

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86 / 2

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to produce benefits for the ghetto, as well as profits to the investor. Jobs and earned incomes would be created, both directly and (through purchases of locally produced intermediate products or services) indirectly. New plants would stimulate the sales of adjacent small businesses such as coffee shops. The facilities would permit the companies to engage in the training of both "line workers" and—perhaps more important in the long run—new managers. Through so-called "turnkey" programs, according to which companies set up subsidiaries intended to be spun off for eventual ownership by community groups, the ghetto would eventually acquire control over profits and the capital stock itself.

In 1967, several U.S. Senators, led by the late Robert F. Kennedy, introduced legislation designed to subsidize white corporate branch-planting [116, Kennedy, 1969]. Although never reported out of committee, the "Kennedy Plan" continues to receive widespread attention by advocates of inner city economic development. The Plan would have provided investment tax credits, accelerated depreciation allowances, wage subsidies, and training allowances, subject to a firm's meeting certain conditions with respect to the hiring of local, *i.e.*, ghetto, residents.

These "branch-planting" efforts have been studied extensively [41, Cohn, 1971; 42, The Conference Board, 1971; 120, Levitan, Mangum and Taggart, 1970; 22, Blaustein and Faux, 1972, Ch. 8; 65, Faux, 1971; 168, Skala, 1969]. Many plants have closed down, while others were (even before 1970) operating with substantial excess capacity. This appears to be true especially for the turnkey operations.

Past efforts of state governments and regional councils to affect the inter-regional location of industry through public incentives have not always produced the intended result. Indeed, it is often the firms operating closest to the margin and which are therefore often the least desirable to an area which are the most responsive to such incentives [65, Faux, 1971, p. 38; 122, Lewis, 1968, p. 44; 120, Levi-

tan, Mangum and Taggart, 1970, p. 64; 179, Stober and Falk, 1969]. A simulated benefit-cost analysis of the Kennedy Plan concludes that: "the firms most likely to respond would be those for whom the subsidies would make the greatest difference . . . low-margin firms producing standardized products in highly competitive markets, paying relatively low wages" [183, Tabb, 1972, p. 51]. In order to attract "better" firms to the program, the government will (writes Tabb) have to change the factors, such as inadequate public services and excessive congestion, which make central city locations so expensive. The Kennedy Plan made no provision for public investment in urban infrastructure.

Tabb's benefit-cost analysis leads to the conclusion that, even with an average wage in a "Kennedy plant" of only \$3,000 (so that, while the Plan might reduce ghetto unemployment, it would not by assumption reduce "working poverty"), program costs would be two and one half times the net returns [183, 1972]. Another evaluation, by Garrity, concluded that 99 percent of American private enterprises would not be able to survive in the ghetto [75, 1968].²¹

Barry Bluestone argues that the branch-planting strategy removes project selection from the control of the community. Moreover, since the "prevailing wage" in ghetto areas is

²¹ Many of Garrity's assumptions about the probable operating characteristics of ghetto-based white-owned plants now appear to have been invalid. Garrity assumed that ghetto labor would be 7.5 percent less productive, 50 percent more unstable, 200 percent as expensive to hire, and 800 percent as expensive to train as the "usual" labor of the participating firms. In fact, private corporations with involvements in the ghetto (including the companies participating in the Job Opportunities in the Business Sector Program to train the "hard-core unemployed") report generally favorable labor performance. Most find their ghetto and non-ghetto employees to be "indistinguishable" in terms of productivity, absenteeism, turnover, and learning rates [43, The Conference Board, 1969; 42, The Conference Board, 1971, vol. 1, Ch. 5; 13, Banfield, 1969]. Moreover, there is evidence that any correlation between tenure and race or quit rates and race disappears when the relationship between quits/tenure and wages is introduced into multivariate regressions [179, Stoikov and Ramon, 1968].

seldom above branch-planting strength of wage floors by to shift part of wage areas [24, programs, cond business consulting confirms that the enabled companies the disadvantages from union negot have been willing tions from union 153]. These find caution and deta branch-planting

The Model Cities

Title I of the Metropolitan Development Act authorized the U.S. Department of Urban Development to administer the Model Cities Program. The program was a public and private comprehensive attack on the social and physical problems of inner city neighborhoods. The program received "grants" to cover the "costs" of providing comprehensive services substantially the level of health and medical care and job training in the "model neighborhoods." The program targeted geographic areas for making applications for general criteria for selection and that "a substantial number of core slums with a high concentration of low income families" and approved, city or state, or a copy of federal general grants" to

Perhaps because of the Model Cities did "community action

assumptions about the probability of ghetto-based white-owned jobs have been invalid. Garrity assumed he was 75 percent less productive, 50 percent as expensive to hire, and twice as expensive to train as the "usual" laborer. In fact, private corporations in the ghetto (including the companies that employ the "hard-core unemployed") report no difference in performance. Most find their ghetto employees to be "indistinguishable" from whites in terms of quality, absenteeism, turnover, and productivity (Conference Board, 1969; 42, The Industrial Revolution, Ch. 5; 13, Banfield, 1969). The fact that any correlation between race and productivity disappears when quality, tenure and wages is introduced is not surprising (179, Stokoy and Ralston, 1970).

The Model Cities Program has great potential, especially for local economic development [144, Ollan, 1972; 65, Faux, 1971]. But the realization of this potential will require major changes, including a Presidential mandate which has thus far not been extended (indeed, President Nixon has now decided to terminate the program altogether). Even the administratively "easier" employment objectives of Model Cities have been seriously subverted by many local mayors and city councils. Both in 1969 (when the program was just underway), and again in 1971 (by which time it was employing some 25,000 people across the country), fewer than half of the salaried jobs in the program had been allocated by local officials to residents of the target inner city areas, in violation of both legislative and (federal) administrative intentions [92, Harrison, 1973; 90, Harrison, 1974]. At stake was an income flow of over \$200 million a year in wages, salaries, and benefits. The cities which allocated the smallest share of their Model Cities jobs to ghetto residents were those whose personnel systems extensively used educational credentials and police records as screening devices (even for unskilled jobs), those with powerful mayors (as measured by their veto au-

thority and number of terms in office), and those which were least confronted with actual or latent "black power" (as measured by the level and growth of the black population, and whether or not the city had experienced a civil disorder in the summer of 1967). Moreover, it was found that target area residents received about \$1,500-\$1,900 per year less in salaries than non-neighborhood residents, after controlling for age, race, sex, education, civil service coverage, occupation, and municipal or non-profit agency.

As with the Community Action Program of OEO, Model Cities *did* provide a vehicle for local political organizing, and has produced a stream of capable, articulate minority leaders and technicians. Nevertheless, on balance, observers have found little accomplishment, or interest in shoring up the program. Efforts to date have produced little real economic development in the inner city.

Community Economic Development

As it became clear that the poverty program itself would not provide a vehicle for "self-determination," many community organizers began to search for a new institutional mechanism. Interest in economic development had created local support for the kinds of programs just reviewed. But these could not—and had not been intended to—promote "local control" either; thus the search continued [146, Perry, 1973]. The vehicle which emerged from this experience is the community development corporation.²²

²² In December 1966, Senator Robert F. Kennedy said, of the new Title I-D ("Special Impact Program") amendment to the Economic Opportunity Act which he and Senator Jacob Javits were co-sponsoring:

The measure of the success of this or any other program will be the extent to which it helps the ghetto to become a community—a functioning unit, its people acting together on matters of mutual concern, with the power and the resources to affect the conditions of their own lives. Therefore, the heart of the program, I believe, should be the creation of CDC's. . . . A critical element in the structure, financial or otherwise, of these corporations should be the

Community development corporations engage in a wide variety of projects. The Bedford-Stuyvesant Restoration Corporation in Brooklyn has investments in at least forty-three separate businesses, several housing programs, and commitments from the New York banking community for a \$100 million mortgage pool for ghetto home buyers [65, Faux, 1971, p. 6]. Restoration has also renovated nearly 1,500 private homes through the employment of 900 unskilled youths, and constructed a series of "superblocks" in the middle of the ghetto: blocks closed to traffic, whose housing has been rehabilitated, and which have been provided with trees, new lighting, and playgrounds [108, Johnson, 1971, p. 1]. Restoration recently purchased the air rights above a Brooklyn day care center, and is constructing new apartments in this location.

The Harlem Commonwealth Council, a CDC located in the Harlem area of New York City, has assets of more than \$15 million, including an office building, a factory manufacturing wood, metal, and plastic interiors for supermarkets, an office equipment and furniture company, a data processing facility, a foundry, a contract construction company, a

full and dominant participation by the residents of the community concerned.

Quoted in Blaustein and Faux [22, 1972, p. 116]. Theoretical support for the new institution (on grounds that no existing capitalist institution(s) could perform the necessary functions) was provided in a series of studies by the Harvard Program on Technology and Society [161, Rosenbloom and Marris, 1969]. The creation of a legally-chartered CDC is hardly a sufficient condition for ghetto development. More fundamental is continuous political organization of the blocks in the ghetto. Most of the CDC's which have enjoyed a measure of success in launching economic development projects have been able to do so by virtue of having created a solid base of political support within the community, in order to present a strong united front to outside agencies. For a review of the experiences of the movement through 1972, see the Special CDC issue of the *Review of Black Political Economy* [159, 1973]. Additional case studies are presented in Blaustein and Faux [22, 1972], Faux [65, 1971]; The Conference Board [42, 1971]; Stein [173, 1973; 174, 1973; 175, 1973; 176, 1973].

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Not all of the Boston CDCs, predominantly black, are predominantly black, and resistance to the EBCDC is on rehabilitation of part of the B. . . . and industrial pp. 19-22]. The largely Mexican that city, where . . . of upholstery operation of . . . franchises [36, . . . nomic Develop

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development corporations entity of projects. The Bed-stor Corporation in projects in at least forty-projects, several housing projects from the New York for a \$100 million mortgage to home buyers [65, Faux, Restoration has also renovated the homes through the employment of unskilled youths, and construction of "superblocks" in the projects blocks closed to traffic, projects has been rehabilitated, and projects provided with trees, new playgrounds [108, Johnson, Restoration recently purchased the Brooklyn day care center, and new apartments in this lo-

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pharmacy, and a sewing/hi-fidelity store [175, Stein, 1973].

Not all of the CDC's are black. The East Boston CDC was organized in 1971 in a predominantly Italian, white working-class community, around a continuing struggle over resistance to the expansion of a nearby airport. EBCDC is currently engaged in housing rehabilitation and the planned redevelopment of part of the Boston waterfront for commercial and industrial use [125, MacPhee, 1972, pp. 19-22]. The Denver CDC operates in four largely Mexican-American neighborhoods of that city, where it is engaged in the manufacture of upholstered furniture, toys, and the operation of supermarkets and restaurant franchises [36, Center for Community Economic Development, 1969, pp. 65-66].

*The Organization of Directly Productive Activities (DPA)*³

CDC's have provided a variety of aids to existing ghetto businesses. The Harlem Commonwealth Council provides loans to local pharmacies whose owners are penalized by delays in the processing of Medicaid forms. Restoration assists local contractors in obtaining bonding, so that they may compete for those larger contracts which require such a guarantee. In Detroit, the Inner-City Business Improvement Forum provides technical assistance (especially managerial training) to private entrepreneurs and operates an emergency revolving fund for small loans.

The possibilities for "exporting" goods and services to nearby institutional consumers have also been studied [205, Vietorisz and Harrison, 1970, Ch. 4]. Schools, hospitals, churches, and office buildings consume large

³ Development economists often distinguish between investment in infrastructure (or "social overhead capital") and investment in directly productive activities [102, Hirschman, 1958, Ch. 5]. In the urban context, the housing, transportation, and public service programs of regular city agencies (including Model Cities) might be considered SOC, whereas the development of new stores and factories represents investment in DPA.

quantities of paper and metal products, photography and repair services, etc. Successful CDC-sponsored (i.e., ghetto-owned and staffed) shopping centers, such as Progress Plaza in North Philadelphia, are often located on the "border" in order to be able to "export" sales to non-ghetto residents.

Existing ghetto enterprises are generally too small and inefficient to be able to fill such contracts punctually and at reasonably competitive cost. One proposed solution is the reorganization of existing businesses into networks of "affiliated independents." These are a form of limited producers' cooperative, in which independently-owned and operated businesses engage in joint purchasing of merchandise, joint advertising, and the pooling of other overhead costs. Between 1946 and 1972, the (white) affiliated independents in the retail grocery industry increased their share of all retail stores from 23 to 33 percent; their share of total retail grocery sales rose during the same period from 29 to 44 percent [151, *Progressive Grocer*, 1973, p. 100]. This success seems to have been built on a combination of the economies of large-scale purchasing characteristic of the chain stores, and the high motivation and flexible adaptation to local conditions characteristic of the independent entrepreneur.

CDC's are also creating totally new ventures. Restoration is developing a series of large manufacturing facilities, which it will sell to the employees and/or local investors once they become profitable; the first of these ventures is a modular housing factory. The East Los Angeles Community Union, a chicano CDC, hired a former mattress industry production worker to manage a new CDC mattress factory; "mattresses were chosen because of complaints from welfare mothers that the Welfare Dept. made them purchase from large downtown stores cheap mattresses that did not last more than a few months" [65, Faux, 1971, p. 81]. The Hough Area Development Corporation has constructed a mixed-zoning

project, the Martin Luther King, Jr. Plaza, consisting of low-income elevated town houses built over a shopping mall. In Seattle, the United Inner City Development Foundation is building an industrial park for large service enterprises and light industrial facilities, including a community-owned construction company (another ghetto industrial park is under construction in Chicago).

The CDC's, especially those in rural areas, are also experimenting with cooperatives, in such fields as pharmaceuticals, furniture production and sales, fish canning and grocerying (at both the wholesale and retail levels). One current manufacturing project involves Crawford Enterprises, a community-owned, cooperatively operated factory in Crawfordville, Georgia, which produces modular housing and is now integrating forward into the acquisition of real estate [147, Plemister and Hildebrand, 1970-71, pp. 200-202].

The initial Harlem development "plan" proposed an enterprise development strategy based upon the exploitation of linkage effects [205, Victorisz and Harrison, 1970, Ch. 3]. On the assumption that economies of scale in production no longer constitute the main barrier to free entry, having been replaced in relative importance by scale economies in advertising and dealerships, the planners recommended a strategy of beginning with the control of the local distribution system (especially retail stores), gradually integrating backward into wholesaling and manufacture of at least some of the items sold in those stores [135, Modigliani, 1958]. This strategy motivated such time-phased development sequences as: cooperative supermarkets and affiliation of existing grocers → food canning → contracts with farm co-ops in other regions; and stationery and office equipment supplies ("sheltered" by state and city government procurement contracts) → printing and metalworking [205, Victorisz and Harrison, 1970, Chs. 4-5]. Some planned linked development has in fact been undertaken in Harlem (by HCC) and in South Los Angeles (by the Watts Labor Community

Action Committee, whose most recent venture is the purchase of cattle farms to supply its urban food stores).

Among the most attractive DPA-type investments being considered by a number of CDC's are those involving the processing and communication of information. The original Harlem Development Project investigated at least two possible areas for community investment: an electronic data processing/bed monitoring service for local hospitals, and the operation of one or more local cable television franchises [205, Victorisz and Harrison, 1970, Ch. 5]. The latter has become the object of increased attention in the United States. In 1970, a Presidential Commission headed by Professor Edward S. Mason of Harvard, a prominent senior development economist, recommended that at least some of the cable franchises rapidly being created by municipal governments across the country be reserved for community groups. In 1972, the Urban Institute inaugurated a Cable Television Information Center, with support from the Ford Foundation, and a more specialized project concerned with the application of cable systems to community economic development [189, Tate, 1972]; the latter was recently spun-off as an independent black firm: the Cablecommunications Resource Center in Washington.

Project Selection Criteria

A fundamental issue in the community development movement—and in its technical literature—concerns the trade-off between commercial profits and community benefits. No single subject more clearly distinguishes this approach to inner city development from those discussed earlier than the avowed commitment of most CDC leaders to give high priority to such "external" outputs as manpower training, consumer education, improvement of the ghetto environment, reduction of *anomie* (especially among young black men), and consolidation of political "clout" in the community's relations with city hall, the state

house, the federal sector [65, Fauriol]. extreme, the programming has been development economics implicit maximization of community benefit, subject to the constraint of financial resources. CDC's speak of community welfare; so do other target variables. objective functions.

One of the main problems of "market failure" in the relationship between output and the power training. developed the now decentralized market in activities generated. The implication—locality—the industry and training. human capital. centralized market training investment "taxing" workers for the specific job. In fact, this neoclassical productivity precludes between the joint 127, Marris, 196

In community political considerations, the training "program" assigned to the ghetto labor force. ern technology. It has become more conventional power training programs for which these programs are unskilled, low-wage (or their peers) have

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s relations with city hall, the state

house, the federal bureaucracy, and the private
sector [65, Faux, 1971, pp. 48-55]. At one
extreme, the objective of development pro-
gramming has been described by an English
development economist, Dudley Seers, as the
implicit maximization of a weighted average
of community benefits, subject to the con-
straint of financial solvency, *i.e.*, that the
project(s) break even. More realistically,
CDC's speak of trading off profits for commu-
nity welfare; so that profits become one of sev-
eral target variables in the CDC's implicit
objective function.

One of the most consequential of all forms
of "market failure" arises from the "jointness"
in the relationship between the production of
output and the provision of on-the-job man-
power training. It was Pigou who first devel-
oped the now well-known theorem that
decentralized markets will invest suboptimally
in activities generating external economies.
The implications of this particular exter-
nality—the indivisibility between production
and training—have been virtually ignored by
human capital theorists, who assume that de-
centralized markets are capable of allocating
training investments efficiently, by "optimally
taxing" workers (through discounted wages)
for the "specific training" they receive on the
job. In fact, this is not possible, at least with
neoclassical production functions; the indivisi-
bility precludes unique allocation of costs be-
tween the joint products [58, Eckaus, 1963;
127, Marris, 1969, pp. 22-23].

In community development programs,
political considerations often force attention to
the training "product," and implicit values are
assigned to the "production" of a trained
ghetto labor force, equipped to deal with mod-
ern technology. This demand by ghetto leaders
has become more insistent as evaluations of
conventional private and public sector man-
power training programs have shown that the
jobs for which ghetto dwellers are trained in
these programs tend to resemble the very same
unskilled, low-wage jobs which the trainees
(or their peers) held in the past [88, Harrison,

1972; 166, Schiller, 1972]. The Harlem Devel-
opment Project team spoke often of "green-
house industries": community-owned or
sponsored manufacturing, commercial, and
service enterprises selected as much for the
nature and extent of the on-the-job training
they are capable of providing as for the prod-
uct and profits they would generate [205,
Victorisz and Harrison, 1970, pp. 67-68,
82-87]. To the extent that the production of
external benefits of any kind costs foregone
profits, subsidies are necessary in a decentral-
ized capitalist economy.⁴

Methodologically, one difficulty in selecting
ghetto development projects lies in the combi-
nation of quantitative and qualitative objec-
tives, and another in the externalities—both
convex, *e.g.*, consumption interdependences,
and nonconvex, *e.g.*, indivisibilities and econo-
mies of scale—that link different projects
together. An operational solution to the sec-
ond problem has been employed by develop-
ment planners for several years; it is the use
of a complex of interrelated activities as the
unit of project planning. This unit is variously
referred to as an "industrial complex" or
"cluster," an "activity complex," a "module,"
or simply a "project" [105, Isard, Schooler,
and Victorisz, 1959; 202, Victorisz, 1968; 20,
Bergsman, Greenston, and Healy, 1972].
Work is presently underway to attack the first
problem through the design of integer pro-
gramming models with ordinal preference
functions and iterative man-machine interac-
tion [203, Victorisz, 1970].

Financing Ghetto Development

Precise accounts of the total resources (pub-
lic and private) invested in the CDC move-

⁴ Publicly subsidized ghetto development would not
constitute any significant departure from traditional
American practice; in the nineteenth century, transfers of
public capital and land to the private railroads to stimu-
late economic development "ran to almost 1 percent of
gross national product during one ten-year period." In the
four years following World War II, the U.S. transferred
nearly \$14 billion to Western European governments and
private corporations [65, Faux, 1971, p. 100].

ment are simply not available but scattered records imply that the total is still very modest.

Since 1967, many CDC's have been funded by the Special Impact Program of OEO (currently being transferred to OMBE). Cumulative Special Impact grants to 23 urban and 20 rural CDC's amounted to \$132.5 million by the end of Fiscal 1973 [35, Center for Community Economic Development, 1973, pp. 4-5]. Although some CDC's have developed contracts with outside white corporations, which provide a source of technical assistance, occasional loans and most importantly procurement contracts, nevertheless, most continue to rely primarily on assistance from the federal government (and, to some extent, from foundations). Certainly the Special Impact and Community Action programs of OEO, together with HUD's Model Cities Program, are the ghetto's principal sources of equity capital. Other federal agencies, especially OMBE, strongly prefer to offer debt rather than equity financing. This has forced many CDC's to acquire seriously excessive debt-equity ratios which hampers their ability to grow through reinvestment of surplus [65, Faux, 1971, p. 86].

Even the grants tend to be "tied" in that the granting agency usually reserves the right to approve or disapprove each individual investment project. CDC's are generally not permitted to use public funds to invest in assets located outside the ghetto, even though such locations may be preferable. And SBA and OMBE regulations prohibit the support of cooperatives [65, Faux, 1971, p. 95].

An important potential source of income for ghetto development projects may be local government. City halls could allocate a share of their procurement contracts to ghetto enterprises, perhaps foregoing competitive bidding, under appropriate circumstances, and could place at least some of their financial accounts in banks willing to invest in the ghetto economy [128, McLaurin, 1968; 129, McLaurin and Tyson, 1969]. In New York City, for ex-

ample, "with a half-billion dollar annual expenditure for purchases and small contracts, a set-aside of roughly 10 percent of this amount could provide . . . an estimated 50 million dollars" for ghetto businesses [129, McLaurin and Tyson, 1969, p. 133].

Recognition of the limits of existing programs led a group of Senators, Congressmen, lawyers and black leaders (notably Roy Innis) to meet in the spring and summer of 1968 to draft legislation—the Community Self-Determination Act—designed to create an entirely new structure to finance ghetto development:

The bill provided for federal chartering of CDC's and Community Development Banks; creation of a nationwide Community Development Bank as a secondary financing institution; authorization of favorable tax status for CDC's as well as "turnkey" tax incentives for cooperating outside businesses; and managerial and technical assistance money for CDC's through the SBA [65, Faux, 1971, p. 114].

Although the bill received support from politicians associated with an extraordinarily broad range of ideological views, it languished in committee for two years, never even coming up for a vote [22, Blaustein and Faux, 1972, Ch. 4].

A revised bill, the Community Corporation Act of 1970, was subsequently prepared by the Staff of the Senate Subcommittee on Employment, Manpower and Poverty. Many of the defects of the original bill (such as a prohibition against CDC investments outside the ghetto) were corrected. Nevertheless, the new legislation has not fared any better than the old. The Center for Community Economic Development is currently preparing model legislation for a national community development banking system [47, Daniels, 1973].

One potential source of financing for ghetto development which has not been explored is revenue-sharing. Because CDC's represent probably the most powerless of a mayor's or governor's constituencies and because the competition among constituencies for public revenues is so great, CDC's are unlikely to be able to capture significant funds from general

revenue-sharing special manpower revenue-sharing funds are restricted thereby reducing among constituencies

Some Political

The tone of the community economic development movement has been optimistic, a sense of the exhaustion of participants. CDC numbers have grown, obstacles, and have a number of victories, private (white) fearful of institutions such as unions which feel empowered it of

Nevertheless, the situation in foreign activities. At least, recent state alternative institutions organization of production with conventional and economic organization contradiction which is going to permit only hold [24, Blaustein more successful-mass," or "take-over simply "a life of allowed to survive existence on outside support—a situation ghetto will continue at least the next ten years them highly vulnerable

This analysis, continued existence depend crucially on and participants of the ghetto. By state elections (as

-billion dollar annual expenditures and small contracts, only 10 percent of this side . . . an estimated 50 percent of ghetto businesses [129, p. 133].

the limits of existing programs of Senators, Congressmen, and city leaders (notably Roy Innis) in the spring and summer of 1968 to create a Community Self-Determined Center to create an entirely new ghetto development:

the federal chartering of CDC's (Community Development Banks); creation of a Community Development Bank as a permanent authorization of federal CDC's as well as "turnkey" operating outside businesses; and financial assistance money for CDC's [cf. Faux, 1971, p. 114].

received support from political leaders of an extraordinarily broad cross-section of the community. It languished in the years, never even coming to fruition [Faux, 1972, p. 114].

Community Corporation subsequently prepared by the subcommittee on Employment and Poverty. Many of the bills (such as a prohibition on investments outside the ghetto). Nevertheless, the new legislation is no better than the old. Community Economic Development Act is currently preparing model legislation [47, Daniels, 1973].

the issue of financing for ghetto development has not been explored in detail because CDC's represent the powerlessness of a mayor's or city council and because the constituencies for public housing CDC's are unlikely to be able to raise funds from general

revenue-sharing. The prospects with regard to special manpower and community development revenue-sharing are a little better, since these funds are restricted to federally-specified uses, thereby reducing the potential competition among constituencies.

Some Political Considerations

The tone of this description of the community economic development movement has been optimistic, reflecting at least, the author's sense of the exuberance and dynamism of the participants. CDC's have survived—and their numbers have grown—in the face of enormous obstacles, and have won a small but significant number of victories over recalcitrant bureaucrats, private capitalists (black as well as white) fearful of social change, and local institutions such as city halls and some labor unions which feel threatened by that potential empowerment of the poor.

Nevertheless, it would be wise to use caution in forecasting continued expansion of the activities of CDC's. Radical economists, at least, recognize that the attempt to create truly alternative institutional approaches to the organization of production, existing side by side with conventional capitalist modes of social and economic organization, creates a powerful contradiction which "the system" may be willing to permit only up to some critical threshold [24, Bluestone, 1971]. As they become more successful—as they achieve "critical mass," or "take-off into sustained growth," or simply "a life of their own"—will CDC's be allowed to survive? Their almost total dependence on outside political and financial support—a situation which the poverty of the ghetto will continue to impose on them for at least the next ten to twenty years—makes them highly vulnerable to such a threat.

This analysis, in turn, suggests that the continued existence of the CDC movement will depend crucially on the ability of its advocates and participants to organize politically outside of the ghetto. By winning local, regional, and state elections (as well as seats in the national

legislature), and by effective lobbying in the administrative agencies of the federal government (through the forging of political alliances with other working class groups), advocates of community economic development may be able to create the political conditions for continued experimentation with alternative paths to inner city development. At least they can hope to use their influence to protect what already exists.

V. Ghetto Development vs. Ghetto Dispersal

Proposals to invest in the redevelopment of the inner city have been dismissed by a number of scholars as wasteful "ghetto-gilding." Development is represented as a retreat from the long-term "national objective" of full racial integration. According to John F. Kain, for example, the "developers" . . .

seem to have concluded that residential integration is either impossible or will take too long. They contend that the problems of the urban Negro are current and real. . . . Proposals to patch up the ghetto and make it a better place to live and to create jobs there are heard with increasing frequency [100, Kain, 1968, p. 242].

Kain opposes "ghetto-gilding." For one thing, he argues, it would reduce political pressure for and interest in integration. For another, the capital absorption capacity of the ghetto is far too small to permit sufficient internal job development to make a difference. Finally, "ghetto improvement and particularly job-creation programs might well have as their principal result increased migration of Southern Negroes to Northern metropolitan areas . . . greatly aggravating the problems" [113, Kain and Persky, 1969, pp. 38-39]. Thus, "there is no alternative but vastly increased suburbanization of Negro populations, if we are to avoid unnecessary economic waste and growing political conflict" [102, Kain, 1968, p. 243]. Programs to implement the suburbanization of ghetto dwellers—re-

²⁴ This subject receives a far more extensive treatment in Harrison [93, 1974, Chs. 4-5; von Furstenberg, Hirsowitz, and Harrison [208, 1974, pt. 1].

verse commuting, open housing, and such—are referred to by Kain as “ghetto dispersal.”

Whether such a thing as “the national objective of integration” even exists may well be doubted, given the overwhelmingly negative popular response to such frankly modest activities as school busing. 1970 Census data indicate at best no decrease in residential segregation in American cities. Attempts to open suburban housing to blacks have been unofficially thwarted as much by public officials as by irate white citizens [88, Harrison, 1972, pp. 162–170]. These ugly facts do not imply that continued segregation must or should be tolerated. They do indicate that integration will carry with it a high social cost, so that some mix of development-dispersal policies is probably optimal. The “there is no choice but dispersal” argument, calling as it does for a “corner solution,” implies an estimate of the social costs of integration which is surely too low.²⁴

The argument that investment in the inner city will lead to improvements which, when signalled to Southern blacks, will induce counter-productive migration, has been challenged on two counts. First, empirical studies (summarized in Harrison [93, 1974, Ch. 4]) indicate the complexity of the migration decision. Regional differences in unemployment and wage rates, housing and social service, e.g., welfare, availabilities are undoubtedly arguments in individuals’ migration-decision functions. But their inter-relationship is not simple. To select but two examples, South-North black migra-

tion has continued since 1947, at least until 1970, even though both nonagricultural employment and per capita income have grown more rapidly in the South than in the North. And between 1960 and 1965, 81 percent of all net migration to urban areas went to just nine places; these had unemployment rates which (during that period) were about 8 percent higher than the average unemployment rates in the 141 other urban labor market areas delineated by the U.S. Department of Labor. Second, researchers have learned—quite in opposition to the conventional wisdom—that South-North black migrants tend to be relatively well-prepared for city life. They display higher average education and skills, and are generally younger than those whom they leave behind [211, Wertheimer, 1974, p. 76]. Their socioeconomic status has actually been found to exceed the average in the destination city as well [124, Long, 1973; 186, Taeuber and Taeuber, 1965]. Finally,

As for the crime and delinquency so regularly attributed to the newcomers, what evidence there is points the other way: it takes sometime in the city for the migrant to catch up with the old residents [193, Tilly, 1968, p. 49].

The conventional wisdom was reinforced by a widely publicized computer simulation model [67, Forrester, 1969]. Experiments with policies of central city low-income housing and job development generated forecasts of further decline in economic welfare in the city, due to the positive feedback of increased immigration which overloaded the absorptive capacity of the model city. This forecast has been shown by critics to be directly attributable to an *assumed* high elasticity of migration with respect to urban development [74, Garn and Wilson, 1970]. The empirical studies from which such elasticities might be derived are yet to be conducted.

Another argument against ghetto development concerns the “suburbanization” and “skill mis-match” hypothesis. Development would attract new migrants to the very site—

the central city—legedly moving leaving behind those with high skills [1968; 111, Kain, 1969; 136, Moynihan, 1994, U.S. Advisory Commission on Environmental Relations]. This literature and published studies, however, indicate that the suburban employment is cyclical, employing more plants than the inner city, and that the suburban area also vary enormously in many services, especially in the provision of a strong police force or density of the national business. The variables mentioned are substantial [1969, Neill]. The conditions are different (nations). And according to the evidence, there is no quantitative evidence of what evidence exists the other way, increasingly service the most “non-skill” commercial.

That “open housing” programs to attract investment suggests that the suburbs as character in which new migrants be able to find (better) to them. Data from comparisons between black workers and “suburban residents” for proximity to

²⁴ Peter Labrie emphasizes the importance of a voluntary component of residential segregation. Even if discrimination in housing were completely eliminated, he conjectures, the voluntary dispersal of the black population would not fit

into the pattern of complete integration used in the quantitative analysis of Kain, a pattern in which black and white households are distributed equally throughout the metropolitan area. As long as blacks remain a distinct ethnic minority with a distinct set of religious, fraternal, and commercial institutions, they will [want to] retain a distinct locational base for these institutions. This has been true of all American ethnic minorities, including Jews and Italians [119, 1970, p. 17].

since 1947, at least until nonagricultural employment income have grown more than in the North. In 1965, 81 percent of all areas went to just nine employment rates which were about 8 percent above unemployment rates in labor market areas defined by the Department of Labor. We have learned—quite in conventional wisdom—that migrants tend to be relatively young, single, and have fewer skills, and are from those whom they leave behind (Harrison, 1970, p. 76). Their assimilation has actually been found to be slower in the destination city (Harrison, 1973-1976; Taeuber and Taeuber, 1976).

They so regularly attend to the evidence there is that the time in the city is spent with the old residents.

Wisdom was reinforced by a computer simulation (Harrison, 1969). Experiments with city low-income housing generated forecasts of economic welfare in the city, which showed a feedback of increased immigration reduced the absorptive capacity. This forecast has been directly attributable to the intensity of migration with development (Harrison, 1974; Garn and Harrison, 1974). Empirical studies from other cities might be derived are yet.

Against ghetto development, "suburbanization" and "dispersal" hypotheses. Development grants to the very site—

the central city—out of which jobs are allegedly moving with increasing frequency, leaving behind a mix of jobs dominated by those with high skill requirements (Harrison, 1968; 111; Kain, 1968; 113; Kain and Persky, 1969; 136; Moynihan, 1968; 54; Downs, 1968; 194; U.S. Advisory Commission on Intergovernmental Relations, 1968, p. 58). A review of this literature and more recent but still unpublished studies of the decentralization phenomenon, prepared for the Urban Institute, indicate that the net changes in central city vs. suburban employment are attributable more to cyclical employment variations in stationary plants than to a literal relocation of plants from the core (Harrison, 1974). Patterns also vary enormously across industries with many services, especially government, displaying a strong propensity for core locations. Age or density of the city and the "stage" of the national business cycle are important explanatory variables; most central cities experienced substantial job growth between 1964 and 1969. Neither job nor residential decentralization are strongly related to the racial mix of the central city population (poverty and fiscal conditions are far more powerful determinants). And according to these recent findings, there is no quantitative (as opposed to anecdotal) evidence of a "skill mismatch." Indeed, what evidence exists supports forecasts that cut the other way; central cities are becoming increasingly service-oriented, and services are the most "non-skilled-intensive" of all industrial/commercial sectors.

That "open housing" receives much more attention by the advocates of dispersal than programs to attack discrimination in employment suggests that these scholars perceive the suburbs as characterized by a tight labor market in which newly suburbanized blacks will be able to find (better) jobs if only they can get to them. Data that would permit systematic comparisons between suburban and inner city black workers are very scarce. Moreover, "suburban residence" is too crude a "control" for proximity to suburban jobs. Definitive re-

search would have to take actual homesite-jobsite distances, the suburban transportation mix, and the access of whites competing for these suburban jobs into account.

A few studies which attempt to draw such comparisons have nevertheless been published, (although none overcomes the previously stated objections). One analysis of white and nonwhite residents of the twelve largest SMSA's in 1966 distinguishes three residential locations: central city poverty areas, the non-poverty central city, and the suburban ring (Harrison, 1972, Ch. 4). Three measures of individual adult male economic welfare are specified: weekly earnings, annual unemployment, and current socioeconomic status (an ordinal index whose values range between 0 and 96). The values of the white indicators generally improve with distance from the core; moreover, the white interpersonal distributions for the three variables are statistically distinct. Among the nonwhite men, however, average values of the indicators are highly insensitive to residential location, and the distributions themselves overlap. Moreover, econometric models of the returns to education reveal that the schedules of returns are themselves highly insensitive to black (but not white) residential location—for women as well as for men. Duran Bell and Bernard Frieden confirm many of these findings for the 100 largest SMSA's (Bell, 1974; 69; Frieden, 1972).

To a great extent, the dichotomy that some have posed between investment in the urban ghetto and dispersal of ghetto residents to "outside" areas (especially the suburbs) is a false one. There exist a number of potential linkages between general urban development and inner city development projects. These economic and political complementarities further reduce the danger that ghetto development will become a fruitless exercise in autarky. For example, it has been suggested that local governments subcontract CDC's to hire ghetto residents to produce and distribute various public services within the community.

[66, Faux, 1972]. Even more consequential—both in terms of the numbers involved and the implications for racial integration—would be the recruiting of ghetto residents for federal, state, and local jobs located outside the ghetto. Jobs in this sector have been found to be far superior to the private sector jobs which ghetto dwellers now hold or aspire to, in terms of relative wages and benefits, cyclical stability, modest skill requirements, and central place orientation [18, Bell, 1974; 94, Harrison and Osterman, 1974]. A panel of economists including William Fellner, John Kenneth Galbraith, Robert A. Gordon, and the author have recommended large-scale public service employment to a U.S. Senate committee as a direct and relatively non-inflationary method for absorbing the disadvantaged into the "primary labor market" [200, U.S. Senate, 1972, pp. 1519–1618]. Bluestone perceives such a policy as potentially capable of bringing much needed upward pressure to bear on private sector wages for ghetto dwellers, by increasing the competitive demand for their services [23, 1972].

Investment in People vs. Investment in Place

In the spatially competitive world of many early mathematical models of urban form, there are no compelling reasons for "investment in place." Investments in people—in their human capital, in augmenting their purchasing power through transfer payments, in subsidizing (e.g., through the federal highway system) their movement to the suburbs—are sufficient in such models to improve economic welfare. Indeed, just as consumers are assumed to have freedom of "movement" among competing producers in the spaceless theory of competition, so they are assumed in mainstream spatial theory to have the freedom to move their residences from one urban jurisdiction to another in search of the optimal combination of public services and taxes, giving rise to a kind of neo-Smithian "theorem of the invisible foot" [192, Tiebout, 1956]. Since externalities are consigned to footnotes in the

neoclassical paradigm, neighborhood effects are largely ignored.²⁷

Other economists argue, by contrast, that externalities are ubiquitous in urban areas [cf. 101, Hirsch, 1973]. We have had occasion to describe some of these factors elsewhere in this paper. Interdependences, indivisibilities, threshold effects, and nonlinearities abound [204, Victorisz, 1959; 201, Victorisz, 1968; 182, Struyk, 1972]. Especially important sources of market failure are the prisoners' dilemmas which permeate land transactions and physical renewal decisions [49, Davis, 1970; 59, Edel, 1972; 61, Edel, 1972]. Under these circumstances, revealed preference breaks down entirely; it is no longer possible to infer that any *ex post* spatial pattern of economic activity, e.g., household location, reflects a Pareto optimal outcome of a large number of decentralized optimizing decisions (households trading off access to the urban core for the amenity of greater open space).

In particular, increases in income no longer necessarily lead to improved access (to jobs, housing, open space, or the central business district), especially when the irregular availability of transport links and discrimination in capital, housing, education, and labor markets are accounted for. Thus, we cannot assume that transfer payments to the poor (or for that matter, to anyone else) will unambiguously lead to neighborhood improvements. This creates one rationale for "investment in place."

A second rationale depends on an important aspect of welfare economics concerning "public goods." Private, decentralized markets will "fail" to produce adequate quantities of those goods and services the consumption of which is at least partly collective (and therefore in-

²⁷ Recently, spatial location models have begun to appear in the literature which attempt to account systematically for congestion costs—a major urban externality—and such neighborhood effects as the sensitivity of household location to the local racial mix and the interrelationships among property values in adjacent areas. On the latter [cf. 114, Kain and Quigley, 1972; 152, Quigley, 1974].

divisible).²⁸ As it grows, the demand for consumed goods becomes absolutely and relatively inelastic. Moreover, to the degradation can be added excess capacity associated with ownership and use of the public/private deliberately added. Bluestone, 1971].

The upshot is that of the poor through or even a "guarantee" induce private provision of the provisions of transportation, and manpower training goods and services distribution of such *i.e.*, if the per capita rectangular, then a policy will "in investment" of the neighborhood changed by the e;

Value Judgments

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divisible).²³ As the post-industrial economy grows, the demand for collectively produced or consumed goods and services grows, both absolutely and relatively [73, Galbraith, 1958]. Moreover, to the extent that environmental degradation can be related to the chronic excess capacity associated with the private ownership and use of durable goods, this trend in the public/private good "mix" may have to be deliberately accelerated [63, England and Bluestone, 1971].

The upshot is that increases in the incomes of the poor through a "negative income tax" or even a "guaranteed annual income" will not induce private producers to adequately expand the provisions of education, housing, health, transportation, environmental quality control, manpower training, or other "quasi-public" goods and services. If the interneighborhood distribution of such services is not "equal," i.e., if the per capita distribution is not roughly rectangular, then the only completely effective policy will be "investment in place"—public investment in the physical and human capital of the neighborhoods which have been short-changed by the operations of the market.

Value Judgments about Ghetto "Turf"

"What to do about the ghetto" depends, to an extent seldom appreciated by economists concerned primarily with the rather narrow question of efficiency, on attitudes about city living. The critics of development treat the inner city as a temporary staging area, occupied by low-income migrants and to be abandoned by them as they "adjust" to middle-class urban life [110, Kain, 1968; 118, Kristol, 1972].

²³ The definitive paper on market failure is still Bator [14, 1972]. For a simplified discussion of the subject, see Bator [15, 1960]. A complete theoretical analysis of non-convexity in urban economics would be a valuable addition to the literature, given the apparent ubiquity of such phenomena. Perhaps it is the memory of Tjalling Koopmans' identification of the extent to which neoclassical equilibrium and welfare theorems depend upon the assumption of convexity that has at least subconsciously deterred neoclassical mathematical economists from exploring these questions in the detail they deserve [117, Koopmans, 1957, Essay One].

Advocates of development tend to attach a different value to inner city "turf."

We understand also that the urban setting, throughout history, has been the energizer of mankind, the cradle of change. It is there that blacks, too, will have to find their solutions. We cannot go off to conduct a masquerade of change in newly created little rural centers [104, Innis, 1969, p. 53].

The former administrators of OEO's Special Impact Program introduce another element into the debate:

... the cost-effectives argue that the function of the ghetto is a transition to assimilation into suburban life. ... The social utilitarians hold that the blacks now occupy prime land in our inner cities which will ultimately be reclaimed and rebuilt, and that large numbers of blacks should remain and benefit from the rebuilding [82, Green and Faux, 1969, p. 2].

Urban planners and sociologists have identified the sense of community (another externality) as an important value, especially among low-income urbanites.

Poorer families are more constrained by the shortage of suburban housing at prices they can afford, but many would be reluctant to leave in any case. Recent research and relocation experience in low-income neighborhoods demonstrates clearly that a high proportion of the people living there want to stay nearby in order to keep up their ties with friends, relatives, organizations, churches, and with a style of life that can hardly be found in newer suburbs [70, Frieden, 1968, p. 201].

The point was made most succinctly by Paul Samuelson, in a 1958 commentary on the Tiebout "invisible foot" theorem. Concerning the "freedom" to move out of one's neighborhood to find a better tax/public goods mix, Samuelson wrote: "People want to improve their community, not abdicate from it" [164, 1958, p. 33].

VI. Some Concluding Thoughts on Research

Since we have had occasion to refer in passing to a number of ongoing research projects in this field these closing comments on future research will be brief.

Examination of the applicability of the in-

sights and techniques of development planning to urban economic development constitutes one important area for future research. We must expand and operationalize the technical concepts of linkage and SOC-DPA sequences. Effort should be addressed to the development of planning models with multiple partly qualitative objectives, indivisible constraints, and sequencing requirements.

The engineering-economics interface has become an important part of public policy analysis in such fields as environmental pollution and water resources research. A similar thrust in urban and ghetto developmental analysis seems called for. Engineers and architects are already designing new "three-dimensional" (but not necessarily "high-rise") urban structures for exploiting high density space, but with one exception [103, Hoch, 1969], the economics literature gives no attention to the subject. Urban economists generally agree that a single engineering innovation—the internal-combustion engine—has had a greater influence on urban form than any other development in modern history. Co-operative engineering-economics research would therefore seem to be sensible if only for its value in forecasting future changes of this type.

It should be clear from Part III that our knowledge of the structure of the ghetto economy is extremely thin. Reliance on published data sources will not quickly remedy this deficiency (although as indicated earlier, existing published data have been underutilized). Economists and other social scientists will have to engage in far more primary data gathering than has been their wont up until now. The elaboration and extension of Schaffer's "community income accounts" is an especially important task. Income flows, multipliers, and input-output relationships are indispensable tools, the development of which provides a rich and exciting research agenda, especially for graduate students.

This review has stressed production in its analysis of ghetto economic development. Lit-

tle attention has been given to the consumption side (some material on this subject is contained in Bell [17, 1971]). We need to know much more about present and possible ghetto purchasing behavior. For example, how do the community-oriented development strategies affect the attitudes of that community with regard to private versus collective consumption? To what extent might quality of service substitute for lower prices, *i.e.*, productive efficiency, in the preference functions of ghetto consumers?

Now that some ghetto enterprises *have* been established, and *are* producing goods and services, what are the obstacles to their export? How are they being received by their "outside" (presumably white) customers? What policies can government undertake to further promote ghetto exports (and does the international trade literature shed any light on this matter)?

Certainly we need to know much more about the political economy of the ghetto: who benefits from the existence of a segregated pool of low-wage labor? How are those benefits distributed among the various groups operating in the urban economy? Do proposed policies (such as income maintenance) "really" help? If not, under what circumstances might they be made more effective?

Finally, we need to undertake much more research on the significance and plasticity of the concepts of "community" and "neighborhood." Robert Yin and others at M.I.T. and the N.Y.C. Rand Institute are currently studying this question. Indeed, the whole area of sub-municipal political activity is an area where economists could usefully join political scientists in developing research projects.

Although it has probably been the political "relevance" of these issues which has attracted the attention of those relatively few economists who devote substantial time to the study of the urban ghetto, the long-term payoff to expanded research will go far beyond "simply" contributing to important matters of public policy. In the urban field, it is impossible

to ignore the much of needs of urban ghettos, but the challenging task embodies structural "market failures" from the foot of the consequences of income and power resource allocation, operative that the "bedded" in we. These challenges new development years ahead may field of urban policy of its most exciting urban ghetto.

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to ignore the superficiality and selectivity of much of neoclassical economic theory. Students of urban phenomena have no choice ultimately but to confront the enormously challenging task of developing theory which embodies structural nonconvexity and other "market failures," in which externality moves from the footnote to center stage, and where the consequences of any given distribution of income and power feed back directly into the resource allocation process. Moreover, it is imperative that these economic models be "embedded" in well-defined social institutions. These challenges suggest to me that the major new developments in economic theory in the years ahead may well emerge from the parent field of urban political economy and from one of its most exciting sub-fields: the study of the urban ghetto.

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COMMUNITY DEVELOPMENT CORPORATIONS: THE PROBLEM OF MIXED OBJECTIVES

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In commenting on the urban riots of the 1960's, W. H. Ferry has noted that the most important force to emerge "was the explosive renaissance of the idea of black manhood, of black dignity and worth, of the black's desire to run his own affairs." Ferry added that he regarded "this welling-up within the black psyche as a permanent force in our national life and a matter for great rejoicing."¹ Indeed, this rebirth of racial pride is the foundation for much of the discussion and activity centering around the concept of community development corporations (CDC).

In any discussion of community development corporations it is important to distinguish between those already established corporate entities (of which there are some one hundred in the United States) and the provisions contained in the Community Self-Determination Bill² which was introduced during the Ninetieth Congress. This paper will focus primarily on the organizational effectiveness of the existing community or local development corporations rather than on the provisions of proposed legislation designed to accelerate the expansion of such corporations. It should also be noted that while a number of these established CDC's are operated by low-income American Indian and Mexican-American communities in rural as well as urban areas, this paper will primarily treat the role of the CDC's in black urban ghettos.

In general, these corporations are "community-based organizations that conduct revenue-generating business with the primary purpose of economic and social development of their community."³ In most cases these CDC's either involve or ultimately call for widespread ownership of shares in the corporation by members of the local community. Furthermore, most of the earnings of the business usually are committed to community well-being rather than to the economic enhancement of individual shareholders. While the specific organizational forms among the various community development corporations vary widely, it should be possible to treat the question of whether such a type of corporate ownership provides an effective base upon which to construct viable economic-social institutions. In approaching the problem, it will be necessary to analyze the types of challenges facing those who would create and direct such corporations in their communities, and to evaluate the capability of these organizations to surmount those challenges.

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¹ Ferry, *The Case for a New Federalism*, SATURDAY REVIEW, June 15, 1968, at 14.

² S. 3876, 90th Cong., 2d Sess. (1968).

³ Note, *Community Development Corporations: Operations and Financing*, 83 HARV. L. REV. 1559, 1560 (1970).

Fields of study ranging from architecture to biology to organization theory suggest that organisms must be adaptive to their *environment* if they are to be effective—indeed, if they are to survive. A closely related matter is the issue of *resources*. An organizational form must be evaluated not only in terms of the availability of resources such as capital and expertise, but also with respect to the capacity of the organization to marshal these resources through effective management. Finally, the *objectives* of the enterprise must be evaluated in light of the environment and the resources of the organization.

I

THE BUSINESS ENVIRONMENT OF THE NEIGHBORHOOD

The rediscovery of poverty by the dominant society in the United States during the 1960's produced a seemingly unending series of portraits of the physical and emotional decay that characterizes the urban slum. Most of the books, articles, television documentaries, and speeches treating poverty in the United States focused on the most visible and seemingly fundamental aspects of the problem: education, medical care, housing, and unemployment. The issue of business development within the ghetto, however, was largely ignored. Even the discussions of unemployment generally concentrated on training and employment opportunities in businesses outside the ghetto. Gradually, however, it came to be recognized by people both inside and outside these depressed areas that economic development was central to dealing effectively with the nation's urban crisis.

An important segment of any economy is the retail sector. The state of its health is often a vital sign of the overall well-being of the community. This is indeed the case in black ghettos. As psychologist Kenneth Clark has noted, "The black ghetto is not a viable community. It cannot support its people; most have to leave it for their daily jobs. Its businesses are geared toward the satisfaction of personal needs and are marginal to the economy of the city as a whole." He further explains that "It has few large businesses. Most of its businesses are small, with what that implies in terms of degree of stability. . . ." The structure of the retailing communities in black ghettos can be best described as atomistic. That is, the predominant form of retail establishment is the small, owner-operated "mom-and-pop" store.

Mass merchandising firms are seriously underrepresented in such areas. Clark notes, for example, that in 1965 there was only one large department store in Harlem. In most cases where units of large chain organizations are found in ghetto locations, such stores were established in a period when the area was neither economically depressed nor black. There are generally a few "middle-sized" retail firms often dealing in appliances or groceries, and there are the ubiquitous door-to-door peddlers. It is often in these two categories, as opposed to the mom-and-pop operations or large retailers, that parasitic practices are found. The inflated prices, bait-and-switch sales techniques, misrepresentation of goods, and illegal rates of interest that have

⁴ K. CLARK, *DARK GHETTO* 27-28 (1965).

been documented by David Caplovitz and others too often characterize the buyer-seller relationship in the ghetto.⁵

Inefficiency, however, is an even more significant feature of the ghetto marketplace than exploitation. Inefficiency not only characterizes the generally under-capitalized and poorly managed mom-and-pop stores, but also the consumers who patronize the retail establishments. It is, for example, inefficient to shop frequently and purchase in small lots. This kind of buying behavior maximizes wear-and-tear both on the shopper and on the facilities of the retailer. It eliminates the opportunity for savings through quantity purchases and increases the cost per transaction. Heavy reliance on credit is also inefficient in that the interest charges consume many dollars that could otherwise be used to purchase needed goods and services.

These inefficiencies on the part of the consumer are largely explained by low-income. How can large quantities be purchased when the income is meager? How can large quantities of food, for example, be purchased when not only the income is limited but also the consumer's storage facilities? These limitations coupled with relative immobility of the customer group also discourage comparative shopping and bargain hunting beyond the bounds of the ghetto.

The shopping behavior of the area residents represents only one set of problems faced by the ghetto retailer. While he is often pictured as a nefarious exploiter who every evening tosses a money-stuffed bag in the trunk of his Cadillac and drives off to the suburbs, the description is grossly misleading. A study by the Federal Trade Commission in the Washington, D.C. area of ten low-income market retailers and ten general market retailers of furniture and appliances revealed the following:

<i>Revenue Component</i>	<i>10 low-income market retailers</i>	<i>10 general market retailers</i>
1966 net sales	\$5,146,375.	\$5,405,221.
	%	
Operating ratios as percent of sales	100.0	100.0
Cost of goods sold	37.8	64.5
Gross profit margin	62.2	35.5
Salary and commission expense ¹	28.2	17.8
Advertising expense	2.1	3.9
Bad-debt losses ²	6.7	.3
Other expenses ³	21.3	11.2
Total expenses	58.3	33.2
Net profit return on sales	3.9	2.3

¹ Includes officer's salaries.

² Includes amounts held back by finance companies to cover bad-debt losses.

³ Other expenses, including taxes, after deduction of other income.

Source: FEDERAL TRADE COMMISSION, ECONOMIC REPORT ON INSTALLMENT CREDIT AND RETAIL SALES PRACTICES OF DISTRICT OF COLUMBIA RETAILERS.

⁵ D. CAPLOVITZ, *THE POOR PAY MORE* (1963); *THE GHETTO MARKETPLACE* (F. Sturdivant ed. 1969).

It can be seen that the substantially higher gross margins are largely consumed by personnel expenses, bad-debt losses, and other expenses which are higher in ghetto locations. Problems of insurance rates, vandalism, and theft are reported to be major problems for ghetto retailers. Indeed, the same FTC report found that while net profit as a percent of sales was higher in the ghetto stores studied, the return on investment was substantially lower than in comparable general market stores. (These data include other stores in the FTC sample in addition to the 20 low-income and general market retailers noted above.)

<u>Type of retailers</u>	<u>Net profit after taxes as a percent of sales</u>	<u>Percent rate of return after taxes on on stockholders' equity</u>
Low-income market retailers	4.7	10.1
General market retailers:		
Appliance, radio, and television stores	2.1	20.3
Furniture and home-furnishing stores	3.9	17.6
Department stores	4.6	13.0

Source: FEDERAL TRADE COMMISSION, ECONOMIC REPORT ON INSTALLMENT CREDIT AND RETAIL SALES PRACTICES OF DISTRICT OF COLUMBIA RETAILERS.

In addition to having limited income opportunities, ghetto merchants are also faced with community hostility. The fact that most retail establishments are white-owned and controlled by outsiders is the cause of much of the bitterness. As Clark notes, "Property—apartment houses, stores, businesses, bars, concessions, and theaters—are for the most part owned by persons who live outside the community and take their profits home."⁶ While black-owned businesses have not escaped looting and destruction during riots, much of the dialogue and action associated with efforts by black people to gain local control of economic institutions is based on the bitterness toward white-owned businesses.

Although the role of the manufacturing sector of the ghetto economy is less well documented than that of retailing, it is clear that the industry suffers many of the same environmental problems. James L. Sundquist has summarized the basic elements of the problem as follows:

The realities of land and production economics suggest that the possibilities of ghetto industry, without substantial subsidies—and possibly even with them—are severely limited. Vacant land is often scarce and costly. Existing commercial buildings are cramped and outmoded. The ghetto labor force lacks skill and experience. Insurance rates are high. So are the city tax rates. Transportation for materials and products is expensive. For all these reasons, ghetto industries are usually at a marked competitive disadvantage.⁷

⁶ K. CLARK, *supra* note 4, at 28.

⁷ Sundquist, *Jobs, Training, and Welfare for the Underclass*, in *AGENDA FOR THE NATION* 57 (1968).

These barriers to success in part explain why less than one percent of the manufacturing enterprises in the United States are black-owned.⁸

Thus, if one combines the economic forces which have a direct impact on ghetto retailing and manufacturing establishments with the dismal conditions that often prevail in the schools, the problem of narcotics and crime, and the pervasiveness of the dehumanizing and inadequate welfare programs, it can be seen that the total environment for business is not attractive. These factors pose a major challenge to the operation of any successful business whether it be a community corporation or some other form of enterprise.

Does an organization owned by local citizens and committed to the social as well as economic well-being of the community have any unique advantages in dealing with the environmental forces which have been noted? Clearly if the local development corporation is successful in getting wide-spread community involvement and creates an *esprit de corps* among the shareholders, employees, and managers, it may be able to deal effectively with the problem of hostility toward business. It is important to note that if success is achieved in this area, the corporation's chances of survival will have been increased.

Assuming that the CDC spirit does spread through the community, the organization still faces a number of very difficult problems. The CDC certainly does not offer any unique advantages in dealing with the atomistic structure of the ghetto retailing community. Indeed, a number of these corporations have achieved little more than transferring the ownership of inefficient mom-and-pop stores from white to black hands. The most notable attack by a community corporation on the problem of the scale of ghetto enterprises has been made by Zion Investment Associates, Inc., the Reverend Leon Sullivan's well-known Philadelphia-based company.⁹ Unfortunately, the fact the Sullivan's enterprises stand out is a reflection of their atypical scale of operation.

Perhaps the most crucial of the challenges are those related to efficiency. The issues of costs, profitability, and customer satisfaction are, of course, interrelated. In order to attain maximum levels of profitability a business must control costs. For the new enterprise, it is especially difficult to arrive at the proper level of expenditures for payroll, supplies, rent, and the like. For example, the general manager of Shindana, the Operation Bootstrap manufacturer of black dolls, has reported: "That first year was a messed-up year. We didn't know anything about business. We had more so-called white-collar workers than factory workers. Then last year, we had about 75 workers. This year we have 65."¹⁰ It should be noted that these reductions were made during a period when output of the manufacturer increased sharply.

⁸ THE THIRTY-FIFTH AMERICAN ASSEMBLY, BLACK ECONOMIC DEVELOPMENT 5 (1969).

⁹ For description of Zion Investment Associates, Inc., see J. HUND, BLACK ENTREPRENEURSHIP 59-61 (1970); *Community Development Corporations: Operations and Financing*, *supra* note 3, at 1562-67.

¹⁰ *Shindana Discovers the "Together" Dolls*, BLACK ENTERPRISE, Dec. 1970, at 24, 25.

Many of the costs of doing business in the ghetto, as noted above, are external to the firm. These costs are especially burdensome for the ghetto enterprise that must retain the patronage of its local customers and be competitive in the outside market. According to James M. Hund, "In order to compete, both in the ghetto setting and in the wider market, black enterprises beyond the scope of the 'mom and pop' grocery must be able to offer the same quality of services as white counterparts competitively located."¹¹ One of the unfortunate myths contained in much of the rhetoric surrounding the CDC concept is that "buy black" campaigns will assure black enterprises a guaranteed market. However, as ghetto residents become more affluent and mobile and as racial barriers diminish, the retailers in those areas face increasing competitive pressures. Theodore Cross has suggested that "The Negro entrepreneur is being buffeted by pressures from . . . the growing affluence of his once-captive customers. The mortician, the beautician, the barber is finding much of his clientele deserting him for stronger and 'more prestigious' white competitors."¹² Even the few black-owned firms which have operated in the national market, such as the Supreme Life Insurance Company, have faced intensified efforts of "white" companies to penetrate their traditional markets.

In sum, if the community development corporation's businesses are to be viable, they must have effective control over their internal costs and work to offset those external cost differentials which place them at a competitive disadvantage with firms operating in the general economy. While ethnocentrism is increasingly a fact of life in black communities, it would be dangerous to assume that even local customers will remain loyal if more attractive competitive alternatives are available to them.

II

NEIGHBORHOOD RESOURCES

A major determinant of whether or not any enterprise can meet such a challenge will be the resources it has at its command. The essential ingredients in creating a successful business can perhaps be summarized as follows: entrepreneurship, managerial skill, and financial strength.¹³

"Entrepreneur" is a much abused word. Often used to describe the MBA who becomes a junior executive in a giant corporation, it also frequently is applied to the owner of the corner gasoline station. Instead, it should be thought of in the Schumpeterian sense of the word—innovative, driving men who are agents for change because they conceive of new relationships between products, services, and markets and possess the courage to assume the high risks associated with launching enterprises committed to exploiting those opportunities. They are the type described by Lenin's teacher, G. V. Plekhanov:

¹¹ J. HUND, *supra* note 9, at 25-26.

¹² T. CROSS, *BLACK CAPITALISM* 62 (1969).

¹³ The most obvious omission from this list is labor. However, there are no labor problems that are essentially unique to CDC's, and thus the topic is not discussed here.

The more or less slow changes in "economic conditions" periodically confront society with the necessity of more or less rapidly changing its institutions. This change never takes place "by itself"; it always needs the intervention of *men*, who are thus confronted with great social problems. And it is those men who do more than others to facilitate the solution of these problems who are called great men.¹⁴

Does the black community have such men among its numbers? One need only observe the charismatic leadership of articulate and dynamic men within the community to be convinced that the potential seems to exist. Because of racism in the dominant society and the absence of a business heritage among blacks, these talents have often gone untapped or else they have been unleashed in other directions; but the potential exists. This view was expressed excellently by Elmer Young, as associate of Leon Sullivan, during a conference on community-based economic development at the Cambridge Institute.

All of us are starting out as infants in a man's world. If you told me back in 1962 that Elmer Young was going to develop a shopping center I'd have said, "You're crazy." Same thing with Lou Smith who I knew back in Philadelphia. If I'd said, "Lou, you'll be president of a company making black dolls," he'd have told me I was crazy. But we had the guts to try it. And I think that's what any black group has to have. You have to stand up and there and say, "White folks can do this, and we can too." This doesn't mean you're not going to stumble. We still have to stumble.¹⁵

Will community-based forms of organization provide the appropriate mechanism for attracting the talents of local entrepreneurs? Certainly in a limited number of cases they have. Leon Sullivan is probably one of the outstanding entrepreneurs produced by this country in recent years. In too many cases, however, the CDC's have done little more than encourage the development of a class of marginal shopkeepers. Perhaps the essential point to be made is that a black entrepreneur may well view the CDC as one of a number of attractive avenues to be considered along with traditional corporate organizations, partnerships, sole proprietorships, and the like. He must have the freedom to select from among these alternatives the organizational form that is best suited to the opportunities which he has identified. One of the more unfortunate features of the Community Self-Determination Bill was that because of certain tax provisions and lending arrangements, it would have discriminated against existing and would-be entrepreneurs who elected not to participate in the CDC.¹⁶ Any legislation designed to stimulate economic development in the inner-city should not unnecessarily restrict the freedom of action for these agents of change by granting discriminatory advantages to one particular organizational form.

The qualities of innovativeness, drive, and a high propensity for risk taking

¹⁴ J. HUGHES, *THE VITAL FEW* 14 (1966).

¹⁵ *THE CAMBRIDGE INSTITUTE, COMMUNITY BASED ECONOMIC DEVELOPMENT*, JUNE 1970, at 18.

¹⁶ Sturdivant, *The Limits of Black Capitalism*, HARV. BUS. REV., JAN.-FEB., 1969, at 122, 124-25.

that distinguish the entrepreneur do not necessarily make him a good manager of a firm's day-to-day operations. An additional resource that is vital to community economic development, therefore, is managerial talent. Such skills are acquired through formal education or practical experience or some combination thereof. Because of barriers to full participation by blacks in business in the past, the pool of experienced managers in the community is quite shallow.

One of the challenges facing the community corporation, therefore, is to compete effectively for experienced black managers. The black community orientation of the business will in itself represent a strong appeal to many who feel that they have not received equal opportunities in white businesses. Two examples can be cited from Shindana, the black doll company. Phil Gilyard who is 38 and general manager of the company explains that he "was an administrative supervisor at Hughes Tool Company and I couldn't go any farther. I took this job not for the money, but to develop my management potential." Thirty-five year old foreman Ralph Reggin left Eldon Industries, another toy company, where he was a supervisor and came to Shindana at a lower salary. "I felt that I would only go so far because of its being a white company. Here, I can go any place and I'm doing something for the black."¹⁷

In spite of the strong appeal of "doing something for the black," it is unlikely that experienced managers can be attracted and retained unless they feel the enterprise has sufficient potential to offer them a challenge and an opportunity to develop their "management potential." Thus CDC's must undertake ventures which have excellent growth potential. At the same time they must recognize that their internal organizational structure must allow for maximum managerial freedom in conducting the affairs of the business. The community ownership and social development objectives of many of the local development organizations pose a number of difficulties which will be discussed more fully below. In terms of its implications for management, perhaps a brief analogy with cooperatives will be sufficient.

In its purest form the managerial atmosphere of a community development corporation closely resembles that of a cooperative. As the Cambridge Institute bulletin puts it, "A CDC is simply a corporation based in one geographic area and controlled democratically by the residents."¹⁸ This is not to suggest that all CDC shareholders vote on every management decision. In addition to the traditional board of directors, however, there generally exists a business management board or some such body composed of local residents who are responsible for the management of the enterprise. Democratic management, whether it be in a cooperative or a CDC, according to James Hund "can be stultifying to the conduct of the business."¹⁹ It is not difficult to imagine the frustrations that would be encountered by an experienced manager in such situations. Indeed, it is probably safe to say that the greater the

¹⁷ *Shindana Discovers the "Together" Dolls*, *supra* note 10, at 26-27.

¹⁸ *THE CAMBRIDGE INSTITUTE*, *supra* note 15, at 1.

¹⁹ J. HAND, *supra* note 9, at 65.

degree of democracy in the enterprise, the less effective its management will be. This weakness is clearly a major flaw in the concept of community-based development corporations.

The third critical resource which needs to be considered is financing. Community development corporations have drawn on a wide range of sources for funds. The Hough Area Development Corporation in Cleveland received its initial capital in the form of a \$1.6 million Special Impact grant from the Office of Economic Opportunity. Subsequently, to found a rubber company, Hough raised an additional \$350,000 through a Small Business Administration loan guarantee. The Operation Bootstrap company, Shindana, received its initial \$200,000 gratis from Mattel, Inc. Another corporation, El Mercado de Los Angeles, raised \$1,040,000 for a shopping facility housing forty small businesses in the Mexican-American barrio, the money being obtained through loan under the provision of the Small Business Investment Act of 1958. In addition, some \$260,000 was raised in the community through the sale of stock. Zion Investment Associates, Inc., in Philadelphia raised its initial capital through the monthly investments of some 200 members of Sullivan's Zion Baptist Church. The 10-36 plan (\$10 per month for 36 months) began in 1962. The corporation now has some 1,000 shareholders and an additional 6,000 persons are making installment payments for shares. Additional funds have been raised through loans from banks.

The *Harvard Law Review* has reported that managements of ten of thirty community development corporations interviewed had "acquired sufficient funding for substantial business activity and [had] begun operating such businesses."²⁰ In each case, however, even these organizations "were struggling to secure additional venture capital to allow continuation and growth of their businesses."²¹ Another third of the organizations interviewed were operating on a very small scale, generally fewer than ten employees, and had received little outside financial or technical assistance. The remaining third had not yet launched their business operations, but several had received funding commitments for operations which were in an advanced stage of planning.

The key to raising funds, either equity, debt, or gifts is, the viability of the enterprise. Investors, loan officers, and benefactors must have confidence in the leadership of the company. This confidence is enhanced by the existence of a well-planned and well-managed venture that holds good promise of achieving its objectives. For the investor and the lending institution the ultimate objective must be the generation of sufficient profits to protect the investment or to repay the debt. Even the funds received by outright grant must be received on the assumption that the funds will assist in the creation of a viable business that will produce long-range benefits for the participants and the community. Thus the definition of the community corporation's goals is closely related to its capability to raise capital.

²⁰ *Community Development Corporations: Operations and Financing*, *supra* note 3, at 1576.

²¹ *Id.*

III

THE OBJECTIVES OF THE CDC

The major problem facing community-based development corporations is the formulation, adoption, and achievement of goals and objectives. The people who come together to create or to participate in virtually any kind of organization generally share in a complex set of goals. Even the traditional business corporation is clearly more than an economic institution. However, its fundamental objective—to make a profit—is well-defined and provides the basis which makes the achievement of all of its other goals possible.

The goals of most CDC's are highly complex and in many cases they make the attainment of this fundamental objective of long-range economic viability difficult if not impossible. While community-based development corporations are not legally bound to the goals called for in the Community Self-Determination Bill, most are committed to similar objectives. Therefore, it is useful to consider what the *Harvard Law Review* described as the three primary goals of the CDC:

First, as a political institution, it provides a mechanism through which the poor can achieve meaningful participation in the control of significant aspects of their community life. Second, the CDC as a service organization provides needed services to the community while avoiding the handout syndrome surrounding public welfare. Third, as an economic institution, the CDC promotes the economic development of the community through investment in community businesses.²²

The article notes that the draftsmen of the bill viewed economic development as the most important function. However, Gar Alperovitz, a coauthor of the original bill has emphasized that all three goals are essential elements of the legislation:

The critical word in the legislation is community development. I want to distinguish that from economic development, because the whole assumption of community development is that jobs or the ownership of stock—either one alone—is insufficient to deal with some of the critical problems of the ghetto. The view here, which relates to community participation and the poverty program, is that some way must be found to bring together some form of cohesive unit in the ghetto, and that is the critical first assumption you must begin with. Thereafter, the questions of economic development, transfer of resources, jobs and capital come up.²³

Thus Alperovitz views the creation of a sense of community of the forming of a cohesive unit in the ghetto as a necessary precondition to economic development. Alperovitz also explains the linkage between social services and the community's business operations.

²² Note, *Community Development Corporations: A New Approach to the Poverty Program*, 82 HARV. L. REV. 644, 645 (1969).

²³ *A Dialogue on Community Self-Destruction: Problems and Potential*, NEW GENERATION, Fall, 1968, at 22.

What we are trying to do here is to get away from bureaucratic administration of various social service programs. We are attempting to transfer to the people in the community control over decisions that affect their lives. In one sense this approach has grown out of the experience of projects like Crawfordville, a Georgia textile operation which is essentially a non-profit, one-man, one-vote community corporation, like a co-op, only it doesn't give dividends at this stage.

What this new legislation proposes is to link the social services controlled by a community with an economic profit-making enterprise.²⁴

The soundness of this organizational form as a vehicle for a dramatic transformation of the nation's ghettos rests with the compatibility of its political and social goals with its economic goals.

A. Compatibility of Political and Economic Goals

The political goals center around community control of economic resources and social services and widespread community participation in the decision making process. Implicit in much of the discussion of political goals, however, is the development of a power base within the community which can be used to deal with outside agencies such as the city or the federal government.

The demand for local control over economic institutions is an interesting anachronism in an era of conglomerates, chain stores, and franchising. While there has been some resistance to these forces throughout the society, the resistance generally has been based on the increasing dissatisfaction with the depersonalization and sameness of the strings of hamburger stands, fried chicken establishments, muffler and automatic transmission repair shops, and discount houses that have spread from coast to coast to deface the landscape. In the ghetto, however, hostility has grown out of years of bitterness associated with the inefficiency, corruption, and insensitivity of the businesses and governmental agencies with whom the residents of the ghetto have normally interacted. Therefore, the desire for local control is understandable. But is it feasible?

If the community corporation had the resources needed to gain control of extant businesses, create new growth firms within the ghetto, and manage these enterprises without outside assistance, then such an objective as local control might well be within its reach. However, when the community corporation turns to outside sources for the capital that is needed, it necessarily incurs restrictions on its freedom of action. Private sources of funds are reluctant at best either to invest equity dollars in or make loans to ghetto enterprises because the risks of failure are greater than in non-ghetto businesses. Therefore, it is not at all uncommon for restrictions to be placed on the use of the funds, the qualifications for members of the management group and the types of businesses to be established or acquired. And certainly restrictions of this kind are imposed when federal funds are obtained be they from the Small Business Administration, the Office of Economic Opportunity, or other agencies.

²⁴ *Id.*

In the same manner, local groups may find encumbrances resulting from the use of outside experts. As Bernard Gifford of FIGHT in Rochester has indicated, the outside consultant may speak a very different language and his role may ultimately be determined by the funding source:

The white individual who comes in to offer his expertise has to think differently. Basically you have to decide which side of the fence you're talking about: profits or people. If your motivation is determined by material gain instead of by human beings, then you're going to find yourself hung up in the same kind of situation that created these problems in the first place. People who don't share this kind of philosophy—that people are more important than profit—work against you Do-gooders who want to come down and give some input may have a lot of expertise in some areas, but they have to be willing to listen to people here with good ideas about what their community needs, what's best for their community, and then try to work out the solutions to do that, which is contrary to the present system. Under this system, your funding source dictates how things are to get done.²⁵

The dilemma of outside resources suggests that the more self-sufficient the local corporation the greater the degree of local control possible. If substantial seed money can be raised within the community, as in the case of Zion in Philadelphia, then the corporation is in a stronger position to minimize restrictions tied to outside funds. As Elmer Young explains, "We . . . had to establish credibility. But I'll tell you one thing, a few hundred thousand dollars in a banker's face did an awful lot to help us."²⁶ Credibility is more readily established, as well, when the management of the community corporation has established programs which are consistent with traditional management practices. Indeed, if the economic structure of the ghetto is to undergo dramatic transformation, it may be necessary that even the strongest community corporations compromise their desire for complete control by inviting outside firms to participate in community-inspired plans for business development. Such, for example, was the case in the Progress Plaza shopping center in Philadelphia. Six of the sixteen units in the center are "white" businesses which not only helped secure financing but also reflected the results of a consumer study conducted in the area to determine the desired make up of the center.²⁷ In sum, it is essential that realistic priorities be established and that it be recognized that "social" goals may have to be deferred for some time.

A closely related political goal of the community corporation which poses challenges is the desire for community participation. The objective of creating a "cohesive unit in the ghetto" through involving a maximum number of people in the decision making process of the community corporation is one which has proved to be largely impractical. In its survey of CDC's, the *Harvard Law Review* found

²⁵ THE CAMBRIDGE INSTITUTE, *supra* note 15, at 8.

²⁶ *Id.* at 17.

²⁷ Sturdivant, *supra* note 16, at 126.

that "In practice there has been little community-wide participation in all but a very few community corporations."²⁸ Generally, the control of the corporations rests in the hands of the leaders who established them. "This concentration of control appears to be due in large part to the need to devote almost all energies to establishing a viable business organization, rather than expending efforts to inform, motivate, and organize large numbers of community persons."²⁹

Again, this political objective appears to be in fundamental conflict with the economic objective of creating a viable enterprise. Frances Fox Piven has suggested that "The corporation is not an organism which lends itself to democratic control by shareholders, as any scrutiny of private corporations in America will confirm . . . [because of] . . . the tendency of a corporation management to acquire control by the mere fact of constant involvement in intricate corporation affairs."³⁰ To a great extent the lack of democracy is related to shareholder apathy. Shareholders with relatively small investment in a corporation have little incentive to participate in forums designed for shareholder involvement. This problem is even more complicated in a ghetto setting because of the disillusionment experienced in the past. Getting local residents to invest in a community corporation and participate actively in its public meetings would be a formidable task. One critique of the Community Self-Determination Bill stressed this point by noting that:

if shareholders are to retain their shares in the corporation and are to participate actively in its functions, and if new shareholders are to be encouraged to invest after formation, then concrete benefits must derive from stock ownership. However, unlike investors in business corporations, shareholders in the CDC cannot realize capital gains because of the restriction on transferability and the continuing offer of shares by the CDC at the five dollar par value. Moreover, distribution of CDC profits to shareholders ordinarily may be made only in the form of community services. Intangible considerations, such as community pride or pride in being a shareholder-owner of visible and tangible assets, may serve to secure participation at the outset, but these are thin reeds on which to rest a continuing financial commitment by the poor.³¹

Even if community development corporations were allowed to pay cash dividends to their shareholders, it is clear that their ghetto enterprises generally will be starved for capital and any profits generated for the foreseeable future should be retained in the businesses.

B. Compatibility of Social Service and Economic Goals

The lack of compatibility between political and economic goals is closely related to the conflict between social and economic objectives. If social services are to be

²⁸ *Community Development Corporations: Operations and Financing*, *supra* note 3, at 1582.

²⁹ *Id.* at 1582.

³⁰ Piven, *Community Control: Beyond the Rhetoric*, *NEW GENERATION*, Fall, 1968, at 7, 8.

³¹ *Community Development Corporations: A New Approach to the Poverty Program*, *supra* note 22, at 649-50.

provided to the community by the corporation then profits must be generated by the corporation's enterprises. Since it is highly unlikely that the enterprises can be effectively managed by means of a democratic decision-making process, the most visible benefits to be derived by the local residents will be the social services. Again, the community corporation faces a difficult problem, as suggested by Louis Smith of Operation Bootstrap in Los Angeles: "If people think you're going to start a business and that business is going to generate any real capital to put back into your community, you're really thinking in terms of years."³²

While community corporations have been largely unable to contribute to the improvement of health, recreation, housing, and medical services in their communities, they offer other social benefits that are of major importance. By creating businesses of any reasonable scale in the ghetto the corporations are providing training to the unskilled, employment to the unemployed, management development opportunities to blacks who might otherwise face racial barriers on the outside, and a model of business adventure for the younger members of the community. Simply by accepting the challenge of locating in the ghetto and hiring and training local people the corporations have incurred a "social service overhead" which makes their long-range viability that much more difficult. Perhaps one of the major weaknesses of this form of organization is that these basic, enterprise-building activities may not be viewed as being sufficiently dramatic to enlist the support of the community and therefore the organizations may undertake other social services before being in a sufficiently sound economic position to support them.

Frances Fox Piven suggested that "On its own, the ghetto seems better described as an economic backwater than an economic colony, the sluggish backwater of a swift and dynamic economy."³³ Even a brief review of the economic environment in the ghetto suggests that it is far from being a fertile field for business growth. The costs of conducting business there, the limited resources, and the general hostility toward business help explain why the black ghetto has been left to stagnate while the economy of the dominant society has moved ahead at a rapid rate. After first being victimized by racism its residents have become the victims of opportunity costs. In general, there have simply been too many profitable alternatives to investing in or conducting business in the ghetto.

It is of paramount importance, therefore, that it be clearly understood that the establishment of viable enterprises in the ghetto is extremely difficult. It requires imaginative leadership, resourceful management, and substantial funds to create the kinds of enterprises that will transform the economic status of the ghetto. These enterprises must overcome the environmental problems, such as higher costs, and be capable of competing with companies from the general market. It must also be recognized that economic development is a long and difficult process whether it be

³² THE CAMBRIDGE INSTITUTE, *supra* note 15, at 6.

³³ Piven, *supra* note 30, at 8.

Nineteenth Century America or the five year plans in the Soviet Union or China and it is unrealistic to assume that the process can be speeded without the infusion of outside capital and technical assistance. As Bayard Rustin has stated, "we have to get rid of this idea that people can lift themselves by their bootstraps. No social class has ever got out of being in the lumpen proletariat except by social engineering."³⁴

This process of social engineering requires the involvement of local groups such as community development corporations, government, and the business system in general. Conceding the fact that local involvement poses certain managerial problems, the notion of local participation is still one of the essential strengths of the CDC concept. If it can be accomplished, at least to the extent of communicating to the community that local people are controlling the direction the economic development is taking, then the general atmosphere for the conduct of business can be improved sharply. On the other hand, the most serious weakness of the concept is the danger of confused objectives. The primary objective must be the establishment of self-sufficient, viable enterprises which are capable of attracting the necessary financial, technical, and managerial resources. In short, many of the broader social service benefits must be viewed as long-range. Shareholders and managers alike must recognize that if resources are to be attracted and utilized effectively the objectives of local control and democratic rule by the area residents must be subordinated.

In communities which enjoy imaginative and strong leaders with a commitment to sound management practices and the capacity to raise the capital for seed money, these compromises should be minimal and relatively painless. Unfortunately, such conditions are found in a minority of locations where community corporations are presently in operation. Thus, while in some cases the community-based development corporation represents a promising and exciting approach to economic development, in a majority of situations the mixed objectives and managerial problems associated with the community decision-making process will probably condemn the local corporation to failure.

These strengths and weaknesses of the community corporation approach to economic development reinforce the view that a variety of approaches must be attempted in dealing with the plight of the ghetto. Among the unfortunate features of the debate which centered around the Community Self-Determination Bill were the claims made for the CDC approach by its more enthusiastic supporters. In discussing the bill, Oscar A. Ornati observed that "there is clearly nothing wrong with the Act as one more tool in the kit of national anti-poverty policies. What is wrong and fundamentally dangerous are the claims made for it. . . . [T]he well-being of slum inhabitants can come only through many and massive national programs geared to maximum employment, effective markets, the ending of discrimination, and more health, housing, and education."³⁵

³⁴ J. HUND, *supra* note 9, at 6.

³⁵ Ornati, *A Noble Cop-Out*, *NEW GENERATION*, Fall, 1968, at 10.

It was because of the recognition of a need for diversity in the approaches to dealing with black economic development that the American Assembly on that topic listed a series of approaches ranging from CDC's to the location of branch operations of big companies in the ghetto. In support of these efforts, it was recommended that a Marshall Plan commitment of resources be made by the federal government to be coordinated by a "National Development Corporation." This program was to be supported by the creation of a network of regional discount banks to stimulate the infusion of capital and other programs including tax incentives to offset the higher costs of doing business in the ghetto.³⁶ The attack must be made on a wide front utilizing a variety of vehicles for economic development. The community-based corporation is one such vehicle, but alone it offers relatively little promise because of its organizational weaknesses.

³⁶ T. Cross, *supra* note 12, at 5-9. For the background papers used by the Assembly, see *BLACK ECONOMIC DEVELOPMENT* (W. Haddad & G. Pugh eds. 1969).

CHAPTER 2

THE BEDFORD STUYVESANT RESTORATION CORPORATION

The Bedford Stuyvesant Restoration Corporation is the most widely known CDC participating in this evaluation and, perhaps, in the nation. It is, also, the largest CDC which has been created to serve minority communities. Restoration's prominence is attributable both to the circumstances surrounding its creation in 1967 as the first CDC to be funded under the Special Impact Program and its demonstrated ability to retain substantial funding.

In 1966, Bedford Stuyvesant's severe problems of physical and economic decay and increasing social bitterness caught the attention of Senators Kennedy and Javits. The pressing need for a solution to the critical conditions existing in Bedford Stuyvesant and other communities with similar problems prompted the Congress to pass legislation, introduced by the Senators from New York, establishing the Special Impact Program. The purpose of this amendment to the Economic Opportunity Act was "to establish special programs . . . directed to . . . have an appreciable impact in such communities and neighborhoods in arresting tendencies toward dependency, chronic unemployment, and rising community tensions"¹

Whether or not the SIP amendment would have passed Congress without the specific program envisaged by Kennedy aides for Bedford Stuyvesant at the time the legislation was introduced is debatable. The Bedford Stuyvesant program, however, offered a promising new approach and had substantial support from New York's business and financial community. Specifically, the plan was to merge the resources of government, business, and local residents to launch a comprehensive redevelopment effort in Bedford Stuyvesant. Two separate, tax-exempt corporations were established which would cooperate in implementing the program. The Restoration Corporation, representing about 400,000 local residents, would be responsible for implementing specific activities assisted by its sister corporation, D & S, representing established business and financial interests in New York. As joint sponsors of the Bedford Stuyvesant program, both corporations required the support of the federal government in order to carry out their plans.

1. Public Law 89-794, 89th Congress, H. R. 15111, November 8, 1966, "Economic Opportunity Amendments of 1966," Part D--Special Impact Programs, Sec. 131 (a), p. 5.

Subsequent to the legislative passage of the Special Impact Program, Restoration and D & S became the first organizations to receive financial assistance. In June, 1967, the corporations began operations with an \$8.6 million three-year contract with the Department of Labor. The Ford Foundation contributed to the initiation of the program with a \$750,000 grant for the first year of operations, \$1 million during the second year, and \$1.8 million during the third year.

As far as we know, no other minority CDC has been conceived and implemented with as large a level of financial, political, and business support as Restoration received in its early years. These beginnings have had a significant influence on the evolution of Restoration as a CDC with a sophisticated corporate structure and strong internal organization. Continued growth in expenditure levels during recent years demonstrates the corporations' success in maintaining the external support of both the private and public sectors. In fiscal year 1974, the year coinciding with this evaluation period, Restoration's expenditures reached a level of \$14.5 million, about 60 percent higher than fiscal year 1971 expenditures of \$8.9 million. The Ford Foundation contributed more than \$1 million during this period. Increasing assumption of managerial and operational responsibilities by Restoration in recent years, culminating in the merger of remaining D & S staff within Restoration in 1974, is indicative of Restoration's progress with respect to internal development. Restoration's institutional development as a vehicle for the revitalization of Bedford Stuyvesant has followed a relatively steady and even path. Unlike some other CDCs, it has not deviated significantly from its original course, but has worked to formalize and refine the basic premises underlying its initial design. In terms of an overall strategy for improving the quality of life in Bedford Stuyvesant, Restoration has maintained an approach concentrating on programs directed toward the physical and economic development of the area as well as social service programs.

This chapter is a summary discussion of Restoration's specific activities and performance during the period of our evaluation, particularly during the milestone year July 1, 1973 through July 1, 1974. Some general observations about the structure of Restoration programs are necessary to put the individual activities into perspective.

As of April 1, 1974 all Restoration programs and subsidiaries were reorganized into three corporate divisions: (1) Physical Development Division, (2) Economic Development Division, and (3) Non-profit Community Program Division. The first two divisions contain the programs which are currently considered profit centers

or potential profit centers. The Non-profit Community Program Division contains programs in the development stage which may or may not become profit centers in the future.

Community development corporations, like Restoration, contain both profit and nonprofit centers and recognize that subsidization on a long-term basis for all their activities is unlikely. They have responded to this recognition in two ways--first, by increasingly organizing their activities in such a way as to clearly identify activities which may become profitable, and second, by emphasizing that, although they strongly desire self-sufficiency, becoming self-sufficient is likely to take a considerable time.

The major funding source for Restoration (the Special Impact Program) has increasingly emphasized self-sufficiency through physical, commercial, and economic development.¹ This emphasis is reflected in Restoration's SIP IV proposal, where they say:

In 1966, we were a vision; in 1967, a reality; and in 1972, we have become the prime force in the rebuilding of a vast ghetto through physical development, economic development and a spiritual rededication of people. We want a stake in the future, an equity stake that will allow us to truly participate in this great enterprise. A continuing effort is not built on grants and debt, but on capital.

. . . the principal theme for the first half of SIP IV, although it may not be frequently articulated in this document, is the consolidation and refinement² of programs, companies, and concepts that are already in place.

A recent reorganization of Restoration is a step in consolidation and refinement. The Physical Development Division brings together under one vice president the following entities:

1. Restoration Development Corporation (RDC),
2. Restoration Development Corporation Commercial Center (RDC-CC),
3. Restoration Construction Corporation (RCC),
4. Restoration Funding Corporation (RFC),
5. Sheffield Rehabilitation Corporation (SRC), and
6. Property Management and the FIA Securing and Maintenance Program.

These entities carry out activities concerned with acquiring and utilizing property, constructing commercial and housing stock, rehabilitating housing, and managing it. Additionally, the Restoration Funding Corporation provides services to facilitate home purchase by community residents.

¹ See National Advisory Council on Economic Opportunity, Sixth Annual Report, June, 1973, Washington, D.C., U.S. Government Printing Office, 1973.

² Proposal for Grant Under Title VII, Part A of The Economic Opportunity Act of 1964, as amended for Special Impact Program IV in Bedford-Stuyvesant, Brooklyn, New York.

The Economic Development Division contains investment and loan funds, management and technical assistance functions, and those business corporations wholly owned by Restoration. Included in the first category are the local business development fund, the industrial development fund, communications investment fund, and the equity investment fund. The management and technical assistance functions of the Economic Development Division are not currently conducted as a separate corporation.

The Non-profit Community Program Division contains the following programs:

1. Area development, including five neighborhood centers run by the Restoration Corporation,
2. The Comprehensive Manpower Program,
3. The Construction Worker Training Program,
4. The Home Improvement Program,
5. Day Care Program,
6. The Health Center Program,
7. The Billie Holiday Theatre,
8. Research, Planning, and Evaluation section,
9. Public Information, Government Relations, and Fund Raising.

The expenditure levels and relative emphasis on the three major programs from 1970 to 1974 are shown in Table 1. Combined physical and economic development expenditures have almost doubled over this period. Non-profit program expenditures have increased by about 50 percent.

A. Physical Development Division

The Physical Development Division brings together the subsidiary and divisional entities related to real estate development, housing, and construction. Real estate development has been a major component of Restoration's program from the beginning, but is now seen as a major focus for the Corporation.

During our evaluation, the Physical Development subsidiaries for which milestones were established were:

1. Sheffield Rehabilitation Corporation--a nonprofit corporation for purchasing properties to be rehabilitated, planning the rehabilitation, arranging financing, and supervising construction work;
2. Property Management Group--a subdivision within Restoration for managing Restoration-owned properties and the FHA Securing and Maintenance Program;
3. Restoration Funding Corporation--a for-profit mortgage company;

Table 1

EXPENDITURES
Fiscal Years Ending June 1971, 1972, 1973, and 1974

	June 1971		June 1972		June 1973		June 1974	
	Amount (\$)	Per- cent	Amount (\$)	Per- cent	Amount (\$)	Per- cent	Amount (\$)	Per- cent
<u>Physical Development</u>								
Community Facilities, Housing Rehabilita- tion, Construction, & related activities	4,379,419		5,064,762		6,558,607		9,754,763	
Mortgage Pool	133,271		150,970		181,906		219,464	
Federal Housing Administration activities	463,450		593,046		408,020		576,709	
Total	4,976,140	(56)	5,808,778	(60)	7,148,533	(59)	10,550,936	(72)
<u>Economic Development</u>								
Business Develop- ment Loans & equity	1,201,041		790,207		1,413,446		636,220	
Other	620,462		510,662		519,527		420,992	
Total	1,821,503	(20)	1,300,869	(14)	1,932,973	(16)	1,057,212	(7)
<u>Non-Profit Community</u>								
Area Development	754,336		925,273		1,070,311		985,557	
Comprehensive Man- power	173,953		234,432		242,459		207,943	
Community Services	114,185		121,988		381,895		349,861	
Total	1,042,474	(12)	1,281,693	(13)	1,694,665	(14)	1,543,361	(11)
<u>Central Administration</u>	1,110,013	(12)	1,201,863	(13)	1,289,722	(11)	1,383,028	(10)
Grand Total	8,950,130	(100)	9,593,203	(100)	12,065,893	(100)	14,534,537	(100)

Source: The figures are compiled from previous financial statements and are approximate because of shifts in organizational structure over the years. Depreciation is excluded.

4. Restoration Development Corporation of Bedford Stuyvesant, Inc. --a for-profit development company;
5. RDC Commercial Center, Inc.--a for-profit corporation for developing, building, leasing, and operating the Commercial Center;
6. BSR Construction Company--a for-profit general contracting firm.

Each of these entities are discussed below. The Physical Development subsidiaries are a tangible representation of the importance of real estate development in Restoration's overall strategy, and of the recognition that Bedford Stuyvesant has a stock of housing and other structures which are worth utilizing as a major asset in attacking the community's problems.

1. Sheffield Rehabilitation Corporation

The Sheffield Rehabilitation Corporation was organized as a nonprofit corporation in December, 1969. The corporation was set up to buy and sell real property in Bedford Stuyvesant. Aside from its ownership role, SRC engages in renovation of property which it will either hold and lease or resell.

There are plans to link the rehabilitation program with the RFC mortgage pool as renovated housing becomes available for sale. RFC did not expect these plans to materialize before 1975. The rehabilitation program of Sheffield Rehabilitation was linked, for a time, with the Restoration Construction Corporation. Sheffield Rehabilitation developed the plans for rehabilitation, including architectural design, financial feasibility, clearances, and financial arrangements. Restoration Construction Company was used as the general contractor for the construction work. This arrangement has since been changed as a result of several problems with the performance of RCC, and its subcontractors. Sheffield Rehabilitation is now acting as the general contractor for renovation work, in addition to its other responsibilities. Sheffield Rehabilitation is linked to Restoration's economic development objectives through its use of local minority subcontractors where feasible.

These linkages with other programs are cited because Restoration views its real estate development programs as activities which enhance economic development goals as well as housing goals. In the SIP IV proposal, Restoration states:

Real estate development is involving local residents at all levels so that the wages earned and expertise derived therefrom will remain in Bedford Stuyvesant. The Corporations are shaping their real estate program to further this goal. The builder, the developer, the architect, the engineer, the general contractor, the sub-contractor,

the laborer, the property manager, and the mortgage broker should all be Bedford-Stuyvesant residents.¹

The fundamental direct goal of SRC, however, is to efficiently repair and renovate housing units which are structurally sound in order to help arrest the physical deterioration of Bedford Stuyvesant. In practice this means acquiring properties, planning the needed work, arranging financial packages, and, now, supervising construction.

Early experience with the program, beginning in 1968, was valuable as a learning device, although jobs sometimes took longer than expected and as a result units were more costly to complete. This explains, at least in part, why only 27 units had been completed as of July 1, 1972. Restoration concluded from its experience that:²

- (1) the rehabilitation program has both a strong visual and economic impact;
- (2) unit costs of acquisition and rehabilitation are lower than unit costs of new housing for comparable quality;³ and
- (3) operation of the program led to the development of "sound procedures and techniques."

Clearances through the required bureaucratic machinery and development of financial sources have been major problems. Building Department approval is required on all rehabilitated units prior to construction, and, in turn, construction is subject to approval prior to obtaining certification of the unit for occupancy. Such requirements exact a toll both in terms of time and funds. Funds, of course, are not overly abundant for rehabilitation work. The federal government initiated a moratorium on all such work during our evaluation period. This adversely affected the achievement of milestone targets. Sheffield Rehabilitation has been seeking funding sources other than the federal government. Although this effort has not yet resulted in many completed units, numerous alternatives have been explored and delays due to funding should be reduced.

1. The adoption of this goal reflects an awareness of the systematic interconnections required in major efforts.

2. These observations are from the SIP IV proposal.

3. Restoration estimates that current acquisition and rehabilitation costs are about 60 percent of the costs of new housing. The authors of the SIP IV proposal state: "The unit costs of acquisition and rehabilitation, while too high to permit resale within the FHA subsidized home mortgage limits, are substantially lower than unit costs of new construction." Since the writing of the SIP IV proposal Restoration has informed us that "Some of our rehabilitated properties have been sold; several others have been completed at a cost within the FHA insurance maximum. Further, even for houses where the total project cost exceeds the FHA maximum, sales can be made if the buyer can provide the required down payment or if we are willing to take a personal note from the buyer."

The funding alternatives include: conventional financing with Restoration equity, co-op financing, and municipal loan financing. Conventional financing arrangements have proven to be the best source. Restoration interprets the willingness of conventional financial sources to join in rehabilitation as a positive sign and vote of confidence in Sheffield Rehabilitation Corporation's efforts. They write:

Our prime indicator of the health of a community is the availability of uninsured conventional financing for both purchase and rehabilitation. These commitments represent a certain degree of confidence in the stability and potential of a community on the part of the business community.¹

Conventional financing is advantageous because resale is not limited by FHA maximums. On the other hand, it requires Restoration to take a substantial initial equity position. National banks will provide financing in some cases up to 90 percent of the appraised value of the property; city banks will only go to 70 percent. The banks, of course, use their own appraisers and the appraisal is sometimes too low for the package to be feasible to Sheffield Rehabilitation. Relief on some properties might be obtained through favorable rulings on tax abatement by the City of New York. The primary tax exemption and abatement, called J-51, requires completion of rehabilitation work before properties become eligible. Restoration expects requests for such rulings to be favorably reviewed as they have been in the past. In addition, assessment challenges may be filed, a process which has proved successful on some properties in the past even though it takes considerable time.

Thus, in spite of the continued low volume of finished work over the past two years, the situation looks more promising for Sheffield Rehabilitation Corporation over the next two years, barring unexpected adverse decisions on tax abatement or a failure by the City of New York to certify construction on the 100 units now before them, as a result of the conventional financing arrangements which have been made.

Milestones and Achievements

The milestones and achievements for Sheffield Rehabilitation are shown in Table 2. The milestones established for our evaluation seem much more realistic than the 500 unit per year goal in the SIP IV proposal. Even so, there has been a significant shortfall in completed units. With respect to earlier years, however, the 50 units completed during the last year represent an increase in volume.

1. Quarterly Report, July, 1974.

Table 2
SHEFFIELD REHABILITATION - SELECTED MILESTONES AND ACHIEVEMENTS

	Actual		Expected		Actual	
	As of 7/1/73	During the year, 7/1/72 to 7/1/73	As of 7/1/74	During the year, 7/1/73 to 7/1/74	As of 7/1/74	During the year, 7/1/73 to 7/1/74
1. Owned units scheduled for rehabilitation	441	31	309	132	309	132
2. Units rehabilitated	58	31	190	132	108	50
3. Rental income on rehabilitated units		\$93,570		\$208,240		\$179,588
4. Rental income on other occupied units		\$153,500		\$153,500		\$132,986

Note: Additional milestones were established for number of buildings acquired for rehabilitation, number of units to be rehabilitated (inventory), buildings scheduled for rehabilitation, and buildings rehabilitated; these milestones are not shown on this table.

The rehabilitation program potentially offers Restoration, and the community, a valuable stock of assets in the form of additional well-renovated housing units. In order to make good on the equity position taken in these units and to meet mortgage requirements, delays in construction need to be further reduced, and sale or rental of units speeded up. The shortfall of eighty-two units (132 expected against 50 units completed), plus the delays in construction have resulted in a loss of potential revenue. For Sheffield Rehabilitation Corporation this has led to a net loss after depreciation, and before allocation of central administration charges, of about \$60,000.

2. Property Management Group

The Property Management Group was established in February 1970. It has not yet been formally organized as a corporation. In the April reorganization of Restoration, Property Management Group became part of the Physical Development Division. This arrangement recognizes the interdependence of property management with both the new housing, commercial, and property development of RDC and the property ownership and renovation work of Sheffield Rehabilitation. The reorganization reflected, also, the more explicit treatment of Property Management as a potential profit center within the framework of Restoration subsidiaries. In pursuit of this goal, contracts with both Restoration subsidiaries and external groups will be established to provide sufficient fee income to cover operating expenses of the unit.

Operationally, the unit has responsibility for management and maintenance of Restoration-owned properties, management of FHA-owned housing which is occupied, and a securing and maintenance function for FHA-owned property which has been abandoned. Property Management Group is responsible, also, for tenant education in managed units to insure tenant help in maintaining desirable rental housing. This activity is directed particularly toward tenants in new housing units developed by RDC and rehabilitated units developed by Sheffield Rehabilitation Corporation.

Considerable learning appears to have occurred in the development of the property management function. There remains the difficult problem of deciding between the interests of the tenants and the interests of property owners when the two conflict. As the property management function has evolved into a potential profit center, the Property Management Group has had to pay attention to possible differences between owner interests and tenant interests.

The Property Management Group is clear about its obligations to the owners (in this case, primarily Restoration or its subsidiary agents), as is shown in both interviews and such documents as the SIP IV proposal. In the supplementary information to the SIP IV proposal, for example, it is stated:

The Property Management Division is being viewed as a conventional property manager, i.e., the agent of the owner.

In many conventional property management arenas, the above view would be taken for granted. Within a CDC, however, the issue is a more tricky one.¹ The Property Management Group is, almost necessarily, caught in a dilemma which characterizes many CDC activities. If it pursues its objective of becoming a self-sufficient for-profit entity rigorously, it must undertake actions which may be opposed by a segment of the community. Some Restoration managers and board members have commented about a possible image being developed of Restoration as a new "slum landlord." On the other hand, if it does not engage in selective tenant approval, rigorous rent collection, and cost-saving activities, continuous subsidies will be required. Restoration's Property Management Group has chosen to attempt to reach self-sufficiency while trying to minimize problems with tenants.

Milestones and Achievements

During our evaluation, milestones were established for the major activities of the Property Management Group, except tenant education. These milestones are shown in Table 3.

1. See discussion of Jackson Park Terrace in Woodlawn for a similar issue.

Table 3

PROPERTY MANAGEMENT GROUP - SELECTED MILESTONES AND ACHIEVEMENTS

Milestone	Actual		Expected		Actual	
	As of 7/1/73	During the year, 7/1/72 to 7/1/73	As of 7/1/74	During the year, 7/1/73 to 7/1/74	As of 7/1/74	During the year, 7/1/73 to 7/1/74
<u>FHA Securing and Main- tenance Program</u>						
1. Number of houses in program	799		850		836	
2. Gross revenues from FHA (\$)		\$780,310		\$864,777		\$1,008,061
3. Expenditures on program (\$)		\$330,358		\$363,200		\$567,709
<u>FHA-Owned Tenant- Occupied Housing</u>						
1. Number of units managed	50		200		33	
2. Fee at 10 percent of rents collected		\$3,369		\$22,930		\$3,381
<u>Restoration-Owned Properties</u>						
1. Number of units managed						
a. Newly constructed and rehabilitated	113		383		296	
b. Other occupied	140-145		-		162	
c. Vacant units	80- 85		-		583	
2. Rents collected		\$368,776		\$637,000 to 653,500		\$337,710
3. Fees earned at 5% of rents collected		\$12,087		\$31,800- 32,600		\$20,829

Note: Additional milestones were established for: houses added during year (net), net income, number of buildings managed, gross rentals at 100 percent collections, actual rental receipts, number of properties owned; these milestones are not shown on this table.

Property Management has fallen considerably short of expected levels of performance. As is true of many of these interdependent activities, the shortfalls were caused, in part, by the delays in completion of new units by RDC and Restoration Construction Corporation and in the completion of rehabilitated units by Sheffield Rehabilitation which were not expected when milestones were set. Property Management has linked all its major projections to expected levels of performance of these other entities.

The Property Management Group--without the FHA Securing and Maintenance program--must generate considerably greater revenues to achieve its goal of covering operating expenses out of fee revenues. The future possibilities look brighter now that Sheffield Rehabilitation has generated financing for a number of new projects and, therefore, anticipates additional construction. The volume of activity, however, has to increase very rapidly for revenue gains to exceed cost increases over the next five to ten years.

3. Restoration Funding Corporation (Mortgage Pool)

The Restoration Funding Corporation was organized in April 1970 as a fully owned subsidiary of Restoration Corporation. The Corporation is an FHA-approved mortgagee. Its primary function is to broker mortgages between those desiring to buy homes in Bedford Stuyvesant and a consortium of New York City banks who have agreed to purchase mortgages up to an initial total commitment of \$65 million. Both new purchases, normally with FHA insurance, and refinancing of old mortgages are arranged by RFC.

According to virtually everyone's account, the volume of mortgages which have been closed in the program has been a major disappointment.¹ At the inception of the program, three facts stood out which led to great expectations for the mortgage pool:

- (1) The rate of home ownership in Bedford Stuyvesant was high relative to many other poverty areas and much of the basic brownstone housing stock was substantial and worth saving;
- (2) The existing brokerage industry had a very bad reputation, due to the practice of charging points and financing multiple mortgages at high interest rates--even when mortgage money was available; and

1. This is discussed in the SIP IV proposal as follows: "Results to date have been well below expectations. Instead [of] the \$10 million annual target for loan closings, RFC closed about \$5 million from the time FHA-approved status was achieved until June 30, 1972. Several factors account for this.

a. FHA activity in inner city areas has been cut back significantly in recent months, following a significant increase in foreclosures in some parts of the country and the exposure of unscrupulous practices on the part of some speculators and FHA personnel. . . . Further, some lending institutions have virtually stopped making FHA-insured loans.

b. Continuous resistance of local real estate brokers. Since inception, local brokers have been reluctant to refer clients to the Pool, preferring instead to earn higher points and discounts from private funding or mortgage placement companies.

c. RFC's advertising has not produced the results anticipated. Most of the advertising dollars went to the print medium. Efforts are being made to change the advertising by using different media.

d. The amount of fees generated per loan has been less than was expected since FHA has now allowed RFC to earn legal fees."

- (3) The willingness of banks to guarantee the purchase of mortgages packaged by RFC would effectively eliminate the previous redlining of much of Bedford Stuyvesant for mortgages and homeowners' insurance.

The demand for purchases (even though RFC charged no points and provided relatively low interest rates) was much lower than expected. Refinancing became the major part of RFC's activity. Although the proportion has fluctuated, RFC estimated that about 85 percent of the mortgages closed were refinance loans.¹ From July 1973 to July 1974, however, 28 of the 46 mortgages closed were purchases rather than refinancing.

The RFC staff attribute the unexpectedly low demand to the general economic situation--which has affected home buying elsewhere, opposition to the pool from the extant brokers--including the legally questionable simultaneous closers, FHA slowness and (more recently) scandals--which resulted in the closing of the office with which RFC customarily dealt. As of July 1, 1974, slightly over 900 mortgages had been closed with a dollar value of about \$17.5 million or under 30 percent of the initial \$65 million bank commitment. This rate of activity does not provide RFC with sufficient revenues to support its staff and inhibits RFC in its stated objective of becoming a full mortgage banking operation.

In its operations, RFC provides initial counseling, both financial and legal, to prospective purchasers or refinancing owners. RFC makes the initial assessment of the ability of the client to fulfill the mortgage. Since most mortgages are FHA insured, FHA must inspect the property for appraisal and required repairs and renovation. RFC uses its line of credit (\$1 million) to buy the mortgage. They then hold the mortgage until final sign-off by FHA for insurance and the subsequent purchase of the mortgage by a bank in the consortium.

RFC provides a warehousing service for the mortgage in the interim and receives short-term funds from the Economic Development Division to finance repairs. These funds are returned to the Economic Development Division when the mortgage is sold to a bank.

Although RFC intends to become a full mortgage banker over time and, therefore, service loans held, this function is currently performed only during the interim period after initial closing and bank purchase of the mortgage. Consequently

1. This does not imply that there are no benefits from refinancing. In the SIP IV proposal, RFC estimated that they had saved owners over \$1 million on points and discounts, much of which developed from earlier multiple mortgages. Refinancing, however, does not increase the rate of home ownership, which was a major objective of the program. It does provide an alternative, otherwise probably unavailable, which may prevent the rate of home ownership from declining.

RFC has not been able to capture this additional source of revenue to date. RFC does provide, however, some service for consortium banks by doing investigations and setting up renegotiated arrangements for some mortgages which get into trouble after they are purchased by the bank.

Milestones and Achievements

Given the factors mentioned above, RFC fell short of its expected milestone achievements in all categories. Selected milestone targets and achievements for July 1, 1973 to July 1, 1974 are shown in Table 4.

Table 4

RESTORATION FUNDING CORPORATION - SELECTED MILESTONES AND ACHIEVEMENTS

Milestone	Actual 7/1/72 to 7/1/73	Expected 7/1/73 to 7/1/74	Actual 7/1/73 to 7/1/74
1. Number of loans closed:			
a. During the year	113	68- 74	46
b. Cumulative	869	937-943	915
2. Dollar value of commitments closed:			
a. Total	\$1,983,800	\$3,000,000	\$1,058,733
b. Cumulative	16,699,164	19,699,164	17,757,897
3. Total revenue to RFC after interest expense	30,081	64,000	25,848
4. Total expenditures	202,378	288,900	185,412

Note: Additional milestones were established for: number of applications processed, number of mortgages serviced, fees earned, interest earned less interest expense (loss), gross fees earned on commercial and FHA rehab mortgages, and fees and interest earned on mortgages serviced.

It is clear from these figures that RFC would require a substantial increase in the volume of activity to be self-sustaining in terms of revenues generated from its own activities. Over the year, in spite of considerably lower expenditures than were anticipated in the milestones, the cost to RFC per mortgage closed, based on total expenses excluding interest, has more than doubled (\$1,383 per close for July 1, 1972 to July 1, 1973, compared to \$3,392 per close for July 1, 1973 to July 1, 1974). Alternatively stated, if the rate of gross fees remained the same as in the milestone period, the volume of activity would have to more than triple to cover costs out of gross revenues. Such an activity level, in the face of a continuation of high interest rates (RFC mortgages are processed at the prime rate) and serious increases in unemployment in Bedford Stuyvesant, seems highly unlikely. From July 1973 to July 1974, according to RFC's Director, only 850 new mortgages were closed in the whole of Bedford Stuyvesant. RFC would have to

capture a very high portion of these to break even. Earlier plans for providing additional linkages to community and FHA rehabilitation units have not yet materialized. Nor has RFC yet begun full servicing of mortgages. Both of these activities were scheduled to start after the beginning of 1975.

It should be added that this situation is one of those where the major factors affecting the disappointing outcomes appear to be outside the control of the CDC entity. It is possible that some actions by RFC could increase the activity level, but this will continue to be an uphill struggle barring a dramatic improvement in the state of the economy and resolution of problems associated with FHA operations in Bedford Stuyvesant.

4. Restoration Development Corporation and Restoration Development Corporation Commercial Center

RDC is the major physical development arm of the Restoration Corporation. Its primary function is to plan and implement major development in Bedford Stuyvesant involving land acquisition and new construction for residential, commercial, or industrial purposes. The plans for the creation of such a development company were formulated in 1971. Formal incorporation, as RDC of Bedford Stuyvesant, Inc., occurred in December 1972. In pursuit of its objective of meeting some of the major physical development needs of the community, RDC has general responsibility for:

marketability and feasibility studies, preliminary decisions regarding feasibility, land acquisition, design coordination, construction coordination, financing, leasing and management of each project.¹

Over the course of our evaluation, RDC has had specific responsibility for the development and implementation of five firm projects in housing and commercial development and three potential development projects. Of these projects, Site 66 (housing plus an Early Childhood Center) and a major Commercial Center were scheduled to be completed during the milestone period. Site 66 was completed, but the Commercial Center was not. Restoration Construction Company, in a co-venture arrangement with a major construction firm, carried out the construction on Site 66. There were some delays and construction problems with Site 66 partially attributable to RCC acting as general contractor on both the Site 66 project and the Commercial Center Project.

Although RDC and RDC-CC are separate entities formally, there is considerable staff overlap. During the evaluation period, almost all of RDC's efforts were concentrated on the completion of the Commercial Center, the largest physical

1. From Supplementary Information - SIP IV Proposal.

development project undertaken by Restoration to date. Restoration's experience with the Commercial Center is one of the case studies our evaluation team conducted of large-scale projects. Since this is discussed in Chapter 5, RDC and RDC-CC will not be further discussed here.

5. Restoration Construction Corporation

The BSR Construction Corporation (BSRCC) was organized in October 1967. It was formerly the Sheffield Management Corporation. BSRCC was organized as a 100 percent Restoration-owned for-profit subsidiary solely for the purpose of general contracting. Restoration has demonstrated a strong interest in the success of BSRCC throughout its existence.

This interest springs from a recognition of the relative absence of minority firms in the construction industry, as well as from the desire of Restoration management to have a subsidiary which can handle Restoration physical development work in new housing construction, renovation and rehabilitation of old housing and commercial site construction. There have been expressions of interest in attracting outside business (that is, work unrelated to Restoration projects) for the construction company, but to date relatively little such outside work has been acquired.

Since its inception, BSRCC has been involved with new housing construction (Site A and Site 66), renovation work (for Sheffield Rehabilitation Corporation), public facility construction (Early Childhood Facility at Site 66), and commercial development (Restoration Commercial Center). Work for other Restoration subsidiaries has remained central to future projections.

However, the Construction Corporation has not yet established itself as an organization with independent profit-making potential and its current prospects are not promising. There have been unanticipated costs and delays on many jobs, which have led to reduced outputs in Sheffield Rehabilitation renovations. These led to the eventual take-over of rehabilitation construction work by Sheffield Rehabilitation. Subsequent problems led to the removal of BSRCC as the general contractor for the Commercial Center.

The kinds of problems experienced with BSRCC in the Commercial Center project were summarized in a May 1973 report of Foundation advisors. They included: time delays in doing work, inadequate investigation of subcontractors, inadequate backup data, and unrealistic scheduling and materials ordering.¹

There has been an effort by BSRCC to use minority subcontractors on its jobs. On Site 66, for example, about 29 percent of the construction dollars went to minority subcontractors. Eight of the 22 subcontractors for the housing portion

1. From Technical Advisor's Report, May 1973.

of the project were minority and four of the 22 subcontractors on the Early Childhood Development Facility were minority.

As indicated above, BSRCC's experience with subcontractors has not been entirely good. The Construction Company had to perform work for 14 of the 22 subcontractors on the school portion of Site 66. Of the deficient subcontractors on the housing portion, four were minority and on the school two were minority subcontractors. In addition to this BSRCC is engaged in litigation with a number of other subcontractors.

Milestones and Achievements

The milestones which were established for BSRCC related entirely to revenues, costs, profits, and retained earnings. Table 5 shows the milestones and achievements for the year July 1, 1973 to July 1, 1974.

Table 5

RESTORATION CONSTRUCTION CORPORATION - SELECTED MILESTONES AND ACHIEVEMENTS
JULY 1, 1973 TO JULY 1, 1974

	Milestone Expected	Actual
1. Gross Revenues - Total	\$5,225,000	\$2,603,845*
2. Costs	5,060,000	3,044,145
3. Net Profit (Loss)	157,000	(440,300)

*Figure is for both RCC and the co-venture partner.

Note: Additional milestones were established for: housing portion Site 66 revenues, Early Childhood Facility revenues, and retained earnings (deficit).

As can be seen from the table, the construction activities have fallen far short of expectations for the period. Nor does the asset and liability picture look better than the above figures. As of June 30, 1974, BSRCC had current assets of \$436,759 against current liabilities of \$637,594. The co-venture partner had assets of \$515,659 as against \$659,069 in liabilities. The combined retained earnings deficit of the two companies as of June 30, 1974 was \$496,745.

Future Prospects

Obviously, the current situation for BSRCC is not promising. As of late July, 1974, the manager indicated the possibility of a joint venture with another construction corporation for construction of all or part of two major housing projects on RDC's drawing board. As far as we know, Sheffield Rehabilitation does not intend to use BSRCC for additional rehabilitation work. BSRCC's manager indicated some considerable scaling-down of expectations for the Construction

Corporation--no current plans for outside work, co-venture arrangements on large jobs, and handling fewer jobs at any one time. These scaled-down expectations seem more realistic than the earlier projections, particularly in an industry as hard hit by inflation and recession as is the construction industry. There is little doubt that the experiences of BSRCC staff over the evaluation period have led to learning some of the major pitfalls in construction work. Turning BSRCC into a profit-making subsidiary will take some more time, however.

B. Economic Development Division

The Economic Development Division, the second major component of the Restoration Corporation, provides loans and equity funds for businesses operating in Bedford Stuyvesant. The emphasis is on local companies. The division, also, provides management and technical assistance to companies in the area, primarily to companies in the loan and equity portfolio of the division. Prior to the recent reorganization, the economic development group worked with the D & S staff in attempting to bring in outside business. The effort to attract outside business has not proven to be very successful, but attracting new industries or expansion of existing industries continues to be an objective along with the loan and equity strategy for local businesses.¹ EDD staff point, for example, to successful efforts to prevent existing businesses from relocating, such as the Daily News.

The program has made use of training credits to portfolio companies. The training credit arrangement allows businesses who conduct training to reduce their outstanding loan balances to the Economic Development Division. The strategy of providing training credits to portfolio companies was being reviewed by both the Manpower Program and the Economic Development Division during our evaluation. At issue is whether or not, given the range of normally expected problems in new businesses, they can also be expected to carry out training without adversely affecting their performance.

The strategies employed by the Economic Development Division to encourage business development and success in Bedford Stuyvesant are:

- (1) loans, both long-term and working capital;
- (2) training credits;
- (3) purchase of equity;
- (4) provision of management services and technical assistance; and with a lower priority currently,
- (5) attracting new outside industries and assisting expansion;
- (6) assistance to relocating firms; and
- (7) construction and rehabilitation of industrial facilities.

1. See Report to the Congress by the Comptroller General of the United States, Economic Development Programs in Bedford-Stuyvesant, Brooklyn, New York Under The Special Impact Program, Office of Economic Opportunity, B130515, U.S. General Accounting Office, Washington, D.C., August 20, 1973, p. 20.

Milestones and Achievements¹

During the year for which performance was evaluated, the Economic Development Division made fewer loans than had been anticipated when milestones were set. It was expected that most of the funds available for loans and equity positions as of July 1, 1973 (approximately \$3.5 million) would be committed by the end of the year. One million dollars had been reserved for a cable television franchise. These funds have now been reallocated for housing rehabilitation, primarily as equity funds. It appears that the bulk of the lending activity of the Division is being tied in closely with the Commercial Center. The division has packaged eighteen deals relating to the Commercial Center which were to be finalized during the last half of 1974. These packages would commit \$668,200 in loans and \$925,000 in equity funds.

The federal funds utilized in the past have been leveraged by participation of the owners and other non-federal sources. Over the period of this evaluation, the overall leverage obtained has declined about 3 percent as a result of more extensive use of federal funds relative to other funds in construction and equity investments.

It was anticipated that 22 to 26 new companies would receive loans between July 1, 1973 and July 1, 1974. This target was not reached, although additional loans were made to companies (predominantly construction loans) already in the portfolio.

Thirty-one of the 89 companies which had received loans had become inactive as of July 1, 1974. Most of the loans to inactive companies were made prior to 1971, indicating improved selection of more recent loan recipients. Loans of slightly over \$1.8 million were disbursed to inactive companies. This is 35 percent of total funds disbursed up to July 1, 1974.² Funds recovered from these inactive companies have been \$385,000 (about 20 percent of the amount disbursed to them).

No additional companies have become inactive over the period of this evaluation. However, the companies in Economic Development Division's portfolio show

1. The following discussion refers to milestones and accomplishments as shown in Table 7.

2. This is a slightly higher loss rate than that experienced by 32 SIP grantees, including Restoration, as reported by the Abt Associates in 1973. They report a loss rate of 33 percent compared to Restoration's 35 percent (An Evaluation of the Special Impact Program: Final Report, Volume 2: Analysis of Program Performance, Abt Associates, Inc., Cambridge, Massachusetts, 1973, p. 150). Restoration management, however, feels that this loss rate is not excessive for high-risk lenders.

signs of experiencing difficulty, reflecting the general decline in business prospects nationally. Delinquencies on active loans have mounted during the past year as shown in Table 7. However, the number of active companies has increased by four, from 48 to 52 companies, and the number currently profitable has increased by seven, from 42 companies to 49, over the evaluation period.

Payments to the Economic Development Division consist of payments on principal (in cash or training credits) and interest. Early loans were interest free, but more recent loans have carried interest charges. Rates charged are below-market rates, but serve to help motivate borrowers to recognize their obligations for repayment. The effects of this change in policy are reflected in the trends of interest payments on outstanding loans. Table 6 shows interest paid to date as percentages of disbursements. To date, principal repayments have totalled \$1,270,507 on \$4.9 million in loan disbursements. About \$483,000 of this has been in training credits. Training credits are about half the size of total cash principal recovered, \$787,221, from both active and inactive companies. In the case of fully paid loans, on the other hand, cash recovery of principal was 90 percent of the total principal recovered. As of July 1, 1974, there had been returned \$427,423 as opposed to only \$166,397 worth of fully paid loans as of July 1, 1973. During fiscal year 1974, the year coinciding with this evaluation period, cash principal repayments were \$263,835 while repayments by training credits were \$46,782.

Table 6

INTEREST PAID AS PERCENTAGE OF DISBURSEMENTS, AS OF JULY 1, 1974

	(1) Interest	(2) Disbursements	(1) ÷ (2)
Inactive companies	\$ 9,717	\$1,805,439	0.54%
Loans paid in full	10,555	477,204	2.21
Active companies	<u>94,896</u>	<u>2,624,969</u>	3.62
Total	\$115,168	\$4,907,612	2.34%

1. Training Credits

The training credit arrangement provides a useful example of the complex benefits and costs associated with CDC programs. Training credits are paid to EDD's loan recipients for providing training. Payments are billed as training is provided. These credits are applied to the outstanding obligations to EDD of the company which provides the training. As of July 1, 1974 training credits of \$483,285 had been provided. Additional credits of about \$66,000 have been booked in July and August of 1974.

Table 7

ECONOMIC DEVELOPMENT DIVISION - SELECTED MILESTONES AND ACHIEVEMENTS

Milestones	Actual		Expected		Actual	
	As of 7/1/73	During the year, 7/1/72 to 7/1/73	As of 7/1/74	During the year, 7/1/73 to 7/1/74	As of 7/1/74	During the year, 7/1/73 to 7/1/74
1. Leverage (ratio of non-federal funds to federal funds disbursed)	1.005		-		.975	
2. Companies ever receiving loans	89		111-115		89	
a. Number of loans	128		150-155		140	
b. Federal funds disbursed (\$m)	\$4.641		\$5.8		\$5.223	
c. Active companies	58		86-93		62	
d. Currently profitable	44		70-77		49	
3. Loss ratios: Amount disbursed to inactive companies divided by total disbursement	35%		33-36%		35%	
4. Delinquencies on active loans: Percent of active companies delinquent more than 60 days	26%		50% or less		61%	

Note: Additional milestones were established for: federal funds available (loan and equity funds), federal funds committed, companies receiving other loans, active companies, and currently profitable companies, amount of loans to inactive companies (committed).

For those provided with jobs and training, the program is clearly beneficial. For the company, the relationship between benefits and costs is more complicated. On one side, training credits reduce the outstanding obligation. In some cases, this results in a very large offset to the initial borrowing. For three companies, training credits constituted 98-100 percent of the initial obligation. On the other hand, these companies may well be experiencing the normal problems associated with operating a new business plus the additional problem of training people.

The other major complication is that the Economic Development Division does not receive the funds from training credits for recycling as new loans or equity investments. Although the operation of the system may keep some companies afloat (Restoration Construction Company, for example, has earned or booked training credits of over \$54,000 in the evaluation year on an initial equity investment of \$155,000), the EDD requires additional usable revenues for reinvestment. Not surprisingly, therefore, they have argued against training credit contracts, except in those cases where the company can clearly afford the additional costs of providing training while remaining profitable.

2. Loan Packaging and Technical Assistance

It is the long-run intent of BSR and the Economic Development Division for the division to be self-sustaining from its own revenues. One means of increasing EDD's revenues is to charge fees for the management and technical assistance provided by the division to local companies as well as portfolio companies. At the time milestones were set, EDD anticipated providing technical assistance to 40 local industrial companies and earning fees of approximately \$12,000. As of July 1, 1974, these expectations had not been realized. Although four companies received assistance, no fees were earned. EDD continues to provide management assistance on a regular basis for portfolio companies, having done so for 39 companies compared to a projection of 43. In the first half of 1974, EDD assisted 27 companies and devoted over 3,000 man-hours to this activity. EDD did not derive fees from this activity.

EDD also develops loan packages for a variety of ventures. During the period January 1, 1974 to July 1, 1974, 48 loan applications were received, 7 were packaged and 6 forwarded to the EDD Loan Division.

In general, there has been some shortfall in reaching milestone projections by EDD. Some of this is attributable to the general decline in business prospects and some of it is due to delays in the start-up of the Commercial Center. However,

during the period of this evaluation the EDD has made some major strides in developing sophisticated data sets on Bedford Stuyvesant which will help in future planning. Estimates have been made by EDD of expected growth patterns by detailed types of businesses and the data have been analyzed to determine those activities which are likely to be in shortest supply. These planning efforts should enable EDD to target both loans and equity interests in activities with an increasing prospect of success.

3. Costs and Revenues

As indicated above, the long-run intent is for EDD to be a self-sustaining entity, covering its costs from revenues generated from its lending operations and fees for managerial and technical assistance. Most of the revenues currently generated by the Economic Development Division are in the form of principal repayments, which become recycled funds, and interest. In the period July 1, 1973 to July 1, 1974, the division received cash repayments of \$263,835 on loan disbursements of \$5.2 million. Interest payments of \$69,162 were received during that same period.¹

The costs incurred over the period (exclusive of a share of central administration costs) to operate the division, according to the combined statement, were about \$420,000. Equivalent costs for the previous fiscal year were \$519,527. The major source of the reduced cost in the evaluation period appears to be a reduction of about \$100,000 in staff costs.

At the current rate of interest payments on the average outstanding loan balance, EDD would need to increase the outstanding loans by about ten times to pay operating costs of around \$400,000 out of interest receipts. Outstanding loan balances over the current year averaged a little over \$2.3 million. EDD has charged, however, a higher interest rate on its more recent loans so the above estimate exaggerates the loan funds needed to pay operating costs from interest revenues.² An effective interest rate of 17.4 percent on outstanding loan balances of \$2.3 million would be required to produce \$400,000 in revenue, as compared to the current effective rate of about 1.8 percent.

4. Future Plans

EDD devoted considerable time to analyzing the economic base of Bedford Stuyvesant during fiscal year 1974. The data developed and the assessment by EDD of its implications for business development are significant and should lead to an

1. The interest figure shown is from the EDD quarterly reports. The unaudited combined statement shows interest receipts of \$80,756.

2. As indicated earlier, EDD also plans to supplement interest revenue with fee revenue but this latter has not provided significant amounts to date.

improved ability to achieve priority objectives successfully by better targeting of activities. The priority objectives for EDD are described in their new five-year plan. The prime priority is return on investment; the second priority is to provide incentives and assistance to tenants in the Commercial Center, particularly local tenants. A third priority is to become involved in businesses that meet community needs.

The analysis mentioned earlier has led to the development of two major strategies for business development. As stated in the five-year plan:

With respect to Business Development, two key strategies have evolved:

- (i) To assist or create businesses for which there is a local market demand.
- (ii) To assist, create, acquire or joint venture in businesses within an industry which may not show a trend, but one which is stable and requires small capitalization.

These plans and strategies reflect several positive aspects of the operation of EDD. Although there have been problems, EDD has both learned from them and responded with new ideas. The strategies contemplated make use of potential complementarities with other Restoration programs. The shift of emphasis to ownership, through acquisition and equity positions, should allow EDD to actively affect management and Restoration to develop an improved asset position in the future, assuming a continued search for viable entities serving a real demand.

C. Non-Profit Community Programs Division

In the April 1974 reorganization, a new division of Non-Profit Community Programs was created. The division includes two major program activities, the Area Development Program and the Comprehensive Manpower Program. The division also includes a variety of ancillary services. These are:

- 1. research,
- 2. planning and evaluation,
- 3. government/CDC relations,
- 4. fund-raising activities, and
- 5. public information.

The Construction Worker Training Program is treated as a component of the Comprehensive Manpower Program. Components of the Area Development Program are:

- 1. five neighborhood centers,
- 2. Home Improvement Program,
- 3. Billie Holiday Theatre,
- 4. Day Care Program, and
- 5. the proposed Health Center.

In this section, Area Development, Comprehensive Manpower, and Ancillary Services will be discussed in turn.

1. Area Development and Neighborhood Centers

The Area Development Program is an important component of the not-for-profit division of the Restoration Corporation. This program has been an integral part of Restoration's programming from inception. The major responsibilities of the program are:

- (1) to provide mutual feedback between Restoration and community residents,
- (2) to relate community residents to available public services,
- (3) to directly provide, either alone or with the cooperation of other institutions, public services,
- (4) to analyze community needs for social services, and
- (5) to develop and implement longer range programs to reduce these needs.

Operationally, these responsibilities are performed through a central staff and the staffs of five neighborhood centers.

The programs with which Area Development has been involved are both extensive and varied. During its earliest years, Area Development trained community planners and organizers and operated two community planning offices. A survey of community residents was conducted, also, to better identify community needs and concerns. In the subsequent period, studies of health, welfare, education, cultural affairs, housing, sanitation, and youth development were conducted and priority programs established for each area of concern. During this period, the Ex-Offender Program was undertaken as well as the Neighborhood Improvement program. In the period immediately prior to our evaluation study, Area Public Services (essentially the planning and development function of Area Development) continued to establish and then implement the Ex-Offender Program and helped develop the Billie Holiday Theatre project. They also worked on the development of day care centers, the Tenant Aid program, a local sanitation company, a program for senior citizens, and a health center.

The Ex-Offender Program was started but funding was not renewed after the first year, in part, because of difficulty in achieving community agreement on a proposed site. The Billie Holiday Theatre is operational. The day care program has not yet been implemented due to a funding moratorium. One day care center foundered on problems in the community associated with the site and structure of the proposed center. The private sanitation company has not materialized, in considerable part due to lack of support from city and union officials. The Health Center is not yet in being, nor is the Senior Citizens' Center. A Tenant Aid unit has been established in the Nostrand Avenue Center as a marketing arm of the co-op conversion program. Milestones were not established for these programs;

however, they are noted here since better outcomes on these programs had been sought by Area Development.

The Neighborhood Center programs, for which milestones were established, have remained operational. There are five centers, each with a special function in addition to general responsibility for dealing with the full range of service or information requests of people who contact them. Functional responsibility for health and welfare is assigned to Center 1, youth development to Center 2, cultural affairs and education to Center 3, housing and sanitation to Center 4, and Hispanic-American affairs to Center 5.

Milestones and Achievements

Establishing milestones for social programs, such as those of Area Development, presents greater problems than for many economic and physical development programs. Nevertheless, we jointly identified activity areas and overall objective statements for each activity with Area Development managers. From these, representative quantitative milestones were agreed on. The milestones, as in the other cases, do not represent ultimate impacts on the community or the values which the community attaches to the service. Rather, the milestones represent activity targets over which the staff has some control. Table 8 provides a selected set of milestones for various activities.

The center programs appear to be reasonably well structured, recognized in, and credible to the community. The costs associated with maintaining the centers demonstrate a substantial willingness on the part of Restoration to maintain a community presence.

Output levels on milestone targets are mixed, with some increases and some decreases in levels. The center program seems to be working more effectively than new program development, given the failure to have the Ex-Offender Program renewed or a permanent site accepted, the postponement (at least) of the day care program and creation of a sanitation company, and the further delays in getting a health center started.

2. Comprehensive Manpower and Construction Worker Training Programs

Recent surveys of urban poverty areas, including Bedford Stuyvesant,¹ highlight the importance of both job creation and job placement for Bedford Stuyvesant residents. The Economic Development Division has primary responsibility for the former objective. The Comprehensive Manpower Program and the Construction Worker

1. See AREA TRENDS in Employment and Unemployment, July 1974 and March 1975, U.S. Department of Labor, Manpower Administration, Washington, D.C.

Table 8

AREA DEVELOPMENT AND NEIGHBORHOOD CENTERS - SELECTED MILESTONES AND ACHIEVEMENTS

Milestone	Actual 7/1/73	Expected 7/1/73 to 7/1/74	Actual 7/1/73 to 7/1/74
<u>Health</u>			
1. Health Fairs conducted	11	10	2
2. Health Screenings provided			
a. Hearing	552	200	1,002
<u>Social Services</u>			
1. Referrals to welfare agencies	550	900	395
2. Senior Citizens Assistance	238	400	248
<u>Youth Development</u>			
1. Trips			
a. Number of trips	23	25	67
b. Number of participants	4,706	4,000	4,297
2. Clubs and youth groups			
a. Number of groups	78	100	101
b. Number of participants	1,180	5,000	6,413
<u>Cultural Affairs and Education</u>			
1. Art exhibits	38	30	47
<u>Education</u>			
1. Scholarships	28	30	8
2. Participation in classes			
a. Credit education	24	30	9
b. Typing	15	15	15
c. High School Equivalency	38	200	238
d. Bookkeeping	10	10	69
<u>Housing and Sanitation</u>			
1. Housing complaints processed	4,279	5,000	4,420
2. Housing referral assistance	1,426	2,000	1,468
<u>Contact Between Community and Restoration</u>			
1. Interaction with organizations and block-tenant associations	160	200	878
2. Participation in other community meetings	290	300	1,031

Note: Additional milestones were established for: health screenings provided for visitation, Sickle Cell Anemia, lead poisoning, other and referrals; Youth Development, number of athletic events and estimated attendance, enrollment in Neighborhood Youth Corps; Cultural Affairs and Education, workshop participation in modeling/good grooming, dance, drama, music, photography, sculpture, Drum and Bugle Corps participation; Education, school admissions, tutorial programs; Housing and Sanitation, housing cooperatives, number of buildings in process and number of buildings with cooperatives established, reported abandonments of automobiles and buildings; Contact Between Community and Restoration, distribution of Outreach Literature, participation in general meetings related to community activities, and coordinating activities with other organizations.

Training Program have responsibility for the latter objective. These three programs (as well as Restoration Construction Corporation) come together in connection with the Training Credit portion of the manpower program.

The purpose of the Comprehensive Manpower Program is to place residents of the community in public and private jobs as a supplement to other manpower and training programs in the area. Comprehensive Manpower does not normally provide training; rather it is a recruiting, processing, and placement service. Some counselling is provided as well as follow-up services. Follow-up services include questionnaires to employees and employers, as well as employer site visits. Applicants are referred to both jobs and training programs carried out by others. The training credit component provides Comprehensive Manpower with funds to be used as credits against loans companies have received from the Economic Development Division in return for the company providing on-the-job training to trainees referred to the employer by the manpower program. The Construction Worker Training Program is designed to insure on-the-job training in all of the major construction trades by contractors and subcontractors of construction and rehabilitation work sponsored by Restoration. In this program there are provisions, also, for training payments to contractors and subcontractors for on-the-job training provided. The CWT program, however, has not yet been effectively implemented. This is due, in considerable part, to construction union opposition and difficulties in relating to other city-wide anti-discrimination efforts in the construction industry.

Milestones were established for most of the Comprehensive Manpower Program's activities, except the computerized Manpower Information System which contains information on the persons who come into the program and their status. However, the system is a useful means of developing and maintaining information on persons entering the program. This information can be used by counselors in attempting to make good employer-employee matches although the system itself does not have a job-people matching capability.

The Comprehensive Manpower Program operates by linking prospective employees to job training slots identified by employers. This is accomplished by developing information on personal characteristics and work experience of applicants at intake and attempting to find matches between applicants and employer requisitions. Most of the program emphasis is on the successful processing of prospective employees. However, an attempt is made by the program to identify both suitable training programs and potential job sources.

A positive aspect of the Comprehensive Manpower Program is its explicit recognition of the importance of jobs in a manpower program. Although it may seem

somewhat self-evident that jobs are important, recent studies have shown that the placement of a trainee in a job explains a far larger portion of the outcome of training programs than the type of program or type of training provided. The success or failure of the approach used by Restoration, therefore, rests critically on the jobs available.

Survey data show that unemployment and sub-employment are high in Bedford Stuyvesant. Relatively few new jobs are being created. An important component of the program, therefore, is to solicit access to new job possibilities. This has been done in three ways:

- (1) standing announcements with employers about the placement program,
- (2) surveying prospective employers in the community and in the broader metropolitan area to solicit joint planning and employer requisitions, and
- (3) the training credit program linking employers receiving Economic Development Division support to training commitments.

Most open slots, in the recent past, have come from employer requisitions. Not surprisingly, as the job market has loosened for employers, the structure of such requisitions has shifted in the direction of higher skills. In the earlier years of the program, lower skills were being requested with a sizable portion of entry level jobs. At the same time, a higher portion of potential employee intake is low skilled.

Milestones and Achievements

The performance of the manpower program from July 1, 1973 to June 30, 1974 has been mixed. Much of the difficulty can be traced to the twin obstacles posed by the national recession (declining numbers of jobs and increasing numbers of unemployed and subemployed to be placed), rather than the specific actions of manpower staff. Table 9 shows the major milestones and the level of their achievement. As can be seen from the table, no one was placed under the Construction Worker Training Program either during the preceding or the evaluation year.

The overall performance record may be attributed to a number of factors. Intake exceeded expectations as more people became unemployed. Employer requests fell off, resulting in a lower placement rate than in the previous year and considerably lower than anticipated in the milestones. Projected rates of referral relative to intake (56 percent) were unrealistically high, relative to both past experience and the job market. A referral rate was achieved that was higher than the previous year (35 percent to 28 percent), but not high enough to reach the projected levels.

Table 9

COMPREHENSIVE MANPOWER AND CONSTRUCTION WORKER TRAINING PROGRAMS -
SELECTED MILESTONES AND ACHIEVEMENTS

Milestones	Actual		Expected		Actual	
	As of 7/1/73	During the year, 7/1/72 to 7/1/73	As of 7/1/74	During the year, 7/1/73 to 7/1/74	As of 7/1/74	During the year, 7/1/73 to 7/1/74
<u>Comprehensive Manpower and Construction Worker Training Programs</u>						
1. Number of people processed through intake		5,106		3,000		5,306
2. Number of employer requests received		1,145		1,667		1,033
3. Number of people referred to prospective employers		1,421		2,000		1,869
4. Number of people placed	4,600	602	5,600	1,000	5,258	658
5. Cost per placement		\$400		\$237		\$316
<u>Training Credit Program</u>						
6. Number of companies in payment credits program	18	2	23	5	22	4
7. Number of training slots hired	348	65	416	68	369	21
8. Credits earned by employers through program	263,055	60,207	326,023	62,969	310,615	47,560

Note: Additional milestones were established for: number of trainees placed through the Construction Worker Training Program and number of training slots authorized in the Training Credit Program.

The cost per placement experienced during July 1973 to July 1974 is less than the previous year, although significantly higher than the milestone figure of \$237 per placement. If the expenditures made for the Construction Worker Training Program, which resulted in no placements, are added to those for the Comprehensive Manpower Program, cost per placement is raised from \$316 to \$362.

Future Prospects

The future prospects for this program and for reducing the cost of placing people in full-time jobs over the near term are not bright. This type of program is especially hard hit by a job market which is as weak generally as the current

market. More aggressive solicitation of employer requisitions might help somewhat, but should not be expected to solve the problem. Not only are requisitions unlikely to increase sharply, but the requisitions received are likely to be somewhat poorly matched with the intake in terms of skill levels. It is clear that there is great need for additional job possibilities for residents of Bedford Stuyvesant. The Comprehensive Manpower Program showed an early recognition of the importance of a suitable match in an ongoing job--well ahead of a similar recognition in other programs. Unfortunately, such a program works far better when employers are competing for scarce employees than when the situation is turned around.

3. Ancillary Services

We did not establish milestones for the units of the Non-profit Community Programs Division which we have labelled ancillary services. These include: planning and evaluation, government/CDC relations, fund-raising, public information, and research. They will not be discussed extensively here.¹ A few comments, however, are in order.

It has been a great strength of Restoration that it has consistently maintained an effective working relationship with most governmental organizations affecting its operations. Such a situation does not happen accidentally and deserves, therefore, a strong plus for Restoration and its managers. Similarly, Restoration has consistently had a strong public image outside of Bedford Stuyvesant. Our own impression is that this is due, not only to the scale of Restoration's activities but also to the work of its public information office.

The research and planning and evaluation functions are duplicated in neither of the other two CDCs we have been studying. There appears to be a useful interaction between program staffs (e.g., the Economic Development Division) and the developing research. The detailed examination and patient development of primary data on Bedford Stuyvesant carried out by program and research staffs is an asset of considerable magnitude to Restoration and should be seriously considered by other CDCs.

1. Planning and evaluation, fund raising, government/CDC relations, and public information are, however, important parts of a developed resource mobilization function and would be more extensively examined in future research.

the concept of having the rural CDCs involved in screening loan applications, and in recommending potential borrowers, in their impact areas. Although the CDC would not make actual loans (the sign-off authority on loans would remain in Washington), the CDC's knowledge of local groups and conditions could be used to increase the quality of loans made by CSA.

Involving CDCs in this manner might also clarify the role that FmHA should play. Further, it could aid in solving the potential personnel problem at CSA in trying to implement this program. Of course, it is also hoped that the expected reorganization of CSA and the assignment of additional employee slots to CSA by OMB will aid in seeing that rural programs get the priority they deserve.

The obvious conclusion to be drawn at this time is that rural groups will become increasingly active in freeing up this money and will move to seek support from urban areas to assure implementation of these programs which are designed specifically for rural development. The National Congress for Community Economic Development has recently formed a Rural Committee to address this issue, among others, and the organization's rural membership has been assured by its urban associates that such support would be forthcoming. Everyone recognizes that this is not the time for factionalism. It is essential to unite behind the effective utilization of any funding that could further the cause of community economic development and reverse the trend of neglect and disinvestment.

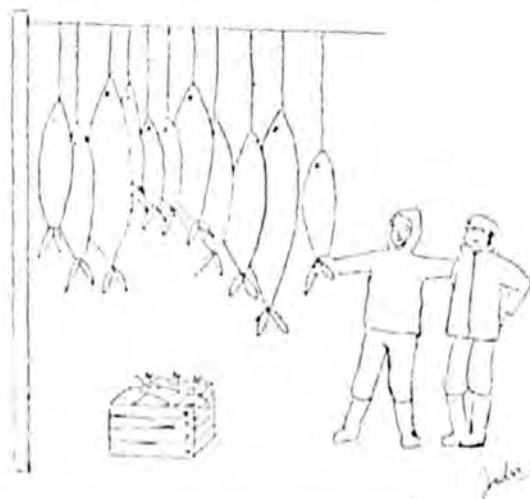
Susan Horn-Moo

Community Enterprise Development Corporation of Alaska

In an environment outside of the experience of most U.S. citizens, the Community Enterprise Development Corporation (CEDC) of Alaska is effectively addressing the unique problems of its state and people. Much of how CEDC approaches economic development and what it has accomplished can serve as valuable learning tools for community economic development practitioners. To assist in the educational process, the Center for Community Economic Development is completing a case study on CEDC (one of a series of such studies on selected CDCs throughout the country) for publication later this year. This article provides some informational

background and impressions gained from the author's visit to Alaska in midsummer in conjunction with development of the CCED study.

Incorporated in 1968, CEDC of Alaska began with an \$800,000 research and demonstration grant from the Office of Economic Opportunity (now the Community Services Administration). With a staff of six, it provided assistance in its early months to four ventures, three fishing co-ops, and a cooperative general store. By the beginning of this year, CEDC had grown to support over 35 fisheries, co-op stores, and other enterprises, with gross sales of nearly \$6 million annually; was directly employing 38 people; and, through its ventures, was providing jobs for over 500 low-income rural residents. Its combined investments in rural businesses, including funds leveraged from a variety of sources, was in excess of \$3.6 million.



CEDC operates on the belief that one way to break the poverty cycle in Alaska's rural communities is by providing an opportunity for low-income groups to participate in the free enterprise system. Using CSA funds as seed capital, CEDC assists in developing and supporting rural business enterprises through loans and grants; in addition, CEDC strives to fill the educational gaps of emerging rural businesspeople by providing training and technical assistance. During 1975 alone, CEDC invested over \$2 million in loans, grants, and equity investments in 20 community ventures—a figure nearly three times as large as in 1974.

Now CEDC is seeking a \$17 million, two-year grant from CSA/OED, which would enable it to continue current activities and substantially increase its potential to initiate and support new ventures

throughout the state. Of the requested funds, \$11.5 million would go to development of new rural businesses in the priority areas of fisheries, retailing, tourism/real estate, and timber, and \$1.5 million to delivery of technical assistance and training. As this article went to press, it seemed probable that CSA's Office of Economic Development would approve funds in excess of CEDC's current level of \$3 million (for 18 months), though federal fiscal constraints are likely to keep the total amount well under the \$17 million requested.

While the figures cited would seem impressive for antipoverty programs in any environment, a personal visit to CEDC and to some of its ventures in Alaska's back country adds considerably to an understanding of both the immense task facing CEDC and its competent performance in maximizing the use of its resources.

Environmental Problems

Those who have never traveled to Alaska, studied its history, or become involved with its people would have difficulty comprehending its incredible size, complex social structures and values, and several of its other uncommon features. Although our forty-ninth state, Alaska is in many ways another world.

The state's geography and climate alone make it unique. Alaska — by far our largest state — encompasses an area equivalent to that ranging from southern California to Florida. CEDC's impact area is the rural sector of the state — over 500,000 square miles. A good portion of the terrain is uninhabited; much that is populated is not readily accessible and can be reached, in good weather, only by boat or small plane. While precipitation (including snowfall) in most of Alaska is not excessive, much of the land remains permanently frozen. The average temperature in December in at least half the state is well below zero. Temperatures fluctuate to extremes throughout the year in other areas, ranging from plus 100 degrees (Fahrenheit) in summer to 80 below in winter in some locales.

Obviously, geography and climate have a great deal to do with how CEDC must operate. To say that its problems in countering the effects of distance and difficult weather conditions are unusual would be to understate the situation. As an example, planning, carrying out, and financing the costs of a board meeting, routine for most CDCs, is a major production for CEDC.

For board members of CEDC — who come from throughout the state — to meet for a day in a central location requires, for some, up to a week for

round-trip travel in good weather, probably averaging three days for most members. The native population, whose representatives constitute a majority of the CEDC board, live for the most part in remote villages served only by private charter aircraft. To make connections with infrequently scheduled domestic flights in some areas often requires a one- or two-day layover. Flights are often cancelled due to inclement weather. The cost of travel by air is extremely high, and expense to CEDC is increased by the necessity to provide living expenses for board members throughout their trips.

Problems caused by geography and weather are compounded by the lack of modern facilities and services. Communication with many of the villages is by citizen-band radio or infrequent mail service. Where other CDCs can simply arrange a conference call of board members in a crisis, most CEDC board members live in distant villages where there are no phones. The limited range of the radio transmissions requires messages to be relayed from one village to another, with the sender often not knowing for hours or even days whether his message has been received.

For these and many other reasons, CEDC must plan far ahead for its needed board and committee meetings and delay full resolution of the inevitable crisis situations longer than is desirable. While streamlined efficiency can never be achieved in the Alaskan environment, CEDC has minimized costs of board meetings and made effective use of time. Training sessions for board members are frequently planned in conjunction with board meetings. Meetings are held in different locations to accommodate members by rotation, and the timing of meetings is planned to adjust to the vagaries of weather and to the availability of members, as well as to the needs of the organization. Despite the difficulties, CEDC is committed to a full involvement of its board in all major policy and funding decisions.

Alaskan Poverty

A sampling of Alaskan demographics, living conditions, and services reveals other unusual characteristics of the state that inevitably influence CEDC policies and practices. A rapid increase in immigration in recent years—tied largely to the Alaska pipeline and related development—has brought the total population to over 400,000. Most of the poverty continues, however, to be centered among the 53,000 or so (1970 census) Native Alaskans still living in the state who are CEDC's primary constituents. Of this group, approximately 28,000 are Eskimos, 16,000 are Indians, and 6,500 are Aleuts, though each

group has many subgroups, with distinct cultures, languages, and other distinguishing features.

Most Native Alaskans are tied to a subsistence economy. They fish and hunt for food; in the more temperate portions of the state they can farm as well. Those who are generating a degree of income do so from fishing, mining, arts and crafts, agriculture, and provision of various services.

It is estimated that nearly 40 percent of all Native Alaskans live in poverty. The median income in 1970 of those Native Alaskans living in small rural villages, usually of between 100 to 400 people (CEDC does not serve the urban areas of Anchorage, Fairbanks, Juneau, Sitka, and Ketchikan), was \$916 per year, which is among the lowest in the western hemisphere.

Living, as they do, nowhere near facilities or services, Alaska's rural poor are often without electricity, water, sewerage, medical care, transportation, and adequate housing. The cost of food and medical supplies in most villages (and throughout Alaska's urban sector as well) is astronomical. The quality of education, despite the efforts of the often maligned Bureau of Indian Affairs, has been generally dismal. Job opportunities are either nonexistent or, at best, seasonal for most villagers. Moreover, because of their minority status and geographical isolation, Native Alaskans are frequently overlooked in the distribution of services and self-help programs.

Rural communities within Alaska are generally unable themselves to provide the community services that are normally available in larger towns: their population base is not large enough to generate revenues sufficient to support these services. Liquor sales and bingo receipts bring most rural communities the bulk of their limited revenues.

Nondalton Village

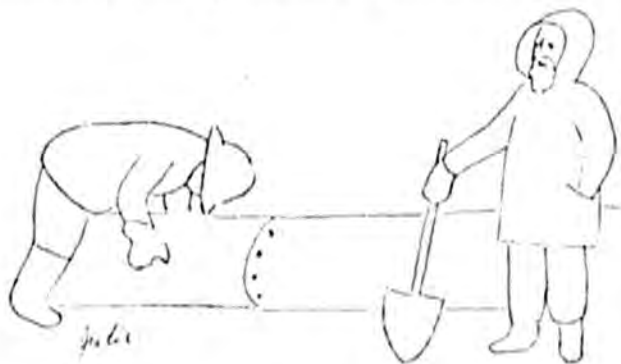
Because the villages are isolated, have different subsistence patterns, and are populated by different ethnic groups, there may not be a "typical" village. But the similarities among them are strong, and many problems and needs are shared by all the villages in rural Alaska. One example, therefore, can serve to give the general picture.

The village of Nondalton has a population of about 200 people, 99 percent of whom are Athabascan Indian. It is located at the base of small mountains, on the shore of the "Six-Mile" conclusion of Lake Clark in the Bristol Bay region. There are approximately 30 families in the village, most of whom live in wood-frame houses built of timber from the surrounding area.

There is one road, from the airstrip to the town. The airstrip is gravel, 2,300 feet long, and unlighted. The village is fortunate to have an air taxi service available from Iliamna, a town 20 minutes distant by air; the Twin Otter plane is the only cargo plane which can be accommodated by the airstrip. In the summer, there is access to the village by boat via Lake Clark, and by foot from the lake to the village.

The village has two commercial businesses, both of which are retail stores. One is a privately owned store selling groceries, snow machines, and some hardware. It also shows movies and has a pool table. The other store is a CEDC-backed cooperative, selling groceries, hardware, clothing, and snow machines and parts; it plans eventually to sell outboard motors.

Villagers obtain from 30 percent to 70 percent of their food by hunting caribou, moose, and small game, and by fishing. There are few opportunities for regular employment in the village; the existing possibilities are provided primarily by government agencies. Other employment is seasonal, and includes fire fighting in the summer months, as well as occasional guiding of outside hunters and fishermen.



An Era of Change

While Alaskan poverty has been a constant, CEDC also works in an environment marked by rapid change. The development of the pipeline is having a major effect on population shifts, the overall Alaskan economy, and the land. Speculation abounds about other major oil reserves available to be tapped in the state and the potential for new industries. Alaska is rich in natural resources that are still in the early stages of development. The Alaskan frontier is now being traveled by profiteering interests as well as by those more traditional rugged individualists seeking to make a new life.

The encroachment of the profit-motivated cash economy on the native way of life, recently

accelerated by the rush to tap Alaskan oil, has been going on for some time. Until passage of the Alaska Native Claims Settlement Act in 1971—which provides considerable funds for investment in income-generating activities to twelve regional (plus a number of individual village) corporations controlled by native interests—native villages and their way of life were threatened with virtual extinction.* Now, some believe, despite the Act's limitations and the geographic barriers to development, Alaska's rapid change can be influenced by native people, reversing the traditional exploitation of the indigenous population. Increasingly, native spokespersons are insisting on the right to guide their own evolution.

CEDC's Direction

If there is a long-range goal inherent in CEDC's efforts, it is that the organization wishes to insure the preservation and enhancement of the positive values of native independence—the people's cultures, identity, and environment—through economic development strategies, so that any change is in a direction they desire and can absorb.

Within that context, in the short run, CEDC's objectives are modest and practical. Emphasis is placed on making sure and steady progress in villages through financial and technical support of rural businesses desired and planned for by the residents. Every enterprise applying for assistance from CEDC must first demonstrate that it is a community-based business located in the target area of CEDC and must show that its members fall within the CSA poverty guidelines, thus providing for representation from the low-income segment of the population—CEDC's true constituency.

To insure that the greatest number of people will benefit from the program, the board of directors only

approves assistance to those businesses with broad community ownership. Since 1968, CEDC has assisted over 60 community-owned businesses throughout the state, including such industries as fish processing, consumer stores, hotel/motel complexes, fuel distribution, construction, specialty foods, and credit unions. Because of the extremely high-risk nature of rural businesses in Alaska, the inaccessibility of potential collateral to financial institutions in urban centers, and limited management expertise, commercial banks rarely provide funds to rural businesses. Other federal programs are limited both in scope and willingness to assist native villagers in ventures planned by the people themselves. Even where money is provided, it is seldom accompanied by the necessary technical assistance.

Examples of some of the ventures CEDC has assisted follow.

The *Norton Sound Fishermen's Co-op* at Unalakleet (population 434) purchased the local processing plant for its first year of operation in 1974. They bought local fish, as well as fish from nearby villages, and moved a total of 710,000 lbs. of dressed salmon through their operation that first year.

The *Bering Straits Federal Credit Union*, located in Nome, was chartered in July 1974, to serve as a savings and loan organization for approximately 7,000 Native Alaskans enrolled in the Bering Straits region. Its primary concern is to provide low-cost credit and financial independence from high-cost financial institutions. The credit union is providing the experience and tools necessary to aid the transition from a subsistence to a cash economy. Initial funds included deposits from village corporations, land allotment deposits, and CEDC financial participation of \$31,700. As of the end of September 1975, the credit union had 870 members.

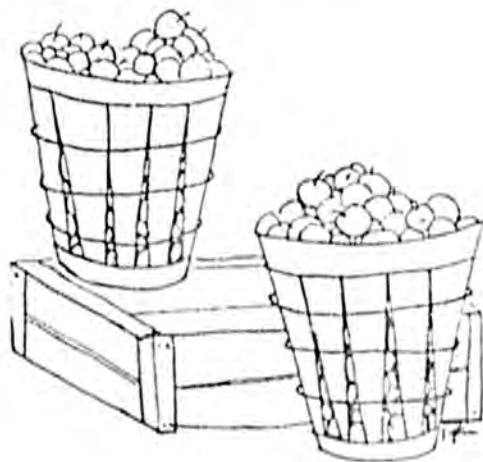
The *Innuik Cooperative*, the "People's Co-op," of Beaver, is a village-owned retail cooperative located 100 air miles north of Fairbanks. It was organized by the residents to buy out the only store in the community, which had ceased operating in the fall of 1973. The co-op, which opened its doors for business in September 1974, hoped to lower the cost of groceries and to provide better service. CEDC provided \$33,000 in funds, and the remainder was contributed by the village, whose 100 residents have a high degree of interest in the co-op. Gross sales in 1975 were \$57,991.

* The Act divides the state into 12 regions (called Alaska Native Claims Settlement Act [ANCSA] regions), and provides for organization under the laws of Alaska of a native regional corporation in each region. Each native in the region will receive 100 shares of stock in the corporation, whose assets include the cash settlement from the U.S. Treasury, mineral revenues, fee title to the land, and income from the investment of the cash and management of the property. A certain percentage of the funds (not less than 45 percent the first year and 50 percent thereafter) that are not invested for the production of income must be distributed to the villages in the region and to the stockholders. Each corporation is authorized to approve or disapprove village plans for the use of the distributed funds.

Yakutat Gulf Fishing Company, Inc., is located 210 air miles northwest of Juneau, in the village of Yakutat, which has a population of 190. Founded in October 1973, the company enables local fishermen to compete with the larger vessels coming into the area from Canada and the "lower 48." It arranged for the construction and financing of a 58-foot limit sloop ("Gulf Queen"), which began its fishing operations in late 1974, harvesting the dungeness, tanner, and queen crab. CEDC's financial participation amounted to \$165,000. Other financing was provided through a bank loan and by owners of the corporation. In 1975, gross sales were \$93,951, which represented a slight loss due to a poor harvest, but the venture has continued to meet its bank payments.

Akuliak, Inc., is a retail fuel distribution cooperative located in Selawik, (a village of 429), 73 air miles east of Kotzebue. Through consignment arrangements with the regional fuel distributor, a bank loan, and a \$40,000 CEDC investment, the village was able to buy out the company that was operating the venture. Gross sales of \$69,000 were projected for its first year of operation, and have continued in this range.

Wildwood Village Grocery, Inc., is a subsidiary corporation of the Kenai Native Association, a village corporation formed under the Alaska Native Claims Settlement Act in the 3,533-resident area. The KNA formed the subsidiary to buy out a privately owned case-lot and retail operation located in Wildwood Station. The grocery will provide a steady source of income for KNA and also will provide training for natives in managerial and occupational skills. CEDC invested \$100,000 in the project in 1974; KNA contributed the balance. Gross sales for 1975 were \$626,688.



CEDC, by operating as a traditional CDC, thus plays a unique role in the state. However, its limited resources cannot be scattered in too many directions. As with other CDCs, CEDC has had to set priorities. For the foreseeable future, its funds will continue to support the priorities of the past few years—an increasing number of fishing cooperatives and co-op stores.

These stores are often the villages' only retail outlets. In those villages that do have a store other than CEDC's, the merchandise selection is usually poor, management routinely incompetent, and prices high. CEDC both finances and offers technical support to its stores to help overcome these deficiencies. Through a centralized expediting arrangement, which has grown into a full-scale operation, it has been able to improve delivery; make bulk purchases of groceries, outboard motors, snow machines, tools, and appliances, at lowered costs for stores; and help with merchandising. Through its operations division and training program, it has increased village competencies in management and accounting. Most stores are showing a profit and their outlook is sound. About six new retail outlets in villages not now served will be supported in the next two years.

Fisheries Development

While the stores provide a needed service and increase the ability of villages to deal with and manage their involvement in the cash economy, CEDC's fisheries are a more central strategy in providing the means for eventual village self-sufficiency. Commercial fishing is of tremendous importance to many rural Alaskan communities. Many coastal and inland river village residents rely on this industry for the major part of their annual income.

Still, the greatest profits from Alaskan fishing go to large firms from outside the state, for processing and marketing activities. Natives have long been employed for seasonal work at low wages, or paid unfair prices for their catch, by these corporate interests. Many villages have also been dependent on and trapped in an Alaskan version of the company town, with residents in bondage to the corporations.

During the past few years, several rural communities, with CEDC's assistance, have attempted to gain more control over the fishing resources near them. In 1974, five commercial fishing ventures owned by low-income rural residents were functioning in the communities of Kotzebue, Golovin, Unalakleet, Emmonak, and Bethel. Since that time, several other communities have organized to operate

similar ventures, and more will be aided in the next two years.

Already, CEDC's work has helped to boost the prices paid to village fishermen and to offer an improved source of employment. Many of the ventures have generated ancillary projects that have created local sanitation, water, fuel, and electrical supplies for both processing facilities and the communities.

Commercial fishing in Alaska will continue to be a mainstay of the economy. Through a state "renewable resource fund," financed from receipts for leases to permit oil, gas, and other mineral development, at least \$50 million annually will be spent on commercial fisheries enhancement programs, beginning in 1977. The long-term decline in salmon runs is expected to be reversed by this state investment and by other factors such as enforcement of new offshore fishing limits on boats of other nations. CEDC will continue to aid rural communities in developing fishery-related enterprises that will allow them to obtain a larger share of the \$200-\$300 million annual wholesale value of this industry's sales.

CEDC Benefits

In its seven years of operation, CEDC has benefited rural communities in a number of ways. CEDC-assisted ventures have brought money and/or cost savings into rural communities. Salaries and wages paid by these enterprises totaled \$1,048,723 in 1975. This, together with part time work in construction, represents a substantial sum in communities that previously had limited job opportunities. Fishing enterprises have increased prices for the fishermen and improved markets for their products. Arts and crafts cooperatives have also brought increased prices for the participants. Retail cooperatives and credit unions have reduced the cost of goods and borrowed funds, sometimes by as much as 50 percent, stretching limited incomes over more goods and services.

Various training assistance is available for CEDC-assisted ventures. Board training is given to ventures when first incorporated and on a periodic basis thereafter. CEDC also offers a management and bookkeeping program for venture employees, as well as specialized training when necessary (for example, courses in refrigeration repair and boat maintenance were organized with other agencies).

The experience of project development is also a form of training. As the residents learn why steps such as incorporation are taken and understand the ramifications of their decisions, they are enabled to develop independent projects in the future.

CEDC is also a resource that villagers draw on to control the development of their community. Lacking very basic community services, many villagers do not have the wherewithal to effect economic development. With CEDC assistance, then, some villages set up retail stores and petroleum distribution businesses to establish an economic foundation. Other villages have obtained CEDC assistance to control resources such as fisheries that otherwise would have been developed by outside firms, thus insuring that local resource development benefits the residents and not just outside investors.

The development of community-owned ventures also attracts funds from other agencies. A CEDC investment within a community is an indication to such agencies that the village is stable or growing and is therefore a good investment. Sometimes other agency funds are obtained to supplement CEDC funds—for example, the Alaska State Rural Development Assistance will provide labor monies to assist in the construction of a CEDC retail store.

A Future for Rural Alaska

CEDC's board of directors and its membership help ensure local control of and benefit from CEDC's development activities. Of the 30-member board, 20 seats are held by representatives of the community-based enterprises CEDC has assisted; 7 seats are held by the representatives of the 12 ANSCA regional corporations and rural CAP regional corporations combined; and 3 seats are filled by representatives from the Alaska business community. The board meets 3 times a year, unless a special meeting is called.

The membership represents the same divisions of the board: one member from each organization CEDC has assisted, each of the rural Alaska CAP corporations, and each of the 12 regional corporations, plus three business representatives. All of these members are responsible for reporting back to their organizations on CEDC's activities. The largest block of CEDC members, therefore, is composed of representatives of community enterprises. By this large representation, CEDC is controlled and directed by those people whom it is designed to serve. The membership meets at least once a year—to elect the board and process any relevant business.

CEDC's past record of success in assisting fisheries, co-op stores, and other ventures is only a beginning, according to its director and chief operating officer, Jerry Nelson. Nelson, one of 25 remaining Eyak-speaking Indians, has been with

CEDC for four years, the past three as director. He feels that CEDC is "finally at the line where [it] can start running." With a positive outlook and a quiet determination and persistence rooted in his native heritage, Nelson looks to Alaska's future, and that of its native people, as one to be shaped and influenced. He plans to insure that CEDC plays its part in an effective manner, not overreaching, but steadily and surely pressing toward its goals.

CEDC's future, intimately bound up as it is with the struggle of Native Alaskans and the challenge and excitement of the state's development, will be instructive to follow for all those concerned with social change.

Lawrence Parachini

Pennsylvania's Neighborhood Assistance Program

A unique program designed to benefit both neighborhoods and corporations is now operating out of the Department of Community Affairs in Pennsylvania. Created by state law in 1967 and the first of its kind in the country, the Neighborhood Assistance Program provides credits on state corporate taxes for businesses that contribute money or other resources to development activities that help needy families or communities. By becoming involved either directly or indirectly, business and industry benefit from the program's substantial financial incentives and better their community at the same time.

How Does It Work?

A corporation may sponsor its own project or contribute to a nonprofit community organization for a specific program approved by the state Department of Community Affairs. The contribution may be in the form of financial help, labor, materials, and/or technical advice. Up to 50 percent of the contribution can then be used as a credit applied against either the state's corporate net income tax, mutual thrift institutions tax, shares tax, or gross premium tax.

The Department of Community Affairs has the authority to approve a total of \$8.75 million in tax credits annually, with the total credit for any one firm limited to \$175,000 a year. The tax credit is available for use for five years from the date of the contribution.

What Does It Cost?

The "cost" of a charitable contribution, when weighed against the tax savings it makes possible, will, of course, vary from firm to firm and year to year.

However, in general, the cost of a contribution to a Neighborhood Assistance Program is less than the cost of a normal charitable contribution because of the large writeoff permitted on state corporate taxes.

In the table below, a sample contribution is made at current state and federal tax rates for a firm with \$200,000 before-tax income which wants to make a \$10,000 charitable contribution. The computation shows that it would normally "cost" the firm \$4,706 in actual cash to make such a contribution, but that the cost goes down to \$2,106 when the contribution is made through Neighborhood Assistance. In other words, for every dollar it contributes to a nonprofit agency or program, the firm would normally "spend" 47 cents, but under Neighborhood Assistance it is out of pocket only 21 cents.*

SAMPLE COMPUTATION

	No Contri- bution	Other Contri- bution	NAP Contri- bution
Income Before Contribution & Penna. C.N.I. Tax	\$200,000	\$200,000	\$200,000
Contribution Made	None	10,000	10,000
Federal Income Before C.N.I. Tax - Penna.	200,000	190,000	190,000
C.N.I. Tax (deduct) 9 1/2 %	19,000	18,050	13,050
Line 28 Fed. Form 1120	181,000	171,950	176,950
Fed. Tax 22% x 25,000	5,500	5,500	5,500
Fed. Tax 46% x 156,000	74,800		
Fed. Tax 46% x 146,950		70,536	
Fed. Tax 46% x 151,950			72,936
Total Fed. Tax	\$80,310	\$76,036	\$78,436
Cash Required			
Contribution	None	10,000	10,000
Fed. Taxes	80,310	76,036	78,436
Penna. C.N.I. Tax	19,000	18,050	13,050
Total Cash Required	\$99,310	\$104,086	\$101,486
Actual Cash Required to Contribute \$10,000	None	\$4,706	\$2,106

* The Governor of Pennsylvania recently signed legislation extending tax credits to 70 percent for certain priority programs. This will also raise the tax credit limitation for corporations making contributions to \$250,000. New regulations are expected to be in effect by the end of September, changing the calculations in the table.

3

Objectives, Types, and Accountability

William G. Shepherd

"Public enterprise" is a broad category, rather than a single type. It can be organized in many different ways, it can serve varying social objectives, and it can be put under many types of external controls.

This chapter extends the concepts of Chapter 2 by assembling and codifying some of these varieties. First I summarize the social objectives which public enterprises may serve. Then I explore what gives a public enterprise its *publicness*: this can include public ownership, management, control, subsidy, or still other criteria. I will define several types of public enterprise which combine these elements in distinctive ways. I will treat the "accountability" problem—the difficulties supervising public enterprises in such a way that their performance is aligned with the "public interest."

Objectives for Using Public Enterprise

Criteria

One may distinguish two broad groups of social objectives which public enterprises may serve.¹

1. First are the familiar *economic efficiency* criteria. They include mainly the following: internal efficiency, within the firm; allocative efficiency, among firms and markets; and optimal rates of innovation. *Equity* is also a criterion. These are usually served by competitive pricing and performance, in the main stream of industry, commerce, and services. Firms attain minimal profit rates while straining for efficiency and innovation and setting nondiscriminatory prices. The marginal Pareto conditions are reasonably approximated, so that prices are brought toward equality with long-run marginal costs (see also Chapter 4). Investment is carried to corresponding efficient margins, where prospective returns—discounted for the main risks—are at least roughly in line with the true cost of capital.²

These rules are not universally binding or easy to apply. Deviant conditions in other sectors may require adjustments in these criteria, in practice. Also, there are many finer points, some still far from settled. The definition of marginal cost, especially in the presence of variable demand, often poses severe practical

problems.³ Still, the main lines of efficient pricing, investment, and innovation are reasonably well settled and clear. They are the central core of social criteria, the first approximations from which other more specific objectives may depart.

2. *Specific social aims* are of many sorts, usually involving an external effect or a specific benefit for some worthy or needy group. They often entail structural changes or social adjustments. A system providing comprehensive health care is one example; another is urban transit systems which are designed to fit interactions among bus, subway, train, bridge, parking, and highway pricing; still another is rural development by the likes of the Tennessee Valley Authority; yet another is a public opera house or library, with "cultural" effects.

These two categories do not exhaust the reasons for using public enterprise, though they include the criteria with which economists are familiar. In addition, societies may, and do, create public enterprises simply because they prefer to, as a sheer expression of cultural choice. Sovereignty is also a common reason; "sensitive" firms and services are often made public in order to protect against foreign control (or against internal rebellion).⁴ These cultural and random reasons are often more decisive than the technical economic criteria. That is attested to by the great variety among countries which Chapter 1 showed.

Enterprises and Sectors

The objectives of public enterprise bear on specific parts of the economy. *Economic efficiency* criteria apply primarily in the mainstream financial, industrial and utility sectors. These markets commonly have no big social or external effects; those that do arise are often balanced out in the flux of adjustments among markets. When they are reasonably competitive, these markets usually approximate the optimum for internal efficiency, allocative efficiency, and innovation.

Deviations occur primarily when there is excess market power which *persists*. The resulting economic losses can be large, and in western economies they are known to be appreciable.⁴ Thus, for example, there is a core of major U.S. industries with excessive degrees of monopoly, and the net, continuing loss is probably over 3 percent of national income each year (some estimates go even higher). Other national economies may have comparable conditions and losses. Where such deviance is not self-correcting and also seems intractable to antitrust and regulatory treatment, some version of public enterprise may be an efficient treatment (or at least part of one).⁵

Such monopoly problems often are sustained by connections between banking and industrial firms. These *banking relationships* are presented more

⁴This internal security aspect is often important. Broadcasting, aircraft, airports, and certain other "key" facilities are prime targets for *coups*. In politically unstable countries, their control via public ownership can be important to the current government.

fully in Chapter 8, but the main lines deserve mention here.⁶ Private industrial firms usually have a primary banking relationship with one bank (or, at most, several). These banking relationships are often deep and lasting. Such ties are likely to strengthen market power in industrial markets themselves. They tend to reduce competition by smaller firms and by new competitors. Dominant firms in major industries are often able to retain their positions mainly because they are backed by major banks. Correctives for this often must include some treatment of the banking relationships, or some replacement of them. The criteria for using public enterprises in financial markets therefore include the effects which banking relationships have on the basic extent and effects of market power throughout the *rest* of the economy.

These industrial and financial conditions are normal and central in modern economies. By comparison, most "utility" sectors are relatively small and peripheral, yet also highly capital intensive.⁷ Therefore, in principle, they can be treated fairly effectively by economic regulation, with little or no need to put them under public ownership or management.⁸ On the whole, public ownership of utilities may yield little social gain, compared to the large commitment of public capital, administrative ability, and indirect subsidies. Therefore, the strictly economic case for public enterprise in utility sectors is—despite common beliefs to the contrary—relatively weak.⁹ Still, other noneconomic reasons may be decisive. Utilities are often "basic." Some are also crucial to ultimate political power, for a society can normally be immobilized or captured by seizing control of its economic infrastructure (e.g., power systems, railroads, communications). Therefore, public enterprise in utility sectors can often be seen as asserting the social power or "cultural preference" use of public enterprise, rather than achieving the narrower economic benefits which are usually proposed.

In short, the natural place for public firms to serve the standard economic objectives is in standard financial and industrial markets, following standard commercial criteria of profits, pricing, and investment. It is also true that conventional public firms are socially desirable mainly in these mainstream markets. In utilities (and perhaps certain "key" industrial firms), there may also be social gains.

Broader social objectives are more varied and controversial than the standard economic ones. They differ among societies, often sharply. They also change over time, as sectors shift and the economy proceeds through stages of development, industrial growth, and postindustrial adjustment.

The main lesson is that these social objectives are germane primarily *outside* the standard financial and industrial sectors. They are served mainly by social enterprises which depart from the conventional economic criteria (profits, pricing and investment, etc.). These enterprises often are subsidized, even totally (as in public schooling). The degree and terms of the subsidy are often the crucial choice. Such social enterprises still pose standard issues of management, competition, investment, and economic behavior. But the social aspects require

major departures. Some degree and form of public enterprise is appropriate. The task is to maintain the standard lines of efficient enterprise behavior while also achieving the "social" departures.

More on the Publicness of Public Enterprise

Evidently, there can be great variety among the proper uses of public enterprise. We will now analyze this variety.

The main elements which define the publicness of a public enterprise are codified in Table 3-1. The two most basic elements are public *cost* and public *control*. Cost can be negative or positive; a public firm can accrue deficits—as many do—or *profits*. Cost also subdivides into several parts: the two main ones are (1) current subsidies, and (2) the provision of capital (either by direct grant from the Treasury or by a public guarantee of securities sold on private markets). *Control* is highly variable, as we will explore.

A third possible element is *management*. Yet this need not be public, in a "public" firm. Thus, many public enterprises contract all or part of their management to private units (an example is the three U.S. uranium-enrichment plants that operate under contract by two private firms).

Two other elements—the degree of *monopoly* and the scope of *geographical coverage* (from local to national)—also help to define a public enterprise. Public firms exhibit much the same performance defects under monopoly that private firms do. Competition is often entirely compatible with the other elements of publicness. And public firms can be purely local, unified nationally, or any variation in between (e.g., regional, or unified but decentralized in operations).

In short, there is great variety within the category labeled "public enterprise," along at least five dimensions. Some public enterprises are indeed, scarcely recognizable as being *public*. The category shades, on one side, over into fully

Table 3-1
Criteria Defining Public Enterprises

<i>Condition</i>	<i>Possible Range of Variation</i>
Degree of Subsidy Current Capital	From Total Subsidy to, to Generation of Large Profits by, the Enterprise
Degree of Public Control Ownership	From Nil to Complete From Nil to Completely Public
Management	From Wholly Private to Wholly Public
Degree of Monopoly	From Nil to Pure Monopoly
Geographical Scope	From Local to National

and quasi-private firms; and on the other, into public "programs" and "departments." Note that public ownership is only one element of public enterprise, though it has often been regarded as the only element. "Nationalization" also is a special subcategory within the varieties of public enterprise; it is only an extreme geographical form, which differs from local and regional enterprises. A "national" firm in a small country would often be little more than "local" within a large one. "Nationalization" is often scarcely comparable between European countries and the U.S.

The possible varieties of public enterprises are nearly infinite, and actual cases are certainly diverse.¹⁰ Yet there are several main types, which help to sort out the variety. The three most common versions are:

1. *The conventional public corporation*¹¹ is commonly in a "utility" or heavy industry, with high capital intensity. Its degrees of public ownership and monopoly are total, or nearly so. Its capital is usually supplied directly by the Treasury, and—despite a degree of formal autonomy—the government does influence (or even control) some policies. When these outside interventions are large, and when the market is shrinking, the public firm often has financial deficits.

2. *Financial public enterprises* are public banks that range from standard deposit and clearing banks to special lending units and insurance systems; they can also be public investment banks (they are discussed further in Chapter 8). The investment banks are distinctive in several ways. They have partial holdings and can often shift these holdings flexibly. They are usually independent and unsubsidized. They are a newer type, with several subcategories, and their experience is growing. Some are directed to specific aims: to assist mergers, foster small business, or protect national sovereignty, for example. Others are simply general-purpose investment banks, free to follow commercial opportunities. Such public investment banking has recently grown, but it is still experimental.

3. *Social enterprises* come in a wide array of purposes and conditions, often with a degree of subsidy and direct governmental control, but also ranging into independent and self-sustaining social enterprises. These too are evolving in many ways, and they are an important part of all governmental activity. They can usefully be evaluated and predicted as public enterprises, rather than just as units of public finance, as they traditionally have been. Indeed, their defects often arise from neglect of the fact that they are *enterprises*, with (1) inputs, (2) a production process which needs to be managed, costed, and evolved, (3) outputs (physical units or services), (4) demand characteristics, much like those of standard enterprises, and (5) market positions and monopoly characteristics.

These three main types, plus other lesser ones, are all public enterprises, but in varying degrees and ways. What, in light of Henry Tulken's analysis in Chapter 2, shows their publicness? It is not just public ownership, though ownership is

perhaps the most tangible element. Publicness resides in no single element, but rather in the more general condition: the degree to which society collectively alters an enterprise's performance away from private commercial lines. This is often a complex matter, involving (1) subtle definitions of private and public performance, and (2) several attributes of the enterprise (ownership, subsidy, control, management, etc., as noted earlier). Public ownership and/or subsidies may be high, and yet the publicness of the outcome may be small. Publicness therefore involves both structure, cost and performance.

A simpler index would be preferable, and indeed public *ownership* is often a useful first approximation. Yet publicness is usually much more complex and subtle. Public *ownership* is not necessarily co-equal with publicness; publicly owned enterprises can be essentially private in behavior and *antipublic* in their performance. Publicness resides in control and behavior as well as formal ownership. We need to work toward a more comprehensive definition of publicness. In the meantime, one needs to use language carefully in discussing public enterprise.

These semantic points can have great practical force. A fixation on ownership alone can lead—and has led—societies to create public enterprises solely by asserting complete formal state ownership—by spending public capital—while neglecting all the other elements of publicness, including the public guidance of the firm along optimal lines. The conventional public corporation often reflects this fixation, which excludes the other choices and may tend to *maximize* certain public costs.

Optimal policy often requires just the opposite from public enterprise. One can define an *optimal* public enterprise as providing the largest net social benefits (in increased efficiency of various sorts, equity, and perhaps other objectives: recall the beginning of this chapter) for a given commitment of public resource *costs*. One *minimizes* the public cost (including ownership) for any given set of benefits.

Another way to classify public enterprises is to group them into polar categories, which either fit or conflict with standard criteria of the public interest. Several such polar categories—of relatively optimal and nonoptimal public enterprises—can be identified from the whole range of variety.

Three Negative Types

First, consider three relatively negative types.

1. *Public sponsorship of activities used mainly by the wealthy.* The variety of these is wide. Obvious examples include many subsidized programs for performing arts, much suburban commuter service, and tax support of university education for children from upper economic levels. The judicial system, in the context of unequal access to legal counsel, can often be regarded as a complex

set of public enterprises which have largely a regressive incidence. Some of the defects could be corrected by altering the pricing and other rules of these units.

2. *The "sick-industry" public firm.* It often uses large volumes of capital and sells primarily to private firms and other unneedy consumers. Since the sickness is often industrywide (with externalities outside the plants but internal to the industry), the public firm is commonly a centralized monopoly financed by the Treasury. There are also external impacts, from closures of plants, new technology, etc. But governments usually find it expedient to leave these local problems as burdens upon the public firm; which then finds it necessary to slow the closures and cross-subsidize the losing parts.¹² The government often intervenes to *limit* price rises and to *increase* wage rises. The main beneficiaries of the public-firm treatment are industrial users and equipment suppliers. The resulting financial losses, redundancy, and demoralization within the public firm are often severe.

3. *The capital-intensive "utility" monopoly* (such as electricity and telephones). It may be "healthy," since its revenues cover costs (often because of excess demand) and there are few big external effects (such as pollution) or social impacts. Yet these enterprises absorb large amounts of capital and administrative talent. The net social gains are often minor and mainly taken by private firms and upper economic groups.¹³ The lack of competitive constraints might breed internal inefficiency, which is just as great as is believed to occur in private utilities under regulation in the U.S. (see Chapter 6). A switch to private bond financing can abate much of these public firms' drain on public funds. But the other costs persist, and the economic and social yields often are marginal.

Many public enterprises in these three categories probably should—on conventional social criteria—be cut back, revised in format, constrained, and put on difference pricing and investment policies. Their objectives are often unclear and their use of tools inefficient. Their defects are primarily: excessive degrees of public ownership and monopoly, drainage of public funds, regressive pricing, neglect of externalities, and rigidity of form.

Four Positive Types

By contrast, certain more optimal kinds of public enterprises have tight constraints (by competition or budgetary control), a sparing use of public funds and talent, a progressive incidence, allowances for external effects, and flexibility in arrangements. They tend to be experiments with short lives, rather than permanent fixtures.

1. *A public-firm competitor.* It may have a third or less of the market and, in most cases, some mixture of private-public ownership and motivation. It can force improved pricing and efficiency in tight-oligopoly markets.¹⁴ Its threat of taking over still other firms in other tight-oligopoly markets can extend its

effects and indirectly induce better performance more widely. (This type is discussed in Chapters 6 through 8.)

2. *A public entity exerting monopsony power against private market power which appears to be beyond other public constraints.* An example of this is a national health service as a unified buyer of drugs from private companies. Utility public firms (electricity, telephones) also can and do exercise monopsony power. Military weapons purchases occasionally, but not consistently, are done on this basis. Public purchases are extensive and varied, and so this kind of effect can be important.

3. *Activities with high, progressive benefits spread widely throughout society.* A downtown public library is the obvious example, as is the provision of good-quality legal services to poor people. Programs stopping contagious disease are another example, as is universal primary schooling (if properly structured and priced) and possibly nursery care. The social-critic and innovator aspects of public universities are also of this sort.

4. *Units whose outputs go mainly to upper-wealth groups, which maximize profits.* Prime examples are state universities, performing arts programs, and high quality medical care, if they are properly priced. This can be done by a careful use of price discrimination. (This group is the mirror image of the first negative type.) The objective is a progressive incidence consistent with the usual efficiency criteria.

Between these polar categories lie many mixed cases.¹⁵ For example, the U.S. social security insurance system is a public enterprise which yields certain high benefits. But the incidence of its financing and benefits is regressive. Certain hospital and health-insurance enterprises (including Medicare, Medicaid, and others) have been lax toward inefficiency or even directly induced it. Public housing projects have had a number of bad effects—because of excessive size, and poor location and design—which could probably be avoided. The three U.S. uranium-enrichment plants have absorbed large amounts of public capital, while subsidizing a narrow group of large firms and utilities which use their services. In most cases such as these, it is the policies which are incorrect, not the mere fact of public enterprise.

Therefore revisions may be appropriate in most existing public enterprises, to prune out barren cases and free resources for good ones. One cannot predict whether such changes toward optimality would expand or shrink the whole extent of public enterprise.

Accountability and the Control Process

A cardinal lesson, therefore, is that the mere creation of a public firm does not assure—or even define—the optimal solution for a market or problem. That solution must often be formulated and guided from outside. It must always at least be monitored, for public firms can deviate widely from the public interest.

This is the "accountability" problem. It is highly complex, but there has been little thorough analytical study of it.¹⁶ It does have important economic aspects. As with public regulation of private firms, there is difficulty in allocating cause and effect—that is, assigning the responsibility for the economic outcomes—between the public firm and the government which supervises and influences it.

There is usually a natural conflict between (1) outside accountability and (2) internal flexibility and innovation by the public enterprise. This opposition is not complete. Yet outside controls commonly do cause rigidity and chill the ability of the public enterprise to adapt and create.

The basic condition is one of *bilateral monopoly* between the public enterprise and the government which supervises it. The interests of the firm are not necessarily congruent with those of the government and/or the larger public interest which the government supposedly represents. Each side—firm and government—has specific motivations, inner conditions, and outside constraints of its own. Each also has a version of the public interest which it regards itself as serving, along with its own internal interests. The actual outcomes will reflect the mutual adjustment of these conditions. The outcomes also reflect the particular structure and economic setting of the public enterprise.

The typical setting of a public firm involves a degree of "regulation" and also some competitive elements. Therefore, the public enterprise is commonly not exempt from the familiar conditions of regulation and antitrust. Often it will be deeply involved with them. For example, the U.S. Postal Service is regulated, in some degree, and it faces competition—and vertical bargaining power—in parcels and other operations. Informally or formally, nearly *all* public enterprises are regulated. And nearly all face—or would face, if it were not officially excluded—competition on all or part of their activities. Once again: public enterprise is a substitute for private *ownership*, not for the other regulatory and antitrust policy treatments.

In addition, there will often be interdependencies and external effects. The supervising public authority will seek to integrate the public firm's operation with other conditions and objectives, some of which arise in *other* public firms (e.g., among transit units in a city). This often involves a degree of shadow pricing and complex "coordination"—of merging some operations of the public firms within larger objectives.

Figure 3-1 indicates the usual setting of a public enterprise. It is surrounded by interest groups, including various parts of the government itself. The public enterprise is naturally likely to respond to all the pressures upon it. In turn the government agencies will seek to change the form and setting of the public enterprise as their own interests evolve. Most public enterprises have a degree of continuity in their top officers and staff members which exceeds that of their official supervisors and regulators. Most top government officials are in and out within two or three years, while the heads of public firms rise in the ranks and stay in office long enough to know—and control—the ropes. This can be partly

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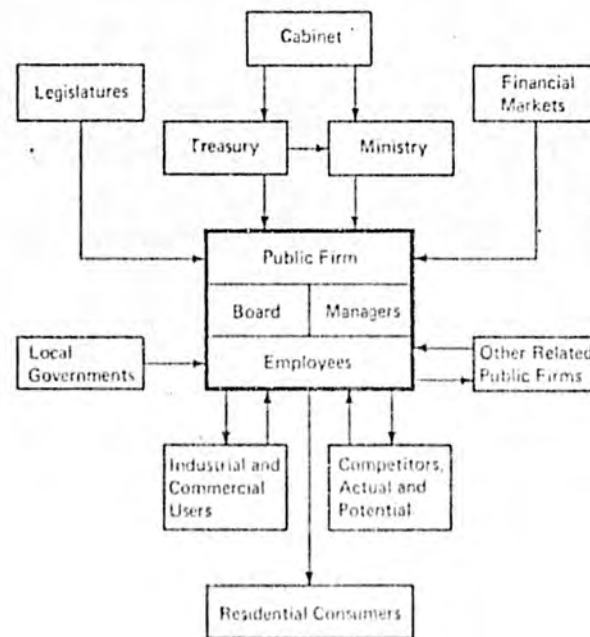


Figure 3-1. The Setting of a Typical Public Enterprise.

offset by the fact that the upper civil servants in the government agencies also tend to last. Therefore the relative continuity and cohesion within the two sides can vary and may often be about equal. Still, a public enterprise typically contains a strong and continuing set of interests over which the supervising agency—because of its own inner flux—often is able to exert relatively little control.

The Role of Accounts

That control is usually based on (1) the actual accounts of the enterprise and (2) an informal interaction process. There are many of the same difficulties which arise under public *regulation* of private firms and, indeed, under *antitrust* attempts to investigate and treat monopoly conditions.¹⁷ For all these policies, the enterprise's accounts are usually very important. They reveal to the outside, on a tangible basis, what the enterprise has done. Such exposure forces the enterprise to bring its activities—or, at least, those which are shown in the accounts—at least partially in line with what the supervising agency and other outside powers wish to occur. This pressure works by anticipation, as well as retrospectively. Therefore the accounts themselves—financial, physical, and other—are a powerful device by which the supervising agency exerts control.