EVALUATING THE IMPACT OF FEDERAL COMMUNITY ECONOMIC DEVELOPMENT POLICIES ON TARGETED POPULATIONS: THE CASE OF THE NEW MARKETS INITIATIVES OF 2000

Dr. Julia Sass Rubin

Assistant Professor of Public Policy

Edward J. Bloustein School of Planning and Public Policy

Rutgers University

Gregory M. Stankiewicz

Ph.D. Candidate

Woodrow Wilson School of Public & International Affairs

Princeton University

gregorystankiewicz@post.harvard.edu

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Abstract

Over the last four decades, the federal government has implemented a series of community economic development programs designed to counter urban and rural poverty. These programs' objectives have exhibited a tension between the pursuit of broad economic growth and a focus on more targeted poverty alleviation.

The most recent examples of this tension are in the new markets venture capital and new markets tax credit initiatives. These programs, sponsored by President Bill Clinton and signed into law in December 2000, were designed to increase the supply of equity capital in distressed regions of the United States by leveraging up to $15 billion in new investments from the private sector.

This paper consists of two parts. The first part examines the enactment of the new markets venture capital and the new markets tax credit programs, focusing on how the political process affected the intended outcome of these initiatives. The second part analyzes the implementation of both initiatives to date, highlighting the impact that a new administration has had on the programs. It also points out the potential unintended consequences of both programs, especially those resulting from the programs' ambivalent objectives.

With great fanfare, President Bill Clinton signed into law the new markets venture capital (NMVC) and new markets tax credit (NMTC) initiatives, as part of the Community Renewal Tax Relief Act. The signing took place on December 21, 2000, just a few weeks before Clinton left office. At the ceremony, Clinton evidenced real pride in the bill that he was signing, stating that it represented "the most significant effort ever" to help distressed communities by leveraging private investment (cited in Pappas 2001, p. 323).

The new markets initiatives were designed to combine public and private-sector resources in order to bring more than $15 billion in new investments to disadvantaged rural and urban communities. Passage of the initiatives generated high hopes that this federal program would help create new jobs and community renewal in some of the most disadvantaged communities of this nation (Walker 2002, p. 28). The fact that new markets was part of a bi-partisan package appeared to help guarantee its success—supporters hailed the fact that it incorporated both Republican and Democratic approaches in using market forces to help distressed areas. Representative James Talent, a Republican from Missouri, stated that the bill "is not only the most comprehensive anti-poverty package coming out of the federal government…in a generation, but it also…has assimilated the lessons that people on both sides of the aisle have learned over the last generations" (cited in Draut, Callahan, & Hawkes, 2002, p. 34).

However, careful observers at the time already noticed some warning signs, indicating that the implementation of the initiatives would not be as smooth as its supporters might have hoped. For one thing, proponents seemed divided as to what exactly new markets was written to do: Was it poverty alleviation, or was it a more straightforward attempt at economic development? For another, the bill was signed by one President but was to be implemented by his successor, who was significantly less supportive of the initiatives. The Bush administration also implemented the programs in the context of much harsher budgetary and economic times. As a result of all these factors, it did not protest when, in the spring of 2003, funding for future rounds of the new markets venture capital program was eliminated entirely from the federal budget.

The Bush administration also placed the new markets tax credit program in danger by attempting to eliminate what it calls the "double taxation" of corporate dividends, as part of its 2003 tax cut package. If

it had been successful, it would have weakened severely the incentive for corporations to purchase any type of federal tax credits, including the new markets credits (Ernst & Young 2003). Congress ultimately adopted a different approach to reducing the dividend tax, one that does not impact the value of the new markets tax credit (New Markets Tax Credit Bulletin 2003b). Nevertheless, the administration's efforts in this area call into question how much support exists within the Bush administration for the new markets tax credit program.

This paper examines the passage, implementation, and current status of the new markets initiatives, in order to recommend ways of strengthening the new markets tax credit program. The paper also focuses on what the new markets case study can reveal about the changing direction of federal community economic development policies in the United States.

The paper consists of two parts. The first part examines the creation and enactment of the new markets programs. The second part analyzes the implementation of both programs to date and assesses the likely impact they will have on their target populations.

THE GENESIS OF THE NEW MARKETS INITIATIVES

As with so many other policy initiatives, passage of new markets was in no way a foregone conclusion and was in doubt until shortly before President Clinton signed a compromise bill. In examining this process, it is useful to refer to John Kingdon's model of public policymaking. For Kingdon, policy entrepreneurs succeed in passing new legislation when they are able to take advantage of an open "policy window." Such windows open at moments when actors and stakeholders recognize specific problems, when policy prescriptions are already available to deal with such problems, and when the political environment is receptive to taking action (Kingdon 1984, pp. 20-21).

The Problem: A Need for Equity Capital in Disadvantaged Neighborhoods

In the case of new markets, the problem that the Clinton administration wished to address was the continued presence of what the administration called "places left behind," areas of distress whose residents had not shared in the strong economic growth of the mid-1990s. These areas were identified as existing in urban, older suburban, and rural regions of the United States (U.S. Department of Housing & Urban Development 1999).

Solutions Already Available on Policymakers' Agendas

For the administration, potential solutions to the problem of helping such communities ranged from traditional Democratic anti-poverty programs to more business-oriented policies designed to increase economic growth in the affected regions. In examining the available policy alternatives, the administration was drawn to the more business-oriented, entrepreneurial policies, since they seemed to fit better with the tenor of the administration's governing philosophy and of the political and economic environment. Many of these policy ideas were adopted from recent academic and applied research.

For example, beginning in the 1980s, many academics who studied economic development began to urge state-level practitioners to ignore the traditional methods of attracting new business through the use of tax incentives. Instead, they urged them to focus on stimulating the demand for new business. In 1988, one such academic, Peter Eisinger, published The Rise of the Entrepreneurial State, which documented a wide variety of economic development policies that used such demand-side methods. In a passage that could easily describe the future new markets program, Eisinger wrote:

> Underlying the actions of the entrepreneurial state is the assumption that growth comes from exploiting new or expanding markets. The state role is to identify, evaluate, anticipate, and even help develop and create these markets for private producers to exploit, aided if necessary by government as subsidizer or coinvestor. The policies of the entrepreneurial state are geared to these functions. They include the generation of venture capital for selected new and growing businesses. (Eisinger 1988, p. 9)

That same year, David Osborne popularized many of these same methods in his book Laboratories of Democracy, which praised as worthy models many of the entrepreneurial polices being implemented in a number of the states. The foreword to Osborne's book was written by the then-governor of Arkansas, Bill Clinton, who was praised by Osborne as an example of the new breed of pragmatic governors who were willing to try such approaches (Osborne 1988). Only four years later, Clinton would be elected president of the United States and would look to many of these policy ideas as models for what the federal government could do to assist distressed communities.

A second impetus for new markets came from the research of a Harvard Business School professor. In 1995, Michael Porter published an influential journal article in which he stated that new entrepreneurial approaches could help disadvantaged inner cities in the United States. Porter argued that past efforts to help inner cities had failed because they focused on meeting social needs, rather than on

strengthening inner cities' own competitive advantages as centers of business. According to Porter, "Our policies and programs have fallen into the trap of redistributing wealth. The real need—and the real opportunity—is to create wealth" (Porter 1995, p. 56). Porter added that "a sustainable economic base can be created in the inner city, but only as it has been created elsewhere: through private, for-profit initiatives and investment based on economic self-interest and genuine advantage" (pp. 55-56).

Porter's diagnosis and proposed solutions almost directly contradicted other contemporary analyses of inner-city problems (see Lemann 1994). Nevertheless, his article's impact was enormous. Porter correctly highlighted the potential market power of dense, inner-city neighborhoods, writing that "at a time when most other markets are saturated, inner city markets remain poorly served" (Porter 1995, p. 58).

For Porter, one of the main barriers that kept private businesses from serving these new markets was a lack of access to capital, especially equity capital (p. 64). His proposed solution relied not on grants and tax credits but on tax incentives via the elimination of federal capital gains and dividends taxes on "inner city-based businesses or subsidiaries that employ a minimum percentage of inner city residents" (p. 69).

Porter had contact with both President Clinton and Vice President Al Gore (Gozner 1998, p. 56). Not surprisingly, much of Porter's general approach subsequently was reflected in the new markets legislation (though Porter is more contemptuous of many public-sector efforts, like community development banks, which were championed by the Clinton administration; Porter 1995, p. 64).

The Porter model driven by the private sector had an even greater impact because of the dissemination efforts of a think tank and consulting organization that Porter founded, called the Initiative for a Competitive Inner City (ICIC). ICIC uses its own studies to show how inner cities "represent a vast untapped market for goods and services" (Dougherty 2000). It also produces business school case studies. As an ICIC vice president stated, "We try to get business school students and faculty to see the inner city for what it is, an emerging market. And like any other emerging market, there are great opportunities for investment in it" (quoted in Dougherty 2000). In 2000, ICIC raised its own $125 million venture fund, ICV Partners L. P., which focuses on inner-city and minority-owned growth companies (ICIC 2003).

Other organizations supported and disseminated similar ideas (Carr 1999, p. 23). One such example is the work done by the Social Compact, a nonprofit established in 1990 that is dedicated to helping businesses invest in inner-city areas (Social Compact n.d.). It coordinates the "Emerging Markets Neighborhood Initiative," which is an effort to quantify the need for inner-city business by promoting "the development of data and indicators of inner-city market potential for commercial development" (Merkel & Testa 2000).

By the late 1990s, numerous foundations and think tanks were working to further popularize the idea of using business-oriented mechanisms to help disadvantaged communities increase wealth and jobs (Draut, Callahan & Hawkes 2002, p. 12). Furthermore, the very concept of urban neighborhoods representing "untapped markets" was gaining in popularity. For example, business, community, academic, and public-sector participants at the 1997 American Assembly meeting issued a report urging business leaders to reinvest in urban areas in the U.S. The final report also pushed nonprofit and government officials to help lead this new effort to open untapped markets through a fostering of "community capitalism." It defined community capitalism as a "for-profit, business-driven expansion of investment, job creation, and economic opportunities in distressed communities, with government and the community sectors playing key supportive roles (American Assembly 1997a).

To accomplish this revival, participants called for improving access to capital (especially through equity investment) and ensuring greater technical assistance for businesses. These were seen as the two key ways of "energizing community capitalism in distressed areas" (American Assembly 1997a). The report added greater detail to many of Michael Porter's recommendations (Porter was one of the conference's keynote speakers) and set out crucial components of the future new markets initiative. The American Assembly disseminated the final report widely, including sending it to the White House and Congress. Vice President Al Gore, in support of the conference conclusions, stated that "the greatest untapped markets In the world are right here at home, in our distressed communities" (American Assembly 1997b).

Clinton's Third Way Policies

For President Clinton himself, such ideas were powerful examples of his belief in "third way" policies, ones that used market forces to better people's lives, while eschewing both traditional Republican and Democratic policy approaches. As Clinton stated back in 1992, "I got into this race for President

because I was tired of Republican neglect and Democratic allegiance to programs that were outmoded. I thought we ought to have a third way" (quoted in Chait 1998).

The new markets approach fit very well with the Clinton administration's governing philosophy, both in the way it identified the problem of distressed communities as being driven by a lack of private capital and in its solution, a public-private partnership to overcome barriers to investments in what it saw as "new markets" here in the United States (Rubin and Stankiewicz 2001, p. 137). Clinton viewed these new markets as a business opportunity for American corporations and urged America's corporate leaders "to invest in poor communities" out of their own self-interest (Scales 1999). He wanted to "create a partnership between private investors and the federal government" (Shepard 1999) in order "to prove that we can bring the benefits of free enterprise to every neighborhood in America" (Babington 1999b). For the President, such emerging "new markets" held "greater economic potential than many people realize[d]," (Babington 1999a) and were an opportunity "to foster an inflation-free economic expansion" at a time of general economic prosperity (Scales 1999).

New markets also fits into a more recent trend in public administration, which promotes the themes of the New Public Management movement. These theorists argue for less reliance on the federal government and its role in governing and more on the concept of governance, including partnering with private-sector and nonprofit organizations. Proponents hail such efforts as building on the perceived strengths of private and nonprofit sectors, while weaning organizations from increasingly scarce government funding (for an overview of these arguments see Rubin & Stankiewicz, 2001, p. 136; O'Connor 1999, p. 82; Stoker 1988; Osborne & Gaebler 1992).

This approach, however, has its detractors, from both ends of the political spectrum. Those on the left argue against relying on the markets as a way to end poverty, pointing out that government in the United States cannot ameliorate, to any meaningful extent, the negative outcomes of a capitalist system without tackling the fundamental underlying problems of racism, ownership of capital, and distribution of political power and wealth.

Ali Modarres, for example, argues that federal anti-poverty programs since the 1960s have not resulted in any large-scale reduction in urban poverty because "we cannot fix capitalism with capitalism" (Modarres 2003, p. 41, p. 48). He concludes that government initiatives such as "entrepreneurship

programs… and other popular methods of reaching out to poor communities simply expand the presence of the state and its capitalist hold on the residents' lives" (Modarres 2003, p. 48). Similarly, David Brady argues that President Clinton's new markets effort was a meager, disappointing response to issues of poverty, precisely because it reflected the administration's "devotion to orthodox economic thinking" (Brady 2001, p. 4).

Conversely, those on the right attack third way programs for the very fact that government still plays too powerful a role. For example, according to Tamar Jacoby and Fred Siegel, "As long as government is involved, it will bring inefficiency, bureaucracy, and politics. Government procedures will guide—and skew—investment decisions" (Jacoby & Siegel, 1999, p. 23). Focusing specifically on the new markets initiatives, they write that Clinton's proposals "reflect a new consensus, even on the left, that the answer to poverty is capitalism—not government handouts but private business" (p. 22). Nevertheless, they warn that new markets-type approaches continue earlier federal policies' fundamental failings: "Though the new hybrid approach to poverty is a clear improvement over Great Society liberalism, it may also reenact many of the failings of that earlier era" (p. 23).

The Underlying Political (and Economic) Environments

At first glance, the political environment in which the new markets initiatives emerged did not seem to be conducive to any type of policy initiative dealing with "places left behind." James T. Patterson described the prevailing political environment as one in which "conservatives continued to command the high ground in debates, while liberals lacked consensus and were stymied by fiscal realities blocking bold new ventures" (Patterson 2000, pp. 232-233).

Nevertheless, the administration shrewdly appealed to the Republican majority in Congress, by working out a deal with the Republican leader of the House and by marketing the program as a non-partisan, business-oriented means of extending the nation's prosperity. On a tour to increase public support for the new markets program, President Clinton stated clearly that, in order for his initiatives to pass, "We need help from Republicans and Democrats alike. This is not a party issue" (Ross 1999).

Administration officials saw the presence of business leaders accompanying President Clinton on this tour as a way of emphasizing the business-friendly aspects of the initiative and giving it added

legitimacy. As one administration official stated, “We think Congress especially is going to be impressed that you have private-sector executives stepping up to the plate saying, `We believe in this, we know that these are good new markets for our company, we’re prepared to make the investment’” (CNN 1999).

The Policy Entrepreneurs Who Helped Pass New Markets

Outside Advocacy Pressure

The immediate stimulus for the new markets legislation came from someone who would be classified by John Kingdon as a leader of an outside “interest group” (Kingdon 1984, p 49). Reverend Jesse Jackson organized a powerful campaign, focused on business and on the federal government, in an effort to bring attention to the capital needs of poor communities.

Jackson began his “Close the Gaps: Leave No American Behind” campaign in April 1998, with a town hall meeting in Appalachian Ohio (Holland Sentinel 1998). Working with traditionally white unions, Jackson saw this new campaign as a way to reach beyond his base and create a multi-racial coalition in support of a broad array of proposals to help low-income Americans.

Jackson consciously focused on Appalachia because it was a region that included a large concentration of both white and black citizens with high rates of poverty. For Jackson, Appalachia would be a “test of America’s character,” just as it had been in 1967 when Robert Kennedy undertook his famous poverty tour through the region. As Jackson stated, “Jesus said you judge character by how you treat the least of these. Our moral obligation is to include all and leave no American behind.” On a more practical level, Jackson also saw his new initiative as a way of shifting media and public attention away from the ongoing Monica Lewinsky scandal that had been dominating President Clinton’s, and the nation’s, attention and toward issues of poverty and justice (Holland Sentinel 1998).

A month later, Jackson met with President Clinton. He encouraged the President to make the same effort to channel economic resources to distressed communities within the U.S. as the federal government was pursuing in its international development efforts. Toward that end, Jackson proposed “vehicles to move capital” such as low-interest loan funds and a domestic entity similar to the Overseas Private Investment Corporation, which would make government guarantees available to domestic businesses operating in distressed communities (Miller 2003).

As with many other federal economic development programs, a second source of outside pressure was the community development movement itself (see O'Connor 1999, p. 78). Movement members worked actively to influence the writing, passage, and implementation of the new markets initiatives. The new markets venture capital program strongly reflects the input of the Community Development Venture Capital Alliance, the trade association for the developmental venture capital industry, as well as that of individual developmental equity fund managers. Likewise, the new markets tax credit was shaped by the New Markets Tax Credit Coalition, a group of leaders in the community development finance industry, which came together in 1998 for that very purpose (New Markets Tax Credit Coalition 2003).

Inside Actors

President Clinton took a personal and direct interest in new markets, giving the initiatives prominence. As Kingdon has written, the support of the president is tremendously important, since "the President can single-handedly set the agendas, not only of people in the executive branch, but also of people in Congress and outside of government" (Kingdon 1984, p. 25).

For Clinton, cooperating with Jesse Jackson provided an opportunity to strengthen his standing among many liberal groups, while thanking Jackson for his support during the Lewinsky scandal (Fisher 1998). In the past, Clinton's personal ties with Jackson sometimes were rocky. One of Clinton's defining moments in the 1992 presidential election came at Jackson's expense, when the candidate criticized the rapper Sister Souljah in front of a meeting of Jackson's Rainbow Coalition. In what became known as the "Sister Souljah moment," Clinton established his independence from a core Democratic group, while "angering his audience and insulting Jackson" (see Lizza 2003, p. 12).

As his presidency unfolded, however, Clinton cemented a very strong relationship with African-American organizations and turned to Jackson for help on numerous occasions. Jackson's efforts to bring capitalism to distressed urban and rural American communities gave Clinton a chance to repay Jackson, while profiting from the publicity and pressure that Jackson's efforts generated.

Jackson's efforts also created a fertile policy environment for individuals within the Clinton administration, who believed that additional stimulus was needed for domestic economic development. Michael Barr, the deputy assistant secretary of the Treasury for community development policy, along with several colleagues at Treasury, had been working for several years on ways to attract investment capital to

distressed communities. Believing that a tax incentive was more likely to appeal to a Republican-controlled Congress, Barr had advocated for a community development financial institution (CDFI) tax credit. He was successful in getting legislation authorizing $100 million dollars for such a program included in both the 1998 and the 1999 budgets. However, neither effort passed Congress (Barr 2003).

In early June 1998, Gene Sperling, director of President Clinton's National Economic Council, convened a group of individuals from various agencies of the federal government to put together a policy proposal designed to increase investment capital in distressed communities (Miller 2003; Barr 2003). The group met repeatedly during the summer and fall of 1998 and fashioned a package of programs that came to be known as the new markets initiatives, which included the tax credit and venture capital provisions, as well as a proposal for American Private Investment Companies, entities designed to address Reverend Jackson's call for a domestic OPIC (Shepard 1999; Carr 1999, p. 23). [1]

President Clinton gave the programs his enthusiastic support. He began promoting it in mid-January 1999 by telling hundreds of business executives gathered for Reverend Jackson's Wall Street Project conference that "the largest pool of untapped investment opportunities and new customers are not beyond our shores; they're in our back yard" (Shepard 1999). [2] Clinton formally introduced the initiatives during his State of the Union speech later that month.

Clinton's poverty tour

In the summer of 1999, President Clinton followed Jesse Jackson's example and undertook a four-day, six-state tour of impoverished parts of the US, to highlight the need for the new markets programs. Flanked by Reverend Jackson and business and congressional leaders, Clinton visited the Mississippi Delta, the Watts area in Los Angeles, a barrio in Phoenix, Appalachian Kentucky, East St. Louis, and the Pine Ridge Native American Reservation in South Dakota (Babington 1999a; Broder 1999).

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[1] The tax credit proposal that was part of the original package included a 25% tax credit versus the 39% tax credit that was ultimately part of the legislation. The amount of the tax credit was increased by the administration in early 2000.

[2] The Wall Street Project was created by Reverend Jackson in 1997 to promote corporate investment in minority and poor neighborhoods. As one observer wrote, "On the premise that the most entrenched divisions in America are no longer based on race but on wealth, or 'access to capital,' [Jackson] began a campaign in which the project buys stock in corporations and lobbies C.E.O.'s to open up jobs, contracts, loans and boardrooms to the 'locked out.' Before long, some of the largest corporations in America were answering his call for expanded minority hiring and investment in minority-owned companies" (Packer 1999).

There were a number of reasons underlying this tour. It paid homage to Jackson's policy proposals, as well as his multi-racial call to help distressed communities in all regions of the country. Furthermore, the new markets tour also consciously echoed earlier visits to Appalachia made by Presidents Kennedy and Johnson. Even more specifically, it echoed Senator Robert Kennedy's poverty tour of 1967, when Robert Kennedy traveled to rural Mississippi to hold congressional hearings (Edelman 2001, pp. 48-52; Thomas 2000, p. 339). The parallels became even stronger when Clinton stopped at the Pine Ridge Reservation, which Senator Kennedy also had visited three decades earlier (DeParle 1999).

In scheduling the new markets tour, the administration was looking for favorable press coverage, not just for the proposed legislation but also for President Clinton himself, still under fire for the Lewinsky scandal. Clinton also may have been trying to burnish his credentials with the liberal wing of his party by supporting a policy identified with Jesse Jackson. Such a policy would have allowed him to try to prove his interest in anti-poverty legislation at a time when he found himself under a tremendous amount of criticism from liberals for signing the 1996 welfare reform legislation, which did away with the premise that there was a federal entitlement to welfare (Edelman 2001, pp. 140-141; DeParle 1999).

Nevertheless, press coverage of the new markets tour was lukewarm, at best. Clinton's "third way" language and approach alienated many liberals (DeParle 1999, Huffington 1999a). One former Clinton appointee even scolded the administration for undertaking a poverty tour that totally misunderstood "the state of the poor in America" (Edelman 1999; see also Edelman 2001, p. 125). Conservatives, on the other hand, bristled at the idea that government still had a prominent role to play in the new markets program, even if that role was in support of the private sector (Thomas 1999).

Ironically, the cool reaction masked some parallels in President Clinton's approach to community development with that of Senator Kennedy in the late 1960s. Kennedy came to believe, according to one of his biographers, that "the only real hope for the inner city lay in attracting capital—in persuading business to invest in the inner city" (Thomas 2000, p. 340). Upon completing his tour of Mississippi in 1967, Kennedy returned to the Senate and tried, in vain, to pass anti-poverty legislation that used tax incentives to accomplish this goal (Thomas 2000, p. 340; see also Edelman 2001, pp. 39-40).

For Senator Kennedy, the way to help America's poor was not through welfare but through jobs. Outside businesses would provide new jobs to residents of the inner city, while nonprofit community

development corporations—more responsive to their local communities—would guide development (Sandel 1996, p. 303). These ideas were echoed in many of President Clinton's initiatives, including the expansion of the earned income tax credit, creation of the Community Development Financial Institutions Fund, establishment of Empowerment Zones/Enterprise Communities, and the proposal of the new markets initiatives.

While the tour might not have been successful with much of the press, Clinton did manage to do a good job of selling the program politically, by portraying it as a pro-growth, third way bi-partisan bill. At the end of a second, shorter tour in early November 1999, Clinton appeared in Chicago with the Republican speaker of the House, J. Dennis Hastert of Illinois, announcing that they had agreed to support compromise legislation designed to spur economic development in distressed communities (Scales 1999).

The new legislation would combine the President's package of initiatives with a bill that the Republicans had been trying to pass for years: the American Community Renewal Act. Sponsored by Republican representatives James M. Talent of Missouri and J. C. Watts of Oklahoma and supported by Hastert, the American Community Renewal Act called for capital gains tax cuts in selected distressed communities (Shesgreen 2000b). Versions of this bill had been pending in Congress since 1996, including one version in a 1999 bill that had been vetoed by President Clinton (Huffington 1999b).

In December 1999, Congress passed an appropriation for the new markets venture capital and APEC programs. However, it did not authorize either of these programs (Turner 1999). In mid-April 2000, President Clinton took a third new markets tour, continuing to press for passage of the new markets legislation.

On May 23, 2000, six months after Clinton and Hastert had pledged to work together on a package of incentives to help distressed communities, they appeared jointly once again to announce they had reached agreement on specific legislative language. As anticipated, it included aspects of both the new markets and renewable communities programs.

It was relatively easy, at least superficially, to reconcile the two proposals. As one journalist at the time reported, both proposals were "driven by the same philosophy: using tax incentives to attract business to neglected areas, rather than funding new government programs to help those who live there" (Shesgreen 2000b). This rejection of direct government spending marked a significant departure from many previous

anti-poverty initiatives. In describing the combined proposal, Gene Sperling, Clinton's director of the National Economic Council, called it "neither a laissez-faire approach, nor a direct, top-down government spending approach." Instead, the legislation "creates 'incentives that would encourage the private sector to find profits and create opportunities'" (Shesgreen 2000a).

The bi-partisan support for the combined bill did not translate into an endorsement by the parties of the individual components of the package. Instead, it was seen as a marriage of convenience for politicians from both sides of the aisle—a chance for Clinton and Hastert to pass legislation important for their policy goals and their own respective constituencies. As analysts would write later: "The combination of the two approaches may be bi-partisan, but it does not reflect consensus on core values" (Draut, Callahan & Hawkes 2002, p. 36). In late July 2000, the House of Representatives overwhelmingly approved the combined legislation. It would take an additional five months for the Senate to do the same. The final package included the new markets venture capital and tax credit programs but not the APEC initiative.

New markets had been approved, thanks to a skillful campaign by policy entrepreneurs, who married a specific problem with a proposed solution that coincided with a political and economic environment open to such ideas. However, the difficult task of implementing this new legislation still lay ahead.

ENACTING THE NEW MARKETS INITIATIVES

Although modeled on existing programs, the new markets initiatives also represented what were seen as important innovations in the federal government's approach to economic development and poverty alleviation. They were written to take advantage of two of the more successful aspects of recent federal community economic development programs: a reliance on the skills and advantages of financial intermediaries, who are able to guarantee and package private funding, and the use of tax credits as incentives to help raise these private funds (Vidal 2002, pp. 237-238).

The Reliance On Intermediaries

Analysts credit much of the recent successes in housing and community development to the role played by nonprofit financial intermediaries, such as the Local Initiatives Support Corporation (LISC) and the Enterprise Foundation (Vidal 2002, p. 224; Walker 2002, p. 4). Such intermediary organizations reduce private-sector risk by brokering deals between private sources of capital and nonprofit and for-profit

developers of housing and other community needs. They then help use and sell federal grants and tax credits, as part of the financing packages (Vidal 2002, p. 228).

The new markets initiatives relied on such intermediaries to an even greater extent than had previous federal programs. Unlike previous programs, such as the community development block grants and the low-income housing tax credit, which left decisions regarding specific allocations to individual states and municipalities, the new markets initiatives were designed to go directly from the federal government to private intermediaries. The intermediaries then would use the new markets government incentives, such as tax credits and matching grants, to raise private-sector investment capital.

The Use of Tax Credits

The new markets' use of a tax credit was a continuation of recent trends. In addition to the CDFI tax credit, several programs had been implemented that used a federal tax incentive to spur economic development. The low income housing tax credit (LIHTC), which had been enacted as part of the Tax Reform Act of 1986 and made permanent in 1993, has resulted in the creation of more than a million additional units of affordable housing (Steinbach 1998). Additionally, a Community Development Corporation (CDC) tax credit pilot program, approved by Congress in 1993, made $40 million available to 20 CDCs for the promotion of economic development in low-income areas (Steinbach 1998).

The popularity of tax credits also reflected the fact that they are easier to pass politically than are direct allocations. As one political scientist has pointed out, "Perhaps the most common way to keep the costs of a program relatively invisible is to use the tax code rather than the budget for delivering benefits. Most changes in the tax code are written in technical language and are relatively obscure to all except those who will use them, whereas all direct subsidies are listed prominently in the federal budget" (Arnold 1990, p. 113).

Tax credits, in effect, do not have to be paid for by members of Congress, since the cost is entirely borne by the federal government as an opportunity cost—the amount of taxes that were not collected due to the new program. In the words of another analyst, "A spending program would be critiqued as 'tax and spend,' whereas a similar program implemented through a tax credit looks like a tax cut so it gets a warmer reception from conservatives" (Burman 2003).

Not only do tax credits make it easier to pass a program, but they also make it harder to end the program in later years. In effect, cutting a tax credit program gives the appearance of raising taxes, since it results in higher effective tax rates for the former beneficiaries.

To better understand how the new markets initiatives were designed and implemented, we focus on each of them separately. We begin with the new markets venture capital program.

New Markets Venture Capital

The new markets venture capital (NMVC) program was designed to increase the supply of equity capital flowing into distressed communities. The program, administered by the U.S. Small Business Administration (SBA) in the Department of Commerce, was based on the SBA's earlier Small Business Investment Company (SBIC) program and on the community development venture capital industry. It provided applicants that received NMVC company designation with matching capital, both debt dollars for making investments and grant dollars to offset overhead expenses. The Clinton administration designed the program to be place-based. At least 80 percent of all investments made by NMVC companies had to be in low-income areas, designated by their level of poverty, level of median income, or by their already established status as federal empowerment zones, HUBZones, or enterprise communities.

The legislation required NMVC companies to be newly formed, privately managed, for-profit investment funds. To receive NMVC designation, these companies needed to provide the SBA with information about their proposed business plans and management teams; document the need for developmental venture capital investments in the geographic areas in which they intended to invest; indicate the extent to which they would concentrate their activities on serving these areas, and on how the activities proposed by them would expand economic opportunities there; and document their plans for providing operational assistance to their portfolio companies. Based on this information and an additional geographic objective of promoting the formation of NMVC companies throughout the U.S., the SBA would use an internal selection process to determine which new markets venture capital companies would receive initial "conditional" approval (Small Business Administration 2000).

The conditionally approved new markets venture capital companies had to raise at least $5 million of private equity capital or obtain binding capital commitments for at least that amount from one or more investors. They also needed to obtain binding commitments for grant capital or in-kind services equal to at

least 30 percent of the total private capital they raised. The grants were designed to pay for the operational assistance that the NMVC companies would provide to their portfolio companies. If the conditionally approved new markets venture capital companies met these requirements within two years, they would receive final new markets venture capital company designation and would enter into a participation agreement with the SBA. If they failed to meet these requirements, they would lose their conditional NMVC company status.

Once a NMVC company entered into a participation agreement with the SBA, it became eligible for the matching federal loans and overhead grant dollars to equal those that it had raised from private sources. The matching loans would be interest free for the first five years, with semi-annual interest payment due in years six through 10 and principal due upon maturity.

At the urging of the Clinton administration, which feared that the incoming Bush administration might try to end the NMVC program, the SBA quickly wrote the regulations for the program, submitting them for approval prior to the January 20, 2001 transition to the new administration, and for publication in the Federal Register shortly afterward (see Federal Register 66,14, 7217-7246). The applications for the program became available in April 2001, with a late May deadline for submission. The SBA announced the first group of NMVC companies on July 9, 2001. The seven conditionally approved NMVC companies included six existing community development financial institutions and a fund created by the University of Maryland business school to invest in its surrounding community.

--Exhibit 1 --

Although the NMVC legislation allowed the conditionally approved NMVC companies up to two years to raise the required private equity and grant capital, the SBA set September 14, 2001 as the actual deadline for doing so. The SBA's expedited timing was a result of the appropriations language for the grant portion of the NMVC program, which did not specifically state that the funds were to remain available for obligation through 2006, the authorized period of the new markets program. As a result, the SBA was required to treat the funds as one-year monies, which meant they had to be fully obligated by September 14, 2001 or they would be forfeited. The SBA translated the need to fully obligate the grant monies by the

September deadline into a requirement that the applicants obtain commitments for both the private equity and grant portions of the fund on the same rapid timeframe. The agency argued that the grant amount was a percentage of the overall fund; thus, companies had to raise the overall fund in order to know how much grant money would be required.

This gave the NMVC companies only two months to accomplish a task that generally takes years, even under the most favorable of circumstances. In response, the NMVC companies successfully lobbied Congress to change the grant funds to "no-year money." The change was part of the supplemental appropriation bill that President Bush signed into law July 24, 2001 (SBA 2001). This removed the justification for the September 14, 2001 deadline, and the SBA subsequently gave the conditionally approved NMVC companies an additional three months to raise the required capital (SBA 2001). Following the September 11, 2001 attack on the World Trade Center and the resulting economic slowdown, the agency extended the deadline again to December 31, 2002, but required the seven conditionally approved companies both to demonstrate binding equity and grant capital commitments and to submit final documentation by the revised deadline.

All seven companies were able to raise the required capital by October 2002. However, the SBA was behind schedule in processing the necessary paperwork and extended the final deadline to March 31, 2003. This deadline was extended once again to July 9, 2003 to accommodate the delayed announcement of the new markets tax credits recipients.[3]

As of July 1, 2003, five of the seven conditionally approved NMVC companies had received final approval. Two NMVC companies, the Southern Appalachian Fund, LP, and Southwest Development Fund, LLC, were still trying to resolve some last-minute issues that the SBA had identified after it had reviewed their applications. For both companies, the concerns holding up final approval were very minor, raising the possibility that the SBA's unwillingness to give them final NMVC status was being driven by political considerations. The SBA, under the Bush administration, made no secret of its dislike for the NMVC program. The perception that political considerations were driving the SBA's actions was

[3] Several of the seven NMVC funds also applied for New Markets Tax Credits. The NMTC program originally intended to announce those organizations that had received tax credit allocation in the fall of 2002. This information was not released, however, until March 14, 2003. The delayed announcement did not leave enough time for NMVC companies to revise their final documents to reflect receipt of a NMTC allocation.

reinforced in March 2003, when funding for the second round of NMVC, which had been scheduled to take place in the spring of 2003, was deleted from the 2003 budget during the budget reconciliation process. At present, it is not clear whether NMVC proponents will be able to reinstate this funding and allow for new NMVC companies to be selected.

Problems with Program Design

The primary problem with the NMVC program is a mismatch between sources and uses of funds. By using debt to fund mostly equity investments, the NMVC program duplicates a capital structure that led to financial problems for many of the participants in the federal Small Business Investment Company (SBIC) and Specialized Small Business Investment Company (SSBIC) programs (Bates 1997). The SBA had addressed this mismatch in its 1992 revisions to both programs (NASBIC n.d.).

As soon as an NMVC company accesses the matching debt capital from the SBA, it begins accumulating an interest obligation on those funds. On the other hand, the same NMVC company is required to invest its capital almost entirely as equity, which usually has a longer holding period and a much less predictable repayment schedule than does debt.[4] Therefore, although the five-year interest deferment on the loan provided by the SBA is helpful, it still is unlikely that a NMVC company could invest its capital in equity and then exit those investments quickly and profitably enough to pay the loan and interest back to the SBA.

The NMVC companies have been lobbying Congress to revise the statute in order to allow them to make investments that include amortized loans and royalty payments tied to gross revenue instead of

[4] The NMVC statute specifies that 80 percent of all NMVC investments must be in the form of equity, which is defined as "common or preferred stock, limited partnership interests, options, warrants, or similar equity instruments, including subordinated debt with equity features if such debt provides only for interest payments contingent upon and limited to the extent of earning. Equity capital investments must not require amortization...Equity Capital investments may provide for royalty payments only if the royalty payments are based on the earnings of the concern." (13 CFR 108.50 (definitions). By restricting amortization, the statute makes it impossible for NMVC companies to receive an ongoing stream of interest payments from 80 percent of their investments. Such interest is very important since the NMVC companies have to begin repaying their loans to the SBA in year six, and are unlikely to have exited many of their equity investments by that time. Equity investments can take a long time to exit, particularly when those investments are in companies that focus on distressed geographies or populations. Thus, the NMVC companies are likely to run out of money before they begin receiving the bulk of the returns from their investments. The limitation that NMVC companies can utilize royalty payments only if they are tied to earnings versus gross revenue, further exacerbates this problem since earnings are unlikely or, at best, limited in the kind of young firms that are most in need of NMVC funds.

earnings. Such a change is key to the long-term success of the program and would give NMVC companies the same investment options available to Small Business Investment Companies.

New Markets Tax Credits

The second program under new markets was the new markets tax credit (NMTC) program. It is "designed to stimulate private-sector investment in the economic development of low-income communities" (O'Neal 2002). It does so by offering a 39 percent cumulative tax reduction to investors who make capital available to intermediaries — known as qualified community development entities (CDEs) — for investing in such communities. The credit can be taken over seven years— equal to a 5 percent reduction in each of the first three years and a 6 percent reduction in each of the remaining four years (CDFI Fund 2002).

The Community Development Financial Institutions (CDFI) Fund of the U.S. Treasury Department certifies CDEs and determines which ones will receive the tax credit allocations. To be certified, CDEs must have a primary mission of community development, as demonstrated in their organizational documents and by a commitment of at least 60 percent of their activities to serving or providing investment capital to low-income communities or people, either directly or through other entities. They also must be accountable to residents of the low-income communities they serve, as demonstrated by having such residents represented on the CDEs' governing or advisory boards. Representation is generously defined and can include being a resident of a low-income community, a member of the board of directors or staff of a community organization, or an owner of a small business located in the community.[5]

CDEs apply for tax credits by submitting an application to the CDFI Fund that details their intended efforts in four areas: their business strategy (consisting of a market analysis, an investment strategy, and a history of their investments overall as well as in distressed communities); their capitalization strategy (the level and intensity of investor commitments, or strategy for obtaining those commitments, along with a history of being able to do so); their management capacity (the composition of the management team, its experience raising capital and making investments, and its ability to manage the administrative requirements of the program); and, finally, community impact (the amount of investments

[5]Already-recognized entities, consisting of Community Development Financial Institutions, which are certified by the CDFI Fund, and the Specialized Small Business Investment Companies, which are approved by the Small Business Administration, automatically qualify as CDEs.

that will serve targeted low-income communities; the accountability to residents of the target communities; and the amount of economic impact resulting from the projected investments). Each of these four sections is rated on a scale of 0 to 25. Additionally, applicants can receive up to five extra points for having a track record of serving disadvantaged businesses or communities, and up to an additional five points for investing substantially all the NMTC capital in unrelated entities.

The NMTC Selection Process

The CDFI Fund has conducted one round of NMTC allocations to date. The selection process for that round primarily consisted of a peer review, in which three reviewers independently read and evaluated each application. The reviewers included federal employees working on community development-related programs, along with individuals from the private sector who are knowledgeable about aspects of investing in distressed communities relevant to activities allowed under the NMTC program.

The reviewers scored the applications, tallying the four primary categories and the two extra categories, for a final possible total of 110 points. Based on their individual composite scores, the reviewers then recommended whether the applicants should receive an allocation and, if so, for what amount of funds. The scores of the three readers then were added together and ranked. Fund staff reviewed the applications with the highest scores to ensure compliance in terms of program eligibility and regulatory matters. Those applications then were forwarded to an NMTC program manager for an allocation determination. If the program manager's allocation amount differed substantially from that recommended by the peer reviewers, the Fund's deputy director made the final determination on the allocation (Department of the Treasury 2002).

Recipients of NMTC allocations must sign an allocation agreement with the CDFI Fund, which details the specific terms of their obligation under the program. The allocation agreements will identify those aspects of the applicant's business plans that likely increased their scores during the selection process (such as indicating that they will invest primarily in very distressed communities or in unrelated entities). The applicants will then be required to carry out those promised activities. Additionally, the agreements will specify the approved uses of the allocation and the approved geographic areas in which the funds must be invested.

All NMTC allocation recipients must invest at least 85 percent of their NMTC leveraged dollars in qualified low-income community investments. Such investments include making loans or equity investments in a business that has at least 40 percent of its tangible property located in a low-income community; at least 40 percent of its employees' services performed in such communities; or at least 50 percent of its total gross income derived from the active conduct of a qualified business within a low-income community. Additional qualified investments include the purchase of qualified loans from another CDE; equity investments or loans made to another CDE; and financial counseling or other business assistance services to businesses located in, and residents of, low-income communities (Local Initiatives Support Corporation 2002).

The CDFI Fund received 345 applications totaling almost $26 billion in NMTC requests for its first round of allocation. On March 14, 2003, the Fund announced that 66 CDEs had been selected to receive the $2.5 billion available for 2002 and 2003 (Department of the Treasury 2002). The Fund is expecting to post a Notice of Allocation Availability (NOAA) for the second round of allocations, worth $3.5 billion, in mid-July (New Markets Tax Credit Bulletin 2003a).

Concerns About the NMTC Program

The new markets tax credit program is too new to evaluate the impact it will have on its target communities. It is already apparent, however, that there are numerous potential problems that could preclude the NMTC program from positively impacting its target audience. A number of these stem from the vague nature of the legislation, which left out many details of how the new markets tax credit program would be implemented.

Although the goals of the NMTC program were not stated explicitly in the legislation that authorizes the program, congressional supporters of the NMTC legislation indicated that "the program's goals are to direct new business capital to low-income communities, facilitate economic development in these communities, and encourage investment in high-risk areas" (GAO 2002: p. 1).[6] As the General Accounting Office has reported, the legislation "does not specify that the investment be new capital, that performance measures be established to show that investment leads to economic development, or that the

[6] Tax legislation does not generally include language regarding its purpose.

investment be in high-risk areas within eligible communities" (p. 1-2). However, the legislation provided the CDFI Fund with broad latitude in implementing the program, and the Fund included some criteria in the NMTC application that addressed these objectives.[7]

The drafters of the original language of the law establishing new markets intentionally left the legislation very general, giving the CDFI Fund the critical role of interpreting it and putting its objectives into operation. They selected the CDFI Fund for this purpose because of its focus on community development objectives and its experience providing capital to and monitoring the compliance of organizations that invest in distressed communities. They believed that it was more effective to give the Fund the responsibility of ensuring that NMTC allocation recipients were using the money for appropriate community development purposes, rather than to try and write specific enforcement language into the legislation. Delegating these tasks to the CDFI Fund also provided greater flexibility in program implementation.

However, the NMTC program's creators did not fully anticipate the very different political environment in which the program would be implemented, under the presidential administration of George W. Bush, which is significantly less friendly than its predecessor was toward both community development and the work done by the CDFI Fund. Initially, the program's supporters had reason to believe the new administration would embrace the initiatives. As a candidate, Bush had espoused a governing philosophy of "compassionate conservatism." As part of this philosophy, Bush was sympathetic to using "tax incentives to aid poor neighborhoods" (Milbank 1999). Furthermore, during the campaign, one of his chief economic advisors was Lawrence Lindsey, who had community development experience. Lindsey, during his earlier tenure as a Federal Reserve Governor, had been a strong supporter of the Community Reinvestment Act and also had chaired the board of directors of the Neighborhood Reinvestment Corporation (Ullman 1999; The Economist 1999). After Bush became President, he named Lindsey director of the National Economic Council.

[7] The community impact section of the New Markets Tax Credit application attempts to evaluate the likely economic impact that an applicant's proposed investments would have on the targeted distressed community. The allocation agreement that successful NMTC applicants must sign and adhere to is based on these proposed investments. It sets measurements that each CDE must meet in order to be in compliance.

Nevertheless, under the Bush administration's priorities, the SBA and the CDFI Fund quickly found themselves operating in a budgetary environment that threatened both agencies with cutbacks. Programs initiated by President Clinton found themselves particularly vulnerable. This impression was so widespread that many observers came to label it as the new administration's "ABC" policy—a need to support "anything but Clinton" (Clift 2003).

Initially, NMTC seemed to be protected because of its status as a tax credit. Cutting a program that relies on tax credits, paradoxically, opens an administration to the charge that it is raising taxes, since it means taking back promised tax credits. Nevertheless, the CDFI Fund received minimal funding with which to administer the NMTC program. President Bush also proposed cuts to the CDFI Fund's overall budget in each of the first three years of his administration (see Exhibit 2). His proposed 2004 budget would result in cuts of more than 50 percent as compared to the last year of the Clinton administration. The funding cuts were particularly difficult for the Fund to manage, given the high level of interest in the NMTC program, as indicated by the 345 applications the Fund received for the first round of funding.

Exhibit 2: CDFI Fund Budget, FY 2001 - 2004

Fiscal Year	Amount
2001	$118 million (Last year of President Clinton's budget)
2002	$80 million
2003	$75 million
Proposed 2004	$51 million

Source: CDFI Coalition 2003; Brown 2003

Given a vigilant and somewhat hostile presidential administration, it was important that the Fund be seen as keeping the NMTC selections removed from political pressure and thus inoculate itself from any perception of impropriety. This made the apparently more subjective selection process that the Fund uses for its other community development programs—first-round peer review followed by site visits and additional due diligence by Fund staff—politically impractical. In an environment of dwindling budgetary resources, such an extensive approach also was not cost effective. Furthermore, the Fund did not have the staff necessary to conduct due diligence on such a large scale. Finally, the Fund did not have experience dealing with many of the organizations that were applying for NMTC designation—these organizations

were less concerned with, or knowledgeable about, community development issues and were more willing to use lawsuits to challenge unfavorable decisions.

As a result, the NMTC selection process relied overwhelmingly on expert reviewer evaluations of the applicants and the scoring system that the Fund created to facilitate the process. Although the Fund allotted up to five extra points each for those applicants that had a history of making investments in distressed communities and those planning to invest in unrelated entities, the primary weighting was allotted to those applicants that had the most solid capital commitments. The CDEs' capitalization strategy section was worth 25 points, most of which was likely to be allotted to applicants who had firm capital commitments in place or a good plan for raising capital. Applicants with secure capital commitments also were more likely to receive larger allocations, as the allocation process factored in what percentage of an applicant's capital was already firmly committed.

Furthermore, although a CDE must have a primary mission of community development, its parent entities do not need to have such a mission. The only portion of the NMTC application that potentially rewards those parent entities that do have such a mission is the five points that an applicant can receive for having a track record of successfully providing disadvantaged businesses or communities with capital or technical assistance. The legislation intentionally did not restrict participation in the program to only those organizations that had a community development mission because members of the Clinton administration believed that the amount of capital involved was too large to be managed exclusively by such entities. They also believed that opening the program to more traditional financial intermediaries would increase its impact and bring traditional financial sources into distressed communities on an ongoing basis.

The downside of not restricting the program to organizations with a community development mission, however, is the greater likelihood that the tax credits will be used to subsidize activities that have a limited community development impact and that would have occurred even without the extra subsidy. In other words, the tax credits could be used to "supplant" rather than "supplement" the cost of many investments. This is made more likely by the program's flexibility, allowing related entities to both fund a CDE and then decide on how that CDE should make its investments.

Although the NMTC application provides five extra points to applicants that will make substantially all of their investments in an unrelated entity, these points are dwarfed by the weight allotted

to applicants with a firm capital commitment, and such commitments are much easier to obtain if the CDE is being financed by its parent entity. The chances that the investments will not be "new capital" also are increased by the legislation's silence on this subject (General Accounting Office 2002).

An additional concern about NMTC program funds being used to finance projects that would have occurred without the subsidy arises from the program's lack of restrictions with respect to "double-dipping" with other state and federal programs. The only such program expressly forbidden to be used in combination with the NMTC is the low income housing tax credit (IRS 2002). As a result, applicants can combine the NMTC with other economic development incentives to receive an even larger subsidy.

One example of such a double subsidy is apparent in the case of Advantage Capital, which received an NMTC allocation of $110 million, the seventh largest allocation in the first round. Advantage is a certified capital company (CAPCO), which makes equity and debt investments in specific states in exchange for a 100 percent subsidy from those states (Barkley, Markley, and Rubin 2001). Advantage intends to use its NMTC allocation for investments in seven states. In at least four of those states, Advantage also could qualify for the 100 percent state subsidies for those same investments.[8]

The NMTC also faces the challenge that many place-based programs must confront: distressed geographies, as defined through census data, also include relatively affluent downtown business areas that qualify by virtue of their sparse but largely impoverished residential populations. Such regions are not uncommon. Prior to the 2000 census, for example, much of Wall Street in Manhattan was classified as a low-income area. In this scenario, a CDE would be in full compliance with the requirements of the NMTC program if it invested in businesses located in such geographies. Yet, from a community economic development perspective, the benefit of having such projects receive an NMTC subsidy is questionable.

A further concern is that the NMTC program may encourage a "race to the bottom," in which CDEs compete for investors by offering them the most financially profitable investments. The NMTC selection process allows CDEs to demonstrate their ability to raise capital via letters of intent from potential investors. These letters are non-binding, and investors may withhold their funding until they can review

[8] Advantage Capital currently has CAPCO funds established in New York, Louisiana, Florida, and Missouri, four of the seven states in which it anticipates focusing most of its NMTC activities (CDFI Fund 2003). For a list of state CAPCO programs in which Advantage Capital was participating as of 1999, see Markley, Barkley and Rubin (1999).

specific deals. Such a scenario would give preference to the most lucrative deals instead of those that would have the greatest community development impact.

The Internal Revenue Service recently ruled that CDEs may leverage the equity investments they receive with debt, to increase the value of the tax credits to the equity investors (IRS 2003).[9] While such leverage could double or triple the value of the tax credits to the equity investors, it could also increase the cost to the debt investors and subsequently to the CDEs, which could be forced to absorb the extra cost of the interest on the debt. This too could create competition for investors between those CDEs willing to take on the extra interest expense as against those who wish to pass this subsidy on to their target communities.

A final concern with the NMTC program is the likelihood that CDE investments will be used for business loans and commercial real estate development rather than for making equity investments in businesses. While all the potential uses of the tax credits are necessary and important, business equity is undeniably the most limited form of developmental capital and the most difficult to obtain, particularly in distressed geographies. The primary challenge in using the NMTC for business equity comes from the program's requirement that all qualified investments be held for a period of seven years. Any investment

[9] The IRS provides the following example to illustrate under what conditions such leverage would be allowable: "In Year 1, CDE, a qualified community development entity under § 45D(c), receives a new markets tax credit allocation of $2,000x from the Secretary of the Treasury. In Year 2, X, a widely-held C corporation, contributes $792x for a 99-percent member interest in LLC, a limited liability company that is classified as a partnership for federal tax purposes. Y, a widely-held C corporation, contributes $8x for a 1 percent managing member interest in LLC. LLC borrows $1,200x from Bank, an unrelated third party. LLC contributes $2,000x for an equity interest in CDE, which is a limited liability company classified as a partnership for federal tax purposes. CDE designates LLC's equity investment in CDE as a qualified equity investment under § 45D(b)(1)(C). The $1,200x loan from Bank is a nonrecourse liability that is characterized as indebtedness of LLC for federal tax purposes. The loan is secured only by LLC's interest in CDE. The loan is not secured by any assets of CDE. The full amount of the loan is repayable at the end of Year 9. The loan is not convertible into an equity interest in LLC. On April 1 of Year 2, CDE lends the $2,000x to a qualified active low-income community business, as defined in § 45D(d)(2)(A). This $2,000x loan is repayable in full at the end of Year 9. Interest payments received by CDE from the qualified active low-income community business are distributed to LLC. X and Y retain their membership interests in LLC, and LLC retains its $2,000x equity investment in CDE, until the end of Year 9. The entire $2,000x loan by CDE remains outstanding, and the borrower continues to qualify as a qualified active low-income community business, until the end of Year 9. LLC claims its qualified equity investment in CDE is $2,000x on each credit allowance date and allocates the new markets tax credit with respect to this amount to X and Y in accordance with § 704(b)." (New Markets Tax Credit 26 CFR 1.45D-1T: New markets tax credit. Revised Ruling 2003-20).

that is exited before the end of year seven must be reinvested in another qualified investment within one year, or the CDE's investors face the risk of tax credit recapture.

The problem that this requirement presents for investors is the difficulty of predicting, ahead of time, how long an equity investment will last. Furthermore, should a venture fund exit an investment before the end of year seven, there is no guarantee that it would have an opportunity to reinvest the capital within the required one-year window. Furthermore, venture funds typically have limited life spans, usually of around 10 years. The need to reinvest any capital held for less than seven years becomes particularly problematic toward the end of a venture fund's life, when the fund's management is trying to exit its investments and is reluctant to undertake new ones (Bylund 2002).

CONCLUSION

In many ways, new markets is a continuation of the trends in federal economic development policies in the United States over the last 50 years. Alice O'Connor notes that "community development is a time-honored tradition in America's response to poverty," and that over the last half-century, the U.S. government has undertaken a large number of federal place-targeted initiatives (O'Connor 1999, p. 77).

For O'Connor, most of these initiatives share a number of similarities. The new markets initiatives, in turn, continue many of these characteristics: the program can be seen as another community economic development policy that "swims against the tide" of overall federal policies, which in the main still encourage new development in suburban areas, rather than disadvantaged urban and rural areas (O'Connor 1999, p. 83, pp. 79-80).

In addition, Congress approved this particular program only thanks to "tenuous political alliances," in this case between Democrats and Republicans. The resulting initiatives continue to suffer from "administrative fragmentation and bureaucratic rivalry," with the venture capital portion run by the Small Business Administration and the tax credits portion by the CDFI Fund at Treasury. Furthermore, the initiatives continue the trend of reliance on partnerships with nonprofits and the private sector (O'Connor 1999, pp. 79-83). Finally, new markets augments the trend of federal programs increasingly shifting power to private-sector actors, in order to leverage resources and establish legitimacy (p. 83).

That new markets fits comfortably as part of the trend of federal community development policy over the last half-century is illustrated in a small but telling detail. As O'Connor points out, in the 1950s

many policy analysts were warning of the dangers of persistent "pockets of poverty" in America and recommending place-based programs that could ameliorate conditions in these pockets (O'Connor 1999, p. 95). President Clinton, in describing his vision of new markets, used the exact same phrase—"pockets of poverty"—to describe the areas he wanted to help (Huffington 1999a; Edelman 1999).

Nevertheless, in other ways new markets represents a change from some of the older federal policies. For the Clinton administration, new markets, along with other programs like the empowerment zone and enterprise community initiative of 1993, were created based on the belief that government could help integrate disadvantaged area residents into the mainstream economy, by pulling down the barriers that kept private-sector companies from taking advantage of available new domestic markets.

Thus, Andrew Cuomo, secretary of Housing and Urban Development during the time of the new markets tours, told reporters that the program "is not about charity. It's about investment" (CNN 1999). That message was underscored by the fact that only one part of the proposed program was to be administered by HUD—the APIC portion. The rest of the program was to be administered by the seemingly far more business-friendly SBA, at the Department of Commerce, and the CDFI Fund, at Treasury.

In effect, new markets was a way of using micro-level federal economic development policy to strengthen macro-level economic policies, taking advantage of the fact that the economy was operating at full employment in order to try to expand the employee base in a non-inflationary way. By designing community development policies to work in tandem with macro-level economic policies, the Clinton administration tried to strengthen what in the past has been the marginalized role for federal place-based economic development strategies (O'Connor 1999, p. 80).

Furthermore, it tried to take race out of policies that for too long had suffered from being seen as helping only minorities (O'Connor 1999, p. 83). The administration focused on the fact that new markets would help disadvantaged white areas in parts of Appalachia as much as Native American reservations, Latino barrios, and African-American communities. It was a message that amplified the multi-racial coalition vision of Jesse Jackson. As Jackson stated, while he accompanied Clinton during the new markets tour, "When you look at the market, it's not just race. These areas have been denied access to capital" (Ross 1999).

Writing of Clinton's new markets tour, a journalist stated that "Amid the river of dismissive reaction, it is worth mulling over an unconventional thought: It is possible that historians find more to praise in the Clinton anti-poverty record—perhaps even in this mad-dash trip itself—than meets the eye" (DeParle 1999).

After all, new markets was just one component of President Clinton's community development policies, which also included the empowerment zones and enterprise communities initiative, an expansion of the low income housing tax credit, and the creation of the CDFI Fund. All these proposals worked in large part through changes in the tax code, to encourage changes in private-sector behavior. However, these policies also worked in tandem with Clinton's macro-level anti-poverty initiatives—expansion of the earned income tax credit, an increase in the minimum wage and in the number of students attending Head Start, and the creation of the state Children's Health Insurance Program (DeParle 1999).

Clinton's efforts should be judged in that context. As for new markets, the program struggles to survive in a very different political and economic climate. It is too early yet to evaluate its effectiveness in helping its targeted communities and population, but it does show that, as is often the case, the major battles only begin after the flashy presidential signing ceremonies are over.

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Exhibit 1: Conditionally Approved New Markets Venture Capital Companies

Name	Adena Ventures	CEI Community Ventures Fund, LLC	New Markets Growth Fund	Murex Investments I, LP	Pennsylvania Venture Partners LP Fund	Southwest Development Fund, LLC	The Southern Appalachian Fund, LP
Capital Committed	$34 million	$10.2 million	$20 million	$14.3 million	$ 25 million	$5 million	$5 million
States served (region within state)	KY (northeast) MD (west) OH (southeast) West Virginia	ME (primarily) NH VT	MD (Baltimore) VA (north) Washington, DC	DE (north) NJ (south) PA (southeast)	PA (central)	AZ	AL (north) GA (north) KY MS (north) TN
Target Investments	Diverse (Technology, Manufacturing and Wholesale food).	Diverse industries	Technology Manufacturing Services	Manufacturing Environment Services	Manufacturing Energy Software Electronics Materials-Related Industries	Diverse Industries	Diverse Industries

Source: CDVCA (2003) and individual NMVC company websites.