CALIFORNIA BUDGET PROJECT

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NEW STUDY OVERSTATES EFFECTIVENESS OF ENTERPRISE ZONES

The following analysis finds that a report prepared for the Department of Housing and Community Development provides an overly optimistic assessment of the Enterprise Zone (EZ) Program.[1] The report overstates the performance of EZs and downplays findings from the report's survey that the program's tax credits often do not affect hiring choices or encourage business investment. In addition, the report suffers from a lack of data to assess the program's effectiveness.

Businesses Indicate That EZ Tax Breaks Are Not Effective

Though not highlighted by the authors, the report's survey indicates that EZ tax breaks often do not affect businesses' hiring and investment choices, even among businesses that had participated in the program.

- Nearly half (47.1 percent) of businesses report that the EZ hiring credit – the most expensive component of the program – "never" or "rarely" influenced their hiring decisions, while less than one-third (32.5 percent) report that the credit "often" or "always" affected their decisions.
- Three in five businesses (61.5 percent) indicated that the hiring credit "never" or only "rarely" played a role in deciding whether or not to retain workers.
- Nearly half (47.3 percent) report that the EZ Program did not affect their investment decisions. Only one in 10 (10.8 percent) based their decision to locate in an EZ based in part on the program's existence.
- Fewer than one in 20 businesses (4.5 percent) that relocated to an EZ moved from out of California. The remainder came from another EZ (35.2 percent) or from another part of the state (60.3 percent).

These results may actually overstate the impact of EZ tax breaks – which cost the state over $320 million in 2004 – on employer decisions because the survey only contacted businesses that participated in the program, and fewer than one in 10 businesses who received the survey responded. In addition, businesses that value the tax breaks may have been more likely to return the survey and exaggerate the impact of the tax breaks on their employment and investment decisions. The survey data suggest that the EZ Program costs the state hundreds of millions of dollars annually without encouraging job creation or investment.

The Report Exaggerates the Performance of Enterprise Zones

The report overstates zones' effectiveness in several ways. For example:

- **EZ income gains were likely driven by the 1990s high-tech economy, not the EZ Program.** The report finds that EZs experienced greater growth in median household incomes between 1990 and 2000 than did the rest of the state. However, especially strong wage and salary income gains in the San Jose and San Francisco zones boosted EZs' overall growth between 1990 and 2000. Wage and salary income grew 51.6 percent in the San Francisco EZ and 44.0 percent in the San Jose EZ between 1990 and 2000. Income growth in these two EZs is more reasonably attributable to the high-tech boom of the late 1990s than to the EZ Program.
- **Economic performance differs substantially among zones.** The report's reliance on data that groups together all EZs masks disparities among zones. Of the 18 zones established

in the 1990s, eight had higher unemployment rates in 2000 than they did in 1990.[2] In addition, 10 had lower wage and salary increases than the rest of the state. In contrast, the report cites a decline in the unemployment rate and a substantially larger increase in household income for these EZs as a whole.[3]

- **The report overstates changes in poverty rates.** The report's finding that EZs experienced larger declines in poverty rates than the rest of the state is based on a misleading calculation. The report's finding that the overall poverty rate in EZs established in the 1980s dropped 8.5 percentage points between 1990 and 2000, compared to 1.6 percentage points for the rest of the state is factually accurate.[4] However, it masks the fact that poverty rates in EZs are approximately two to three times higher than in the rest of the state and thus have much farther to fall. In 1990, for example, the overall poverty rate was 43.1 percent in EZs established in the 1980s and 14.6 percent in the rest of the state. In fact, the percentage decline in the overall poverty rate for EZs was more modest relative to the percentage decline in the rest of the state (19.7 percent for EZs and 11.0 percent for the rest of the state). In addition, the percentage decline in poverty rates was similar for both EZs established in the 1980s and comparison areas over the same period (see below).

- **Comparison areas are not similar to EZs.** The report compares changes in economic indicators within the EZs to those in nearby census tracts, which it considers "a type of control group." However, the comparison areas are economically stronger in terms of poverty, unemployment, and income measures. A more appropriate comparison would be to identify census tracts with similar demographic and economic characteristics, an approach used by a prior evaluation of California's EZ Program.[5] Since the report's comparison areas are not a valid control group, any differences in the performance between EZs and the comparison areas should be interpreted with caution.

- **The report overstates savings from public assistance programs.** The authors suggest that the EZ Program could result in substantial savings to public assistance programs if the hiring credit encourages businesses to hire individuals who were formerly receiving income support. However, the EZ Program's own administrative data indicate that few hiring credit vouchers were issued for individuals receiving cash assistance. In 2004 only 2.7 percent of hiring credit vouchers – which are needed for businesses to claim the hiring credit – were issued for workers who were participants in or eligible for income support programs.[6]

The Report Does Not Directly Evaluate Effectiveness of the Hiring Credit

The report makes the implicit assumption that economic improvement within zones is due to EZ tax breaks, despite survey findings that the tax credits have no effect on the hiring and investment decisions of many zone businesses. Economic improvement could be attributable to other factors, including regional economic trends and local economic development assistance available to EZ businesses. A rigorous examination of the effectiveness of EZ tax breaks would compare employment at businesses that use tax breaks to businesses that do not. The authors do not attempt to make this comparison and thus cannot conclude whether employment increased or decreased at businesses that use the tax credits. The authors could not make this comparison because firms are not required to report the data that would be needed for this analysis. However, without this data, economic improvements in EZs cannot be attributed to the EZ Program.

The Enterprise Zone Program Evaluation Suffers from Lack of Data

The authors could not fully evaluate any of the five issues outlined in the report due to lack of available data. The five issues included the impact of "each EZ incentive type" on zone development and on "the effectiveness of providing jobs to qualified employee populations through EZ hiring credits." In each of the five cases, the authors cite lack of available data for being unable to fully respond to the issues. These data do not exist in part because organizations representing EZs and companies that claim tax breaks have opposed even minimal data collection requirements. In addition, authors requested data from banks that claim the EZ net interest deduction, but the banks refused.

Conclusion

The report exaggerates the performance of California's enterprise zones, inaccurately attributes economic improvements in zones to EZ tax breaks, and understates evidence that EZ tax breaks are not effective. Furthermore, the report highlights that sufficient data are not available to conduct a full assessment of the program.

David Carroll prepared this Budget Brief. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

[1] Nonprofit Management Solutions and Tax Technology Research, LLC, *Report to the California Department of Housing and Community Development on Enterprise Zones* (August 18, 2006).

[2] These figures exclude the Sacramento Army Depot and Shasta Valley (Siskiyou County) zones because, according to the report, sufficient data were not available.

[3] It is not possible to know how many zones performed better than comparison areas since the report does not present these data.

[4] The report uses Decennial Census data for 1980, 1990, and 2000. Data typically refer to the year prior to the survey (1979, 1989, and 1999). However, this *Brief* follows the report's convention of referring to these data by the survey year.

[5] Suzanne O'Keefe and Roger Dunstan, *Evaluation of California's Enterprise Zones* (California Research Bureau: August 2001).

[6] California Budget Project, *California's Enterprise Zones Miss the Mark* (May 2006).