Give Them a Break

Tax Advantages in Enterprise Zones Fail to Boost Business in Problem Areas

BY JEAN ROSS AND DAVID CARROLL

TWO VIEWS

The Business Journal solicited these opinion columns regarding proposals for renewal and-or reform of the Enterprise Zone Program.

MORE than two decades after California's Enterprise Zone Program was created to encourage job and business growth in economically distressed areas, the program is in need of reform.

Enterprise zones have cost California over $1.5 billion, yet neither program proponents nor state administrators can conclusively establish a link between enterprise zone tax breaks and increased employment, firm growth, or economic development. The state spends hundreds of millions of dollars a year in tax breaks for businesses in the 42 zones around the state, regardless of whether these businesses create jobs or make new investments in the distressed communities zones are designed to help.

The sheer size of the program illustrates the need for better targeting, with eight zones in Los Angeles County alone and one includes much of downtown San Francisco – some of the most expensive real estate in California.

While often touted as a strategy for helping struggling small businesses, most of the cost of the program goes to providing tax breaks for the state's largest corporations. In 2003, for example, companies with assets of $100 million or more claimed over 80 percent – $134 million – of the tax credits claimed by zone firms.

Indeed, the program has grown so large and unfocused that about one out of every eight California workers is employed in a zone. But lack of targeting isn't the only problem. Assisted by a cottage industry of consultants, businesses claim tax credits for highly skilled workers who live in up-and-coming neighborhoods and employers seek tax credits for individuals with traffic violations under provisions aimed at aiding ex-offenders. Outdated rules allow employers to claim benefits using eligibility criteria for a federal program that was abolished in 2000. Finally, if local administrators do not allow employers to claim tax credits,

PHOTO BY AGUSTIN TABARES

Special Assistance: Long Beach is the site of one of the area's Enterprise Zones.

employers can "shop" for other zones that interpret program guidelines more leniently.

With the hope of improving program accountability and ensuring that taxpayers' dollars are spent wisely, our new report, "California's Enterprise Zones Miss the Mark," makes five key findings:

1. The cost of the program has increased substantially.

The cost of the enterprise zone program grew 19-fold between 1993 and 2003, from $15.6 million to $299 million.

2. The program fails to effectively target areas most in need of assistance.

The number of zones prevents the program from targeting areas most in need. Businesses in urban areas, such as San Francisco and Los Angeles, claim the lion's share of zone tax breaks. In contrast, enterprise zones in poor rural areas, such as Calexico and Delano, account for a relatively small share of program costs.

3. The "hiring tax credit" rewards businesses that do not hire workers with barriers to employment or create new jobs.

Nearly two-thirds of 2004 hiring tax credits were approved for workers who happened to live in the right neighborhood, not because they faced a specific barrier to employment. In contrast, only 2.7 percent of approved hiring credits were for workers who were either participants in or eligible for income-support programs – the very individuals the program was designed to assist.

4. The hiring tax credit is prone to abuse.

Businesses can seek approval for hiring tax credits from the enterprise zones most willing to approve them. A recent audit found that more than half (61 percent) of hiring credits approved by the Oakland zone were for compa nies located in other zones.

5. Program eligibility criteria are overly broad.

Areas can qualify as a zone, for example, if they "have a history of gang-related activity," whether or not violent crimes have actually been committed. In addition, state law allows enterprise zones to expand into areas that fail t meet definitions of economic distress.

To all of these problems, the report offers solutions, including reducing the number of zones, reassessing zone eligibility every five years, and eliminating zones that are no longer economically distressed.

In addition, the hiring tax credit needs to be reformed and made more accountable. The hir ing credit should only be claimed by businesse that create new jobs and hire workers with bar riers to employment, and businesses should nc be able to claim hiring credits retroactively.

With 23 of the state's zones set to expire this year and next, lawmakers have an opportu nity to make needed changes. Without these changes, the Enterprise Zone Program will fai to live up to what it promises California's busi ness owners: valuable incentives for businesse willing to risk locating and creating jobs in the state's most economically distressed areas, an hiring people who most need work.

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