Time to Rethink California Enterprise Zones
Testimony by AFSCME, AFL-CIO
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As the Assembly Jobs, Economic Development and the Economy Committee continues to vet the impact of enterprise zones in hearings throughout the State, the American Federation of State, County and Municipal Employees (AFSCME), AFL-CIO would like to thank you for providing us the opportunity to participate during the committee's informational hearing on enterprise zones and other geographically-targeted economic development areas.

We would also like to thank you and the committee for holding these hearings in various communities throughout the State and strongly encourage this committee, and other standing committees of the legislature to do the same so that Californians are able to directly participate in the dialogue and decision-making toward making California better.

AFSCME has reviewed material provided by the committee regarding this subject as well as studied various aspects of the impacts of enterprise zones on California's communities and the economy and is providing to you our analysis as detailed below.

The enterprise zone program represents a large and growing investment by California taxpayers. The cost of the hiring and sales tax credits grew 12 percent in 2007, to 430 million dollars.

Lack of Results

The theory behind the program is that a government partnership with private business can do more to stimulate economic growth in depressed communities, increasing employment and alleviating

poverty. When the state seeks to carry out a program with the private sector, it is extremely important to monitor and oversee the results, in order to make sure the *public's* goals are being met. The state has for years neglected that responsibility.

Independent researchers have evaluated the program, however. The bulk of the research – and especially the most careful studies – tell us the program is not achieving its goals:

- The Public Policy Institute of California, in a study published this year, found "enterprise zones have no statistically significant effect on either business creation or employment growth rates." PPIC found that zones where local administrators spent more time facilitating the hiring tax credit performed *worse* than average. That's remarkable. The more they focused on delivering credits to employers, the worse the results for jobs and economic growth. And yet, this is one of the zone administrators' top activities. They spent far less time helping businesses with zoning, getting workers training, and operating hiring centers.

- Alan Peters and Peter Fisher of the University of Iowa wrote a book in 2002 called *State Enterprise Zone Programs: Have they worked?* They examined 75 zones in the 13 largest industrial states, including California, using a sophisticated economic model. The authors found, to their surprise, that enterprise zones were not successful. Like the later PPIC study, Peters and Fisher found zone incentives had "no appreciable impact on local establishment growth" nor on employment growth. They concluded that taxes are too small a factor in business decisions, and most programs do not provide a rich enough incentive to overcome the challenges of economic development in distressed areas. A

few programs that are generous enough to have an impact are fiscally detrimental.

- These studies confirm earlier findings. A 2003 LAO study observed that enterprise zones may shift jobs within the region rather than increasing them for a region as a whole; a 1994 California Policy Seminar study found little evidence that enterprise zones are effective and that most businesses accepted subsidies for jobs they were creating anyway; and a 1995 state audit found the benefits of enterprise zones could not be determined.

Some of the studies that have reported positive results have serious flaws. For example:

- The 2006 study commissioned by the state Housing and Community Development Department compared *rates of change* in poverty, unemployment and two measures of income between enterprise zones and the rest of the state from 1990 to 2000. This is a confusing measurement. Recall that this time period included the longest economic expansion in United States history, and the benefits of economic growth reached all income levels. It would be surprising indeed if the rate of change in poverty, for instance, was lower in an area with a higher starting point than one with a lower starting point poverty rate.

- The 2003 Applied Development Economics study commissioned by the California Association of Enterprise Zones (CAEZ) stated that a dollar in enterprise zone tax benefits produced one dollar and 44 cents in new revenue. To arrive at this conclusion, the study assumed, absurdly, that all new taxes paid by firms located in enterprise zones

was a result of the incentive. In fact, Professors Peters and Fisher cite a large body of research that finds that only 9 percent of firm locations can be attributed to incentives. Peters and Fisher's study finds that, at the average net costs and benefits for enterprise zones nationally, at least 30 percent of firm locations must be attributed to the program – meaning, they would not have occurred but for the incentive – for the incentive to "break even." The CAEZ study, again, assumes 100 percent.

Flaws in the Program

These findings should come as no surprise when you think about the flawed structure and policies of the enterprise zone program. There are too many zones covering too broad an area. The intent was to focus incentives on the most economically distressed communities in the state. Many of us here care deeply that same goal. But how could the enterprise zone program accomplish that when, today, zones are found in portions of more than two thirds of Assembly Districts and in nearly 9 out of 10 Senate Districts?

Just as problematic is the structure of the hiring credit – the largest component of the enterprise zone program. This credit pays businesses half the cost of salary up to one-and-a-half times the minimum wage for the first year. The benefit goes down to 40 percent in the second year, 30 percent in the third, et cetera.

- So it is front-loaded and the benefit diminishes over time, instead of rewarding stable employment.
- Because of the salary limit, it provides a proportionately greater subsidy for low-wage jobs than for good jobs.
- Companies can claim credits retroactively – for jobs they *have already created*. 15 percent of the benefits went to retroactive credits in 2003. One of the great risks of incentive programs is

that you subsidize activity that would have occurred anyway. A retroactive credit ensures that you will make this mistake.

- The credit is good for new *hires* and not just new jobs. Turnover creates an opportunity to claim a credit. So does part-time work.
- Anyone living in a Targeted Employment Area is eligible to generate a credit, not just people with barriers to the labor force. If you are going to have a subsidy for low-wage jobs, it should at least provide an opportunity for hard-to-employ individuals.

A Lack of Accountability

Most government agencies and programs are subject to regular performance appraisals. In California, the Bureau of State Audits has issued reports covering more than 70 state and local agencies over the past two years. These analyses determine if a program is being carried out properly and whether it is performing as intended.

Poor evaluation results and an unwillingness to address the issues uncovered can impact a program's funding. For example, the Technology, Trade and Commerce Agency was eliminated in 2003 following negative performance appraisals because, among other reasons, it "had failed to demonstrate that it ever measurably improved the state economy," according to news accounts. Workforce development, juvenile justice, early childhood education, and a host of other programs are constantly scrutinized to measure their effectiveness, and continually evolve as experience and analysis reveal shortcomings and new models arise.

Yet PPIC said enterprise zones have little to fear from a poor record, because they are at almost no risk of losing their special designation. The report pointed out that in 2006, *every applicant* was granted a zone or included in another zone's territory.

Meanwhile, California has been cutting funding for programs *with* proven records and compelling bases for support. For example, California has carried out:

- Education cuts that shorten the school year, lay off teachers, reduce training and pay, cut school bus service and increase class sizes.
- Health funding reductions that cut off health insurance from thousands of children, eliminates adult dental and optician services, reduce money for immunizations, cancer screenings, HIV and maternal health programs, and cut payments to providers, safety net hospitals and nursing homes.
- In-Home Supportive Services cuts that eliminate services for most recipients. This is a program that saves the state money by keeping people out of more expensive nursing homes.
- Cuts to child care and income supports for low-income and disabled Californians that will diminish their purchasing power and stymie economic recovery efforts.
- And the state has cut funding for its most basic obligations to the public's safety and health: for example, child welfare, court operations, and corrections.

Under these budget circumstances, when valuable and proven programs are being cut, it makes little sense to continue a program that *lacks* a record of performance. We must prioritize our public spending. A temporary reduction in the ratio of

vouchers to credits is not enough. The program needs to be fundamentally reformed. We agree with PPIC's conclusion, when they wrote "Our findings cast a skeptical eye on California's enterprise zone program. For a cash-strapped state, it is too costly a program to simply continue with 'business as usual' without clearer evidence of the program's benefits or a well-defined plan to make the program more effective."

Conclusion

Just last week, Dell Computer announced they were closing a plant in North Carolina and moving production overseas, which will cause 900 workers to lose their jobs. The state and local governments in 2004 offered up 300 million dollars to Dell to build the plant. This is a company that earned nearly half a billion dollars in profit in the last quarter. While most of the state incentive offer will be recovered, much of the local subsidies have already been spent and those jurisdictions will have to try to recoup their investment. But aside from the clawback problem, the bigger issue is this: when government offers such an enormous incentive and the company is profitable, and it's *still* not enough to keep them, you have to wonder the point of this game governments are playing to try to land business deals.

Our approach to enterprise zones is not working, and it represents a costly failure we can no longer afford. If the state wishes to keep some sort of geographically targeted incentive system, we recommend you start with a handful of locations and an incentive structure that rewards real progress toward our goals, not just a distribution of corporate benefits.