolitan areas.[45] In subsequent years, the legislation was ex-

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years; or 3) 100% above the national average for one of the preceding two years.

38. *Id.* § 101. *See* C. MARTIN & R. LEONE, LOCAL ECONOMIC DEVELOPMENT: THE FEDERAL CONNECTION, 34-39 (1977) [hereinafter cited as LOCAL ECONOMIC DEVELOPMENT].

39. *See Selected Essays on Patterns of Regional Change, the Changes the Federal Role and the Federal Response, submitted by Senator Henry Bellmon to the Senate Committee on Appropriations*, 95th Cong., 2d Sess. 644 (1977) [hereinafter cited as *Selected Essays*].

40. *Id.* at 632. *See generally* HEARINGS ON EXTENSION OF THE APPALACHIAN REGIONAL DEVELOPMENT ACT BEFORE THE SUBCOMMITTEE ON ECONOMIC DEVELOPMENT OF THE SENATE COMMITTEE ON PUBLIC WORKS, 94th Cong., 1st Sess. (1975).

41. 42 U.S.C. §§ 3121-3246h (1976 & Supp. 3 1979).

42. LOCAL ECONOMIC DEVELOPMENT, *supra* note 38, at 45.

43. 42 U.S.C. §§ 3201-3204 (1976).

44. LOCAL ECONOMIC DEVELOPMENT, *supra* note 38, at 49.

45. Pub. L. No. 94-487, tit. I, § 102, 90 Stat. 2331 (1976).

tended to include aid at the community and neighborhood levels, aid to business and industry, and more assistance for urban areas.[46] Place-oriented aid for economic development also encompassed assistance for rebuilding certain aspects of the physical plant.[47]

The first major legislation concerning mass transportation was the Urban Mass Transportation Act of 1964.[48] This Act authorized grants and loans by the Housing and Home Finance Administrator for the purposes of acquiring, constructing, and improving mass transportation facilities and equipment.[49] To receive the assistance, localities were required to have an areawide transportation plan to improve mobility. In 1966, funds for planning, engineering, design, and management training were made available,[50] and in 1974, funds were authorized for transit operating assistance.[51]

B. Mixed Places and People Approach

Although most of the federal government's urban economic aid programs during the last fifty years have been place-oriented, it has at times been combined with the idea of aiding people directly. President Johnson's "Message on the Cities," delivered to the 89th

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46. LOCAL ECONOMIC DEVELOPMENT, *supra* note 38, at 81-82.

47. The collapse of the 1,753 foot Silver Bridge between Point Pleasant, West Virginia, and Kanauga, Ohio, on December 15, 1967, prompted the federal government to take a sharp look at the condition of the nation's bridges. CONG. RESEARCH SERV., THE NATION'S BRIDGES: PROBLEMS AND PROGRESS 1 (1978) [hereinafter cited as THE NATION'S BRIDGES]. In 1968, the Federal Aid-Highway Act, Pub. L. No. 90-495, 82 Stat. 815 (1968), established national inspection standards for bridges. *Id.* § 26. The Federal Aid-Highway Act of 1970, Pub. L. No. 91-605, § 144, 84 Stat. 1713 (1976), provided funds for replacing bridges on the federally-aided system. *See* THE NATION'S BRIDGES, *supra* at 2. The Surface Transportation Assistance Act of 1978, Pub. L. No. 95-599, 92 Stat. 2689 (1978), brought two significant improvements in the federal government's plan to ensure the safety of bridges. First, it enlarged the program to include rehabilitation as well as replacement. Second, it broadened the program to include non-federally-aided roadway bridges. States were allowed to use up to 35% of their apportioned funds for the needs of those bridges. 23 U.S.C. § 144 (1976 & Supp. III 1979).

48. *See* note 35 *supra* and accompanying text.

49. 49 U.S.C. § 1602 (1976 & Supp. III 1979). These duties were subsequently undertaken by the Secretary of HUD at the inception of that Department and then by the Secretary of Transportation when that post was created.

50. Pub. L. No. 89-562, 80 Stat. 715 (amending 49 U.S.C. §§ 1603-1611 (1976 & Supp. III 1979)). *See* U.S. DEP'T OF TRANSPORTATION, PUBLIC TRANSPORTATION, AN ELEMENT OF THE URBAN TRANSPORTATON SYSTEM 17 (1980) [hereinafter cited as PUBLIC TRANSPORTATION].

51. Pub. L. No. 93-503, § 110, 88 Stat. 1573 (amending 49 U.S.C. § 1602 (1976 & Supp. III 1979)). *See* PUBLIC TRANSPORTATION, *supra* note 50, at 19.

Congress on March 2, 1976,[52] requested the establishment of a Department of Housing and Urban Development ("HUD"),[53] matching grants for building new basic community facilities emphasizing relocation of displaced tenants, rehabilitating existing housing, and providing rent supplement assistance.[54]

The mid-sixties saw significant expansion of the concept of urban economic development to include social and physical improvements that culminated in the Model Cities program.[55] With the enactment of the Model Cities legislation,[56] urban economic development returned to the RFC's goal of job creation under the new name of manpower training, as well as continuing to pursue the goals of the urban renewal program. Any municipality with general governmental powers was eligible for financial and technical assistance for planning, developing and carrying out comprehensive lo-

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52. Special Message to the Congress on the Nation's Cities, Mar. 2, 1965, 1 PUB. PAPERS OF THE PRESIDENTS, LYNDON B. JOHNSON 231. The President emphasized that whether people or places were the targets of direct aid, the true goal is the betterment of the quality of life.

> Let us be clear about the core of this problem. The problem is people and the quality of the lives they lead. We want to build not just housing units, but neighborhoods; not just to construct schools, but to educate children; not just to raise income but to create beauty and end the poisoning of our environment. We must extend the range of choices available to all our people so that all and not just the fortunate, can have access to decent homes and schools, to recreation and to culture.

Id. at 232.

53. *Id.* at 233. The President proposed that the new agency take over the responsibilities of the Housing and Home Finance Agency, as well as serve as "a focal point for thought and innovation and imagination about the problems of our cities." *Id.* at 233-34.

54. *Id.* at 236-37.

55. Title I of the Demonstration Cities and Metropolitan Development Act of 1966, Pub. L. No. 89-754, 80 Stat. 1255 (1966), established the Model Cities program which purported

> to rebuild or revitalize large slum and blighted areas; to expand housing, job, and income opportunities; to reduce dependence on welfare payments; to improve educational facilities and programs; to combat disease and ill-health; to reduce the incidence of crime and delinquency; to enhance recreational and cultural opportunities; to establish better access between homes and jobs; and generally, to improve living conditions for the people who live in such areas. . . .

Id. For a complete account of the Model Cities program, see C. HAAR, BETWEEN THE IDEA AND THE REALITY: A STUDY IN THE ORIGIN, FATE AND LEGACY OF THE MODEL CITIES PROGRAM (1975). *See also* SUBCOMMITTEE ON HOUSING OF THE COMMITTEE ON BANKING AND CURRENCY, 93 Cong., 1st Sess., MODEL CITIES IMPACT ON BETTER COMMUNITIES (Comm. Print 1973) (a study of eight cities in which the Model Cities program was seen as having had a noticeable impact); Olken, *Economic Development in the Model Cities Program*, 36 LAW & CONTEMP. PROBLEMS 205 (1971) [hereinafter cited as *Economic Development in Model Cities*].

56. Pub. L. No. 89-754, § 103, 80 Stat. 1255 (1966).

cal programs with emphasis on new and imaginative proposals. Although the initial emphasis was on direct job training, in 1967 HUD indicated that incentives stimulating expansion of commercial and industrial employment opportunities for neighborhood residents would be acceptable in the Model Cities framework.[57] Congress was slow to appropriate funds for the program and it took three years before the first seven cities received a total of $42 million.[58] In total, only about 150 municipalities participated in the Model Cities program, and in those cities only $100 per-capita was spent in the name of the program.[59] This sum did not have much impact on the massive problems the program was intended to solve.

While some federal programs for urban economic development combined aid for places and people, the Community Development Block Grant ("CDBG")[60] program mixed categorical grants for places with direct aid for physical plants. Categorical grants, which allocate federal funds to local governments to be spent in a specified way, served as the primary form of federal aid to urban areas from the enactment of the major urban development legislation in 1949 until 1974. The categorical grants were criticized, however, for lack of flexibility because the funds were allocated on a project-by-project basis according to the kind of grant. In addition, it has also been charged that the categorical grants promoted "grantsmanship."

In his State of the Union Message in 1971,[61] President Richard M. Nixon proposed a restructuring of national economic development programs and policies that would give the local governments broad discretion regarding the use of federal development aid.[62] In

57. *Economic Development in Model Cities, supra* note 55, at 207. HUD indicated that new projects and activities should be designed to achieve additional sustained employment in the public and private sectors. *Id.*

58. *Progress of the Model Cities Program, Hearing before the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency,* 91st Cong., 1st Sess. 2 (June 9, 1969).

59. Stoloff, *Model Cities: Model for Failure,* FORUM 79 (Jan./Feb. 1970).

60. Housing and Community Development Act of 1974, 42 U.S.C. § 5301 (1976 & Supp. III 1979). *See* note 2 *supra* and accompanying text.

61. Annual Message to the Congress on the State of the Union, Jan. 22, 1971, PUB. PAPERS OF THE PRESIDENTS, RICHARD M. NIXON 50-59.

62. *Id.* President Nixon called for a system of revenue sharing in which Congress would appropriate $16 billion for state and local government. Five billion dollars would be in un-

1975, seven categorical grant programs were consolidated: urban renewal, public facilities loans, rehabilitation loans, water and sewer grants, neighborhood facilities, model cities, and open space land programs.[63] Under the CDBG program, the funds for these grants were combined and localities were given the ability to make project-by-project decisions once they receive the funds. Basically, CDBG aids a wide range of activities in a broadly defined area where the recipient can decide how to use the funds and the reporting required by the federal government is minimal. CDBG was not without its own purposes. The legislation's clearly stated intent was "the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. . . ."[64]

Initially, CDBG emphasized alleviation of physical distress by providing housing and community services to low- and moderate-income individuals. From 1975 to 1977, half of the CDBG funds went for land acquisition and relocation activities, with increasing emphasis on funding public works.[65] The 1977 reauthorization, however, offered a new twist when CDBG funds were approved for stimulating private investment to ease economic distress.[66]

There are several criticisms of the CDBG method of distributing federal aid for urban economic development. Six years after the creation of CDBG, a HUD review[67] of the projects funded indicated that many local governments failed to develop the capacity to plan and implement programs, low-income people were not identified, and new housing was built at the cost of displacing low-income residents.[68]

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restricted funds, while the remaining $11 billion would be earmarked for certain broad categories within which the states would spend the money as they saw fit. *Id.* at 54.

63. 42 U.S.C. § 5301 (1976 & Supp. III 1979).

64. *Id.* § 5301(c) (Supp. III 1979).

65. LEGISLATIVE REPORT, NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT, CDBG: A VERSATILE ECONOMIC DEVELOPMENT TOOL 2-3 (1980).

66. *Id.*

67. *See* THE FIRST REPORT FROM THE NATIONAL CITIZEN'S MONITORING PROJECT ON COMMUNITY DEVELOPMENT BLOCK GRANTS, MONITORING COMMUNITY DEVELOPMENT, THE CITIZEN'S EVALUATION OF THE CDBG PROGRAM (1980).

68. *Id.* at 11-13.

C. Targeting

One of the major areas of controversy surrounding the federal urban economic development programs is the problem of targeting aid. Choosing who and what places to aid can be politically unpopular, to the point where programs can be rendered ineffective or even defeated. A prime example of this phenomenon was the legislative fate of the National Development Bank. In March 1978, President Jimmy Carter urged the Ninety-fifth Congress to enact a national development bank bill that would stimulate private business investments and increase the rate of job creation in distressed areas.[69] As is true of UDAG, the development bank combined aiding places with job creation. The underlying premise for the bank was that the existence of capital market shortages 1) inhibited redevelopment financing for large projects; 2) prevented the expansion of small- and medium-sized firms which provide the most new jobs; 3) inhibited new product development financing at small- and medium-sized firms; and 4) excluded minority borrowers, especially in central cities.[70] The Carter Administration believed that by reducing the cost of capital through grants, loans, loan guarantees, and interest subsidies, firms planning to leave a distressed area could be encouraged to remain, other firms could be induced to expand, and new firms might be encouraged to relocate in distressed areas.[71]

Although the National Development Bank, in all of its incarnations,[72] failed to pass the Congress, the debate on the proposals provides an excellent summary of the current controversy on targeting of federal financing of urban economic development.[73]

69. H.R. 13230, 95th Cong., 2d Sess. (1978); S. 3233, 95th Cong., 2d Sess. (1978).

70. *See* G. Meadows and J. Mitrisin, Cong. Research Serv., A National Development Bank: Survey and Discussion of the Literature on Capital Shortages and Employment Changes in Distressed Areas 3 (1979) [hereinafter cited as National Development Bank]. *See also New Urban Economic Development Initiatives, supra* note 5, at 813.

71. *See New Urban Economic Development Initiatives, supra* note 5, at 813-17.

72. First, the Carter Administration withdrew its proposals in 1978. In 1980, a similar congressional proposal for a development bank failed, H.R. 7902, 96th Cong., 2d Sess. (1980), as did a compressed version that appeared as part of the National Public Works and Economic Development Act of 1980, H.R. 2063, 96th Cong., 1st Sess. (1979) and S. 914, 96th Cong., 1st Sess. (1979).

73. *See Hearings before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 55-70 (1979) (statements of Harold Hovey, Richard Nathan and Belden Daniels) [hereinafter cited as

The criteria in the original legislation made approximately forty percent of the population eligible, but when the development bank idea appeared as part of one version of the Public Works and Economic Development Act,[74] ninety percent of the population had become eligible.[75] Clearly, aiding ninety percent of the country was not really targeting the aid. Further debate centered on the question of what criteria to use. Certain of the criteria used in the PWEDA, such as national per-capita income and percent of families in poverty, work against high-cost-of-living areas.[76] Use of local data would solve that problem, but local data is not consistently available. Even if local data was available, low income does not equal unemployment and low per-capita income is an average that does not indicate distribution of income. On the other hand, population loss or lack of population growth, another PWEDA criterion, might actually relieve distress if the loss of population eased the strain on an area's physical plant and services.[77] Other criteria that are frequently suggested include income distribution, existence of a dominant industry, ratio of employed to total population, tax delinquent and vacant properties, and change in real estate values.[78] Regardless of what criteria are used, the data will have to be consistent, reliable and current. Nevertheless, in all probability, exceptions will have to be made for special situations, even if more equitable criteria can be developed.

Another area of concern was the size of the firm that should be eligible for aid. In the 1978 proposal, the Carter Administration wanted to aid larger, more mature companies even though research indicated that the smaller firms have the greatest expansion potential.[79] There was also some debate concerning forms of aid to firms, including providing equity capital for smaller firms.[80] Opponents of the equity financing proposal were concerned about federal government ownership of private companies and noted that the Small

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Hearings].

74. *See New Urban Economic Development Initiatives*, *supra* note 5, at 823.

75. *See Hearings*, *supra* note 73, at 257.

76. *Id.* at 233.

77. C. BECKENRIDGE, CONG. RESEARCH SERV., ELIGIBILITY CRITERIA FOR EDA TITLE IX; AN EXAMINATION 3 (1978) [hereinafter cited as ELIGIBILITY CRITERIA].

78. *Id.* at 4.

79. *See* NATIONAL DEVELOPMENT BANK, *supra* note 70, at 10.

80. *Id.* at 92. *See* INNOVATIONS IN DEVELOPMENT FINANCE, *supra* note 6, at 72-73.

Business Administration offers equity financing.[81] Proponents of equity financing argued that the SBA's resources were pathetically limited and small business needed equity financing because they lacked the capacity to service debt financing.[82]

The UDAG and CDBG programs have also encountered targeting problems. Under UDAG criteria, fifty-two percent of the nation's cities and urban counties are eligible for assistance.[83] The eligibility criteria include lagging per-capita income, population or employment growth, housing stock, and above average unemployment and poverty population.[84] In addition, HUD has special distress factor criteria for acute problem areas and separate criteria for small cities. Nonetheless, UDAG criteria have been criticized because they are not sensitive to the severity of distress, except poverty[85] and because the data available for the targeting are out of date and not particularly reliable and therefore, may not catch current distress.[86] In 1978, the "pockets of poverty" criterion was added to allow UDAG grants to be targeted to areas of cities that met UDAG criteria even though the entire city did not.[87] One critic of this provision noted that growing cities with expanding resources should aid their own "pockets of poverty instead of looking to Uncle Sam's pockets."[88]

Under CDBG legislation, all governing entities from small cities to Indian tribes are eligible for CDBG assistance. The various grants are allocated by complex formulas which are based, for entitlement grants, on population, poverty, and overcrowded housing.[89] The CDBG criteria are subject to the same criticisms as the UDAG criteria and in addition, the formulas can be criticized for flaws in allocation of funds to non-metropolitan areas. CDBG formulas allow allocation of funds to suburban communities with less than

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81. NATIONAL DEVELOPMENT BANK, *supra* note 70, at 93. *See* H. HOVEY, DEVELOPMENT FINANCING FOR DISTRESSED AREAS 29 (Northeast-Midwest Inst. 1979).

82. *See* M. KIESCHNICK, VENTURE CAPITAL AND URBAN DEVELOPMENT 24-30 (1979).

83. REPORT BY THE COMPTROLLER GENERAL OF THE UNITED STATES, CRITERIA FOR PARTICIPATION IN THE URBAN DEVELOPMENT ACTION GRANT PROGRAM SHOULD BE REFINED 3 (1980).

84. *Id.* at 14.

85. *Id.* at 20.

86. *Id.* at 8.

87. 42 U.S.C. § 5318(b)(2) (Supp. III 1979). *See* U.S. DEP'T OF HOUSING AND URBAN DEVELOPMENT, POCKETS OF POVERTY: AN EXAMINATION OF NEEDS AND OPTIONS (1979).

88. 124 CONG. REC. S11243 (1978).

89. THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM, *supra* note 1, at 13.

50,000 population if they are also center cities of metropolitan areas.[90] It is certainly possible to question whether these suburban communities which are frequently well-to-do should receive federal aid which had been earmarked for economic development in distressed areas.

III. The Reagan Administration Approach

The federal government has a broad spectrum of programs to aid urban economic development and the question for the 1980's and the Reagan Administration is what the future role of the federal government should be. In order to know what policies to pursue, one should know the extent of the economic needs of urban areas. Studies have been done which indicate that more cities will experience severe fiscal stress in the 1980's,[91] that cities are seriously undershooting their capital budget expenditures,[92] and that the total value of public capital is not growing significantly.[93] Nonetheless, no one knows the full extent of the financing required to maintain and improve the infrastructure of urban areas. The Urban Institute has done studies of various cities that outline the extent of planned capital budget expenditures for these cities,[94] but there is no overall compilation of the size of the investment that is required to bring the infrastructure of the nation's cities up to standard.

Despite the lack of solid data defining the magnitude of the problem the Reagan Administration apparently agrees that an urban economic development problem exists. And although its ap-

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90. 42 U.S.C. § 3304(b)(3) (1976 & Supp. III 1979). An example of such a community is Poughkeepsie, New York.

91. *See* TRENDS IN THE FISCAL CONDITION OF CITIES, 1978-1980, *A Study prepared for the use of the Subcommittee on Fiscal and Intergovernmental Policy of the Joint Economic Committee*, April 20, 1980, at 5.

92. *Id.* at 31-32. *See generally* D. GROSSMAN, THE FUTURE OF NEW YORK CITY'S CAPITAL PLANT (Urban Inst. 1979); N. HUMPHREY, G. PETERSON & P. WILSON, THE FUTURE OF CLEVELAND'S CAPITAL PLANT (Urban Inst. 1979).

93. CONSAD RESEARCH CORP., U.S. DEP'T OF COMMERCE, A STUDY OF PUBLIC WORKS INVESTMENT IN THE UNITED STATES 13 (April 1980).

94. *Hearings, supra* note 73, at 11. George Peterson, Director of Public Finance at the Urban Institute stated that the cost of needed infrastructure repairs in many cities is well beyond the reasonable capacity of these cities to finance. For example, Buffalo has not resurfaced streets in five years and now requires $125 million in repairs. Cleveland must replace a water treatment plant at a cost of $141 million. *Id.* at 12.

proach may include elements of past programs,[95] the Administration will probably add some new ideas as well. In a speech to the National League of Cities in December, 1980, Ronald Reagan said that he would "move to consolidate the present grants programs into block grants, so that local governments can use the funds flexibly within the broad limits to meet local needs efficiently."[96] That approach would mark a return to the Nixon Administration's consolidation of categorical grants into CDBG's.[97] Further clues to the direction of President Reagan's urban economic policy are probably found in the "British enterprise zone" proposal and the statement that "a rising tide raises all boats." Apparently, the Reagan Administration will follow an urban policy that is a combination of a macroeconomic approach and locational programs.

The British enterprise zone concept was taken up by the Conservative Government in 1979 and describes an area or zone which is exempt from taxes and government regulations[98] in the hope that this forebearance will spur development and the entrepreneurial spirit.[99] A bill[100] introduced in the second session of the Ninety-sixth Congress by two New York congressmen would provide tax incentives for businesses in depressed areas designated as enterprise zones, but the plan does not follow the British scheme insofar as exemption from regulations is concerned. Under

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95. The new Administration's approach, however, differs from the Carter Administration's, whose urban policy programs essentially provided aid to places. Also in contrast to the urban policies of the Carter Administration are the conclusions of the PRESIDENT'S COMMISSION FOR A NATIONAL AGENDA FOR THE EIGHTIES (U.S. Gov't Printing Office 1980) [hereinafter cited as PRESIDENT'S COMMISSION]. The report concluded that "[f]ederal efforts to revitalize urban areas through a national urban policy concerned principally with the health of specific places will inevitably conflict with efforts to revitalize the larger economy." PRESIDENT'S COMMISSION, *supra* at 166. The Commission therefore recommended a policy that promoted national economic revitalization and allows distressed urban areas to accommodate and adjust to redistribution trends, rather than attempt to retard or reverse them. *Id.* at 166-67. The major long-term goal of federal urban policy should be to assist the efforts of the unemployed to retrain and relocate, in order to "link people with economic opportunity, wherever that opportunity might be." *Id.* at 70.

96. Kramer, *"Dear Ed Koch: Watch Out for Jake Garn,"* NEW YORK MAGAZINE, Dec. 15, 1980, at 16.

97. *See* notes 60-64 *supra* and accompanying text.

98. BRITAIN'S ENTERPRISE ZONE: A BOLD EXPERIMENT IN UNFETTERED CAPITALISM, BRITISH INFORMATION SERVICES, NEWS DIVISION, Sept. 19, 1980.

99. *See generally Kemp-Garcia Bill, supra* note 7, at 659-62.

100. H.R. 7563, 96th Cong., 2d Sess. (1980).

the Kemp-Garcia plan, the Secretary of Commerce would approve the zone upon request of the local government using criteria similar to those already used by the EDA.[101] The package of federal tax incentives includes 1) reduced capital gains tax, 2) reduced corporate federal tax rates, 3) accelerated depreciation for small business, 4) reduced Social Security tax, 5) extended net operating loss carryovers, and 6) an optional cash method of accounting for small businesses.[102]

Criticism of the Kemp-Garcia bill points out that the tax benefits in the zone benefit established businesses as opposed to new small businesses because the latter already have minimal tax liability, if any.[103] Therefore, small businesses, which provide the most new jobs, are not positively affected by the Kemp-Garcia bill. Further criticism has been aimed at the local property tax reduction provision. In all likelihood, the property tax reduction will fall on localities that are least able to bear a reduction in municipal revenues; this provision of the bill ignores the probable increased cost of municipal services as activity increases.

The enterprise zone would not be immune from the same targeting problems that have plagued the other programs. Under the proposed criteria almost every city would qualify for a zone.[104] And with no limit on zones, there is no control over the cost, a key drawback for tax incentive proposals.[105] Finally, emphasis on corporate incentive does not necessarily alleviate unemployment and poverty problems.[106] Despite these anticipated problems with enterprise zones, the Reagan Administration's interest in such a program probably indicates that they do not intend to follow the recommendation of President Jimmy Carter's Commission for a National Agenda for the Eighties.[107]

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101. *Id.* tit. I, sec. 101(a), subch. C, § 7871(c).

102. *Id.* tit. II. *See* C. Breckenridge, Cong. Research Serv., "Enterprise Zones" for Distressed Areas: Background Observations 2 (1980) [hereinafter cited as Enterprise Zones].

103. Enterprise Zones, *supra* note 102, at 3.

104. Fitzpatrick & Tropper, Northeast-Midwest Inst., Tax Cuts for Business, Will They Help Distressed Areas? 50-51 (Sept. 1980) [hereinafter cited as Tax Cuts for Business].

105. Enterprise Zone, *supra* note 102, at 4.

106. Tax Cuts for Business, *supra* note 106, at 51.

107. *See* note 95 *supra* and accompanying text.

IV. Conclusion

The tortuous history of federal financing of urban economic development is evidence that the solutions are far from easy to implement. Several points are clear, however. The nation's cities will not be able to finance their infrastructure needs by themselves, and, without properly operating transportation, water, sewer and other capital plant systems, cities cannot retain and attract the business activity that provides income and employment for their residents. Nonetheless, the federal government has only limited resources available and whether these resources are in the form of subsidies or tax incentives, they must be targeted for maximum impact. As the latest EDA reauthorization debate has shown, choosing targeting criteria that are politically and economically acceptable will be difficult. Furthermore, while the broad national economic approach will provide the necessary improvement in overall economic conditions, it is not at all certain that an economic recovery can be structured in such a way as to benefit all regions and urban and non-urban areas equitably. Therefore, the continuation of programs targeted to specific urban areas that are experiencing distress, is a necessary element of any urban policy.