SCOMM

#9:116

Alaska State Legislature
House

JUNEAU ALASKA

May 26, 1977

MEMO TO: PAT COSTELLO, ADMINISTRATIVE SERVICES

FROM: CLARK GRUENING

RE: REP. MILES TUITION AND TRAVEL TO HARVARD GRADUATE SCHOOL

Representative Bill Miles will be attending a course entitled "Non-traditional Techniques for Local Economic Development" at the Harvard Graduate School of Design June 6 through June 10, 1977. He will be traveling from Anchorage on June 5 and returning from Boston on June 12. I hereby authorize payment for his tuition, travel and perdiem to be paid out of Permanent Fund FY 77.

Clark Gruening

Rep. Clark Gruening, Chairman
House Special Committee on Alaska Permanent Fund

PLICATION

Please complete this form and mail with a $50. deposit
urse to:

Continuing Education Program
Harvard Graduate School of Design
Gund Hall L-36
Cambridge, MA 02138
(617) 495-2578

/Ms. Rep. Bill Miles
PLEASE PRINT

e Alaska State Representative

siness Address Pouch V
Juneau, Alaska 99811

ZIP

siness Telephone (907) 465-3734

HGSD or MIT School of Architecture and Planning Alumnus/a? Year and degree

Yes, please enroll me in the following course(s):

Nontraditional Techniques for
Local Economic Development

Maybe, I need more information. Please send outline(s) for the course(s) indicated below:

ase check one (refer to Accommodations section):
Yes, housing is needed. X
No, I will make my own arrangements.
Yes, enclosed is $10. for the campus garage permit.
Deposit enclosed ($50. per course)

g' enclosed $

ase make all checks payable to the HGSD Association.

GSD

THE MANAGEMENT OF DESIGN AND PLANNING FIRMS

This course is designed for those who by choice or recruitment find themselves in managerial positions in design and planning firms. The goal is to offer these professionals a better understanding of the issues confronting managers; a sense of which problems are unique, and which ones plague the field as a whole; a methodology for analyzing management problems; and a range of techniques for solving these problems. A series of case studies will introduce participants to real, though often disguised, business situations. The course is structured to allow as much interaction among participants and faculty as possible, incorporating the managerial experiences of all the participants in the consideration of the case studies.

Course coordinator David M. Hirzel is a Lecturer on Landscape Architecture at GSD and Senior Associate and Executive Director of Sasaki Associates. James S. Reece is Assoc. Professor of Policy and Control, Graduate School of Business Administration, Univ. of Michigan. John A. Seiler is Vice President and Senior Consultant, Peter McLaughlin Assoc., Boston.

May 6 - May 13 Tuition: $650.00

AIR PHOTOGRAPHIC INTERPRETATION AND TERRAIN ANALYSIS

Thanks to the need for more accurate and reliable environmental data, a familiarity with air photographic techniques is a skill increasingly demanded of professionals in a range of environmentally-related fields, including planning, the government, engineering, design, preservation, and earth sciences. Given in cooperation with the American Society of Photogrammetry, this course is unique in that participants actually learn the procedure of air photographic interpretation, rather than attend lecture/descriptions of the interpretive process. The course covers remote sensing, landform classification and interpretation, data sources and acquisition, terrain analysis, and land use and vegetation interpretation.

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June 6 - June 10 Tuition: $400.00

NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT *

For years the favored method for improving a state's business climate has been through government subsidy of private enterprise. But as a growing body of academic literature makes clear these special financial arrangements do not create new jobs; they only redistribute money from the taxpayer's pocket to the business community. This course examines the practice of economic development at the state and local levels. Participants will review the history of state and local economic policies in the United States, and will consider a range of promising but nontraditional alternatives, including the Altshuler Plan, a proposal for profit-making public enterprise, and community development corporations.

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The focus of this course is the use of advanced computer-compatible techniques for analyzing land resources for planning and designing large, complex development projects. The course is designed to help participants from a variety of design, planning, engineering, and land management professions develop a methodology appropriate to their needs. The curriculum includes a technical survey of resource analysis methods; a survey of data needs, specifications, and inventory methods; and the use of a data bank and IMGRID, a recently developed, user-oriented computer program system for land analysis.

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June 20 - June 24 Tuition: $450.00

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

	Lv			Arr	
Brian 4/29	Juneau	7:15A	60AKA	Sea	10:15A
Sat 4/30	Sea	1:25P	UA150	Chic	7:10P
	Chic	8:00P	UA 128	Bradley	10:54P
Sat 4/30	Bradley	7:35A	AA59	JFK	8:16A
	JFK	7:30 P	AA464	Bradley	8:24P
Sun 5/1	Vermont by auto				
Mon 5/2	Boston by auto				
Tues 5/3	Bradley	8:00A	UA 123	Chic	9:10 A
	Chic	10:00A	UA 143	Sea	12:05P
	Sea	3:45P	AKA 69	Jnu	6:55P

vegetarian

Jim Rhode	Lv		Arr
Fri 4/29	Jnu 7:15A	AKA	Sea 10:15A
	Sea 1:25P	UA	Chic 7:10P
	Chic 8:00 P	UA	Bradley 10:54 P
Sat 4/30	Bradley 7:35 A	AA591	JFK 8:16 A
	JFK 7:30 P	AA4164	Bradley 8:24 P
Sun 5/1	Vermont by auto		
Mon 5/2	Bradley ~~[illegible]~~ 8:00 A	- UA123	Chic ~~[illegible]~~ 9:10 A
	Chic ~~[illegible]~~ 10:00 A	UA143	Sea ~~[illegible]~~ 12:05 P
	Sea 3:45 P	AKA69	Jnu 6:55P

with Edenso

Japan

6-1235

562.04

AK 60 7:15 -10

~~UN NW~~ 150 Sea - Chic

Ht

UN 128 Chi - 10:58

Jane Edens 80

Ward 4/30

5/2/ UN 123 Ht Chic

UN 143 Chic Sea

AK 69 Sea Jun

Check

J+B Leg. Fin.

Pat Williams 3795

War – Dept Rev

Grace: 2380

Edenso ret Monday

Edenso to Bradley Sat 8:30-11pm

or from NYC to Brad AA 464

Bradley 10:54

FRIDAY 29 BRIAN → HARTFORD
JIM → ~~NYC~~ HARTFORD (hotel reservations in Grace NY) → Single Essex

SATURDAY 30 JIM EDENSO → NYC 5:00 (GRACE)
~~Laguardia~~ ~~Kennedy~~ 7:35-8:16 Am. 59

Jim & Brian
Sat am. → NYC - closest to Manhattan
Sat 9 evening → Bradley JFK-Bradley 7:30-8:24 AA 464
Sun - drive to Univ

MONDAY 2 JIM EDENSO UA 123 8:00 / UA 143 90-12:05 Bradley Baltimore HARTFORD → JUNEAU (GRACE)
UA. 471 - Bra-Ch
✓ 147 Ch-Se JIM RHODE - "
AL 69 S-J

TUESDAY 3 BRIAN - HARTFORD → JUNEAU

Pick up 28th Gulliver's

STR 29 J-Sea UA 7:15-10:18
Sat-Den 12:10 - 3:28 P
Den-Brad ~~?~~
3:45 - 7 - Ch
~~Sat~~ Sat 10:58 PM
~~Sun~~

6-6031

Sat 30
Sun 1
~~Wed~~
Monday - May 2
Tues 3

Ward Sattler - Denver to Bradley
7A Sun

29 Fri - to Denver -
Sat Den → Bradley

Return: via WDC on Mon evening from Logan Boston
7:30 - 8:30 - Nat'l

Tues Am WDC → Spokane
3rd NW Nonstop ~~Nat'l 12:45 P - 6:07 P~~ ~~4:50 P~~ OR
5:55 P - 7:18 Minn/9:10 - Spok 9:55 P

Ward Sattler

	Lv			Arr	
Fri 4/29	Jun 7:15A		AKA	Sea 10:15A	
	Sea 12:10 P		UA	Den 3.28P	
Sat 4/30	Den 3:45P		UA	Chic 7:00P	
	Chic 8:00P		UA	Bradley 10:58P	w/Edouso
Sun 5/1	Vermont by auto				
Mon 5/2	Boston by auto				
	Logan 7:20 P		Delta 409	WDC 8:30P (Nat'l)	
	DC - Chi		UA 271	810-904	
Tues 5/3	WDC (Nat'l) 5:55P		NW	Minn 7:28P	95.85
	Chic Sea		UA 143	10-1205	
to Juneo	Minn 9:10 P		NW	Spok 9:55P	657.89
	Sea - Juneau		L 93:45-855		

Friday
Brian

lv Sea

29 7:15 10:15

non-stop
United 150 1:25 - Chic
[illegible]:10

Brad
8:00 - 10:54

Chic
leave 7:45 am - 9:02
Sea
Return 10:35 - 3:15
East
Sun
3:45 - 6:55

Oarlene

routing

	BRIAN	JIM
Friday, Apr 29	leave Juneau	leave Juneau
	1 arrive Seattle	1 arrive Seattle
	2 to New York City	no overnite; arrive 4-5pm Saturday Kennedy
	12 midnite → 3 ~~(drive to Hartford)~~ to Hartford	
Satudday, April 30	(drive to New York	2 fly to New York
	-----1PM----meet with	Mike Tanzer----- ~~3 to Hartford~~
	(drive to Hartford	drive to Hartford)
Sunday, May 1	(drive to Vermont	drive to Vermont)
	---------meet with	Milton Friedman------
	drive to Hartford	drive to Hartford
		from Hartford
Monday, May 2	drive to Boston	3 fly to New York
	-meet w/B Daniels-	4 fly to Seattle
	drive to Hartford	5 fly to Juneau
Tuesday, May 3	4 fly to New York	
	5 fly to Seattle	
	6 fly to Juneau	

~~check to see if it is possible to fly New York → Fairbanks → Anch → Juneau~~

S, MNT. NY-Fbks ? when-cont

Pan Am 911 only Saturday
9:45 pm 11:59 pm

Darlene gullivers 6-6081

Dept Prog Dv Acct | Obj Cd

STATE OF ALASKA

NO. 057439

REQUEST FOR TRANSPORTATION

The ______________________________ requests the
Department or Of...e requesting transportation and address

______________________________ company to furnish transportation

For BRIAN ROGERS From JUNEAU
Name of Traveler

To Hartford Conn & Return JUNEAU 22 APRIL, 19 77
Place and Date of Issue

Ticket No. 027-8231-156-465/466 James S. Rhode
Signature of Traveler

Value $ 502.04 (NO TAX PAYABLE) AA TO REP. COWPER, CHAIRMAN HOUSE FINANCE COMMITTEE
Title of Traveler

Tourist class fare (See instruction No. 1 on reverse Side)
(To be inserted by carrier)

(For Air Charter)

Carrier will forward this request to the Department or Office Requesting Transportation

Hrs | Rate

02-019 (Rev. 9--74) SEE INSTRUCTIONS ON REVERSE SIDE

Dept Prog Dv Acct | Obj Cd

STATE OF ALASKA

NO. 057440

REQUEST FOR TRANSPORTATION

The ______________________________ requests the
Department or Office requesting transportation and address

______________________________ company to furnish transportation

For JAMES B. RHODE From JUNEAU
Name of Traveler

To Hartford & New York — return, JUNEAU 28 APRIL, 19 77
Place and Date of Issue

Ticket No. 027-8437-795-653/654 James B. Rhode
Signature of Traveler

Value $ 616.04 (NO TAX PAYABLE) AA TO REP. COWPER, CHAIRMAN HOUSE FINANCE COMM.
Title of Traveler

Tourist class fare (See instruction No. 1 on reverse Side)
(To be inserted by carrier)

(For Air Charter)

Hrs | Rate

Carrier will forward this request to the Department or Office Requesting Transportation

02-019 (Rev. 9-74) SEE INSTRUCTIONS ON REVERSE SIDE

East Coast

Travel Itinerary
Ward Sattler
April 30, 1977--May 4, 1977

April 30	Travel Juneau to Hartford, Conn. overnight in Hartford.
May 1	Morning, motor to Ely, Vermont. Afternoon, meeting with Milton Frieman, Jim Edenso, Jim Rhode and Brian Rogers. Subject--solicitation of Friedman's expert opinion concerning organization and application of Alaska Permanent Fund. Overnight.
May 2	Motor to Cambridge, Mass. Meeting with Belden Daniels. Subject--Philosophy, strategy and application of Community Ecnonmic Development Corporations as relates to Alaska Permanent Fund. Afternoon, informal visit and discussions. Air travel Boston to Washington, D.C. Overnight in WDC
May 3	12:00 noon. Lunch with Congressman Don Young. Purpose to solicit Congressman's attitudes and opinions regarding Alaska Permanent Fund. 5:00 p.m. Air travel to Denver, Colo.
May 4	Personal leave.
May 5	Air travel Denver to Juneau. Arrive 4:30 p.m.

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811

LA-A 25
Rev. 3-76

STATE EMPLOYEE

PER DIEM AND TRANSPORTATION REIMBURSEMENT CLAIM

TRIP PURPOSE: Meet with Milton Friedman, Belden Daniels and Congressman Don Young regarding Permanent Fund

PER DIEM

This is to certify that I left See Attached (Town) on ______ at ______ am/pm. I overnighted in ______ (Town) on ______ (Dates) and ______ (Town) on ______ (Dates). I returned to ______ (Town) on ______ (Dates) at ______ am/pm.

TRAVEL

(1) I used State TR No. 055702.

(2) My taxi and limousine fares were $22.00.
(Please attach receipts if individual tab total exceeds $6.)

(3) Mileage claimed is between ______ and ______, a total of ______ miles.

(4) Please reimburse me for air fare in the amount of $ 56.00.
(Please attach ticket stub or other receipt.) See Attached

For Office Use Only

Account Code ______

Advance ______ FW# ______

Per Diem ______ FW# ______

Travel ______

FW# ______ Date ______

______
Signature

______
Mailing Address

______

______

______
Date

STATE OF ALASKA

NO. 055702

Dept Prog Dv Acct | Obj Cd

REQUEST FOR TRANSPORTATION

The ______________________________ requests the
Department or Office requesting transportation and address

______________________________ company to furnish transportation

For WARD SATTLER From JUNEAU
Name of Traveler

To HARTFORD, CONNECTICUT AND RETURN APRIL 29, 1977
Place and Date of Issue

Ticket No. 027-0331-186-462/463/464 Ward Sattler
Signature of Traveler

Value $562.04 (NO TAX PAYABLE) Legislative Assistant for Senate Committee on the Permanent Fund
Title of Traveler

Tourist class fare (See Instruction No. 1 on reverse Side)
(To be inserted by carrier)

(For Air Charter)

Carrier will forward this request to the Department or Office Requesting Transportation

Hrs Rate

02-019 (Rev. 9-74) SEE INSTRUCTIONS ON REVERSE SIDE

Part of this trip is being paid for by Department of Revenue, part by Legislative Affairs, and part of it was personal leave:

4/30 Fly to Hartford and overnight. per diem paid by Revenue

5/1 Drive to Vermont, meet with Milton Friedman regarding Permanent Fund, return to Hartford and overnight. per diem paid by Revenue.

5/2 Drive to Mass. to meet with Belden Daniels regarding Permanent Fund. Fly to Washington D.C. and overnight. Per diem paid by LAA

5/3 Meet with Congressman Don Young to discuss his feelings on the Permanent Fund. per diem paid by LAA

5/4--5/5 Personal leave, no per diem involved.

5/6 Travel returning to Juneau. per diem paid by LAA.

The total of this ticket was $670.96. minus the TR which was for.......................... 562.04
108.92 paid for by Ward Sattler by personal check. The portion of the trip from Boston, Mass to Washington D.C. was $56.00 and this portion needs to be reimbursed to Ward Sattler from LAA as this portion was for Permanent Fund, not covered by Revenue.

airfare reimb: — 351.20
perdiem x 295.00

taxi 22
p:d-EstCst 120

788.20

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811

LA-A 25
Rev. 3-76

STATE EMPLOYEE

PER DIEM AND TRANSPORTATION REIMBURSEMENT CLAIM

TRIP PURPOSE: ______

PER DIEM

This is to certify that I left ______ (Town) on ______ at ______ am/pm. I overnighted in ______ (Town) on ______ (Dates) and ______ (Town) on ______ (Dates). I returned to ______ (Town) on ______ (Dates) at ______ am/pm.

TRAVEL

(1) I used State TR No. ______.

(2) My taxi and limousine fares were ______.
(Please attach receipts if individual tab total exceeds $6.)

(3) Mileage claimed is between Juno-Anch-Fbks-Circle and Fort Yukon-Juno, a total of 1756 miles.

(4) Please reimburse me for air fare in the amount of $0.20/mile
(Please attach ticket stub or other receipt.)

351.20

For Office Use Only	
Account Code ______	
Advance ______	FW# ______
Per Diem ______	FW# ______
Travel ______	
FW# ______	Date ______

______
Signature

______
Mailing Address

______

______

______
Date

Applications are still being accepted. Please call if you are interested in enrolling.

PF: Harvard Course

NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT
Monday, June 6-Friday, June 10, 1977

An examination of the practice of economic development at the state and local levels. Participants will review the history of state and local economic policies in the United States and will consider a range of promising but nontraditional alternatives.

Monday 6/6
Morning
9:00-10:00 Orientation

10:00-12:00 Present Economic Programs

Lunch

Afternoon
1:00-3:00 History of State and Local Enterprise

3:00-5:00 CDC's: Their records and prospects.*

Evening - free

Tuesday 6/7
Morning - Tour of Boston programs

Lunch

Afternoon
1:00-3:00 Theory and evaluation of public enterprise

3:00-5:00 Case studies of public enterprise.*

Evening - free

Wednesday 6/8
Morning
9:00-10:30 Local Control

10:30-12:00 Case study: Local Control of Natural Resources.*

Lunch

Afternoon
1:00-2:30 Non-traditional Employment Programs: Coopes, Collectives, Worker Redesign

Wednesday 6/8 (continued)

4:00-5:00 Discussion and individual projects

Evening - free

Thursday 6/9

Morning

9:00-10:30 Employment programs: LEAP, LIP and Atschuler Plan.*

10:30-12:00 Case studies of Coops and Collectives.*

Lunch

Afternoon

1:00-2:30 Equity Financing and the Community Development Finance Corporation.*

2:30-4:00 Banking Policy: Linked Deposits, Redlining and Local Branch Banking.*

4:00-5:00 Discussion and individual projects.

Evening - free

Friday 6/10

Wrap-up.

---

* NOTE: Guest Lecturers have been invited to talk about specific ongoing projects.

** An extensive manual of readings will be available and daily assignments required as part of the program.

NON-TRADITIONAL TECHNIQUES
FOR LOCAL ECONOMIC DEVELOPMENT

JUNE 6-10 GUND HALL, HARVARD UNIVERSITY

STATE REPRESENTATIVE MEL KING
PROFESSOR SANDRA KANTER
CAROL KATZ

Introduction to the course

For years, the favored method for improving a state or city's economy has been through government subsidy of business enterprise. But as the overwhelming body of academic literature points out, tax incentives, work subsidies and investment credits given to firms do not create jobs. Instead, they end up as a redistribution of income from the taxpayer to the business community.

The first part of the course will examine the history of state and local subsidy programs and explore the economic assumptions behind them. The major portion of the course, however, will be devoted to an evaluation of a wide range of alternative methods of development. Each method will be considered from three angles. Initially, we will examine the "economics" behind the program or strategy. Second, we will survey the literature to see if the various strategies have been implemented around the country and if so, the effectiveness of these ventures. Finally, we will meet with people who have had experience in the various methods and learn about some of the practical problems and strengths in the methods studied.

Schedule of events

Monday
9:00-10:00: Orientation, discussion of course objectives.
10:00-12:00: Overview of state and local economic programs
1:00-2:30: History of state and local business incentives
2:30-4:00: CDC's-their records and prospects
4:00-5:00 Discussion and class workshop on assigned readings.

Tuesday
Morning: Morning tour of projects underway in Boston neighborhoods led by Rep. King
12:00-2:00: Theory and overview of public enterprise in the U.S.
2:00-4:00: Discussion with people working in public enterprise.
4:00-5:00 Class workshop

Wednesday
9:00-10:30: Models of local control
10:30-12:00: Discussion with people working in the area of local control of natural resources
1:00-2:30: Overview of alternative employment programs including coops, collectives and worker redesign projects.
2:30-4:00: Discussion with people involved in worker redesign
4:00-5:00: Class workshop

Thursday:
9:00-10:30: Discussion with people involved in LEAP, LIP and the Atschuler plan in Mass.
10:30-12:00 Discussion with people involved in cooperatives.
1:00-:2:30: Equity financing for community economic develop-

ment.
<u>2:30-4:00</u>: Banking policy:
discussion with people involved
in the linked deposit system,
anti-redlining and community
organizing around banking
issues.
<u>4:00-5:00</u>: Class workshop

<u>Friday a.m.</u>
Wrap-up and
discussion of individual
projects.

An extensive manual of readings will be collected and made available to participants in the class. Since most of the discussion will be based on the material in the manual, people should expect to set aside some time during the evening for reading the pertinent material. In addition, a group assignment will be handed out during the first day and form the basis of the discussion on the last day.

EXAMPLES OF READINGS TO BE INCLUDED IN THE MANUAL:

Bennett Harrison and Sandra Kanter, "The Political Economy of State Job-Creation Business Incentives", Working Papers, March 1976.

Gar Alperovitz and Jeff Faux, "The Economy: What Kind of Planning?", Working Papers, Fall 1975.

Peter Bearse, "Government as Innovator: A New Paradigm for State Economic Development Policy", N.J. Economic Policy Council, November 1975.

Thomas Brom and Edward Kirsher, "Buying Power - Community Owned Electric Systems," Working Papers, Summer, 1974, reprinted in Public Policy Reader.

"Public Ownership of Industry", Dollars and Sense, Sept. 1975, pp. 4-5.

William G. Shepherd, et. al., The Economics of Public Enterprise, Univ. of Michigan, 1975, ms., chs. 1,2,4,5, 7,9.

Leonard Goldberg, 'Public Enterprise at the State Level", San Francisco State College, 1975, in Public Policy Reader.

Martin Katzman and Belden Daniels, Development Incentives to Induce Efficiencies in Capital Markets, New England Regional Commission, Sept. 1975, pp. 2-162.

James Ridgeway and Bettina Corner, "Public Energy-Notes Toward A New System", Working Papers, Winter 1975, reprinted in Public Policy Reader.

Thomas Barocci, The Canadian Job-Creation Model and its Applicability to the U.S., U.S. Congress, Joint Economic Committee, Washington, D.C., 1976.

PPLICATION

Please complete this form and mail with a $50. deposit
ourse to:

Continuing Education Program
Harvard Graduate School of Design
Gund Hall L-36
Cambridge, MA 02138
(617) 495-2578

/Ms.______________________________
PLEASE PRINT

le______________________________

siness Address______________________________

______________________________ ZIP

siness Telephone______________________________

HGSD or MIT School of Architecture and Planning Alumnus/a? Year and degree____________________

Yes, please enroll me in the following course(s):

Maybe, I need more information. Please send outline(s) for the course(s) indicated below:

ase check one (refer to Accommodations section):
Yes, housing is needed.
No, I will make my own arrangements.
Yes, enclosed is $10. for the campus garage permit.
Deposit enclosed ($50. per course).

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THE MANAGEMENT OF DESIGN AND PLANNING FIRMS

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TEMPORARY EMPLOYEES - INTERIM - JUNE/DECEMBER 1977

Name	Committee	Location	Phone No.
BUSCHETTE, VALERIE	House Permanent Fund	Juneau	465-3782
BRYSON, CYNTHIA	LAA	Juneau	465-3850
CRANDALL, JOHN	Corrections	Anchorage	276-1912
CHAPPELL, KIM	Resources	Juneau	465-3715
DOOGAN, G. MICHAEL	House Permanent Fund	Anchorage	276-3433
DIAMOND, LUANN	House Permanent Fund	Anchorage	276-3433
DUNCAN, RONALD	Transportation	Juneau	465-4922
DOYLE, SUSAN	Employment Resources	Anchorage	276-5202
FINK, DEBORAH	Senate Permanent Fund	Juneau	465-3880
FENNEL, JAMES	Transportation	Juneau	465-4922
FRASCA, CHERYL	Employment Resources	Anchorage	276-5202
GLASS, FRANK	Resources	Juneau	465-3715
HANSON, SALLY	Agricultural Policy	Juneau	465-3747
HERRMANN, ADELHEID	Subsistence	Dillingham	842-5970
HATHAWAY, KATHY	Resources	Juneau	465-3715
HUGHES, SHERIDA	House Permanent Fund	Anchorage	276-3433
JACK, BONNIE	Energy Policy	Anchorage	276-5775
KNIGHTLINGER, LORETTA	LAA	Juneau	465-3800
LARSON, DOROTHY	Subsistence	Dillingham	842-5970
MacKINNON, ROCHELLE	Retirement	Juneau	465-3777
NELSON, DIANN	Resources	Juneau	465-3715
OSTROSKY, KATHRYN	Education	Anchorage	276-1715
POPE, DOUGLAS	House Permanent Fund	Anchorage	276-3433
RAMAGE, BETTY	Insurance/State Affairs	Anchorage	276-1715
ROGERS, BRIAN	House Permanent Fund	Anchorage	276-3433
ROGERS, DAVID	Energy/State Affairs	Anchorage	276-1202
SINGER, THOMAS	House Permanent Fund	Juneau	465-~~3880~~ 3782
SHARROCK, MARCELLA	Alcoholism	Anchorage	276-8153
SMITH, TERESA	Insurance/House Permanent Fund/State Affairs	Anchorage	276-1715
THOMPSON, MARGARET	House Permanent Fund	Ketchikan	225-6882
WALLACE, BRUCE	FBX-Legis Info Off	Fairbanks	452-4449
WILLIAMS, ROBERT	Insurance	Anchorage	276-1715

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

MEMORANDUM July 6, 1977

SUBJECT: Staff Assignments for Interim Activities

TO: John C. Doyle BGB
Executive Director

FROM: Billy G. Berrier
Director
Division of Legal Services

In order to work more effectively with the Legislative Council interim subcommittees, and certain other legislatively created bodies functioning during the interim which appear likely to generate legislation, I have made specific assignments of attorneys to each. Of course, the entire division is available as needed; but it appears that having an attorney directly responsible for providing assistance as required by the subcommittee will, as it has in the past, be useful to the subcommittees.

The subcommittees or activities and the attorney assigned to each are:

	Subcommittee or activity	Attorney
1.	Alaska Permanent Fund (House)	Billy G. Berrier Kenneth E. Vassar
2.	Alaska Permanent Fund (Senate)	Billy G. Berrier Kenneth E. Vassar
3.	Alcoholism and Alcohol Related Legislation	Joseph A. Guthrie
4.	Correctional Facilities	Joseph A. Guthrie
5.	Educational Program Financing	Richard A. Bradley
6.	Employment Resources and Opportunities	James A. McKenzie
7.	Insurance	David T. Walker
8.	Marine Transportation Oversight	David T. Walker
9.	Resources	Kenneth E. Vassar
10.	Retirement	James L. Baldwin
11.	State Affairs	Richard A. Bradley

12.	Subsistence Hunting and Fishing	Joseph A. Guthrie
13.	Taxation in the Unorganized Borough	John B. Chenoweth
14.	Telecommunications	Randolph G. Berry
15.	Transportation	David T. Walker
16.	Village Lands Reconveyance	John B. Chenoweth
17.	State Energy Policy	Randolph G. Berry
18.	Steering Council for Alaska Lands	John B. Chenoweth
19.	Study Group on Withdrawal from Social Security	James L. Baldwin
20.	Criminal Code Revision Subcommission	James A. McKenzie
21.	Legislative Teleconferencing Network Task Force	Randolph G. Berry
22.	Legislative Board of Retirement Benefits	James A. McKenzie

The attorney's phone numbers are:

Billy G. Berrier	3867 - 3868
James L. Baldwin	4627
Randolph G. Berry	3825
Richard A. Bradley	3896
John B. Chenoweth	3837
Joseph A. Guthrie	3894
James A. McKenzie	4626
Kenneth E. Vassar	3897
David T. Walker	3898

The attorney assigned to each committee or activity will call the chairman of that committee to discuss how we can help. The committee chairmen will be encouraged to feel free to call on the attorney assigned to the committee or activity, or, if needed, any other member of the division for any assistance we can give which they feel will be useful.

BGB:jpd

Copies to: Committee/Activity Chairmen
Council Officers
Presiding Officers

Applications are still being accepted. Please call if you are interested in enrolling.

Belden Daniels

Dev. Banker

NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT
Monday, June 6-Friday, June 10, 1977

An examination of the practice of economic development at the state and local levels. Participants will review the history of state and local economic policies in the United States and will consider a range of promising but nontraditional alternatives.

Monday 6/6
Morning
9:00-10:00 Orientation

Rosabeth Kanter

10:00-12:00 Present Economic Programs

Lunch

Afternoon
1:00-3:00 History of State and Local Enterprise

3:00-5:00 CDC's: Their records and prospects.* Terry Farmer

Evening - free - meet Belden Daniels @ Harvest Rest @ 5:30

Tuesday 6/7
Morning - Tour of Boston programs

Lunch

Afternoon
1:00-3:00 Theory and evaluation of public enterprise

3:00-5:00 Case studies of public enterprise.*

Evening - free

Wednesday 6/8
Morning
9:00-10:30 Local Control

10:30-12:00 Case study: Local Control of Natural Resources.*

Lunch

Afternoon
1:00-2:30 Non-traditional Employment Programs: Coopes, Collectives, Worker Redesign

Wednesday 6/8 (continued)

4:00-5:00 Discussion and individual projects

Evening - free

Thursday 6/9

Morning

9:00-10:30 Employment programs: LEAP, LIP and Atschuler Plan.*

10:30-12:00 Case studies of Coops and Collectives.*

Lunch

Afternoon

1:00-2:30 Equity Financing and the Community Development Finance Corporation.*

2:30-4:00 Banking Policy: Linked Deposits, Redlining and Local Branch Banking.*

4:00-5:00 Discussion and individual projects.

Evening - free

Friday 6/10

Wrap-up.

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* NOTE: Guest Lecturers have been invited to talk about specific ongoing projects.

** An extensive manual of readings will be available and daily assignments required as part of the program.

NON-TRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT

JUNE 6-10 GUND HALL, HARVARD UNIVERSITY

STATE REPRESENTATIVE MEL KING
PROFESSOR SANDRA KANTER
CAROL KATZ

Introduction to the course

For years, the favored method for improving a state or city's economy has been through government subsidy of business enterprise. But as the overwhelming body of academic literature points out, tax incentives, work subsidies and investment credits given to firms do not create jobs. Instead, they end up as a redistribution of income from the taxpayer to the business community.

The first part of the course will examine the history of state and local subsidy programs and explore the economic assumptions behind them. The major portion of the course, however, will be devoted to an evaluation of a wide range of alternative methods of development. Each method will be considered from three angles. Initially, we will examine the "economics" behind the program or strategy. Second, we will survey the literature to see if the various strategies have been implemented around the country and if so, the effectiveness of these ventures. Finally, we will meet with people who have had experience in the various methods and learn about some of the practical problems and strengths in the methods studied.

Schedule of events

Monday
9:00-10:00: Orientation, discussion of course objectives.
10:00-12:00: Overview of state and local economic programs
1:00-2:30: History of state and local business incentives
2:30-4:00: CDC's-their records and prospects
4:00-5:00 Discussion and class workshop on assigned readings.

Tuesday
Morning: Morning tour of projects underway in Boston neighborhoods led by Rep. King
12:00-2:00: Theory and overview of public enterprise in the U.S.
2:00-4:00: Discussion with people working in public enterprise.
4:00-5:00 Class workshop

Wednesday
9:00-10:30: Models of local control
10:30-12:00: Discussion with people working in the area of local control of natural resources
1:00-2:30: Overview of alternative employment programs including coops, collectives and worker redesign projects.
2:30-4:00: Discussion with people involved in worker redesign
4:00-5:00: Class workshop

Thursday:
9:00-10:30: Discussion with people involved in LEAP, LIP and the Atschuler plan in Mass.
10:30-12:00 Discussion with people involved in cooperatives.
1:00-:2:30: Equity financing for community economic develop-

ment.
2:30-4:00: Banking policy: discussion with people involved in the linked deposit system, anti-redlining and community organizing around banking issues.
4:00-5:00: Class workshop

Friday a.m.
Wrap-up and discussion of individual projects.

An extensive manual of readings will be collected and made available to participants in the class. Since most of the discussion will be based on the material in the manual, people should expect to set aside some time during the evening for reading the pertinent material. In addition, a group assignment will be handed out during the first day and form the basis of the discussion on the last day.

EXAMPLES OF READINGS TO BE INCLUDED IN THE MANUAL:

Bennett Harrison and Sandra Kanter, "The Political Economy of State Job-Creation Business Incentives", Working Papers, March 1976.

Gar Alperovitz and Jeff Faux, "The Economy: What Kind of Planning?", Working Papers, Fall 1975.

Peter Bearse, "Government as Innovator: A New Paradigm for State Economic Development Policy", N.J. Economic Policy Council, November 1975.

Thomas Brom and Edward Kirsher, "Buying Power - Community Owned Electric Systems," Working Papers, Summer, 1974, reprinted in Public Policy Reader.

"Public Ownership of Industry", Dollars and Sense, Sept. 1975, pp. 4-5.

William G. Shepherd, et. al., The Economics of Public Enterprise, Univ. of Michigan, 1975, ms., chs. 1,2,4,5, 7,9.

Leonard Goldberg, "Public Enterprise at the State Level", San Francisco State College, 1975, in Public Policy Reader.

Martin Katzman and Belden Daniels, Development Incentives to Induce Efficiencies in Capital Markets, New England Regional Commission, Sept. 1975, pp. 2-162.

James Ridgeway and Bettina Corner, "Public Energy-Notes Toward A New System", Working Papers, Winter 1975, reprinted in Public Policy Reader.

Thomas Barocci, The Canadian Job-Creation Model and its Applicability to the U.S., U.S. Congress, Joint Economic Committee, Washington, D.C., 1976.

BUILDING BOSTON'S SOUTHWEST CORRIDOR

Introduction

Remarks of the Honorable Edward Brooke, United States Senator from Massachusetts at the Boston College Citizen Seminar Series on the Fiscal, Economic and Political Problems of Boston and the Metropolitan Area, March 22, 1976. Other presentations were given by Governor Michael S. Dukakis; Emily Lloyd, Transportation Advisor to the Mayor of Boston; Anthony Pangaro, Principal Agent and Manager of the Southwest Corridor; and Elbert Bishop, Director, Southwest Corridor Coalition, Inc. The Seminar, titled "Building the Southwest Corridor" was chaired by Joseph Turley, President, Gillette Safety Razor Company.

BUILDING BOSTON'S SOUTHWEST CORRIDOR

The development of the Southwest Corridor is not only a subject of great interest for me, it has, in fact, become a major preoccupation in the past few months. As you may know, once the communities had made their comprehensive plans and the State officials had provided the U.S. Department of Transportation with a well thought-out, technically exact grant proposal, very little happened in Washington. Finally, after the frustration of the bureaucratic delays became truly intolerable, Elbert Bishop, on behalf of the Southwest Corridor Coalition, asked me to get Secretary of Transportation Bill Coleman to sit down with them and me in my office. We had a very informative, and I believe fruitful, meeting in December.

I have been in touch with the Secretary frequently since that time. I talked with him just this morning. And as a result of our conversation, I am very optimistic that we will soon have the announcement of a grant of 33.7 million dollars for the first segment of the project, the South Cove Tunnel completion.*

*In April, 1976, Sen. Brooke publicly announced the award of this grant to the Commonwealth by the Department of Transportation.

Although things in Washington are not, and probably never will, be moving as fast as we believe they should, there is a new responsiveness to the Corridor project. And I believe we can count on this continuing because the project seems to have captured the imagination of the Secretary of Transportation. He is not only a brilliant attorney with a fine sense of the procedural requirements of our federal transportation program. He is also, and primarily, a leader with a keen sense of the needs of our cities, the effects of federal development policies and a determination to get healthy growth patterns established in our metropolitan communities. I am certain that the Commonwealth, and the communities along the Corridor and I can count on a fruitful working relationship with him.

I believe the Secretary's concern shows a growing interest among federal officials who are beginning to see the national importance of the Southwest Corridor that most of here perceived long ago. For we are not just working on a local project that brings hundreds of millions of public works and public improvements dollars into the area. I am convinced that we are working on a plan which will be a national model for the way we deal with metropolitan revitalization and growth in the last quarter of this century.

The Southwest Corridor is no highway nor even a mixed transportation package. It is a microcosm of our metropolitan communities, a vital, ecologically sound part of the Boston environment. And I think it is important to appreciate what we have laid forth in these plans.

Of course, there is the important economic contribution we anticipate as a result of the fresh flow of workers and goods to and from the central city. This is critical to establishing a sound basis for creating jobs and moving products in this metropolis. The life of Boston, like that of other older cities, depends on such continued mobility and easy access.

But we are also stabilizing important residential neighborhoods. A strong, liveable Roxbury and Jamaica Plain are essential if the city is to function as a place people can make their home. West Roxbury and Back Bay are no less affected; the Corridor will provide important services and amenities to insure the continued attractiveness of these delightful areas.

One of the most important accomplishments of the project, so far as I am concerned, will be the dismantling of artificial barriers which have too long kept neighbors apart. As soon as that ugly embankment is depressed, residents of Jamaica Plain can shop with Roxbury citizens. Bromley Heath and Mission Hill will no longer be isolated by the encircling "Great Wall," and their residents can share freely and responsibly in the life of the general community. The demise of the elevated tracks for the Orange Line will be a welcome boost to the integrity of neighborhoods in the South End as well as Roxbury. I would enjoy personally wielding the sledgehammer that would bring down these historic blights.

Although we would have been better off if we could have rehabilitated some of the areas along the Corridor, the wholesale clearance of the land has provided us with important opportunities on which the plan capitalizes intelligently. We will be able to cluster major activities so as to create magnet areas in the various communities. Of course, there are the groupings of homes and recreation areas spaced all along the transportation system. And the prospect of sattellite commercial centers and the industrial park should bring new business activity in town. But perhaps the most dramatic cluster will be the educational center which will offer our new Madison Park High School, the long-awaited Roxbury Community College, and the innovative Occupational Resources Center, all of it tied to development at Northeastern University. This educational cornocupia is bound to become an important testing place for imaginative and community-oriented educational ideas. Little could be more important to Boston today.

The genius of the project is that it builds an infrastructure on which the city can develop sound investments for a long and healthy future. Closely related to this achievement is the fact that the Corridor itself is not a place or a set of buildings, but, rather, a living link between our communities. This means that the suburbs, as well as the inner city neighborhoods, will have new ties to a variety of urban activities. To me, and to many others who have had to leave the city for the suburbs, this will have special poignancy. My roots in Massachusetts were put down in Roxbury, the neighborhood perhaps most affected by the Corridor and its controversies. So I am especially aware of

the artificial barriers thrown up between such communities and the metropolitan ring. And I certainly welcome growth which brings Greater Bostonians together more easily and naturally.

A project having such promise will become a model for the way we rebuild all of metropolitan America. The power of the Project idea is that it recognizes the organic nature of the living city. It fortifies the complex interrelationships among business, cultural, and personal activities. It gives new freedoms through new opportunities while binding us ever more closely together. The Corridor project will give us a more humane environment in which we can invest our energy and wealth for years to come.

But, in our excitement over the prospects for the future, we must not forget how we got here. The process by which I-95 was stopped and the exciting plan now before us should have taught us all vital lessons about running and governing the nation. Both business and government learned a sobering lesson when a true grassroots movement of residents from the communities which would have been taken for the Expressway and the Inner Belt sat down together to change the apparent destiny of their neighborhoods. From these times of action we gained new leaders, some prominent, others less well-known, many of whom are here today. But hundreds of other men and women spent arduous hours meeting, researching and pressuring the representatives of the status quo. And, when they had stopped the highway, they came back to the drawing boards and wrote the brilliant Plan we have today. It is to their skill and their power that the completed Southwest Corridor community will be a living monument.

I have heard these events characterized as some sort of urban revolution. In fact, the coalition movement which ultimately stopped the highways from levelling vital neighborhoods was not new or revolutionary. It represents, in a large sense, what our metropolitan areas were and are today. The coalition was Americans who were convinced that they did not need to submit to decisions made by technicians of the past in a bureaucracy which had not considered their needs. They learned their rights and exercised them. Their common interests were more important to them than their traditional but superficial differences. In their unity, they found truly enormous power.

This power was channelled into tough minded, well-informed criticism on the legal and technical issues at hand which confounded the so-called experts. And as a result, the Commonwealth was able to replace a plan characterized by the Governor's Task Force as "a great mindless system charging ahead" with a project that is a truly visionary way of giving new life to city and suburb alike. In the finest tradition of change in our nation, the Coalition members were builders, not naysayers. They have reminded us all that legitimate protest is not necessarily an adversary relationship, but can be an advocacy process. And this example of the process must be taken to heart by everyone in government today.

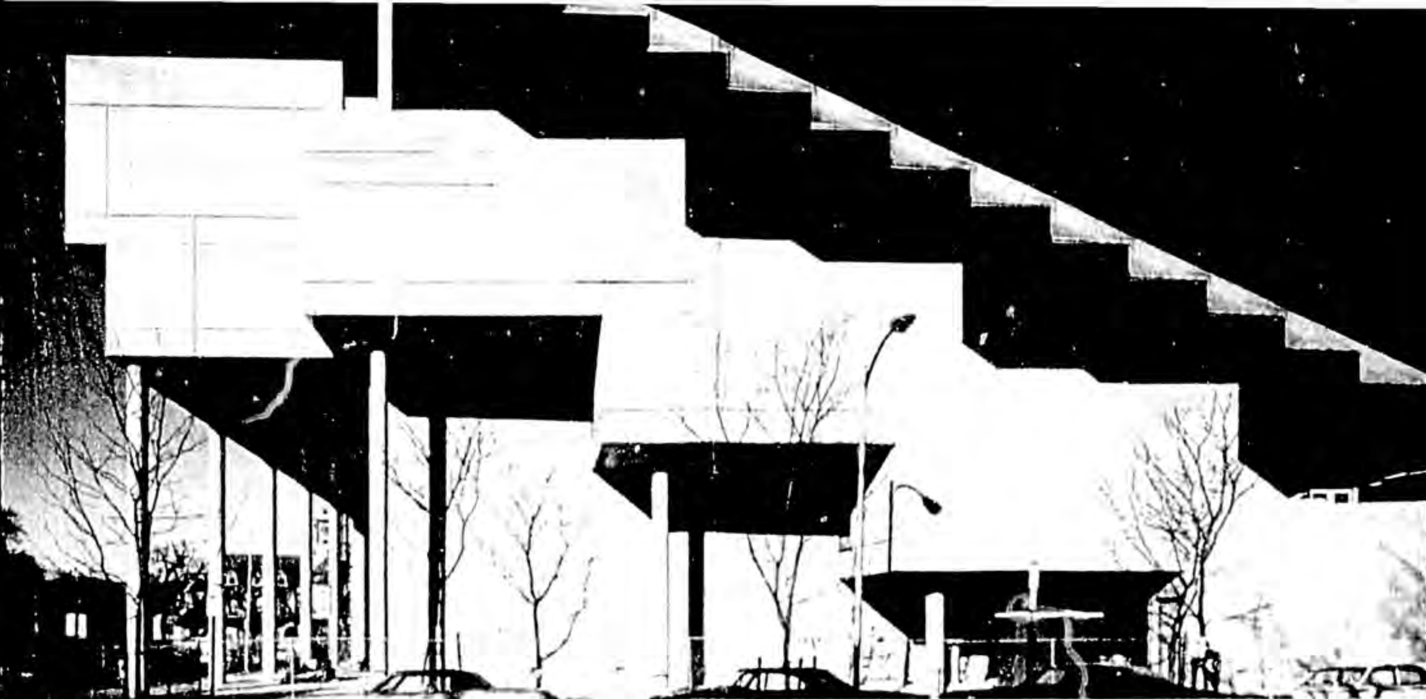
In closing, I must mention the most obvious, and, in these times, the most dramatic lesson we should have learned from the work of the Coalition. The movement against I-95 began in times that were characterized by violence and mortal racial confrontations in our cities. Yet Blacks and Whites, city dwellers and suburbanites found shared goals and worked side by side. Through all the tragic and occasionally brutal history of the past two years in Boston, the Southwest Corridor Coalition has prospered and grown stronger. Of course, black and white communities have their differences, sometimes deep differences. The questions they deal with are central to the personal lives of neighborhood residents. These matters could not be more important nor more emotional. But they work them out. They recognize and they contribute to the mutual interests which underlie the common destiny of Greater Bostonians.

Our pride in this accomplishment must be unlimited. And, of course, our prayer must be that this, too, will be a kind of model for all the Corridor's neighbors.

" A project having such promise will become a model for the way we rebuild all of metropolitan America. The power of the Project idea is that it recognizes the organic nature of the living city. It fortifies the complex interrelationships among business, cultural, and personal activities. It gives new freedoms through new opportunities while bin 'ing us ever more closely together. The Corridor project will give 's a more humane environment in which we can invest our energ, and wealth for years to cor ."

In April, 1976, Sen. Brooke

This brochure is printed and distributed by the SWCC (South West Corridor Coalition) with the permission of the Honorable Edward Brooke, Massachusetts State Senator, at no cost to the taxpayers. SWCC is a non-profit, charitable corporation chartered by the Commonwealth of Massachusetts with offices at 27 Dudley Street, Roxbury, Massachusetts 02119, phone (617) 427-0035.



Architects for George Gund Hall were John Andrews/ Anderson/Baldwin of Toronto, Canada. Prime participants in the design team were John Andrews, GSD '58; John Simpson, GSD '65; and Edward R. Baldwin, Yale '61, who acted as partner-in-charge.

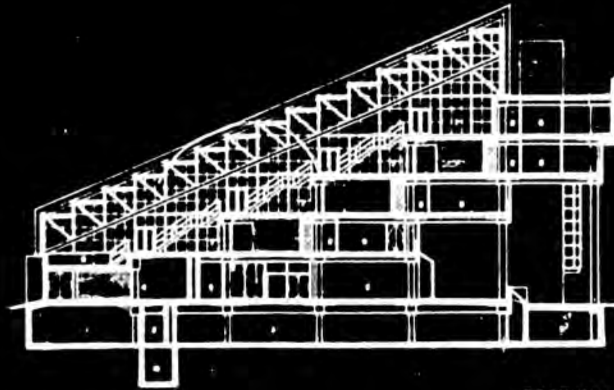
General Contractor was J. Slotnik Company of Boston. The late Moses Slotnik (Harvard Business School, 1927) was president at the time construction began.

Consultants used by the Architects included:
Structural/LeMessurier Associates Inc., Cambridge
Mechanical/G. Granek and Associates, Toronto
Electrical/Jack Chisvin and Associates, Toronto
Acoustical/Harold Mull, Louis Bell and Associates, Wilton, Connecticut
Fire Engineering/Rolf Jensen and Associates, Chicago
Landscape Architecture/Strong, Moorhead, Sigsby, Toronto
Graphics/John Gallop and Associates, Vancouver
Cost Control/Helyar, Vermeulen, Rae & Mauchan, Toronto

GEORGE GUND HALL

FRANCES LOEB LIBRARY
W. T. PIPER AUDITORIUM

HARVARD UNIVERSITY
GRADUATE SCHOOL OF DESIGN
CAMBRIDGE, MASSACHUSETTS



GEORGE GUND HALL

George Gund Hall, the new home of Harvard Graduate School of Design, houses the academic departments of Architecture, City and Regional Planning and Landscape Architecture, as well as the Urban Design Program, the Program for Advanced Environmental Studies and the Laboratory for Computer Graphics and Spatial Analysis.

The building also contains the Frances Loeb Library, one of the world's finest collections on architecture, landscape architecture and city planning, and the W. T. Piper Auditorium.

GUND HALL/THE SCHOOL OF DESIGN'S THIRD HOME

Situated at the corner of Cambridge and Quincy Streets, a block from Harvard Yard and its former home for seventy years, Harvard's new building for the Graduate School of Design, is a striking composition in mirrored glass and reinforced concrete by John Andrews/ Anderson/Baldwin Architects of Toronto.

Gund Hall is the third home of the School. Former buildings occupied by the School were the Holmes Field Architectural Building (1893-1902), and McKim, Mead & White's handsome Robinson Hall, constructed in 1902.

Only two decades after moving to Robinson Hall, the School found it necessary to expand to nearby buildings. At the time ground was broken for Gund Hall in 1969, the School of Design occupied four additional buildings in scattered locations.

The new building groups the faculty and staff of the School of Design together for the first time in nearly half a century. Centralizing such facilities as the library, studios, workshops, laboratory for computer graphics, audio-visual center, offices, classrooms, and auditorium, Gund Hall allows for improved collaboration between the various professional departments and their satellite resources.

The interdisciplinary collaboration essential to the school's goal in providing a comprehensive approach to the study of environmental design is given expression in the building's central studio space which extends through four levels under a vast sloping clear span roof. This sloping structure contains translucent fiberglass and vertical glass for admitting natural light and providing a view to the outdoors from all points within the space. Each level is interconnected by stairways, insuring physical as well as visual communication between each. In close proximity at each level are faculty offices, seminar rooms, and research space for individual projects.

Containing 155,000 square feet of floor space on five floors above and one below ground, the structure is reinforced concrete flat slabs over a 25' column grid with the multi-level studio area free spanned by nine 134' long 11' deep steel trusses made of 12" diameter steel pipe. The entire building is air conditioned, utilizing chilled water from Harvard's new central utility plant two blocks away. Reflecting glass has been used to minimize heat gain. Construction began in November, 1969, and was completed in the summer of 1972. Net construction cost for the building was $6.5 million or approximately $42 per square foot. Overall project cost was $8 million. Construction was funded largely by the George Gund Foundation, the Gund family, GSD alumni, and friends, together with a $2.2 million Office of Education, US Department of HEW grant.

FRANCES LOEB LIBRARY

The gift of John L. Loeb, SB '24, it houses the 155,000 volume GSD collection. In addition, included are over 60,000 slides and a periodical collection which maintains subscriptions to 500 publications. Spanning over two floors in the building, the Loeb Library provides research and study space for 200 students.

W. T. PIPER AUDITORIUM

The gift of the children of William T. Piper, it provides lecture seating for 400 or may be cleared of chairs for large exhibitions. It is fully equipped for multi-projection, audio-visual presentations and is the central large assembly space for the Graduate School of Design.

GEORGE GUND (1888-1966)

The building is named to honor the memory of George Gund.

George Gund was born in La Crosse, Wisconsin, and his family settled in Cleveland in 1897. Following his graduation from Harvard College (1909) and graduate study at Harvard Business School, his early career included banking and real estate in Seattle, developing the Kaffee Hag Corporation in Cleveland, and ranching in Nevada. His interest in banking culminated in his becoming President of the Cleveland Trust Company in 1941. At his death in 1966, he was Chairman of the Board

Closely associated with the arts and education, George Gund was named President of the Cleveland Institute of Art in 1942 and was involved with the Harvard Business School and School of Public Health in 1954-1966; served on the Board of Overseers of Harvard College 1954-1960 and as a trustee of Kenyon College for many years.

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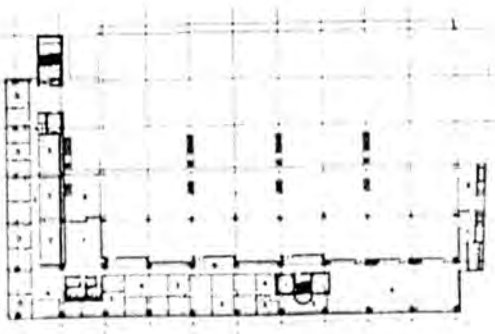
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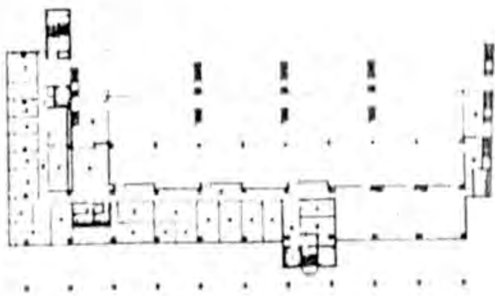
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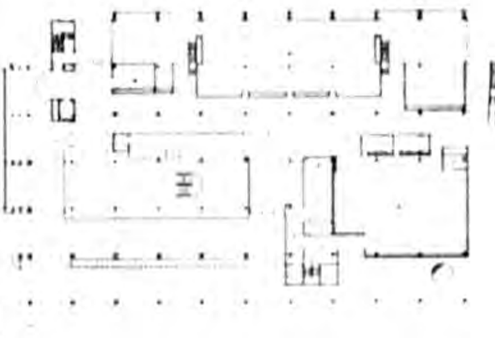
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"MAP OF HARVARD SQ. AREA CAMBRIDGE"

Resources

Books and Reports

Radical Agriculture, edited by Richard Merrill, Harper Colophon Books, 1976, 458 pp.

Hard Tomatoes, Hard Times, The Failure of The Land Grant College Complex, by Jim Hightower, Agribusiness Accountability Project, 1972, 308 pp.

"Economies of Size In Farming," by J. Patrick Madden, Ag. Ec. Report No. 107 from the Economic Research Service, U.S. Department of Agriculture, Washington, D.C.

Proposals for Vermont's Agriculture and Food Future, Report of the Governor's Commission of Food, January 1976, $10, summary 50¢, from Vermont Dept. of Agriculture, 116 State St., Montpelier, VT 05607.

Land, Bread and History, A Research Report on the Potential for Food Self-Sufficiency in Vermont, $2.50, and

Journal of the New Alchemists, To Restore the Lands, Protect the Seas, and Inform the Earth's Stewards, Vol. 1—$4, Vol. 2—$6, Vol. 3—$6, from The New Alchemy Institute, P.O. Box 432, Woods Hole, MA 02543.

Organizing Farmers' Markets, 1975, $2, from the National Organic Farmer's Association, RFD 1, Box 247, Plainfield, VT 05667.

"Agribusiness Directory," by Al Krebs, from Food Task Force, Consumer Action, 26 Seventh St., San Francisco, CA 94103, $5.

Agribusiness Manual: New collection of articles on four aspects of agribusiness, related case studies and action suggestions regarding different companies. By the Interfaith Center on Corporate Responsibility, 475 Riverside Drive, NY, NY 10027. $3.00.

Sowing The Wind, A Report for Ralph Nader's Center for Responsive Law on Food Safety and the Chemical Harvest, by Harrison Wellford, Grossman Publishers, New York, NY, 1972.

Losing Ground, Environmental Stress and World Food Prospects, Erik P. Eckholm, Worldwatch Institute, 1776 Massachusetts Ave. NW, Washington, DC 20036; (202) 452-1999. W.W. Norton, New York, $3.95, 223 p. (*Not* available from Worldwatch).

Country Women: A Handbook for the New Farmer, by Jeanne Tetrault and Sherry Thomas, 1976, 381 pp., $6.95, from Anchor Press/Doubleday, 245 Park Ave., New York, NY 10017.

Food From Windmills, by Peter Fraenkel, 1975, $8.15 surface, $10 airmail, from I.T. Publications Ltd., 9 King St., London WC2E 8HN, England.

Silent Spring, by Rachel Carson, concerning the indiscriminate chemical mass warfare waged against insects, weeds and rodents, from all bookstores.

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1) "The Skill Intensity of Small Farming and the Diversity of Farm Management Abilities"
3) "On The Possibility of a Revival of Feed Grain Production in Maine"
4) "The Political-Economic Logic of Farmer Cooperation"
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Film

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Organizations

Only organizations not listed elsewhere are included here.

Agricultural Marketing Project, Center for Health Services, Station 17, Vanderbilt Medical Center, Nashville, TN 37232. (615) 322-4773

Roger Blobaum, RR 4, Creston, IA 50801; (515) 782-8098

Congress Watch, 133 C St. SE, Washington, DC 20005; (202) 737-3732

Consumer Federation of America, 1012 14th St. NW, Washington, DC 20005; (202) 737-3732

Earthwork, An Urban Center for the Study of Land and Food, 1499 Potrera, San Francisco, CA 94110; (415) 648-2094

Exploratory Project on Economic Alternatives, 1519 Connecticut Ave. NW, Washington, DC 20036; (202) 462-5178

Institute for World Order, 1140 Ave. of the Americas, New York, NY 10036; (212) 575-0055

National Farmers Organization, 485 L'Enfant Plaza SW, Washington, DC 20024; (202) 484-7075

National Farmers Union, 1012 14th St. NW, Washington, DC 20005; (202) 628-9774

United Farm Workers, 1803 Newton St. NW, Washington, DC 20010; (202) 234-3209

National Catholic Rural Life Conference, 3801 Grand Ave., Des Moines, IA 50312

Small Farm Research Association, contact Eliot Coleman, Harborside, ME.

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Wanted:

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How the workers almost pulled it off

At Kasanof's, the road to closing was paved with good intentions

by Howard Husock

Ultimately they got neither the time nor the financial help. As a result, Blue Hill Avenue, an unlikely setting for social experiment anyway, will not be one, and Kasanof's famed rye has gone the way of Roxbury's breweries and kosher meat markets. The efforts at this social experiment have, however, left questions behind. Those involved question whether government did enough to save a business whose demise hits especially hard because of its location. Are banks and the state willing to back a company owned and run by the workers?

For a few weeks in March, Freddy McNeill, a 32-year-old bakery packing foreman from Hyde Park, was on the verge of becoming president of an $11 million company. For those same few weeks, the 97-year-old Kasanof's bakery of Blue Hill Avenue, "New England's Oldest Jewish Bakery," was briefly on the edge of economic experimentation. Closed since January, after running at a loss for three years, it was poised to rise again, you should pardon the expression, as Boston's first major collectively owned and managed corporation. The bakers — along with the teamsters and packers — were going to run the bakery.

Today, Freddy McNeill is collecting unemployment benefits and playing basketball, and what had been the largest industry on the city's poorest main street — it employed 285 people — is its latest abandoned business. Only a skeleton crew remains, supervising liquidation and guarding equipment. The last effects make for a wistful scene. A few rock-like bulkie rolls are lodged in the conveyor belt, where they are prey for sparrows. Ovens and mixers are in place, soon to be sold to equipment brokers. Adding to this gloom on a recent morning was Freddy McNeill, walking through the plant for the last time. He'd worked there 12 years and, in fact, still gets up at 1:30 a.m., out of habit. He had risen from an odd-jobber paid $60 a week to become the packing foreman, supervising the packaging of 100,000 loaves of bread a week. And finally, he'd been designated nominal president, for legal purposes, of the short-lived New Kasanof Corporation, the name chosen by several hundred employees — about half of them black or Spanish-speaking, about three-quarters from city neighborhoods near the bakery — for the business they had confidence they could run cooperatively and make profitable.

Jerry Berndt

Packing foreman Fred McNeill: from the front office to unemployment

"We were really on the move," says the ex-president. "We really had plans." Indeed, preliminary papers for the sale had even been signed by the Fink Baking Company of Brooklyn, owners of Kasanof's since 1971. The unemployed workers had pledged vacation pay owed them, and money out of pocket, as a down payment on the expected $900,000 purchase and another $900,000 loan that would help them get started. Plans to make the bakery more efficient were being proposed by employees. The plant manager had even agreed to work alongside those he'd previously worked above. Consultants from the Washington-based Federation for Economic Democracy were providing advice, as were lawyers from no less a bastion of business than Hale and Dorr. It only remained for the New Kasanof workers to get a small grant from the state and financing from both the federal government and one of the two banks which had expressed interest. And they needed time from Fink Baking — eager to sell off its Kasanof equipment — to make the arrangements.

The New Kasanof's story began with the untimely closing of the old Kasanof's the day after a January 29 strike was called by the 110 employees who were members of Bakery and Confectionary Workers Union, Local 20. Although not a large plant, Kasanof's had three unions — two for bakers, one for drivers. The arrangement, inherited from previous owners, is said to have annoyed Fink Baking — it made for almost constant contract negotiations. The last involved Local 20, whose membership was almost completely black or Puerto Rican and was also the lowest paid among the plant's organized workers. Its members earned at

most $232 a week, compared with a possible $300 weekly for members of the other bakers' local — Local 45 — and $400 plus for truck drivers. In theory, Local 45's members — most of whom were white — were paid better because of their special skills: they baked Kasanof's rye. Local 20's members packaged the rye, as well as baking white bread and pastry. But Local 20 believed the wage gap too great. They asked Fink Baking president George Rosenthal for a $25 increase. When he offered $7, they struck.

"The strike," says Jack Fischer, Kasanof general manager since Fink bought the firm in 1971, "was the last straw for George."

Rosenthal himself declines to discuss the decision to close Kasanof's, which came only one day after the strike and to which he stuck even after Local 20 agreed to accept his wage offer and return to work. General manager Fischer, however, as well as city officials familiar with the business, say the strike was the last in a series of unforeseen complications that began almost as soon as Fink Baking bought Kasanof's six years ago.

Fink had big plans for the plant then. In its first year of ownership, it invested nearly $1 million in new baking equipment and announced plans to spend nearly two million more to expand and modernize the plant. John Weis, who is now the deputy director of the city's Office of Planning and Development and who was then advising Kasanof's on its expansion plans, says, "It's safe to say that Rosenthal didn't expect any problems in trying to expand, given the location." The city, pleased to see any private investment on riot-scarred Blue Hill Avenue, granted the bakery the zoning variances it needed, and construction was set to start.

But neither Fink Baking nor the city had counted on one Martha Williams, a state employee who lives in a modest frame three-decker next door to the bakery's loading area. Today, John Weis calls her "proof that one woman can beat the system." Hers is a story usually told of suburban environmentalists, not Roxbury three-decker residents.

She was bothered by the noise produced by her next-door neighbor, by its unsightly parking lot and late-night operations. "I've lived," she says, "in the closest proximity to a business that operated 24 hours a day, seven days a week. The trucks came through at all hours. My bedroom was right above them, and many a night I had to go sleep in my front room." Rather than see the bakery expand, Mrs. Williams, without help from a lawyer, took Kasanof's to court, charging that its zoning variance had been improperly awarded. She lost in Superior Court but appealed and, in 1972, won her case in a state appeals court. A new plan would have to be drawn up before the city could allow expansion of flour-storage facilities, without which the company said it would lose $150,000 a year. By the time it closed, Kasanof's was losing just about that much.

Mrs. Williams did not stop there, though. In an effort to decrease truck noise, she called inspectors from the city's Air Pollution Control Commission. They ordered the bakery to reduce the noise by half. And by 1974, she was in almost constant negotiation with the city redevelopment authority, which, according to John Weis — then a planner with the agency — had "three people working virtually full-time with Kasanof's, essentially trying to come up with a plan both the bakery and Mrs. Williams would agree to." At one point, Kasanof's offered its neighbor nearly $30,000 for her home. She refused.

By 1976, a new plan was finished. Kasanof's would landscape. It would enclose some of its noisier loading operations. But it would expand. The city approved the plan once again. But once again Mrs. Williams did not. She went back to court, where the issue remained until January of this year. Then, only weeks before the strike, the bakery's plan was upheld. Mrs. Williams announced she would appeal again.

"I have some sympathy for the employees," Mrs. Williams says today. "But am I sorry that the place is closing? Are you kidding? I'm going to have a champagne party." She gives some of the credit for her victory, by the way, to legal advice she got from attorneys she has met on her job — with the state Division of Employment Security.

Freddy McNeill, who would likely have become a party to a legal confrontation between Mrs. Williams and the New Kasanof Corporation, is bitter about her role. "The black community helped to close Kasanof's," he says. Mrs. Williams denies the charge, saying, "I might have been a factor, but the place was losing money right along." John Weis takes something of a middle ground. "Mrs. Williams certainly had a right to protect her neighborhood and, in all honesty, the original plan was lousy. But put yourself in George Rosenthal's shoes. He comes into Boston, into one of the worst parts of the city, and pretty soon he's got lawsuits and air pollution inspections to deal with. And when he finally gets permission to expand, here comes a strike. I think he finally said, 'Screw Boston. I'm getting out.' "

"It's like coming home to find your house burned down," says Abe Feldman, 59, a teamster who worked for Kasanof's from 1952 until it closed. "You just can't believe it can happen." Indeed, the Kasanof name seemed a permanent bit of Bostonia. Cardinal Cushing is said to have suggested once, in jest, that the Lord's Prayer be amended to read, "Give us this day our Kasanof's bread." Indeed, the daily bread that was part of the Boston Black Panther Party's free breakfast program in 1969 was donated by Kasanof's. The film version of the *Boston Strangler* included a shot in the bakery. And delicatessen owners swore by Kasanof's rye, the formula for which was based, according to Jack Fischer, on "all-natural sourdough starters." The recipe was handed down from the bakery's founder — recalled today only as a Dr. Kasanof — through Samuel Cole, an immigrant Jewish baker from Poland. Cole bought the business in 1918 and moved his family in upstairs. He and his sons ran the bakery for the next 50 years, expanding it from a storefront to a plant, before selling out in 1968. Ironically, the Cole family is still in the bakery business: Bernard Cole, formerly Kasanof's general manager, runs a firm which supplies hamburger rolls and English muffins to the New England branches of McDonald's.

It was, in part, the magic of the Kasanof name that helped persuade the bakery workers they could revive the business themselves. "For a month after the strike," recalls Freddy McNeill, "we kept getting calls asking when we were going to open up again. People were even willing to place orders."

The employees were thus receptive when, in late February, they were approached by John Blanchard, a staff member of the Quaker-founded American Friends Service Committee in Cambridge, with the idea of a worker-managed bakery. Blanchard was one of six members of a consulting team affiliated with the Federation for Economic Democracy, which is based in Washington and has offices in Cambridge. The team included Gerard Abeles, a full-time FEDO business consultant already at work trying to set up a "self-managed" poultry processing plant in Connecticut, as well as a group of Boston academics, a Boston College sociologist and a UMass economist among them. Their models included Pacific Northwest lumber co-operatives, a 400-employee insurance firm in Washington, DC, and the Vermont Asbestos Group, whose members bought a mine due to be closed and made it profitable.

Over the next month — from late February to late March — the consulting team was to make an effort to sell the worker-control concept to the Kasanof employees and union leaders, to rouse federal and state bureaucracies into emergency action, and to buy time from George Rosenthal to make the project possible. It would be their frustration to come close — to stir the aspirations of employees, only to see them evaporate in the face of the complexities of private finance and (at least in the opinion of some workers) rejection by the state.

By far the most successful part of the short-lived New Kasanof project was persuading the employees the idea was a good one.

"We got the hang of it right away,"

Jerry Berndt

An idea whose time had not quite come

says Freddy McNeill, one of 12 workers elected to a steering committee (he was eventually named president for incorporation purposes). The concept was presented on location — in the Kasanof's garage, where the consultants stood on crates and outlined the idea over the din of Blue Hill Avenue. Employees, they said, would be the stockholders and the ultimate management. The corporation would be a cooperative: each worker would have a vote in electing the rotating board of directors. The board would appoint a manager to run the plant day to day, and would review his decisions once a month. Employees would provide the money for a down payment on the plant, and profits would be divided and deposited in savings accounts. If there were enough profits, a percentage would be invested in other worker-controlled businesses.

Not all the ideas for the New Kasanof Corporation were coming from the consultants, however. Teamster Abe Feldman, a member of the 12-man steering committee, says, "Everyone had his own ideas on how to run it." Adds Freddy McNeill, "I felt that I knew more about that place than just about anyone. I was down in the plant every day. The white-collar boys upstairs didn't see what went on the way I did."

In fact, had the New Kasanof's ever begun operations, its new management would likely have moved to cut waste and inefficiency in ways that no traditional management with union contracts would dare to consider. Among crackdowns discussed was one on drivers who mistreated trucks ("We all knew who they were," recalls McNeill), another on workers who manned a conveyor belt and who were reputedly given to going out for beers, allowing rolls to fall to the floor. The New Kasanof's even planned layoffs. Says Abe Feldman: "We figured to go slow at first. Everyone would have been allowed to invest in buying the company, but not everyone could have been hired back until we got on our feet." Freddy McNeill even proposed some permanent reductions in the work-force. "We had 15 guys in the plant just to clean up," he recalls. "If we owned the place, we could clean up after ourselves. Before, it was just a job and we'd want to get out right away."

The job of selling the New Kasanof's to the business agents of the bakery's three unions proved somewhat more difficult. Nicholas Hantakas of Local 20 was quickly persuaded; in fact, he was prepared to invest union funds. John Blanchard recalls the different reactions of the other unions. "I think they found the concept foreign. Sometimes it seemed like they thought the consultants were going to be the new management."

One union leader, George Newman of Bakers Local 45, was never convinced the New Kasanof's was viable. "I didn't think it could work," he says. "I knew that the trucks were in poor shape. The machinery was old. The location was bad. I had a lot of doubts."

But after being assured that existing union contracts would continue in effect under the new management — a condition not originally planned — Newman and leaders of the other two unions agreed to help. They would ask their members to pledge back pay toward the down payment on the plant. During the first week of March, workers kicked in some $200,000 in vacation pay owed them by the company. Later, they also pledged funds from their own depleted savings accounts. "That may have been the most dramatic moment of the whole thing," recalls Sev Bruyn, Boston College sociology professor. That moment came after a mid-March meeting of the consultants, McNeill and owner George Rosenthal. Rosenthal expressed doubt that employees would invest in the New Kasanof scheme. The next day, again in the bakery garage, some 50 workers gathered and were told of Rosenthal's doubts.

"They came up with $8800 on the spot," recalls John Blanchard. "They took cash out of their wallets, they wrote out checks. These were guys living on unemployment who had been out of work for six weeks."

But reservations began to be heard more often by the New Kasanof consultants. And they came from institutions whose support was essential — government and banks. The Kasanof purchase was to be financed by a $1.8 million bank loan, secured with the workers' $200,000 down payment and backed, it was hoped, by a federal guarantee from the Small Business Administration or the Economic Development Agency. (Either can guarantee repayment of 90 percent of a loan, dramatically diminishing a bank's risk.)

Having roused worker and union interest in the project, the consultant team was, by mid-March, working desperately to arrange such financing. And they were under the gun, as they learned in a Monday, March 14, meeting with Rosenthal, held at the State Street offices of Hale and Dorr. (One of the law firm's partners advises a state agency just established to help stimulate investment in poor neighborhoods.) Rosenthal was blunt. He was losing $5000 a week in maintenance and security costs at the closed Kasanof's. In order even to consider the sale he would need $50,000 in "option money." He was asking the New Kasanof corporation to buy time. If he could not get the option money, he planned to sell off the bakery equipment immediately; if he could, the consultants would have a month to arrange financing. Freddy McNeill, in turn, offered to find volunteer workers to guard the plant at no cost to Rosenthal, who agreed to reduce the cost of the one-month option to $20,000.

It was ultimately the lack of this $20,000 that permanently closed Kasanof's. The money could not be raised from the workers — it was not refundable, under Rosenthal's terms. If the sale fell through, the money would be forfeited. So the consultants turned to the state. Specifically, they approached Undersecretary for Economic Affairs Richard Geisser.

Geisser was familiar with the situation. He had tried and failed to convince Rosenthal to reopen the bakery at the time of the strike. And, he says, "I'm very interested in the concept of self-managed and employee-owned businesses. I think it could be a good strategy for keeping businesses in the state that might otherwise leave." On Friday, March 18, Geisser called Hale and Dorr, where another meeting between the New Kasanof team and Rosenthal was underway, to say that

the state would consider the request for $20,000. "It was really a dramatic moment," recalls John Blanchard. "We were able to tell Rosenthal he might get his money from the state." As a result, a purchase and sale agreement was signed, giving the New Kasanof team one month to close the deal.

But the consultants had overreacted to Geisser's slight encouragement. Ten days later, the state Economic Development Project Committee (part of the Office of State Planning) turned down the request for $20,000. The Kasanof project, wrote Geisser, was "beyond high-risk." "I felt terrible about the whole thing," he says, "but I just wasn't convinced the thing could work. I had to be able to prove that the state wasn't just shipping $20,000 down the tubes." Geisser's doubts were those of a businessman. He deemed it unlikely that the company could recapture its market after being closed for months. And he doubted that financing could be arranged by the April 18 deadline. "I tried to be pragmatic," he says. "I know it takes at least 90 days to put a financing package together. If they had come to us four months before the place closed, we might have been able to help them."

Geisser insists, however, that the proposed ownership structure was not a problem. "We want projects like it to succeed," he says. "It's extremely important for the first wave of these things to be successful. Because of that, we have to be more conservative than in other situations. Love alone won't make a Kasanof's succeed."

However, even if the New Kasanof Corp. had gotten its $20,000 grant from the state there was no certainty that it would gain the necessary bank financing. Indeed, even while the state was still considering the grant request, the Shawmut Bank turned down the workers' major financing request. Nor had New England Merchants ruled favorably by the time the idea died. John Cunningham, a vice-president of the Shawmut Bank, says, "They were trying to put Humpty-Dumpty together again virtually overnight." Shawmut's decision was made "strictly for business reasons," according to Cunningham. "It had nothing to do with the democratic management idea," he maintains. "I think the principle of participatory ownership is established enough for banks."

Both Freddy McNeill and Abe Feldman are bitter about their treatment by the state. "Twenty thousand," says McNeill. "That's nothing. The state's gonna spend ten times that much in unemployment." Adds Feldman: "It seems like government has lots of money for people who already have money."

John Blanchard does not wholly share that view of the state's role. He agrees with Geisser that time was against the New Kasanof project from the start. The consultant team did not begin its efforts until nearly a month after Kasanof's closed — largely out of deference to a Roxbury entrepreneur who was negotiating to buy the plant and failed. He is also unsure whether owner Rosenthal would have ever accepted the idea of shifting control to a worker's collective. "I'm not sure he believed we were quite for real," says Blanchard.

Still, the Quaker consultant half believes that the $20,000 from the state could have made the difference. "It would have impressed Rosenthal," he says. "Once we got into serious negotiations, he might have given us more time."

Another member of the consultant team, Gerard Abeles, feels the New Kasanof's would not have inevitably failed, had it gotten started. "I think the Kasanof name commanded a lot of loyalty," he says. "Plus the bread could have been marketed politically -- some people would have bought it because of the self-management. Plus, there was tremendous confidence among the workers that losses could be cut by increasing efficiency and eliminating waste."

Almost all those involved in the effort profess to have learned lessons. John Blanchard points out that he and the other consultants have "gained some credibility with the state," and learned more about the mechanics of financing a self-managed business. Blanchard is also hopeful that a newly-funded state agency, the Community Development Finance Corporation, will be a source of money for Kasanof-type projects in the future. Richard Geisser has similar hopes. "I think we'll keep in touch," he says of the Kasanof consultants. "If we had earlier warning, we might be able to help."

It's more difficult for the Kasanof employees to take solace in such sentiments. The vast majority of the 285 workers are still without jobs. Even the highest-paid, general manager Jack Fischer, says he will be looking for work as soon as final liquidation is over, probably by the end of the month. A few employees have found part-time work with the Green-Freedman bakery in South Boston, where business has increased since the demise of Kasanof's. But according to Local 45's George Newman, some of his members have had to quit those new-found jobs already. "A number of blacks I placed there couldn't take the pressure of working in South Boston," he says. "Some of them had car windows smashed. Others were afraid to use public transportation. It's a 15-minute walk from Andrew station." Ironically, a black Haitian immigrant who was beaten by a mob two years ago, in a dramatic incident of racial violence in Southie, was employed at the time by Kasanof's.

The closing of Kasanof's will also be felt keenly along Blue Hill Avenue.

"Poor people used to depend on us for day-old bread," says Freddy McNeill. The Family Hut restaurant across the street estimates its business may be cut in half. The nearby tavern will also feel the pinch. Says John Weis of City Hall: "Mortgages may go unpaid. Housing abandonment may increase. This is a real tragedy for that neighborhood."

The deepest impact, though the most difficult to measure, may be psychological. "Every day we thought we were getting nearer to success," says Abe Feldman, who was only six months away from retirement. "A couple million bucks, it didn't seem like that much. I guess we were kidding ourselves." ●

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HARVARD UNIVERSITY

GRADUATE SCHOOL OF DESIGN

Continuing Education Program

NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT June 6-10.

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NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT June 6-10

Readings

To Be Completed by June 7th

A. History and Economics of State and Local Business Incentives

Bennett Harrison and Sandra Kanter, "The Great State Robbery", Working Papers (Spring 1976.) Pages 57-66.

B. Community Development Corporations

Bennett Harrison, "Ghetto Economic Development: A Survey," Journal of Economic Literature, vol. XII, no. 1, (March 1974,) Pages 1-37.

Frederick Sturdivant, "Community Development Corporations: the Problem of Mixed Objectives," Law and Contemporary Problems, 36 (Winter, 1971) Pages 35-50.

Harvey Garn, "Bedford Stuyvesant Restoration Corporation", Evaluating Community Development Corporations -- A Summary Report, Urban Institute, 1976, Pages 11-41.

Lawrence Parachini, "Community Enterprise Development Corporation of Alaska," Center for Community Economic Development (CCED) Newsletter, (August-September 1976) Pages 5-11.

C. Public Enterprise

William Shepherd, Public Enterprise, Lexington Books, 1976. Chapters 3 and 6.

Jerome Milliman, "Beneficiary Changes -- Toward a Unified Theory", Public Prices for Public Products, Selma Mushkin, ed., Washington: The Urban Institute, 1972. Chapter 2.

Peter Barnes, BackDoor Socialism: Reflections on TVA," Working Papers, (Fall 1974,) Pages 26-35.

To be Completed by June 8th

D. Local Control

Sylvia Kamm, Land Banking: Public Policy Alternatives and Dilemmas, Urban Institute (1970), Pages 6-10 and 28-42.

Peter Barnes, "Buying Back the Land," Working Papers (Summer 1973), reprinted in Second Annual Policy Reader, 1973, Pages 146-153.

E. Coops, Collectives, Worker Redesign

Andre Gorz, "Workers' Control is More than Just That," Participatory Democracy for Canada, Gerry Hunnius, ed., Black Rose Books, 1971. Pages 13-27.

Seymour Melman, "Industrial Efficiency Under Managerial vs. Cooperative Decision Making," Review of Radical Political Economics, (Spring 1970) Pages 9-33.

William Greenwood, "Coops and Net Margins: Retention vs. Cash Payment," Economic Development Law Project Report (Nov/Dec. 1976) Pages 12-13.

Daniel Zwerdling, "At IGP, Its Not Business as Usual," Working Papers, (Spring 1977), Pages 68-81.

Sam Hemingway, "What Makes them Think they Can Run the Mine!" The New Englander, (June 1975.) Pages 27-29.

F. Equity Financing

Carl Sussman, "Development Finance is Underway in Massachusetts," CCED Newsletter, (Dec/Jan 1977), Pages 6-13.

Readings to be Completed by June 9th

G. Employment Programs: LIP and LEAP

Thomas Barrocci, The Canadian Job Creation Model and its Applicability in the United States", U.S. Congress Joint Committee on Economics, Washington,DC 1976. Pages 2-33.

Cynthia Rose, "Massachusetts Local Initiative Program," CCED Newsletter, (June/July 1976) Pages 7-9.

State Manpower Services Council, Abstract and Analysis of "An Evaluation of the Massachusetts Local Initiative Program" 1977.

Feldman, Gould, Katz, Kramer, Rubin, Handbook for CETA Prime Sponsors to Assist in Selecting CETA Job Creation Projects, State Manpower Services Council, 1977. Pages 1-12.

H. Banking Policy

Frances Werner, William Frej, and David Madway, "Redlining and Disinvestment, Causes, Consequences, and Proposed Remedies" Clearinghouse Review, Vol 10, no. 7, October 1976. Pages 501-519.

Derek Shearer, Public Control of Public Money, Institute for Policy Studies, 1976. Pages 23-39.

Alan Dixon, "The Illinois Plan," 1973. Pages 1-4.

HARVARD UNIVERSITY

GRADUATE SCHOOL OF DESIGN

Continuing Education Program

GENERAL INFORMATION

SECURITY There is a security guard in Gund Hall in the evenings and on weekends. Please check in with him at the reception desk in the lobby if you enter the building after 5:30 weekdays and every time you enter on the weekends.

BADGES Please wear your name badge throughout the course. It serves as a means of identification as well as facilitating informal discussion.

MEALS Lunches will be announced in your course schedule. If you are having lunch at the Faculty Club, please fill out one of the slips included in your registration kit.

You are on your own for breakfast and dinner. There is a listing of popular eating spots in Cambridge/Boston included in this notebook.

TELEPHONES/MESSAGES Reverse charge and credit card calls may be made in the Continuing Education office, Room L-37. Messages may be left for you there as well - (617) 495-2578, between 9 am and 5 pm, Monday through Friday.

There are two telephones in the lobby of Gund Hall. One is a pay telephone, to be used for all long distance or credit card calls. The other is a telephone that may be used for local calls only, at no charge.

For those staying in CANADAY HALL: messages may be left at the bell desk (617) 495-5818 in addition to the Continuing Education office.

TAXIS

Ambassador Cab	876-5600
Brattle Cab	492-1100
Checker Cab	536-7000
Yellow Cab	547-3000

If you have problems or questions about the Continuing Education program, please feel free to contact us in Room L-37 or call (617) 495-2578.

UNIVERSITY HEALTH SERVICES
Harvard University
SUMMER-1974

Health Center
75 Mt. Auburn Street

HOURS:
MONDAY
through 8:00 a.m.-5:30 p.m.
FRIDAY

SATURDAY 8:00 a.m.-11:45 a.m.

TELEPHONE: 495-5711
For Physician Appointments - 495-5714

The University Health Services in cooperation with the Summer School offers medical care for Summer School students and faculty.

Payment of the registration fee provides for:

General medical and surgical care of
- ambulatory patients
- Stillman Infirmary Patients
during the Summer School Session.

Also referral within the Health Center to staff specialists (allergy, dermatology, dentistry, ophthalmology, orthopedic surgeons, psychiatry), laboratory and x-ray facilities and nutrition and physical therapy services.

Physicians' visits to homes and dormitories are not included nor are admissions to an outside hospital.

EMERGENCIES - Call 495-5711. At hours other than those listed above, go to the EMERGENCY ENTRANCE - REAR OF HEALTH CENTER on automobile ramp that connects Holyoke and Dunster Streets. (Report emergency cases to the Dean of Students or the Dean of Residence. 495-2951

ACTIVITIES

The Summer School sponsors a variety of extracurricular activities. For these, the Summer School Privilege Card is required for identification purposes. Additional information on activities is available at the Office for Student Affairs. Fees for extracurricular activities are subject to change.

Athletics

Golf

The Cambridge Municipal course at Fresh Pond Golf Club, 691 Huron Avenue, is open to golfers upon payment of greens fees. For information: (617) 354-9130.

Sailing

The Harvard Sailing Center is on Memorial Drive at the foot of Wadsworth Street. Twenty-five Inter-Club Dinghies and six Finns are available; sailing instruction is provided for beginners. A swimming test of 100 yards is required and is administered at the Indoor Athletic Building Pool. For information on sailing and membership: (617) 495-3434.

Sailing Center Card (at Athletics Ticket Office or Sailing Center)	$20.00
Sailing hours (June 27-August 19)	1:30-7:30 p.m.

Sculling

The Weld Boat House is on Memorial Drive at Lars Anderson Bridge. Individual rowing (single shells for a period of 45 minutes or wherries for a period of 30 minutes) is available. Facilities include lockers and shower rooms for men and women (users must supply own towels). A swimming test of 100 yards is required and is administered at the Indoor Athletic Building Pool. For sculling information: (617) 495-2226.

Season ticket (June 27-August 19)	$20.00
Single use (each period)	1.50
Hours: weekdays	10:00 a.m.-5:00 p.m.
Instruction at boathouse, weekdays	10:00 a.m.-4:00 p.m.

Swimming

The Indoor Athletic Building on Holyoke Street has two pools, a small shallow pool for beginners and an intercollegiate-size deep-water pool. Facilities include locker and shower rooms for men and women (users must supply own towels). Nylon tank suits are required. Swimming classes may be provided. For information on swimming: (617) 495-4850.

Season ticket (June 27-August 19)	$20.00
Single use	1.50
Men and Women, weekdays	11:00 a.m.-5:30 p.m.

Tennis

There are thirty University tennis courts at Soldiers Field, across the Charles River. For additional tennis information: (617) 495-4850.

Season ticket (June 27-August 19)	$20.00
Single use per hour:	
Hard surface courts	1.50
Clay courts	2.00
Indoor courts (inclement weather only)	
Singles with season ticket	4.00
Doubles with season ticket	3.00
Singles without season ticket	5.00
Doubles without season ticket	4.00
Hard surface courts,	
Monday through Saturday	8:00 a.m. to dusk
Sunday	8:00 a.m. to dusk
Soldiers Field clay courts,	
Monday through Sunday	8:00 a.m. to dusk

Arrangements may be made for tennis instructions on Soldiers Field courts.

At Garden and Bond Streets in the Radcliffe area four University clay courts are also available, on a first come first served basis. For reservations: call (617) 495-7886 between 8 a.m.-1 p.m., or 3-7 p.m.

Radcliffe area clay courts,	
Monday through Sunday	8:00 a.m. to dusk

The Summer School will have a Tennis Tournament with men's and women's singles and mixed doubles. Dates and sign-up instructions will be announced in the Office for Students Affairs.

Cultural/Educational

Dance

The Harvard Summer School Dance Center offers a number of activities and events this season which are open to the Harvard community and to the general public at no charge.

A series of dance films will be screened Tuesday evenings at 7:30 in the Science Center. At Agassiz Theater in the Radcliffe Yard, student workshop performances will be presented Wednesdays at 4 p.m.; and a guest lecture series with feature members of the professional dance world on Thursdays at 2 p.m.

Museums

Seven Harvard museums are open to the public. The Fogg Art Museum, Museum of Comparative Zoology, Peabody Museum of Archaeology and Ethnology, Botanical Museum, Busch-Reisinger Museum, Mineralogical Museum, Semitic Museum.

Music

Application for the Band and Chorus is found on center fold. Those interested in participating should complete and return the form to the Harvard Summer School.

Harvard Summer Band. In 1972 the Harvard Summer Band was formed as a community organization, open to interested wind and percussion players (without audition) in the area. Conducted by the director of the Harvard University Band, Thomas G. Everett, the summer band will read and rehearse light popular works as well as serious literature. Rehearsals: Wednesdays, 7:15-9:30 p.m. Two informal outdoor concerts will be scheduled in the Harvard Yard and at the Hatch Memorial Shell on the Esplanade in Boston.

Harvard Summer School Chamber Players. Under the musical direction of composer-pianist Leon Kirchner, Walter Bigelow Rosen Professor of Music, the Chamber Players offers its sixth full season of Monday Evening Concerts in Sanders Theatre, July 11-August 8. The ensemble is a unique association of talented student and professional musicians from across the nation. The 1977 series will feature works by Beethoven, as well as occasional works by Bartok, Hindemith, Messiaen, Schoenberg, and Stravinsky.

Harvard Summer School Chorus. The Summer School Chorus, open to members of the student body, will be under the direction of Robert Porco, Assistant Professor of Music, University of North Carolina at Chapel Hill.

Area Concerts. The Boston Pops Orchestra offers the Esplanade concerts on the Charles River for two weeks early in the summer. The Boston Symphony Orchestra presents the eight-week Berkshire Music Festival at Tanglewood in Lenox, Massachusetts, beginning July 8.

Summer Newspaper

The Harvard Crimson will publish twice weekly during the session and will provide opportunities for Summer School students to participate in its operation. The paper carries official notices, announcements, reports of activities, and other news of interest to the student body. For information visit the *Crimson* office, 14 Plympton Street, or call 495-7890.

Theater

Harvard Summer School Repertory Theater June 22-August 20. The professional theater season at the Loeb Drama Center opens June 22 with Harvey Schmidt's and Tom Jones's musical about a marriage, I DO, I DO, which is based on Jan de Hartog's well-known play, "The Fourposter." This will be followed by Arthur Miller's comedy, THE PRICE, which opens July 13, and on August 3 by Noel Coward's immensely popular HAY FEVER, a hilarious situation-comedy set in the 1920's. Each play is given for 19 performances, including 2 performances each Saturday. Tickets should be ordered in advance from the Loeb Drama Center's box office, 64 Brattle Street, Cambridge, MA 02138. Series discounts are available; write for details.

Shakespeare Film Festival. The twenty-four films of Shakespeare's plays to be shown in the *Shakespeare in Film* course (see Department of Visual and Environmental Studies) will be made available to those who are not members of the course on Monday, Wednesday and Friday evenings at 7:30 p.m. in Carpenter Center during the eight weeks of Summer School.

The Festival will include Laurence Olivier's *Hamlet*, *Henry V* and *Richard III*, Orson Welles' *Macbeth* and *Falstaff*, Peter Brook's *King Lear* and George Cukor's *Romeo and Juliet*.

Tickets will be sold at the Office for Continuing Education, Lehman Hall B-3, by subscription only: $25 for all twenty-four films or $17.50 for twelve films of your choice. Tickets will not be available for individual films nor will they be sold at the door.

Tours

Suggestions for tours through historic Boston, Cambridge and other New England areas are available at the Office for Student Affairs. For weekly listings of local events consult the calendar listings of area papers, or call Boston 200, 338-1976.

Religious

Daily Prayers will be held in Appleton Chapel in Memorial Church, at 8:45 a.m., Monday through Friday beginning June 28 through August 19. The services will be conducted by ministers of Cambridge churches and by members of the faculty. Sunday Services will be conducted in Memorial Church at 11 a.m., beginning July 3.

Social

The Summer School sponsors a number of dances and social activities. Information on these events, as well as listings of students clubs which are active in the summer, will be available at the Office for Student Affairs.

NONTRADITIONAL TECHNIQUES FOR LOCAL ECONOMIC DEVELOPMENT
Monday, June 6 - Friday, June 10, 1977

For years, the favored method for improving a state or city's economy has been through government subsidy of business enterprise. But as the overwhelming body of academic literature points out, tax incentives, work subsidies and investment credits given to firms do not create jobs. Instead, they end up as a redistribution of income from the taxpayer to the business community.

The first part of the course will examine the history of state and local subsidy programs and explore the econmic assumptions behind them. The major portion of the course, however, will be devoted to an evaluation of a wide range of alternative methods of development. Each method will be considered from three angles. Initially, we will examine the "economics" behind the program or strategy. Second, we will survey the literature to see if the various strategies have been implemented around the country and if so, the effectiveness of these ventures. Finally, we will meet with people who have had experience in the various methods and learn about some of the practical problems and strengths in the methods studied.

Monday 6/6

Morning

9:00 - 10:30 am	Registration in Lobby - Gund Hall Breakfast and Orientation in Cafeteria - Gund Hall
10:30 - 12:00	Discussion of Current State and Local Economic Programs in Massachussetts Mel King/GaryJefferson

Afternoon

12:00 - 1:00 pm	Lunch/Harvard Faculty Club 20 Quincy St, Cambridge
1:00 - 2:30 pm	History and Economics of State and Local Business Incentives Sandra Kanter
2:30 - 4:00 pm	Community Development Corporations DeForest Brown
4:00 - 5:00 pm	Theory of Public Enterprise, Part I Sandra Kanter

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Tuesday 6/7

Morning

8:30 - 12:30 pm	Tour of Projects Underway in Boston Mel King

Afternoon

12:30 - 1:30 pm	Lunch/Harvard Faculty Club
1:30 - 2:00 pm	Theory of Public Enterprise, Part II Sandra Kanter
2:00 - 4:00 pm	Public Enterprise in Practice Marsha Molay/Ted Vannahl/Dave Davis

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Wedensday 6/8

Morning

9:00 - 10:30 am	Models of Local Control Mel King
10:30 - 12:00	Local control of Natural Resources in Practice Jeff Simon/Susan Redlich

Afternoon

12:00 - 1:00 pm	Lunch/Harvard Fàculty Club
1:00 - 2:30 pm	Economics of Employment Programs Including Coops, Collectives and Worker Redesign Projects Sandra Kanter
2:30 - 4:00 pm	Economics of Community Economic Development: Equity, Financing and the CDFC Belden Daniels/Elbert Bishop
4:00 - 5:30 pm	LEAP, LIP and Banking Policy Overview Sandra Kanter

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Thursday 6/9

Morning

9:00 - 10:30 am	LEAP and LIP in Practice Ralph Jordan/Sandy Leon/Marty Gopen
10:30 - 12:30 pm	Cooperatives and Collectives in Practice John Blanchard/~~Mr. Endresen~~/Steve Klein

Afternoon

12:30 - 1:30 pm	Lunch/Harvard Faculty Club

– Bond Bank authority
– Mtge Ins. Program
– Credit Unions
– Retirement Funds

Thursday 6/9 cont.

1:30 - 2:30 pm	Worker Redesign in Practice Mike Lynch
2:30 - 4:30 pm	Banking Policy in Practice Jim Carras/Jack Kittredge

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Friday 6/10
Morning — Wrap-up

Faculty

Course coordinator Melvin King is a Massachusetts State Representative, Adjunct Professor at MIT, and cosponsor of the recently passed Community Development Finance Corporation Act.

Sandra Kanter is Assistant Professor of Economics at the University of Massachusetts and a former senior researcher with the Joint Commerce and Labor Committee of the Massachusetts Legislature.

Gary Jefferson is the former Deputy Director of the Office of State Planning in Massachusetts.

DeForest Brown is the Executive Director of the Center for Community Economic Development.

Marsha Molay is the Deputy Secretary of State, in Massachusetts (state bookstores).

Ted Vannahl is the Manager of Merrimac Light Inc. (a public utility).

Dave Davis is the Executive Director of the Massachusetts Port Authority (public transportation).

Jeff Simon is the Deputy Director of the Massachusetts Land Bank.

Susan Redlich is the Director of the Division of Agriculture ReUse, in the Office of Agriculture.

Belden Daniels is the former Executive Director of CDFC.

Elbert Bishop is the Executive Director of the Southwest Corridor Coalition.

Ralph Jordan is Director of the State Manpower Services Council.

Sandy Leon is the Director of Massachusetts CETA Program.

John Blanchard is a member of the American Friends Service Committee.

Mr. Endresen is with the Ocean Spray Company, Inc.

Steve Klein is a Consultant to Community Canners.

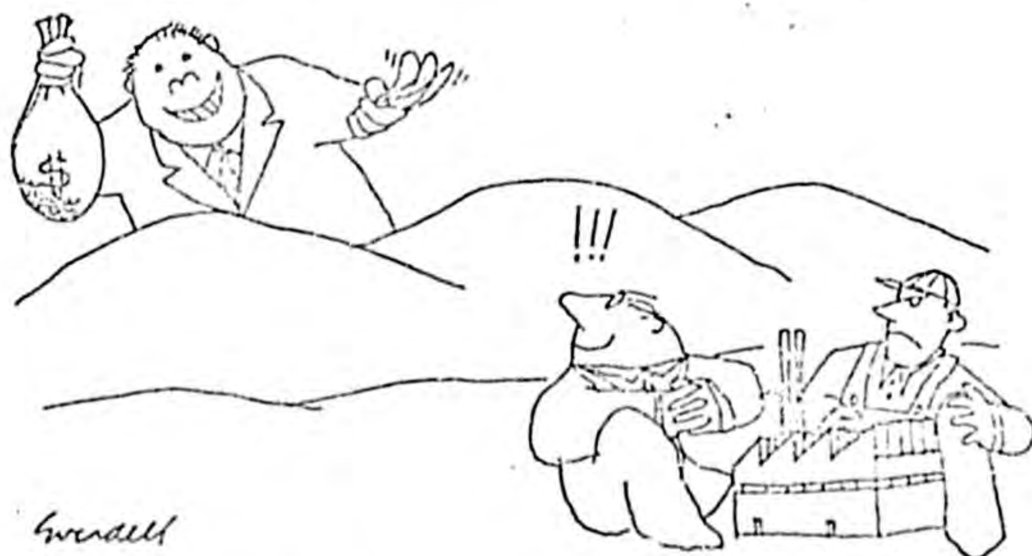
Jim Carras is with the Office of Program Development of the City of Boston (anti-redlining).

Jack Kittredge is with the Social and Economic Opportunity Council (linked deposit system).

The ... State Robbery

by BEN... ...IARRISON and SANDRA KANTER

State tax ... ...es for business have virtually no effect on job creation or economic developm... ...t they do redistribute income—upwards.



Contenders for the office of governor in Mississippi last November agreed on at least one thing, according to a *New York Times* account: "economic colonialism." They were both against it.

Responding to an interviewer's question as to how he felt about "manufacturers building plants in the state to take advantage of cheap labor," Democrat Charles C. Finch (who won the election) said "with a show of passion": "I don't want them to come here just because they may be able to get nickel or dime savings on their labor. We've been holding our head in the sand by offering cheap wages. The blue chip industries are not looking for cheap wages." His Republican opponent proposed putting less emphasis on tax incentives for industry. "The state needs to think instead about incentives for agriculture to get idle land back into production," he said.

BENNETT HARRISON is associate professor of economics and urban studies at M.I.T., and began his research in this area while a consultant to the commerce and labor committee of the Massachusetts legislature. SANDRA KANTER, formerly a researcher for the same committee, is an assistant professor of economics at the University of Massachusetts in Boston.

"The Mississippi race," the *Times* story went on, "is the latest indication that Southern leaders are changing their traditional stance toward industrialization. For generations Southern politicians and businessmen lured Northern industry with every device they could find, from cheap labor to tax write-offs."

Cheap labor and favorable political conditions almost surely had more to do with enticing low-wage industry from the North to the South than tax write-offs. Indeed, the latter may not have made any difference at all. Effective or not, however, "devices" like tax write-offs to businesses are still advocated in practically every state legislature as a way to stimulate production and thus to create jobs within a state's boundaries.

Such incentives are opposed by some observers on the grounds that competition among states for jobs does nothing to increase the country's overall employment; it just changes its location. Other opponents see the incentives as one more example of how public money is used to benefit private corporations. However valid these objections, we are going to make a

different argument against the incentives: They don't work. What's more, they cost states a lot of money in uncollected taxes.

Special-interest lobbyists have succeeded in selling states the idea that incentives are effective and even necessary both to attract and to keep business. Surprisingly little work has been done to find out how firms actually do respond to the incentives. Perhaps that is because the policies sound perfectly plausible. If a state reduces the costs of doing business relative to other states, surely firms will be attracted to it.

That argument may sound right. But there are a host of reasons, some of them even from standard economic theory, why the incentives that most states use will not significantly affect production or employment. And empirical studies, spotty though they may be, provide little or no evidence that business decisions are influenced by these incentives.

The Theory

State subsidies to business are almost as old as the Constitution. In the late 1700s, for example, the government of the Commonwealth of Massachusetts authorized bounties or outright gifts of money to producers of hemp, flax, and glass to encourage production of these goods. The Commonwealth also offered to reduce the taxes of brewers who produced over 100 barrels of beer annually.

Today the rationale for business incentive policies is less to encourage the production of particular goods than it is to encourage the creation of jobs within a state. These policies include tax credits and "forgiveness"; the provision of capital raised through tax-exempt bonds; low-interest loans; and state guarantees of loans or mortgages written by private sector lenders. Nearly every state in the union provides some mix of these business incentives (see box, p.62).

Popular—and legislative—discussions about business incentives are invariably couched in very general terms: "Cut taxes and get businesses to create new jobs." Economic theory cannot tell us with any precision whether or not cutting taxes in a state creates jobs. It can, however, shed light on a number of issues about business incentives that are not covered in the existing empirical studies—and that should be of concern to policymakers. For example, if incentives do work, which sorts of businesses are likely to respond to them? What kinds of jobs are apt to be created? How important to firms are reductions in costs of the magnitude the states can offer, compared to other market conditions?

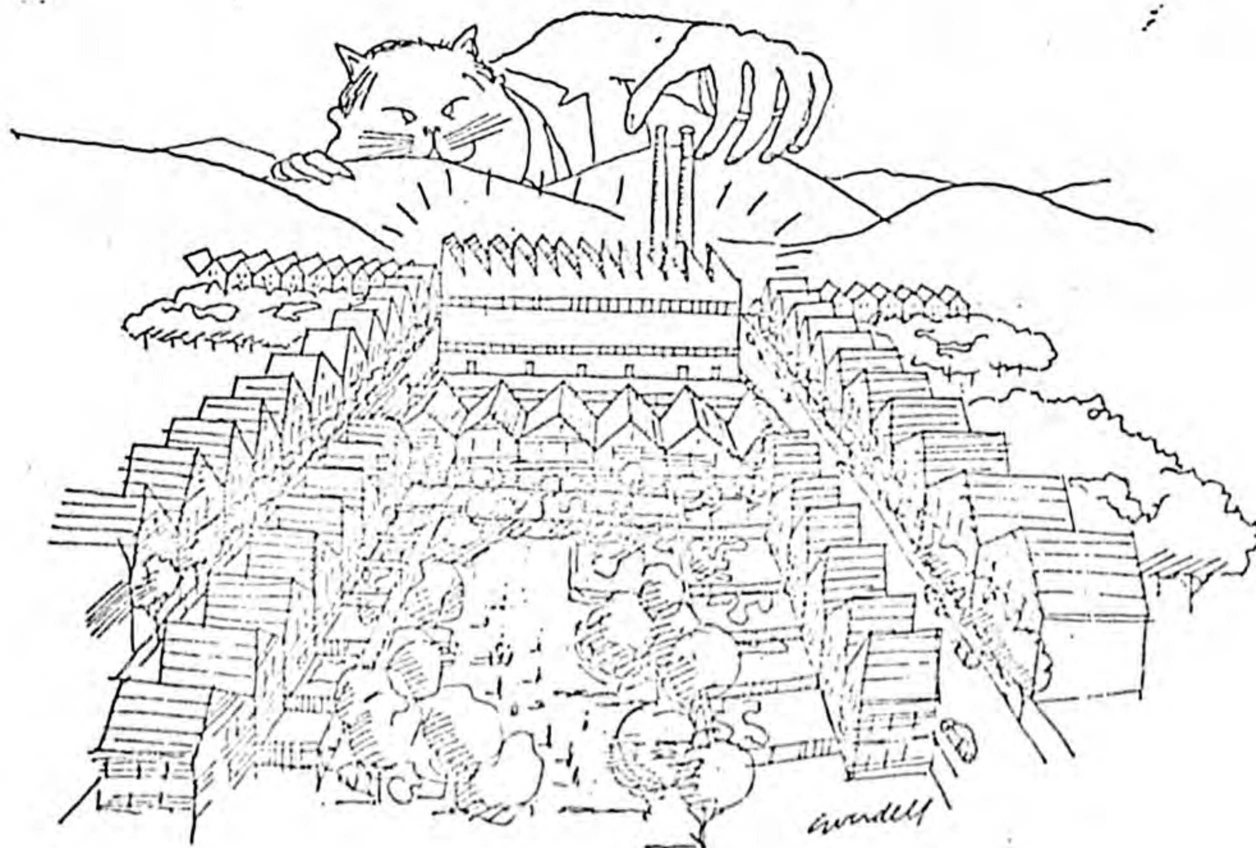
There is, in elementary economics, a model of "perfect competition" in which firms compete with one another on equal terms for markets, labor, and capital. No one firm is so powerful that it can directly influence the price of its product or the prices it must pay for labor or capital. And so on. According to this theory, under conditions of perfect competition, *any* reduction in a firm's costs will induce some change in its output and employment decisions. In its search to maximize profits, the firm will tend to increase production and, therefore, employment.

Though many of these assumptions never hold in the real world, firms do behave differently according to the degree of their competitiveness. Oligopolies, for example, are firms in industries that are characterized by a relatively small number of larger producers. To some extent, oligopolies like Ford or General Motors can set their own prices and output levels without fear of losing out to a competitor. Tee-shirt factories, by comparison, have to produce as many shirts as they can and sell them at a price low enough to be competitive or else they'll go out of business. Though even they do not exactly fit the model of perfect competition, they will respond more nearly to the textbook model than the oligopolies, which are less affected by external market conditions. It follows, then, that if they have any effect at all, incentives that lower the costs of taxes and interest on bonds and loans will have a relatively larger impact on competitive firms than on oligopolies. In theory, at least, the competitive firms are more apt to respond by increasing production and employment.

In recent years, a huge literature has developed on the "rules of thumb" by which oligopolists (and even small firms facing less than perfectly competitive conditions) make output and employment decisions in response to changes or uncertainties in market conditions. This literature stresses the importance of "threshold effects": unless price, cost, and other external conditions change by more than some minimum amount in a given time period, the firm will probably ignore the changes since the very act of adjusting to them would have real costs. For example, if business taxes fall by a small amount, the firm may not react at all. The revenue a firm gains from tax incentives that are granted whether it increases its hiring or not—such as reduced excise taxes on existing machinery—is simply a windfall profit.

Firms of all types are more likely to increase output and therefore employment if there is an increased demand for their goods and services. But at the state level, business tax incentives do virtually nothing to stimulate the demand for goods and services (although consumer income tax deductions and credits may do so).

In principle, of course, there must be some level of



business incentive so great that the resulting cost reduc-tion would, over time, induce at least some firms to increase their output and employment significantly. But the larger the incentives, the greater the tax revenue the state foregoes that might have been used to finance other things, such as state social services, repayment of interest on the state's bonded debt, and so on. There are, therefore, political limits to how much a state can offer in business incentives.

If and when some firms do respond to tax incentives by increasing output and employment, theoretically at least, they are most likely to be firms in the competitive sector, rather than oligopolies. Yet, according to the "dual labor market" literature, these are the industries that in general pay lower wages, offer worse working conditions, provide les stable (full year and/or full week) employment, and make it more difficult for labor to organize. Thus, incentives that lower costs of doing business appear to be policy instruments—if they work at all—that are most likely to "goose" the sector of the economy with the least desirable jobs, while providing windfall profits to the segment of the business community that least needs them.

Some business incentives, for example investment tax credits, are intended to lower the price of capital, and thus encourage firms to invest in new plants, expand existing plants, and relocate from other states. Though economic theory has not had great success in predicting investment decisions, one thing is clear: the decision to invest depends not only, or even primarily, on the cost of capital, but also on expectations about the likely "returns" to that investment through sales. Almost anything that a government can do to reduce the uncertainty about sales is more likely to induce businesspeople to go ahead and build or expand a plant than any other kind of public action—including the granting of incentives.

Orthodox theory ignores the question of who has access to capital for investment in the first place. Most treatments assume that capital is always available for a price. If it pays an investor to borrow the capital in order to build or expand his or her facilities (because the expected rate of return is higher than that available from other applications of the funds), the borrowing and investing will in fact take place.

But capital allocation depends only partly on "supply and demand." Blacks, women, entrepreneurs working in low-income communities, and nonprofit developers have trouble getting capital at *any* price. (Since the New York City debacle, state and local governments may be in the same category.) A particu-

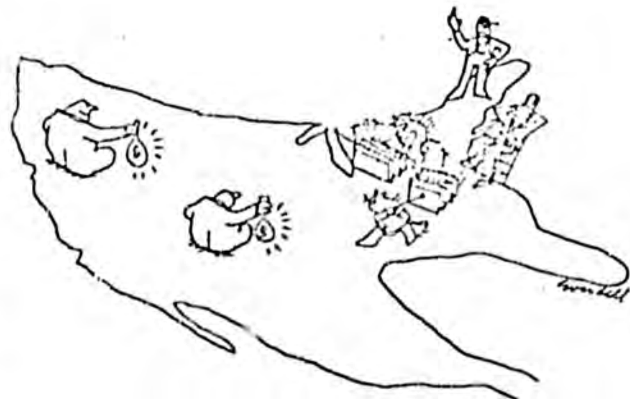
lar problem for these investors is the "debt-to-equity capital mix." Equity capital is usually obtained by selling stock in an enterprise. The lender (stockholder) is paid a share of the profits—if and when there are any profits. When capital is obtained through loans, however, the borrower usually has to begin paying back interest on the loan immediately, whatever shape the business is in. Thus, businesspeople who must rely mainly on loans for capital investments face high probabilities of failure because of their indebtedness. And equity capital is particularly scarce for the traditionally excluded groups mentioned above.

The smallest firms, with the poorest "track records," and the least powerful investors or groups, perhaps with no "track record" at all, find it most difficult to borrow or to attract new equity investments. Large firms with good credit ratings have less trouble raising their own capital, whether externally or through their own retained earnings. But if the investing and lending of private banks, or of state economic development authorities, is based on the creditworthiness of the borrower, then the normal operation of the capital markets will work to channel ever more financial resources to the oligopolists at the expense of the more competitive segment of the market. On the one hand, then, competitive industries are more likely to need tax and interest rate incentives and so they are more likely to take advantage of them. On the other hand, competitive firms face greater uncertainty about business success so they may be less likely to invest at all and thus they may not take advantage of state investment incentives.

Aside from some speculation about the different behavior of firms in oligopolistic industries compared to competitive industries, economic theory is ambiguous in predicting the impact of state incentives on job creation. This even extends to the national level, at least in terms of tax credits or tax cuts. The Brookings Institution conducted a series of econometric evaluations of the impact of the 1962 federal investment tax credit, which was designed to stimulate the business sector's demand for capital goods and therefore, indirectly, the demand for labor. Half of the studies concluded that the credit worked. But half concluded that it did not affect output and employment at all.

The Evidence

Judging from the speeches of elected and appointed officials and the editorials of newspaper writers, most people seem to expect new jobs to be created in a state's economy over time through the relocation into the state of plants that are closed down elsewhere, or through the decision of multiplant firms to build their



next new plant in the state. To this end, states use an additional policy instrument, industrial recruiting. They hire advertising agencies or management consultants to place ads and hustle up new business. Visiting company representatives are wined and dined, and shown around the state.

Most urban and regional economists believe that companies select regions by broad, qualitative criteria such as the availability of basic resources, adequate transportation access, and, though it is seldom put so bluntly, a politically passive labor force. The sort of cost differences that incentives try to create are considered less important.

For example, Peter Bearse, formerly the executive director of the council of economic advisers to the governor of New Jersey, discusses the role of these marginal cost differences in the corporate decision-making process:

> *Decisions can be arrayed in a hierarchy-from minor allocation decisions of the type described by textbook economic theory to major "all or nothing" decisions like the decision to move or build a plant. Major decisions are subject to thresholds and long gestation periods. Marginal adjustments in the cost of debt finance or in certain tax rates do not stand a chance of affecting a major decision unless a firm is at or near a threshold; and even then, several other factors are operative .... It is a question of probabilities-the odds that a given policy can have an intended effect. I claim that the concept of an adaptive, sequential decision making process subject to thresholds makes the efficacy of current policies look very dubious.*

Bearse's doubts appear to be validated by the empirical data, sketchy though they are, that have been collected about corporate responses to the business incentives offered by various states.

Since the 1950s, government agencies and independent researchers have tried to measure the relative impact of business incentives on industrial location or expansion. Unfortunately, the quality of the empirical

material is uneven. Nonetheless, with a very few exceptions, the literature does not reveal significant plant relocation or expansion resulting from interstate differentials in state business incentives.

Surveys have asked employers to name the factors that mattered in their decision either to expand their facilities in a particular location or region, or to move into that area. The firms seldom mentioned such things as state and local taxes or the availability of subsidized credit. When taxes or credits were specified by the questionnaire, the proportion of respondents checking them off usually rose to between 5 percent and 15 percent. When these surveys then asked the respondents to indicate whether these factors were "critical" or not, few considered them as such. The findings were similar for the relative importance of other types of business incentives. A wide range of "mentions" were recorded, state bonding programs for example, but no such factor was considered to be "critical" by more than a small proportion of the sample. The results of these surveys are remarkably consistent even though they were made at different times, under different circumstances, and in different areas of the country.

One of the earliest surveys was conducted in 1950 by the Survey Research Center of the University of Michigan. The managers of only 9 percent of 188 plants moving into Michigan felt that the state's tax benefits were an "important consideration" in their moves. A Regional Plan Association study of firms moving plants out of New York City between 1947 and 1955 concluded that 14 percent of the moves were related to interregional tax differentials. (A more recent study of firms moving facilities out of New York State, however, shows a much greater sensitivity to taxes as a cost of doing business, with half of the respondents indicating taxes as one factor in their relocation decision.) A questionnaire was mailed to firms expanding or relocating into seven southern states in the late 1950s; 11 percent of the respondents checked local taxes as a factor, but only 2 percent called that factor "critical." In a 1963 study of the movement of industrial plants into Ohio since before World War II, only 2 percent of the companies interviewed voluntarily cited tax differentials as a factor.

One particularly careful study was conducted at the Stanford Research Institute in 1964 by economist Robert Spiegelman. He analyzed the locational behavior of one of the more footloose industries, precision instrument manufacturing. More than one-half of the 45 firms in the study considered interregional tax differences relevant, but only one called them "the most important factor." In a mid-1960s survey of industrial migration into Texas, only 13 percent of the firms considered taxes to be one determinant of their decision.

A national mail survey conducted by the U.S. Department of Commerce in 1972, covering 2,900 companies in high-growth industries across the country, revealed that 78 percent considered tax incentives or "holidays" to be relevant to their locational decisions. But only 8 percent rated such incentives as "critical."

There is no way of knowing whether the person who answers these mail questionnaires is a public relations staffer, a lower-level executive, or the person directly in charge. In 1974, to get more precise responses, personal interviews were conducted in Massachusetts and Connecticut. Two legislative staffers interviewed executives of 15 Massachusetts companies from the pool of companies that had applied for state "job-creation tax credits." Credits were claimed by 14 of the companies for alleged expansion in excess of "normal" growth, and one was for relocation into Massachusetts. Every single interview yielded the same result: the company took actions according to its own plans, then learned about the existence of the tax credits and applied for them. An independent set of interviews with Connecticut businesspeople participating in that state's business incentive programs produced identical results. In these two states, at least, the availability of the incentives did not produce business behavior that would not have occurred otherwise. Instead, the incentives functioned as a windfall for the companies at the expense of the taxpayers.

One way to estimate the effects of the incentives while avoiding the inherently subjective nature of the survey approach is to compare the rate of job growth in states with high and low business taxes. C.C. Bloom correlated growth in manufacturing employment with per-capita state and local tax collections among all the states, for two periods, 1939 to 1953 and 1947 to 1953. In neither case was there a statistically significant relationship. An econometric model describing the growth of the Michigan economy between 1947 and 1955 showed no significant relationship between state and local taxes and employment growth over time. A nonprofit citizens organization, the Pennsylvania Economy League, rank-ordered 11 states in 1971 according to the burden of state and local taxation on ten specific industries. We find no systematic correlation between this rank ordering and the state unemployment rates; in fact, the lowest unemployment state, Indiana, was consistently found to be among the very highest tax-burden states for most of the industries. Finally, for 15 of 16 major industries studied in an econometric model of the Massachusetts economy describing the period 1950 to 1972, there was no statistically significant

INCENTIVES GALORE!

Tax credits and forgivenesses. Property tax concessions are the oldest and most important of the business incentives offered by states. Twelve states and Puerto Rico permit cities and towns, counties, or the state itself to exempt part or all of business property from property taxation for a specified time period. Puerto Rico's tax incentive law is probably the most liberal: manufacturers of goods first produced in Puerto Rico after 1946 pay neither property nor income taxes for a period of up to 25 years. Three states provide similar, though smaller, tax concessions to new industry. Nine states give local counties or municipalities permission to give abatements to businesses on some or all of their local property taxes.

Alabama, Mississippi, Georgia, and North Dakota exempt new and/or expanding industries from local ad valorem taxes on all tangible property for a stipulated time period. (Ad valorem taxes are taxes levied on the value of property. Sales taxes, on the other hand, are based on the sale of goods and services.) New York, Massachusetts, and North Dakota give tax credits to businesses that expand employment. In North Dakota, new firms may receive a tax credit of up to 1 percent of their annual gross wage and salary expenditures for three years. In New York, firms that expand in low-income areas qualify for an income tax credit. Massachusetts gives income tax credits to businesses that employ people who were on welfare or drawing unemployment compensation.

Four states permit some form of investment tax credit. Firms may take a certain percentage of the cost of acquiring buildings, structures, machinery, and equipment as a tax credit and reduce their total state tax bill by the amount of the credit, which varies from state to state. New York and Rhode Island allow manufacturing firms a tax credit equal to 2 percent of the cost of new buildings, equipment, and facilities; Massachusetts allows 3 percent. Manufacturers in West Virginia may receive a credit equal to 10 percent of the cost of new production facilities for a period of ten years.

Loan guarantees. Thirteen states guarantee commercial loans. Ten of these states have organized industrial finance authorities specifically authorized to guarantee, on behalf of the state, the repayment of some or all of a mortgage or loan made by a conventional market source on an industrial facility. New Hampshire, the originator of the program, has a relatively modest policy: the state insures the portion of a loan that is in excess of 50 percent of a property's appraised value or in excess of 65 percent of the value of machinery and equipment. At the other end of the spectrum, Rhode Island guarantees up to 90 percent of the cost of plant construction. Most states charge firms a fee for administrative costs that ranges from 1 percent to 3 percent of the outstanding loan.

Industrial development bonds. There are two kinds of industrial development bonds: general (or "moral") obligation bonds, and revenue bonds. Thirteen states permit localities to float general obligation bonds, whose payments are guaranteed by the full faith and credit of the state or municipality. Forty-three states allow local governments to issue revenue bonds that are paid solely from the proceeds of the project and do not become the obligation of any government. Both types can be used to finance the construction of industrial development projects or sports facilities, convention or trade show buildings, docks, wharves, airports, parking lots and garages, sewage or solid waste disposal plants, and air or water pollution equipment. Income from general obligation and revenue bonds is usually exempt from federal taxation.

Low interest loans. Thirty states have state-chartered credit corporations that make loans to businesses unable to obtain long and short-term financing in the conventional capital markets. The corporations issue stock to banks, insurance companies, and other private parties which are often exempt from paying state taxes on their income.

relationship between quarter-to-quarter changes in Massachusetts' share of national employment and changes in the ratio of Massachusetts' business taxes to the average for all states. Ephron Catlin, dean of Boston's financial wizards, banker extraordinaire, was recently quoted in a local paper: "... Our taxes aren't bad. I don't think many firms have moved out because of business taxes."

If, as seems to be the case, tax incentives are not very effective in luring businesses from one state to another, why not? We suspect that the main reason is that state and local taxes are such a small proportion of a firm's total costs of doing business. Incentives, in effect, reduce the cost of something that's not that important a consideration to begin with.

Interestingly enough, none of the empirical studies measure taxes in relation to business costs per se. We can get a good idea of their relative insignificance, however, from studies that estimate state and local taxes as a percentage of sales or of value added. (Value added is the actual contribution of a specific firm to the final market value of a good. If we take an auto factory, for example, the value of "intermediate products" made elsewhere—like steel bars or business forms—would not be included in the value added by the auto factory itself to the market value of autos.)

State and local taxes are consistently estimated at from a half to 3 percent of value added and from 2 percent to at most 5 percent of sales. A 1954 study in New York showed state and local taxes to be 1 percent of value added. In a 1958 calculation for Michigan, the ratio of state taxes to value added was under 1 percent. A study of five western states in 1963 found that taxes as a percent of value added ranged from a low of .93 percent in the food industry to a high of 2.73 percent in fabricated metals. Recently, the Federal Reserve Bank of Boston estimated that the average U.S. business paid 4.4 percent of its income to state and local governments. (This estimate, for 1973, breaks down into .9 percent going to pay corporate income taxes, 1.9 percent for property taxes, .8 percent for unemployment compensation contributions and .8 percent for "other business taxes.") Since corporate and unincorporated business income averages about one-eighth of the value added, this translates into an average ratio of state and local taxes to value added of about .6 percent.

Using another measure, J.A. Stocktish of the California Economic Development Agency found that state and local taxes as a percentage of stockholders' equity varied among selected industries over 17 states within a very narrow range: 3.9 percent (fabricated metals) to 6.4 percent (apparel).

Businesses, of course, must consider not only the cost of state taxes, but federal taxes as well. In Massachusetts, for example, a manufacturing or research-and-development firm is allowed to credit, against its annual state excise tax liability, 3 percent of the cost of new investment in buildings, machinery, or other equipment. The legislature intended this to be quite a large tax incentive to expand or relocate in Massachusetts. But the amount deducted from the state taxes, as a credit, is an addition to the firm's income, which is subject to the 48 percent federal corporate income tax. The saving is, therefore, cut almost in half. Suppose a middle-sized manufacturing firm, with total annual operating costs of $6.7 million, undertakes a new investment of $800,000 in Massachusetts. The state credit for the investment would be $24,000 ($800,000 x .03). But of the $24,000 "saved," the federal tax takes $11,520 ($24,000 x .48). The real saving to the firm is $24,000 less $11,520, or $12,480. And that amounts to a mere .19 percent of its total costs.

Since expansion or relocation decisions are assumed, even by the advocates of these policies, to depend on relative total costs in different places, it is no wonder that these, and similar, state business incentives don't have any great influence over corporate decision making. And since nearly all of the states follow one another in legislating these incentives, the savings differentials from one state to another are by and large meaningless.

Finally, the incidence of physical plant relocations—the objective of the incentives—is actually very small in the United States, *whatever* causes it. Between December 1969 and December 1972, according to an MIT-Harvard Joint Center for Urban Studies report using Dun and Bradstreet credit-rating data on all manufacturing and most nonmanufacturing firms in the country, plants moving into a state added an average of only .3 percent to that state's 1969 employment base; plants moving out took an average of only .2

percent of the jobs with them. In no single state was the gain or loss of jobs due to moving plants ever greater than .5 percent. This was, of course, a recessionary period, and data through 1973 may show increased movement of plants. Nevertheless, this first empirical estimate makes the competition among the states for new plants seem even more futile. There are few winners, yet all states incur costs.

In fact, the winners may not even benefit from relocated industry, however it is attracted. If the company brings part or all of its labor force with it, the new families will place an increasing burden on the social services, housing, and labor markets of the receiving state, and there will be at best only a small net effect on the local unemployment rate. If only the skilled labor force is relocated, the local job creation will occur in the unskilled, low-wage segment of the labor market. Only recently have state and local planners begun to look carefully at the expected impact of new plants on environmental quality and maintenance costs; under many circumstances, these, too, could more than offset the job-creation and tax benefits accruing to the state from successful industrial recruiting.

The Costs

Tax incentives force a state to forego tax revenue—the revenue that would have been collected in the absence of the incentives. The goods and services these foregone revenues could have purchased are called the "opportunity costs" of tax incentives. According to estimates made by the Massachusetts commissioner of taxation, his state lost about $65 to $70 million from six of the ten tax incentives the state offered to businesses in 1974. Calculations were not done for the other four incentives, but they probably would have brought the cost to over $100 million a year.

Mortgage guarantees, loans, and industrial development bonds do not reduce the amount of taxes that accrue to state governments, but there are also opportunity costs associated with these types of incentives.* These costs have to do with the availability and price of capital. Who will be affected by this "capital crowding" depends on the reaction of financial institutions to the overall economic conditions at the time. Though we know of no empirical estimates of these costs at the state and local level, a look at the financing process itself illustrates the problems.

Banks have a finite amount of savings at any one time, and they have to allocate their investments among different kinds of bonds and loans. Assuming everything else is equal, financial institutions prefer mortgages that have their payments guaranteed by government over unsecured loans, and tax-exempt bonds over taxable investments. To compete for these limited bank funds, others who seek capital for investment must pay higher rates of interest to the banks. Private investment is therefore more expensive for the borrower than it might have been in the absence of government-backed and tax-exempt financial instruments.

In recent years, banks have come to hold almost two-thirds of all state and local industrial development bonds. Banks are very "unstable" customers; they tend to purchase tax-exempt bonds when money is easy, when they have met their obligation of a legally required reserve, and when they have satisfied the loan needs of their customers. When money becomes tight, banks raise cash by selling their state and local securities. States and localities wishing to finance capital projects in periods when banks are reducing their portfolios of state and local bonds have two choices: they can either pay high interest rates on the bonds to attract other investors; or, where possible, finance their projects with short-term notes. Short-term notes, however, have their own disadvantages. First, they usually carry a higher effective rate of interest (including underwriting charges) than long-term obligations and thus cost the public more. Second, they are only a temporary solution to a serious economic situation and are not themselves marketable when money is scarce.

If incentives are as ineffective and costly as they appear to be, why are they so widely used? Perhaps the explanation is that state governments have so little power to affect their local economies, officials feel compelled to do *something*; and local taxes and bonding are something they can manipulate. Perhaps these officials are simply serving the class interests of the business sector for whom such incentives are a source of profit.

However uncertain the motivation of state officials, we believe the motivation of private corporations is clear-cut: to increase their own income at the expense of workers, consumers, and the public sector. Governments, of course, must tax the business sector to help finance the production and delivery of public goods and services. Not surprisingly, businesses resist

*They do, however, affect federal tax revenues. Harvard's Stanley Surrey estimates that in fiscal year 1968, the federal income tax deduction of the interest on state and municipal bonds cost the U.S. Treasury about $1.8 billion. According to the U.S. Office of Management and Budget, in fiscal year 1976 the foregone federal revenues will amount to nearly $4.8 billion, with three-fourths of that accruing to corporations and only one-fourth to private individuals. A recent study has concluded that the loss to the U.S. Treasury from the flotation of industrial development bonds alone was about $80 million in 1973.

this redistribution and try to reverse it through lobbying efforts if they can. Peter Bearse notes that some are more successful than others:

It should be no surprise to anyone that development programs are biased towards the established industry, larger firms, low-risk debt finance and manufacturing. Any stroll through state legislative chambers will show that these are the better organized, articulate political interests.

One representative of "Jobs for Massachusetts," a prominent business lobbying group, told Harvard researcher James Dumont that he would prefer an outright cut in the state's corporate income tax rate, but since the former was hard to obtain, "tax incentives will have to do." Another lobbyist, who led the successful struggle for passage of the Massachusetts $500 "job creation tax credit," admitted that his organization fully intended the credit to be a "gift" to companies, to "compensate" for the state's high tax rates.

Some officials think that their probusiness stance will create a "positive climate for investment" in their particular states. If history is any guide, however, that is a losing strategy, particularly when applied to the older industrial areas. Ever since the beginning of the industrial revolution, capitalist economic growth has been marked by "uneven development," a description first used by Friedrich Engels. When capital can be invested more profitably someplace else, those who control the processes of production abandon one area for another—even if it means leaving behind whole systems of physical capital, like neighborhoods and even entire regions. And those who remain become increasingly dependent on the public sector.

Bearse argues that uneven development explains much of the decline in the economic fortunes of the older industrial belt of the United States. As markets, capital, and even new research and development shift from the older region (with New York City at its political center) to the newer South and Southwest (with Texas the potential new "capital"), the older places undergo secular deterioration.

There is some evidence that the business incentives are in fact most readily available in these older areas. But, in the context of the large historical movement of capital, the idea of restoring the older area's comparative advantage seems ludicrous. As the public costs in the South and the Southwest increase over time, taxes and other costs of doing business there will rise too. But there is no reason to think that firms will then turn around and repopulate, say, New England. Clothing firms, in fact, are now moving out of South Carolina to Colombia and other parts of South America.

This shifting of the center of economic activity away from the northeastern and north-central parts of the country (a shift that goes a long way toward explaining the current fiscal crisis of the older cities and states) has been supported and consciously promoted by the federal government since the end of World War II. Public investments in infrastructure, military production contracts, and new bank charters have all been awarded increasingly to southern and southwestern firms, often at the expense of those in the older regions (especially New York). In this context, state incentives to businesses in lagging areas are equivalent to welfare grants, serving at best to ease their pain.

Even if the incentive approach were successful, however, we believe it would be misplaced. The conventional theory of local economic development centers on the concept of industry producing for export. The industry employs local workers and purchases locally produced goods and (especially) services. According to this conventional wisdom, who owns and controls that exporting activity, and whether that ownership/control is "absentee," is of little consequence. Because the payoff for capturing such export-base activity is believed to be so high, states and local governments engage in an expensive competition for the thousand or so new plants built in this country each year.

"Economic colonialism," as the gubernatorial contenders in Mississippi seem to have discovered, is not

the answer to economic development needs within states. That kind of development produces the same sort of dependency and unbalanced economic growth in the rich United States as it has always done in the poor Third World. New plants that are controlled by corporations headquartered elsewhere impose enormous infrastructure costs on a community. They import much of their labor (especially the "good" jobs), and they often house their highest-paid workers outside the taxing jurisdiction where the plant is situated. Then—after all the effort expended to get them in the first place—they often move to some other place when the local inducements run out.

It is the planning and financing of community-based enterprises that should be getting the lion's share of the resources generated by state and local taxes (and federal, for that matter). The present economic development applications of such resources are, we are convinced, going largely to windfall profits for the business sector. Surely that is at best a waste of scarce resources, and at worst a politically inequitable approach to the pursuit of economic development.

NOTES AND SOURCES

There are a number of empirical and theoretical studies in the field of industrial location, some of which are cited in this article. A good, but dated, summary of the literature can be found in John Due, "Studies of State-Local Tax Influences in Location of Industry," *National Tax Journal*, Vol. XIV, June 1961.

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Business Incentives, By States, 1974

1. *State, county, or local property tax exemptions:* Hawaii, Kentucky, Louisiana, Maryland, Michigan, Montana, New York, Oklahoma, Puerto Rico, Rhode Island, South Carolina, South Dakota, Vermont.

2. *Ad valorem or sales tax exemption for plant, machinery, or equipment:* Alabama, Georgia, Mississippi, North Dakota.

3. *Tax credits to expand employment:* Massachusetts, New York, North Dakota.

4. *Investment tax credits:* Massachusetts, New York, Rhode Island, West Virginia.

5. *Mortgage or loan guarantees:* California, Connecticut, Delaware, Hawaii, Indiana, Maine, Maryland, Mississippi, New Hampshire, North Dakota, Ohio, Rhode Island, Vermont.

6. *Local industrial development bonds (general obligation):* Alabama, Arkansas, Hawaii, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, Missouri, North Dakota, Oklahoma, Tennessee, Washington.

7. *Local industrial development bonds (revenue):* Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming.

8. *State-chartered credit corporations:* Alaska, Arkansas, Connecticut, Florida, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wyoming.

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Ghetto Economic Development: A Survey

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The development of this paper was supported by a grant from the U.S. Office of Economic Opportunity to the Project on the Economics of Discrimination at the University of Maryland, with which the author was formerly associated. The paper was completed at M.I.T. in the summer of 1973. I am grateful for comments by Robert S. Browne, Vernon Dixon, and several anonymous referees of this Journal. *For an earlier, more abbreviated survey of the subject and a complementary bibliography, see Spratlen [169, 1971].*

IN THE WAKE of the urban riots of the mid-1960's, many white Americans developed what for them was a quite new concern for the state of economic underdevelopment of the (predominantly black) ghettos of our large cities. The prestigious National Advisory Commission on Civil Disorders issued a "riot report" in March of 1968 which concluded that "enrichment [of the ghetto] must be an important adjunct to integration, for no matter how ambitious or energetic the program, few Negroes now living in central cities can be quickly integrated. In the meantime, large-scale improvement in the quality of ghetto life is essential" [138, National Advisory Commission on Civil Disorders, 1968, pp. 22–23]. In May of the same year, Senator Robert F. Kennedy spoke on the Senate floor in support of his "Urban Employment Opportunities Development Act of 1967," first introduced the year before and designed to federally subsidize the location in the ghetto of corporate branch plants. Two years before, in the wake of the Watts rebellion, Kennedy had visited the Bedford-Stuyvesant ghetto of Brooklyn, New York, a visit which led directly to the creation in 1967 of one of the first—and the largest—of the "community development corporations," and to the Special Impact Program of the U.S. Office of Economic Opportunity, still the government's most important program for the support of minority economic development.

Government and corporate interest in ghetto "enrichment" came at a time when a growing number of black political leaders were expressing—or being pressed by their constituents to express—support for (or at least "interest" in) what has sometimes been called the "separatist" approach to improving minority well-being. These pressures grew out of perceptions within one after another minority "community" that improvement through participation in orthodox legal and economic institutions (often called the "integrationist" approach) was proceeding too slowly and exclusively on the "white man's" terms. Some argued that the development of indigenous institutions—far from representing a retreat from integration—constituted the most effective path to integration, by creating the material basis, a viable economy, with developed physical and human capital, for the acquisition of collective *political* power (seen to be a prerequisite for integration). Still other black leaders took the position that the issue of inte-

gration or separation was irrelevant, that "investment in place" was fully justified by the preference of millions of nonwhites (and many whites as well) for an inner city residential location. If the "white economy" would not develop decent urban communities through normal investment channels and/or to the extent that white-controlled investment in the ghetto would be unresponsive to local preferences with respect to the qualitative nature of those investments, local economic development would have to proceed through "special" institutional processes created for just this purpose. Finally, some black and brown socialists advocated community-controlled planned development as a conscious attempt to provide an institutional alternative to competitive capitalism. As the decade neared its close, white, brown, and red individuals and organizations emerged whose interests in ghetto economic development touched many of the bases which had been staked out initially by blacks.

The relatively few professional white economists who have studied and written on inner city economic development have tended to approach the subject from experiences and perspectives gained in the study of less-developed countries. Their ranks are now being augmented by the emergence of a growing number of nonwhite economists who have chosen to address this area of inquiry. Indeed, the appearance in 1970 of *The Review of Black Political Economy*, whose contents consist largely (although not exclusively) of papers on the urban ghetto, manifests the increasing level of activity of this group.

I. Historical and Cultural Antecedents[3]

While the concept of black (or "ghetto," or "minority," or "urban community") economic development may have been new to white America, it was anything but new to black intellectuals and black political leaders. The dilemma posed by the apparent trade-off between the pursuits of racial integration and the separatist development of the "black community" permeates the history of blacks in America.

This contrast is reflected in the variety of positions taken by prominent black leaders. For example, the first national black spokesman for economic "self-development," Booker T. Washington, advocated literal "black capitalism" in the belief that whites would accept blacks as equals only after the latter developed experience and expertise in orthodox business practice. A contemporary critic of Washington's small business approach, whose own economic philosophy came to represent a counterpoint to the growing interest in black capitalism, was W. E. B. Du Bois. The elements of Du Bois' "socialism without nationalism" were black separation, mutual cooperation, industrial democracy (or "workers' control"), and economic planning. "Negro cooperative stores would obtain their goods from Negro producers, which would be supplied raw materials from Negro farmers. Intermediate stages of production such as extractive industries and transportation, were to be Negro controlled" [98, Henderson and Ledebur, 1970, p. 33][4]. Earl Ofari argues that Du Bois' emphasis on "cooperation" as opposed to individualistic competition represents a revival in America of African communalism, a "tradition of cooperation in the field of economic endeavor [which] is outstanding in Negro cultures everywhere" [142, Ofari, 1970, p. 12].

Marcus Garvey, the first important 20th century advocate of black nationalism and separatist development, rejected integration with whites as infeasible [98, Henderson and Ledebur, 1970, pp. 37–44]. While constantly preparing for an eventual return to Africa,

[3] In addition to the references cited in the text, the reader is referred to the papers in Bailey [12, 1971]. The profiles of important black individuals and organizations involved in economic development are elaborated in any good black history text.

[4] For examples of Du Bois' writing on this subject [cf. 55, Du Bois, 1915; 56, Du Bois, 1903]. This concern for the importance of developing black inter-industry linkages reappears fifty-five years later as the central theme of an economic "plan" for the Harlem ghetto; see Vietorisz and Harrison [205, 1970].

blacks in the U.S. were to reorganize their own communities. Paradoxically, Garvey was a strong advocate of capitalism; indeed, he even opposed labor unions.

Contemporary radical black socialists such as James Boggs follow DuBois in rejecting any system of private property; black community control and development are perceived as simply part of a larger worldwide socialist revolution. In his *Manifesto for a black revolutionary party*, Boggs proposed a program consisting of a guaranteed annual income, worker control of industry, mass-produced public housing "on a scale similar to that of mobilization for war," and free medical and transportation services for workers of all races [26, Boggs, 1968; 27, Boggs, 1971]. See also Allen [9, 1969]; and Franklin and Resnick [68, 1973].

On the other hand, Roy Innis, current National Chairman of the Congress of Racial Equality, describes himself as a Garveyite. He would have the black ghettos become political subdivisions of the state—instead of "sub-colonial appendages" of the city—through a "new social contract" [104, Innis, 1969]. Innis was an early advocate of community control of schools, believing not only in the feasibility of raising the quality and relevance of ghetto education and political consciousness through local control, but also in the potential for using the schools as instruments of economic development. "Harlem schools purchase over $100,000,000 in goods and services each year. Aside from the political implications, community control of Harlem schools could insure that Black community-owned firms benefited from these expenditures" [quoted in 188, Tate, 1971, p. 90].

An equally complex (and infinitely more mysterious) man is the organizer of the "Black Muslims." The Honorable Elijah Muhammad's "Twelve-Point Program for the Development of the Black Race" and his "Three-Year Economic Program" set out the nationalist economics of the Nation of Islam [137, Muhammad, 1965, pp. 169–172 and 192–199]. The Muslims have been extremely successful in developing a network of small black businesses in several large American cities. Their most important long-range economic goal is, however, the creation of a geographically isolated, agricultural-based nation in the American South. An industrial structure would emerge gradually over an agrarian base, through a regime of austere consumption with profits from the sale of agricultural products within the Nation, to neighbors, and to the Muslim stores in Northern cities [137, Muhammad, 1965, pp. 220–247].

Malcolm X became a Muslim in prison. After his release in 1952, he became one of Elijah Muhammad's most successful spokesmen, operating from a mosque in Harlem. Ultimately dismissed from the movement, and subsequently assassinated in 1965, Malcolm was perhaps the most forceful black nationalist in America. His influence on young black intellectuals was profound, and his writings and recorded speeches are today in great demand [cf. 126, Malcolm X, 1966]. Malcolm came to believe that "the economic system was exploitative" and advocated extreme autarchic development for the black community, based on a mercantilist analysis of

> the basic fundamentals: that whenever you take money [*i.e.*, profits] out of the neighborhood and spend it in another neighborhood, the neighborhood in which you spend it gets richer and richer, and the neighborhood from which you take it gets poorer and poorer. This creates a ghetto. . . . We have to teach our people the importance of where to spend their dollars [quoted in 64, Epps, 1968, p. 141].[1]

The programs (and, perhaps more important, the attitudes) of Booker T. Washington survive today in the leadership of those black organizations devoted to business develop-

[1] The admonition to "buy black" has a long history. Black churches have always encouraged their parishioners to patronize black enterprises (while continuing to respect the capitalist ethic). Endorsement of private business by the church, and constant propaganda in the black press, black civic organizations, and black social clubs, emphasized "the duty of Negroes to trade with Negroes and [promised] ultimate racial 'salvation' if they [would] support racial business enterprises" [142, Ofari, 1970, p. 52].

ment within the context of social integration and political non-violence. These organizations include the National Business League (founded by Washington himself, in 1900), the National Urban League, and the National Association for the Advancement of Colored People.

There may be a psychological as well as a political-economic explanation for the continuing black interest in economic development. Du Bois wrote: "one feels ever his two-ness—an American, a Negro; two souls, two thoughts, two unreconciled strivings; two warring ideals in one dark body, whose dogged strength alone keeps it from being torn asunder" [56, Du Bois, 1903, p. 58].[4] Many black psychiatrists look upon the collective struggle for ghetto development and self-determination as a form of group therapy [59, Edel, 1972, p. 313; 84, Hampden-Turner, 1969].

It has been suggested that blacks tend to reject the "ideology of economic individualism" in the belief that whites in positions of economic and political power explicitly use that ideology "to dominate poor people and keep them 'competitively' divided" [84, Hampden-Turner, 1969, p. 83; 154, Reich, 1971]. This criticism of economic individualism was elaborated by the (white) director of a major study of the Los Angeles riots:

> [t]he policies and programs in Washington vis-a-vis the "Negro problem" throughout the country have tended to stress the traditional model of individual success rather than to view the problems of the group as a whole. As a result, a pattern has been encouraged in the Negro community which places a premium on individual mobility rather than on collective concern . . . the Militants . . . have as a common denominator the belief that individual mobility is not the answer and that only through collective concern can the Negro solve his problems [40, Cohen, 1970, pp. 19-20].

There is also a feeling among some that collective approaches to black economic development are both natural and inevitable, given the tradition of African communalism which American blacks have inherited. Badi Foster writes: "Contrary to the thrust of individualism, communalism holds that self-centeredness will not provide a just social order resulting from antagonistic cooperation" [50, Dixon and Foster, 1971, p. 13]. In terms of neoclassical economic theory, communalism involves the interdependence of utility functions [8, Alexis, 1973]. "Service to family, clan, community, or nation becomes more than 'the burden of being my brother's keeper.' Serving others is motivated not by some abstract code of behavior; rather one serves others to serve oneself. Necessity instead of philanthropy marks the encounter between self and other" [50, Dixon and Foster, 1971, p. 10]. Black Americans are allegedly part of a culture which recognizes and values such interdependences. Foster describes this as "empathy as a way of knowing." Subjective (empathetic) and objective (scientific) epistomologies are employed *together* in dealing with the world. "This union of opposites," says Vernon Dixon, "characterizes traditional thinking throughout Africa." This tradition allegedly lends itself to the community development approach in dealing with urban poverty.[5]

II. *The Ghetto as Colony*

Some writers perceive the relationship between the urban ghetto and the mainstream American political economy as one of "internal colonialism." The ghetto is described as a "less developed country" with a severe "balance of payments" deficit and with "foreign" control of the most important local political and economic institutions [cf. 185, Tabb, 1970, ch. 2]. That the ghetto is an inherently open

[4] Vernon Dixon's analysis is more complex. "Two-ness" does not cause schizophrenia, *per se*. Blacks accept their dual acculturation. But this so-called "diunital behavior" is not sanctioned by white America. Blacks internalize this sense of illegitimacy; *that* is the cause of trauma [50, Dixon and Foster, 1971, p. 34].

[5] Foster asserts that the Aristotelian training of Western people makes it difficult if not impossible for most of them to perceive the possibility of what Jung called "the interpenetration of opposites." Thus, for example, whites are allegedly more likely than blacks to treat "the protection of the individual and his inalienable rights" and "collective responsibility and communal discipline" as mutually exclusive, ideologically antagonistic alternatives [50, Dixon and Foster, 1971, p. 11].

economy located physically within the corpus of the "imperial" power distinguishes it from the typical LDC, but—it is argued—these distinctions are relatively superficial; the underlying institutional relationships are allegedly quite similar. Certainly, black leaders of widely varying ideologies have been intrigued by the colonial analogy [33, Carmichael and Hamilton, 1967; 37, Clark, 1965; 38, Cleaver, 1969; 46, Cruse, 1967; 95, Haryou, 1964; 104, Innis, 1969].

The international system of colonialism involved the political and economic exploitation of one country by a (generally small) group of outsiders, supported by the military strength of their home country. It was the colonists who were on foreign soil, not the colonized. The subordination of the natives was often formally recognized in treaties and other legal arrangements. On its face, the urban ghetto system in the U.S. hardly fits this pattern. Here, "the people who are oppressed were themselves originally outsiders and are a numerical minority" [21, Blauner, 1969, p. 395].[4] Internal colonialism has not involved the settlement of large numbers of whites into black-owned land (except perhaps through urban renewal). And while it is sustained by a variety of institutions, not all of the relationships between the ghetto and the "outside" are explicitly—let alone legally—acknowledged. It is these differences in the "colonial" and "internal colonial" systems which are emphasized by those who disparage the analogy.

But if the two *systems* are dissimilar, they appear to share a common *process*. This is the argument of Robert Blauner: international colonialism and "America's internal version" both developed through a process by which a technologically and militarily superior and ideologically racist Western culture imposed itself on non-white, non-Western cultures [21, 1969].

The process consists of four main elements, according to Blauner. The first is "forced, involuntary entry." This is normally followed by "a policy which constrains, transforms, or destroys indigenous values, orientations, and ways of life." This "cultural imperialism"—the forced imposition of Western values—is then institutionalized in administrative organs, as are most of the important functions of local government, with the colonizers in control of this administrative machinery (sometimes using acculturated "natives" as minor functionaries for the purpose of dealing with the local "masses" and providing the latter with models certifying the payoff to cooperative behavior). Finally, the process is explicitly "racist," by which Blauner means that "a group seen as inferior or different in terms of alleged biological characteristics is exploited, controlled, and oppressed socially and psychically by a superordinate group" [21, Blauner, 1969, p. 396]. The imposed contact is perhaps the most subtle aspect of the relationship between the urban ghetto and white America. "The power inherent in the right to define a relationship," writes one Harvard social psychologist, "often goes unappreciated" [84, Hampden-Turner, 1969, p. 64].

While virtually all ghetto institutions are controlled by outsiders, none is more crucial to the colonial model than the police. Whether black or white (but especially if the latter), the city-controlled police are often referred to by ghetto blacks as an "army of occupation" [cf. 38, Cleaver, 1969]. Current public investments in "crime control" are seen to only exacerbate the problem.

Some critics of the analogy argue that "loose talk about colonialism" leads directly to the endorsement of such inefficient policies as "import substitution," the limiting case of which is economic *autarky*. The Wohlstetters, for example, disparage the alleged autarkic aspirations of black economic development advocates, contrasting their "unreasonableness" with the more sensible strategy of specialization pursued by the white ethnics. White ethnic businesses, they write, "all provide goods and services to the larger society and not merely to their own ethnic groups" [213,

[4] William Tabb finds a precedent for this "internal colonialism" in the slave-procurement practices of ancient Egypt, Greece, and Rome [185, Tabb, 1970, pp. 24–25].

Wohlstetter and Wohlstetter, 1969, p. 102].

The criticism of autarkic development seems misplaced. Few if any groups actively engaged in community economic planning seek autarky; indeed, most are consciously seeking "export linkages" and externally located assets to complement their internal activities [65, Faux, 1971]. On the other hand, the model may indeed, perhaps as its critics fear, lead its proponents to a particular (highly political) strategy for ghetto development. Blauner points as evidence to the kinds of institutions which advocates of community control usually seek to "liberate" before any others: schools, social services, and the police. From the economist's point of view, these are largely "infrastructural" activities, the direct control of which yields relatively few direct private economic benefits (at least in the short run). From the perspective of the entire *community*, however, prior control of the infrastructure is essential to control of the process of subsequent development (as most orthodox texts on economic development in LDC's indicate, albeit in another context).

Some analysts reject the "ghetto as colony" model, but accept the analogy between the American inner city and the LDC in the "Third World." Gustav Ranis, Director of the Yale Economic Growth Center, perceives "striking similarities" between the structural dualism pervading so many LDC's and the segmentation of the American economy into a growing "core" and a ghetto "periphery":

> the vastness of the reservoir of unemployed and underemployed labor in one sector (A); the tendency for this reservoir to be constantly replenished, in the short-run, by migration racing ahead of employment opportunities and, in the longer run, population growth; the tendency for the advanced sector (B) to employ a relatively capital-intensive technology—in spite of the availability of abundant supplies of cheap labor from sector A,[3] the absence of sufficient public sector action to provide sector A with adequate transportation, education, and health facilities . . . finally, the absence of a truly national market for capital or other scarce resources permitting a more impersonal allocation of investment, determined by relative rates of return, within and between the sectors [153, Ranis, 1969, pp. 42–43].

In both peripheries, the remedy is intra-sectoral economic development. Ranis believes that the initial absence of significant private investment does not reveal a corresponding absence of investment opportunities, because of the presence of widespread market failure (this is an argument to which we will return later). Ranis draws upon his prior experience as Chief Economist of the U.S. foreign aid program to observe that, for urban ghettos as for LDC's:

> Pumping more outside money in at the margin is clearly not enough; the problem is one of breaking down the enclave characteristic of the ghetto by improving the connectivity between the ghetto and the rest of the economy and enlisting the projective and creative energies of large numbers of individuals in the growth process [153, Ranis, 1969, p. 53].[4]

III. The Structure of the Ghetto Economy

Studies of the structure of underdeveloped economies typically begin with a sector by sector description of the most important elements, to acquaint the reader with what is usually unfamiliar terrain. We shall do the same.

Intraghetto Economic Activity

Qualitative discussions of infrastructural investment in the ghetto, especially in housing and transportation, have existed for some time in the literature of urban economics [cf. 70, Frieden, 1968; 132, Meyer, Kain, and Wohl,

[3] Ranis refers here to the classic "factor proportions problem," which is perhaps best known to development economists through Eckaus [57, 1955]. The most recent restatement of this explanation of structural black unemployment is Davis [48, 1972].

[4] The comparative analysis of dualism in developing and industrial countries is the subject of an interdisciplinary research project and graduate seminar at M.I.T. Ranis' analysis is challenged by Cohen [39, 1969] and Harris [86, 1972]. Franklin and Resnick [68, 1973] argue that the "underdeveloped country" analogy may be dangerously misleading by creating the illusion that significant social change is possible in these small enclaves in the absence of revolutionary change in the wider society.

1965; 112, Kain and Meyer, 1970]. So far as actual measurement is concerned, housing has been the most thoroughly studied [34, Center for Community Change, 1971; 106, James, 1973; 114, Kain and Quigley, 1972; 139, National Commission on Urban Problems, 1970; 152, Quigley, 1974; 172, Stegman, 1972; 177, Sternlieb, 1969; 178, Sternlieb and Burchell, 1973]. Transportation has received some attention [115, Kalachek and Goering, 1970; 145, Ornati, 1969]. Public services have received the least study [131, Mellor, 1972; 165, Schaffer, 1973]; more work is underway on this sector at the New York City Rand Institute, The Urban Institute in Washington, D.C., and the Bedford-Stuyvesant Restoration Corporation in Brooklyn, New York.

One especially important component of infrastructure is space. According to the conventional wisdom, central cities have virtually no usable vacant land. A recent inventory of urban land availabilities, uses, and restrictions indicates that at least 20% of the "buildable" land in the central cities of large metropolitan areas remains vacant [140, Northam, 1971]. Moreover, "space" is not confined to "land" as such. The opportunity to create additional urban space in the third dimension, *e.g.*, through exploitation of air rights, underground development, etc., has barely been explored at all [10, American Public Works Association, 1967; 93, Harrison, 1974, Ch. 7; 103, Hoch, 1969]. No quantitative research on ghetto space *per se* is available.

With respect to ghetto commercial/industrial structure, the research record is more complete. Studies have been published on the industry mix of ghetto areas in New York [205, Vietorisz and Harrison, 1970; 97, Heilbrun and Conant, 1972], Buffalo [11, Andreasen, 1971], Rochester and Newark [48, Davis, 1972F, Chicago [5, Aldrich, 1972; 6, Aldrich and Reiss, 1970; 7, Aldrich and Reiss, 1972; 87, Harrison, 1974; 158, Reiss and Aldrich, 1971], Boston [6, Aldrich and Reiss, 1970; 7, Aldrich and Reiss, 1972; 181, Stone, 1971], and Washington [6, Aldrich and Reiss, 1970; 7, Aldrich and Reiss, 1972; 29, Brimmer and Terrell, 1971].[5] Scale of activity in all these studies is measured by employment. Some additional work has been done on sales, payrolls, and, in one case profits [97, Heilbrun and Conant, 1972]. Ownership of commercial and residential ghetto property by residence or race of owner is analyzed in the papers by Howard Aldrich and Albert Reiss and in two studies of the Harlem economy [205, Vietorisz and Harrison, 1970; 214, Zweig, 1972].

The Census Bureau now publishes a regular series of national surveys of minority-owned businesses, containing data on number of firms, gross sales, and employment [cf. 197, U.S. Bureau of the Census, 1971]. The smallest level of geographic identification is, however, the SMSA. It is impossible to identify individual ghetto areas from these Census tables.

Shortly after the first of the major urban rebellions of the 1960's, the Census Bureau undertook special labor force censuses in several ghetto areas. The data on South (largely black) and East (principally chicano) Los Angeles [195, U.S. Bureau of the Census, 1966], and on the Hough and other areas of inner Cleveland [196, U.S. Bureau of the Census, 1966], while they have been generally available for a long time, have never been fully explored by economic analysts.

In November 1966, the Department of Labor conducted a survey of major proportions (there were nearly 40,000 individuals in the sample) in ten urban ghettos located in eight large cities [199, U.S. Department of Labor, 1972]. This *Urban employment survey*, conducted under the direct control of then Labor Secretary Willard Wirtz, produced a quantitative estimate of *underemployment*, in the form of what Wirtz called a "subemployment rate," which counted as "inadequately employed" (or "underutilized") not only those who were

[5] This is surely only a partial list. Many community groups have undertaken industrial inventories in their areas, and occasionally even rather complete economic base studies. A compendium of these studies would be invaluable. At the moment, they are still among the most "fugitive" of materials.

overtly unemployed, but also those involuntarily part-time employed workers, full-time workers paid "poverty level" wages, and "discouraged" workers.[10] There is considerable evidence that the conventional unemployment rate does not adequately measure slack in ghetto labor markets.[11] Research is now underway at the New School for Social Research and the George Washington University to examine the properties of the subemployment rate as an alternative social indicator.

The availability of these and newer microdata files has permitted the estimation of inter- and intra-ghetto distributions of employment, unemployment, earnings, non-labor income, education and training experience, and many other variables [71, Friedlander, 1972; 79, Gordon, 1971; 88, Harrison, 1972, Chs. 2–4 and Appendix C; 205, Vietorisz and Harrison, 1970, Ch. 1]. Indeed, the ready availability of the Census-produced tapes and computers with which to study them makes the dearth of quantitative (as distinct from speculative) research on ghetto labor markets that much more remarkable—and remediable.[12]

Linkages with the Urban Economy

Gustav Ranis' perception of the fundamental nature of the linkage between the ghetto and the rest of the urban economy is shared by many other students of the subject. Unskilled labor is the community's principal "export." Consumer (and some capital) goods are "imported"; these are financed out of labor earnings ("exports") and transfer payments ("foreign aid"), especially public welfare [48, Davis, 1972; 72, Fusfeld, 1973]. The bulk of the labor income is earned outside the ghetto; James Heilbrun estimates that four-fifths of the Harlem labor force was employed outside the area in 1966 [96, 1970].

The identification and measurement of interregional income flows is exceedingly difficult when the regional economies under study are as "open" as is the urban ghetto. A theoretical scheme for interrelating the various income flows into and out of the ghetto was proposed by Robert S. Browne, Director of the Black Economic Research Center in Harlem [31, 1971; see also 72, Fusfeld, 1973, pp. 41–50]. Thus far, only two attempts to estimate such flows have been published. The first of these [131, Mellor, 1972] examines the Shaw-Cardozo area of the District of Columbia. It reports that residents of the area pay out more in taxes than they "import" in the form of public services. A much more elaborate and statistically sound set of "community income accounts" has been constructed by Richard Schaffer for two New York City areas of similar size: Bedford-Stuyvesant (black) and Borough Park (white) [165, Schaffer, 1973]. The author employs a variety of fugitive data sources (mostly city agency procurement and operations records, and tax data) and an imaginative methodology to produce estimates of income flows. While the black ghetto shows a large annual "balance of trade" deficit of nearly $76 million, the white (predominantly

[10] The concept of subemployment, and its administrative history, are discussed in Harrison [88, 1972]; Levitan and Taggart [121, 1973]; and Spring [170, 1972]. Values of the index for a number of ghetto areas are presented in detail in Harrison [88, 1972, Ch. 3]. The index was recently recalculated for 51 inner city areas, using the 1970 Census Employment Survey. See Spring, Harrison, and Vietorisz [171, 1972]. Many of these articles—and Wirtz' original memorandum to President Lyndon Johnson on subemployment—are reproduced in U.S. Senate [200, 1972, pp. 2276–2339]. An alternative, more conservative, index has been proposed in Levitan and Taggart [121, 1973].

[11] Stanley Friedlander reports that in a large number of regressions, ghetto unemployment rates were statistically unrelated to intercity variations in either job growth or the rate of net employment decentralization across 16 cities in a recession year (1960) and a year of expansion (1966). He is also unable to find any significant relationship between ghetto unemployment rates and the educational attainment of ghetto residents [71, Friedlander, 1972].

[12] The 1966 and 1967 Surveys of Economic Opportunity permit detailed analysis of the poverty areas of 100 large SMSA's (12 identifiable by name). The 1969 Urban Employment Survey contains household interview data on six ghetto and two "control" areas. The 1970 Census Employment Survey permits the study of 51 central city and nine rural poverty areas. All were implemented by the Bureau of the Census, on contract to other government agencies. Only the SEO has been much studied by economists, and few of *those* papers focus on the ghetto subsamples.

Jewish) area's account was estimated to be nearly in balance (with a deficit of less than $6 million). More importantly, the absolute volume of the flows of income into and out of (and therefore through) the white area greatly exceeds the volume of "black" flows; Borough Park can more easily afford to indulge its greater imports. One major form of "leakage" from Bedford-Stuyvesant which is numerically inconsequential in Borough Park consists of expenditures for consumption of illegal gambling services, especially through the "numbers" racket (gross "numbers" or "policy" leakages for all of the black neighborhoods of New York City in 1969 have been estimated at $150 million [134, Mitchell, 1970, p. 52]).

A related quantitative planning tool is the local multiplier. Again the extreme "openness" of the small ghetto economy makes estimation difficult. A unique study of the Hough ghetto in Cleveland, based upon household expenditure diaries, produced an estimate of the "marginal propensity to spend inside Hough" of $0.13 per dollar of family expenditure in 1969 [141, Oakland, Sparrow, and Stettler, 1971]. Additional surveys designed to identify the locational origins and destinations of the inputs to and outputs of Hough-based businesses yielded a second primary data base; the two together permitted the authors to estimate a local multiplier of 1.02–1.03 ("For a large, diversified metropolitan area, empirical studies show the income multiplier to be about 1.8") [184, Tabb, 1969, p. 394]. Various simulated development policies raised the estimated multiplier as high as 1.11.

Finally, the previously cited studies by Aldrich, Reiss, and Michael Zweig on the locus of property ownership permit inferences about the leakage of income out of the black community.

A fruitful object of inquiry which has not yet been well explored in a ghetto context is the journey to work. The only published study known to the author reports that in the city of Philadelphia in 1968, 80 percent of all central city jobs were located within 20 minutes' automobile commuting distance of the inner core [130, McLennan and Seidenstat, 1972]. The Urban Employment Survey of 1969 and the 1970 Census Employment Survey permit the geographic identification of the place of work of each ghetto resident, his or her mode of commuting, the distances involved, and the costs incurred. These data are currently under study by students at M.I.T.

Formal Models

At least two "micro" and three "macro" models of the ghetto economy have appeared in the literature. The models are still extremely crude, but their respective authors are actively engaged in refining them.

1. James Heilbrun's micro model, which he describes as "dualistic," concerns only the business sector [97, Heilbrun and Conant, 1972]. Most white businessmen prefer not to locate their facilities (or to keep them) in nonwhite neighborhoods. This preference reduces the competition for those whites who do operate in the area, raising their potential returns. Such exceptional returns are required by these employers as a condition for remaining in the ghetto. The white excess profits are not "competed away" by the entry of black firms because of (principally capital) market imperfections; the access of black businessmen to loans, insurance, and entrepreneurial experience is restricted. The result is that the ghetto business sector is divided into a small but profitable white-owned enclave and a larger but poorer ("overcrowded") black-owned sector. Heilbrun's study of rates of return to white and black businesses in Harlem (based upon tax records) supports the hypothesis; white-owned establishments in the community are larger than black plants (both within and among industries), and more profitable. It follows that:

> the failure of the present nonwhite sector to produce normal profits does not necessarily argue for a policy of laissez-faire in that area. Instead, public policy might be used to assist in the consolidation and enlargement of existing firms to create black-owned units large enough to survive and prosper in

the face of continuing retail consolidation [97, Heilbrun and Conant, 1972, p. 281].

2. A number of economists have contributed to the development of models of labor market dualism.[3] Individual behavior, economic and even technological constraints are assumed to vary significantly among different labor markets. By acclimating themselves to "local" conditions, and by developing life-styles supportive of these "local" work arrangements, workers find it psychologically as well as technically difficult to move from one segment of the economy to another. These sources of factor immobility, in addition to the well-known impediments created by race, sex, and class discrimination, may explain a wide variety of phenomena, including grossly unequal income distributions (even as, for example, the inter-racial distributions of human capital become less disparate [cf. 190, Thurow, 1972]); and the simultaneous existence of inflation and unemployment in the macroeconomy [163, Ross and Wachter, 1973].

In one version of the model, based directly on ghetto labor market data, jobs located in urban areas are divided into two behaviorally and technologically disparate segments within which mobility is common but between which it takes place infrequently and only with difficulty [88, Harrison, 1972, Ch. 5].[4] The "core" stratum is dominated by a "primary labor market" in which employers possess a high degree of market power, have much of their sales "guaranteed" by government contracts, and are therefore able to generate sufficient profits to be able to pay non-poverty wages. Their economic power permits them to pass at least part of these costs along to consumers in the form of higher prices. Their profitability permits them to invest in both physical and human capital, which in turn increases the productivity of labor which translates into increased profits ad infinitum. Labor effort is assumed to be an increasing function of wages and benefits. The magnitude of the latter induces workers to value these jobs, while the high fixed costs associated with the aforementioned investments encourage employers to value stable job attachment by their workers. These factors converge to increase the probability that jobs in the primary labor market will be stable as well as relatively high-paying.

The "periphery" of the economy contrasts in every respect with the "core." It consists of at least four identifiable sub-sectors. The "secondary labor market" is defined by a class of employers whose labor-intensive technologies and lack of market power restrict their ability (and their need) to pay high wages. Low wages and the virtual absence of benefits combine with undesirable work conditions to discourage stable job attachment by the labor force. Low fixed costs (due especially to low rates of human capital investment in the form of specific training) induce a similar lack of concern for stability on the part of the employers. These jobs therefore display low pay and high turnover. Inadequate capital formation causes low productivity, which in turn prevents these firms from expanding and, in the process, acquiring market power of the kind possessed by core firms (and reflected, for example, in their relatively inelastic product demand curves).[5]

The three other segments of the periphery consist of activities which, although seemingly

[3] The "classic" statement is Doeringer and Piore [52, 1971, Chs. 7–8]. David Gordon has reviewed this literature [81, 1972]. More recent examples may be found in the collection of papers on "dual labor markets" in the May, 1973 *Amer. Econ. Rev.* [148, Piore, 1973, 156, Reich, Gordon, and Edwards, 1973; 207, Vietorisz and Harrison, 1973]; and in Reich, Gordon, and Edwards [155, 1974].

[4] A similar version is presented in Fusfeld [72, 1973, Ch. 3]. Paternity in this field is ambiguous; as Gordon says, a number of scholars developed dualistic models independently of one another at about the same time. If the innovators must be identified, they would probably include Peter Doeringer at Harvard, Michael Piore at M.I.T., and Daniel Fusfeld and Louis Ferman at Michigan. The "school" of dual labor market theorists (such as it is) consists largely of the students and colleagues of these four economists.

[5] In a recent reformulation, Piore divides the primary labor market into "upper" and "lower" tiers, distinguished primarily by job attachment (lower in the former than in the latter) and job control (higher in the former than in the latter). The "lower tier" consists largely of well-paid blue-collar jobs [149, 1972].

far removed from the "world of work," are in fact quite similar to work in the secondary labor market. Dual market theorists speak of the "training economy," the "welfare economy," and the "irregular economy" (or the "hustle"). Individuals in each segment receive poverty-level income payments in return for the investment of time. The low level of these payments, the high risk of engaging in some of these endeavors, the bureaucratic complexities involved in obtaining the payments, and the social stigma often attached to the role of petitioner all combine to encourage unstable behavior. Thus, researchers have learned that many of the same people tend to be found moving back and forth, in and out of the four peripheral strata [30, Brown, 1965; 71, Friedlander, 1972; 85, Hannerz, 1969; 123, Liebow, 1967; 157, Rein and Miller, 1970]. Many hustlers work periodically in low-wage legal jobs, move on and off the welfare rolls, and are not infrequently participants in one or another government training program. Finally, city school and job placement institutions whose ostensible function is to "upgrade" the urban poor, or, in terms of the above model, facilitate intersectoral mobility, often perpetuate poverty by re-circulating these individuals and their children among the segments of the periphery.

Ghetto workers comprise a significant (although not necessarily an overwhelming) share of all urban "secondary workers." On the other hand, a much larger proportion of ghetto residents probably work in the secondary labor market than is true for non-ghetto residents. As is the case with poverty itself, where the majority of the poor are not black but the incidence of poverty is much higher among blacks than among whites, the majority of the "peripheral" labor force probably lives outside the ghetto, but the incidence of peripheral participation is probably much higher within the ghetto than elsewhere.

Research on many aspects of the model is being conducted at M.I.T. and the New School for Social Research. Workers are studying intra- and inter-sectoral "job" (*i.e.*, industry-occupation) mobility, the institutional interfaces between low-wage work and other "peripheral" activities, and the relationship between job status and "job control." Comparative studies of dualism at home and abroad have been undertaken by Harvard and MIT economists, working cooperatively with other social scientists [cf. 51, Doeringer, 1973].

3. Daniel Fusfeld proposes a macro model of the ghetto economy and its relation to the outside, according to which the welfare system—far from raising the well-being of ghetto residents—serves to stabilize the ghetto by subsidizing low-wage employers and the absentee owners of ghetto property. The area is described as a "residual subsystem, a place where society maintains its outcasts. . . . In this context, the welfare system or other forms of income maintenance are not solutions, but ameliorative devices" [72, Fusfeld, 1973, p. 58].

> Welfare payments [preserve] the ghetto itself. . . . For example, [they] enable a larger number of family units to subsist at the poverty level. These family units add to the demand for slum housing. . . . The net result is a larger ghetto area and a larger outflow of [income] into the hands of slumlords. By contrast, if there were no welfare payments the families now receiving them would either perish or double up with related persons into even larger family units. The demand for slum housing would be smaller, and the ghettos themselves would be reduced in size [72, Fusfeld, 1973, pp. 66–67].

This is the ultimate contradiction in the model. So long as transfer income is insufficient to eliminate poverty—so long as it is too low to permit the formation and maintenance of stable families—it only serves to stabilize and preserve the ghetto *qua* poverty area by forcing ghetto residents to accept low-wage ("secondary") jobs or enter the "hustle" in order to accumulate gross earnings sufficient to make ends meet. "Whatever the level, the function of welfare payments in the social system as a whole is to preserve the urban ghetto and its supply of low wage labor" [72, Fusfeld,

1973, p. 87]. The actual flow of welfare payments, writes Fusfeld, will generally "be set at the level which enables law and order to be maintained by the ordinary instruments of social control" (this is also a main theme of Piven and Cloward [150, 1971]). Thus, "the apparent benefits [of] the current welfare reform legislation . . . would freeze a large supply of low wage workers into the [secondary] labor market and solidify a hard core of poverty into the American social and economic system" [72, Fusfeld, 1973, p. 90].

4. Finally, at the most abstract level, the literature contains several unbalanced growth models which embody many of the structural disequilibria contained in the more "micro"-oriented models reviewed above.[14] Frank Davis specifies a model in which "core" products are increasingly subjected to oligopoly pricing, but core firms' demand for "peripheral" labor is highly income inelastic, with the result that peripheral wages do not rise as the economy expands and the "terms of trade" between the periphery and the core steadily worsen (note how this relates to the LDC analogy of Ranis) [48, 1972]. The presence of imperfect competition in the white economy is at the root of the problem. Davis perceives similar explosive disequilibria in the relationship between the agricultural and industrial sectors of the American economy, and between the rich countries of the West and the poor countries of the Third World.

5. The same principle is treated more formally by Peter Albin in a series of papers [2, 1970; 3, 1971]. In this unbalanced growth model, the urban economy is divided into a leading sector consisting of those private industries and government agencies in which wages are growing, and a lagging sector which includes private industries with zero (or lethargic) productivity and (therefore) wage growth. The growth of wages in the private leading sector is facilitated by rising productivity. Wage growth in the public sector is explained by the need of public employers to compete with the private leading sector for skilled labor, but it is not (by assumption; actually the data do not exist with which to test this) accompanied by proportionate productivity growth. As a result, the costs of public services rise over time (this is essentially William Baumol's explanation of the urban "fiscal crisis") [16, 1967]. Acquisition of specified educational credentials constitutes a necessary and sufficient condition for inter-sectoral mobility (my own research invalidates the assumption of sufficiency but not the general principle that the practice of "credentialism" by employers is capable of creating labor immobilities) [89, Harrison, 1972]. Given an initial imbalance in sectoral wages (and, therefore, in the expected returns to educational self-investment) and differential access to the capital markets, the stratification of the economy "might be expected to persist for generations" [3, Albin, 1971, p. 14n]. A revised version of the Albin model is currently being developed.

IV. *Alternative Approaches to Ghetto Development*

Public and private programs aimed at developing the economy of the urban ghetto differ significantly along several dimensions, especially *control* and *power*. Ronald Bailey and other black economists draw an operational distinction between the strategies of "black capitalism," by which they mean atomistic enterprise development under conventional capitalist institutions (especially private ownership and profit maximization), and "community economic development," by which is meant the support of groups of producers or consumers acting collectively, with social benefit and institutional change more important objectives of development than private profit [12, Bailey, 1971, p. 12].[15]

[14] For Myrdalian analyses of unbalanced growth, in terms of the positive feedback mechanisms of systems theory applied to the dual labor market model, see Vietorisz and Harrison [207, 1973] and Fusfeld [72, 1973, pp. 50-53].

[15] With respect to the latter,

More political and economic power for poor minorities as classes or groups is the main goal . . . The use of this power is twofold—to choose whether or not

Thomas Vietorisz and I have argued that "community economic development" involves . . .

> institution-building, and not merely increasing per capita income. Specifically, we envisage the creation of a number of "inside jobs," acquisition by the community of assets both inside and outside the ghetto, a substantial expansion of existing black businesses (particularly through cooperative forms of ownership), the large-scale transfer of ghetto property to ghetto residents and/or the community *qua* community, emphasis on the provision of pre-vocational and skill training within these ghetto enterprises, and local control of infrastructure such as schools, police, and health facilities. This kind of "local control" is, of course, already enjoyed by most suburban communities whose populations [may not be] nearly so large as those of Harlem, Roxbury, or Watts [206, Vietorisz and Harrison, 1971, pp. 29–30].

To be sure, these theoretical distinctions become blurred in practice; actual operating programs cannot be so neatly categorized. Nevertheless, in this paper "black capitalism" and "community economic development" will be treated as alternative policy approaches, at least in principle.

Two other strategies are discernible in the literature and in the actual events of the last eight years. A number of large corporations were induced to open branch plants in the ghetto. Some of these are wholly owned by the white corporations, while others are joint ventures. In some cases, "turnkey" arrangements have been made, according to which ownership of the plant would eventually be transferred to either a community group or an individual black capitalist after "take-off" is achieved. This strategy, which implies still other institutional patterns of control and power, will be characterized below as "corporate location in the ghetto."

Finally, the federal government operates a number of public sector programs in the ghetto. The largest and best-known of these (now being terminated by the Nixon Administration) is "Model Cities," the creation of the Demonstration Cities and Metropolitan Development Act of 1966 (Public Law No. 89–754). Through this legislation, Congress created a program to provide (more or less) non-categorical funds to city governments, to be applied to "breaking the poverty cycle" in (locally-defined) "model neighborhoods." The grants, which are issued after successful processing of an application to the U.S. Department of Housing and Urban Development, are then administered by a "city demonstration agency," an arm of city hall which is supposed to act as the planning institution for the ghetto.[18] Economic development is one of a number of activities supported by Model Cities.

Black Capitalism

A program of federal support for black business development has been justified on several bases, the first being the matter of simple equity. Blacks and other minority groups have been disproportionately excluded from ownership of businesses, even within their own neighborhoods [185, Tabb, 1970, Ch. 2; 12, Bailey, 1971; 22, Blaustein and Faux, 1972, pp. 77–87]. A 1964 study of North Philadelphia found over a third of the black businessmen engaged in hairdressing and barbering [185, Tabb, 1970, p. 45]. Four-fifths of the black-owned establishments in Harlem in the winter of 1967–1968 had fewer than four employees, compared with only a little over 50 percent of the white businesses [205, Vietorisz and Harrison, 1970, p. 39]. White businesses in the Harlem ghetto are also significantly more profitable than black businesses, as revealed by a study of tax records in 1968 [97, Heilbrun and Conant, 1972]. The black merchants in Buffalo's central ghetto are signifi-

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to integrate with other groups (and if so, on what terms) and to obtain the same opportunities for jobs, housing, and so forth that others enjoy, whether the minority person integrates or not [19, Bergsman, 1971, p. 310].

[18] The CDA is one of three important new local political institutions created in the 1960's to implement economic policy. The other two are the Community Action Agency—the local service bureau for Office of Economic Opportunity programs in health, education, welfare, etc.—and the Community Development Corporation, which will be closely examined later in this paper.

cantly smaller and poorer than their national counterparts [48, Davis, 1972, pp. 43, 61]. A program of black capitalism would give minority entrepreneurs "a bigger piece of the action."

Improvement of consumer welfare in the ghetto is another objective of the advocates of black capitalism. Larger, more efficiently operated businesses would (it is hoped) result in relatively lower prices and higher quality of merchandise. An econometric study of the popular hypothesis that "the poor pay more"—focusing on the same area (Harlem) where the original study of that question was made in the early 1960's [32, Caplovitz, 1963]—found that the ghetto and "outside" retail prices of many products were not significantly different, after controlling for size of establishment [4, Alcaly, 1968].

Finally, it is hoped that expanded minority entrepreneurship will contribute to the political stability of the city. Absentee and/or white ownership of the great majority of businesses in the black ghetto (over 80 percent, according to one national survey) is a major source of political disquiet in these areas [158, Reiss and Aldrich, 1971]. Conflicts with Jewish, Italian, and other white merchants occur frequently [185, Tabb, 1970, pp. 40–42]. The Kerner Commission speculated that absentee white ownership "undoubtedly contributes to the conclusion among Negroes that they are exploited by white society" [138, National Advisory Commission on Civil Disorders, 1968, p. 274].[11]

Black capitalism has been offered as a strategy for meeting these objectives of equity in ownership, increased consumer welfare, and greater political stability. In the absence of significant private corporate assistance to minority entrepreneurs, the Kennedy and Johnson Administrations gradually introduced a number of relatively small-scale programs, operated by such agencies as SBA and the Office of Economic Opportunity. Low interest Federal loans with modest equity requirements were provided directly or through private banks with government guarantees. Retired executives were recruited at Federal expense to deliver technical assistance to minority businessmen. And large government contractors, especially in the defense and space industries, were "jawboned" into "setting aside" a small number of sub-contracts for minority businesses.

Immediately after his inauguration in 1969, President Nixon established an Office of Minority Business Enterprise in the Department of Commerce, which, in turn, created a new institution: the Minority Enterprise Small Business Investment Company (MESBIC). MESBIC's are generally operated by large, established white firms, capable of putting up the initial capital contribution and of providing administrative support. The function of MESBIC's is to supply venture capital and long term financing to small businessmen, through purchase of stock or securities issued by the latter. SBA then "leverages" this initial "front-end" capital. The MESBIC Program has been widely criticized for its high minimum capitalization requirements, its preference for funding only relatively small black businesses, and its prohibition against the support of cooperatives [100, Hetzel, 1971; 22, Blaustein and Faux, 1972, Chs. 8, 10; 162, Rosenbloom and Shank, 1970].

In terms of absolute levels of activity, the OMBE program has indeed increased the input of capital into the black business sector. According to a progress report released by the agency in 1972, total government grants, loans, and guarantees rose from about $200 million in 1969 to over $430 million in fiscal 1971. The dollar value of government procurement contracts for minority-owned businesses rose from $8.8 million in 1969 to $66 million in 1971 (*direct* procurement from the fed-

[11] There is no question that the degree of absentee ownership in the black community exceeds that obtaining in other ethnic enclaves. Glazer and Moynihan, for example, report that "the income of Chinese from Chinese-owned business is, in proportion to their numbers, forty-five times as great as the income of Negroes from Negro-owned business" [76, 1963, p. 34].

eral government rose by a factor of 10) [143, Office of Minority Business Enterprise, 1972, p. 9].

The procurement (or "set-aside") program is especially important. The Small Business Administration acts as the prime contractor for goods and services to be delivered to other government agencies. SBA then subcontracts minority firms to "deliver the goods," or else requests a private corporate contractor to participate, with the latter in turn subcontracting to a minority enterprise. Government purchases of goods and services are now such a significant share of GNP ($58 billion in 1971) that this program provides great potential for ghetto development.

Unfortunately, SBA rules for awarding minority set-aside subcontracts exclude participation by such collective entities as community development corporations (which we shall study in a moment). Some critics charge that "this policy . . . can have the effect of promoting the interests of wealthy minority businessmen while excluding poor minority groups" [146, Perry, 1973, p. 12].

OMBE has also had its conservative critics as well. Andrew Brimmer, for example, argues that investment in the ghetto is inefficient, and therefore socially wasteful, given the "unfavorable economic climate," particularly with respect to crime. (the low marginal efficiency of investment in such areas also leads Robert Crandall and Duncan MacRae to recommend against capital subsidies for the ghetto [44, Crandall and MacRae, 1971]). Moreover, writes Brimmer, ghetto development is infeasible as well as inadvisable due to "the high cost and unavailability of adequate land area" [29, Brimmer and Terrell, 1971, p. 306].

In rebuttal, other economists have appealed to the alleged ubiquity of market failure as vitiating inferences about the marginal efficiency of "inside" versus "outside" investment [188, Tate, 1971] and Section V below. The "unfavorable economic climate" of the ghetto, it can be argued, is itself largely a result of the under-investment in the economic base of the ghetto. Improvements in the local economy will improve the "climate."

Similarly, to the extent that "economic crime" is at all related to poverty and social disorganization, investments which increase ghetto economic welfare will reduce the necessity and motivation for at least part of the crime which—Brimmer quite accurately observes—makes it so difficult for ghetto businessmen to survive economically [78, Gordon, 1971].

Finally, as reported earlier, recent studies contradict Brimmer's contention that the stock of land/space in the inner city is already fully utilized.

As an alternative to public (or private) assistance to minority entrepreneurs, Brimmer advocates expanded human capital development programs. Well educated and trained black workers "will be attracted to the higher expected returns and the greater job security in firms operating in the national economy" [29, Brimmer and Terrell, 1971, p. 293]. While it is desirable to be "attracted," the central question is whether these "upgraded" workers would be hired. Much recent econometric research on the returns to ghetto human capital does not support an optimistic forecast.[19]

The Location of Corporate Branch Plants in the Ghetto

A small number of major corporations have experimented since 1966 with, and a few Senators and Congressmen have encouraged federal support of, the location of branch plants within the urban ghetto. These branch-planting investments of 1966–1970 were expected

[19] Examples of econometric studies which have discovered low to insignificant absolute and relative returns to investments in black human capital are Bluestone [25, forthcoming], Harrison [88, 1972; 89, 1972], U.S. Congress [198, 1972]; Michelson [133, 1969]; Schiller [166, 1972], and Wachtel and Betsey [209, 1972]. The hypothesis that education reduces black-white inequality is challenged in Jencks [107, 1972] and Weiss [210, 1970]. At least one black economist believes that the latent function of the federal manpower training programs "is to reduce the costs of welfare by getting Negroes on low-paying jobs, rather than to raise the productivity and total wages of the black community" [48, Davis, 1972, p. 105].

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, Levitan, 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 Raimon, 1968].

Taggart, 1970, p. 64; 179, ...]. A simulated benefit-... Kennedy Plan concludes ...st likely to respond would ... the subsidies would make ...nce . . . low-margin firms ...dized products in highly ...ets, paying relatively low ..., 1972, p. 51]. In order to ...ns to the program, the gov-...s Tabb) have to change the ...dequate public services and ...n, which make central city ...ssive. The Kennedy Plan ... for public investment in ...e.

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...argues that the branch-...removes project selection ...the community. Moreover, ...g wage" in ghetto areas is seldom above the legal minimum wage. Branch-planting programs weaken the strength of union-negotiated non-poverty wage floors by encouraging multi-plant firms to shift part of their production to the low-wage areas [24, 1971]. A study of corporate programs, conducted for the prestigious business consulting firm of McKinsey and Co., confirms that the branch-plant approach "has enabled companies to set lower wage scales for the disadvantaged without meeting objections from union negotiators who, at least to date, have been willing to exempt separated operations from union scales" [41, Cohn, 1971, p. 153]. These findings, if nothing else, call for caution and detailed planning in the design of branch-planting programs.

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The Model Cities Program

Title I of the Demonstration Cities and Metropolitan Development Act of 1966 authorized the U.S. Department of Housing and Urban Development to undertake a "Model Cities Program" which would concentrate public and private resources in a comprehensive attack on the social, economic, and physical problems of slum and blighted neighborhoods. The 150 cities participating in the program receive one year "planning grants" to cover 80 percent of the cost of planning comprehensive programs to raise substantially the levels of housing, education, health and medical treatment, employment and job training, income, and social services in the "model neighborhood" (this is a specific geographic target area defined by each city making application to HUD, according to the general criteria that it be "largely residential" and that "a substantial portion must be hard-core slums with a high concentration of low-income families"). When plans are completed and approved, cities become eligible for a panoply of federal grant-in-aid and HUD "supplemental grants" to carry out their programs.

Perhaps because of its social service origins (Model Cities did, after all, emerge from the "community action" experience), only a fraction of the program's budget has been allocated to activities that could be classified as "operational economic development," *e.g.*, the creation and support of new private and public enterprises or reconstruction of the housing stock. Indeed, the inability to generate much construction or rehabilitation business for minority contractors has been one of Model Cities' most notable failures. Instead, Model Cities is primarily concerned with the delivery of services and combining direct public service employment with manpower training. Even with respect to the latter, only about 20 percent of the regular salaried Model-Cities-funded workers in the Spring of 1971 were employed in development-related agencies, according to an unpublished HUD-commissioned study by the National Civil Service League.

The Model Cities Program has great potential, especially for local economic development [144, Olken, 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 pesonnel 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]

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

[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 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].

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)[23]

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 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

[23] 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.

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 grocering (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, Phemister 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, Vietorisz 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, Vietorisz 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, Vietorisz 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 bureaucracy, and the private sector [65, Faux, 1971, pp. 48–55]. At one extreme, the objective of development programming has been described by an English development economist, Dudley Seers, as the implicit maximization of a weighted average of community benefits, subject to the constraint of financial solvency, *i.e.*, that the project(s) break even. More realistically, CDC's speak of trading off profits for community welfare; so that profits become one of several 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 manpower training. It was Pigou who first developed the now well-known theorem that decentralized markets will invest suboptimally in activities generating external economies. The implications of this particular externality—the indivisibility between production and training—have been virtually ignored by human capital theorists, who assume that decentralized 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 indivisibility precludes unique allocation of costs between 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 modern technology. This demand by ghetto leaders has become more insistent as evaluations of conventional private and public sector manpower 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 Development Project team spoke often of "greenhouse 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 product and profits they would generate [205, Vietorisz 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 decentralized capitalist economy.[24]

Methodologically, one difficulty in selecting ghetto development projects lies in the combination of quantitative and qualitative objectives, and another in the externalities—both convex, *e.g.*, consumption interdependences, and nonconvex, *e.g.*, indivisibilities and economies of scale—that link different projects together. An operational solution to the second problem has been employed by development 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 Vietorisz, 1959; 202, Vietorisz, 1968; 20, Bergsman, Greenston, and Healy, 1972]. Work is presently underway to attack the first problem through the design of integer programming models with ordinal preference functions and iterative man-machine interaction [203, Vietorisz, 1970].

Financing Ghetto Development

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

[24] 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 stimulate 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 example, "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. 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 exhuberance 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 threshhold [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[11]

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 [10?, 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 Negros to Northern metropolitan areas . . . greatly aggrevating the problems" [113, Kain and Persky, 1969, pp. 3?-3?]. Thus, "there is no alternative but vastly increased suburbanization of Negro populations, if we are to avoid unnecessary economic waste and growing political conflict" [10?, Kain, 1968, p. 243]. Programs to implement the suburbanization of ghetto dwellers—re-

[11] This subject receives a far more extensive treatment in Harrison [93, 1974, Chs. 4–5; von Furstenberg, Horowitz, and Harrison [208, 1974, pt. I].

reverse 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.[26]

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 migration 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, 1971, 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 some time 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—

[26] 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].

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 [110, Kain, 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 [93, 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 mis-match." 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 research 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 nonpoverty central city, and the suburban ring [88, 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 [18, 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, Vietorisz, 1959; 201, Vietorisz, 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).[25] 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 deliberatley 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 shortchanged 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].

[25] 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 nonconvexity 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 indispensible 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. Little 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 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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Problems

COMMUNITY DEVELOPMENT CORPORATIONS: THE PROBLEM OF MIXED OBJECTIVES

FREDERICK D. STURDIVANT*

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 renascence 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 Bill[2] 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.

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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 marshall 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 unemploymnet 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 dark 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. . . ."[4] 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 underepresented 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 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 undercapitalized 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:

Revenue Component	*10 low-income market retailers*	*10 general market retailers*
1966 net sales	$5,146,3[illegible]5.	$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.)

Type of retailers	*Net profit after taxes as a percent of sales*	*Percent rate of return after taxes on on stockholders' equity*
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 commerical 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.

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[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 Schumperterian 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 unleased 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.

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[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 r motivation is determined by material gain instead of by human beings, the 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 shareholdres 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 forseeable 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

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[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 atmopshere 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]

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[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.

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[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).

Evaluating CDC's --- a Summary Report

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 refinement of programs, companies, and concepts that are already in place.[2]

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 FHA 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.

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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
Physical Development								
Community Facilities, Housing Rehabilitation, 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)
Economic Development								
Business Development 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)
Non-Profit Community								
Area Development	754,336		925,273		1,070,311		985,557	
Comprehensive Manpower	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)
Central Administration	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.

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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.

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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
FHA Securing and Maintenance Program						
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
FHA-Owned Tenant-Occupied Housing						
1. Number of units managed	50		200		33	
2. Fee at 10 percent of rents collected		$3,369		$22,930		$3,381
Restoration-Owned Properties						
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

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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 where 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 coventure 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.

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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 Achievements[1]

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 changes. 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	94,896	2,624,969	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 Traini g 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

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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
Health			
1. Health Fairs conducted	11	10	2
2. Health Screenings provided			
a. Hearing	552	200	1,002
Social Services			
1. Referrals to welfare agencies	550	900	395
2. Senior Citizens Assistance	238	400	248
Youth Development			
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
Cultural Affairs and Education			
1. Art exhibits	38	30	47
Education			
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
Housing and Sanitation			
1. Housing complaints processed	4,279	5,000	4,420
2. Housing referral assistance	1,426	2,000	1,468
Contact Between Community and Restoration			
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 (66 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
Comprehensive Manpower and Construction Worker Training Programs						
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
Training Credit Program						
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.

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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.

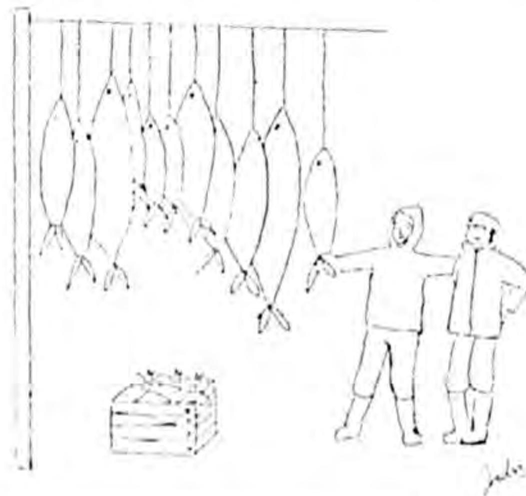
The obvious conclusion to be drawn at this time is that rural groups will become increasingly active in freeing up this money and will move to seek support from urban areas to assure implementation of these programs which are designed specifically for rural development. The National Congress for Community 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

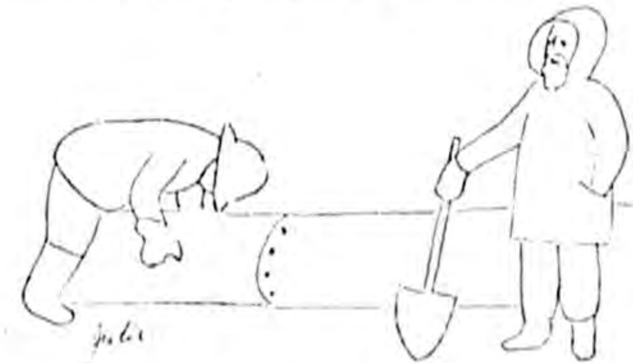
Because the villages are isolated, have different subsistence patterns, and are populated by different ethnic groups, there may not be a "typical" village. But the similarities among them are strong, and many problems and needs are shared by all the villages in rural Alaska. One example, therefore, can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

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 *Innuit 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.

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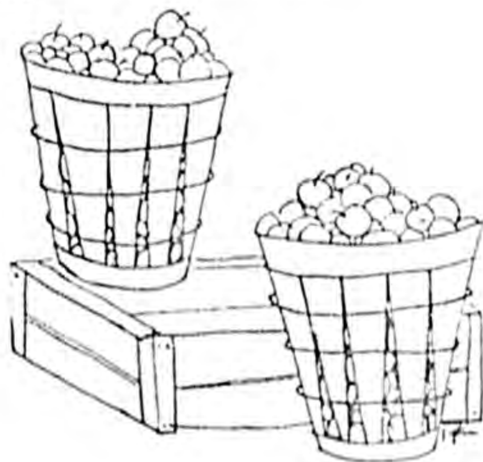
* The Act divides the state into 12 regions (called Alaska Native Claims Settlement Act [ANCSA] regions), and provides for organization under the laws of Alaska of a native regional corporation in each region. Each native in the region will receive 100 shares of stock in the corporation, whose assets 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 seiner ("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 programs, 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 communitiesm 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 Contribution	Other Contribution	NAP Contribution
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) 9½%	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 48% x 156,000	74,880		
Fed. Tax 48% x 146,950		70,536	
Fed. Tax 48% x 151,950			72,936
Total Fed. Tax	$80,310	$76,036	$78,436
Cash Required			
Contribution	None	10,000	10,000
Fed. Taxes	80,380	76,036	78,436
Penna. C.N.I. Tax	19,000	18,050	13,050
Total Cash Required	$99,380	$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).[a] 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

[a] This 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

Condition	*Possible Range of Variation*
Degree of Subsidy Current Capital	From Total Subsidy to, to Generation of Large Profits by, the Enterprise
Degree of Public Control	From Nil to Complete
Ownership	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 Tulkens' 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 *anti*public 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

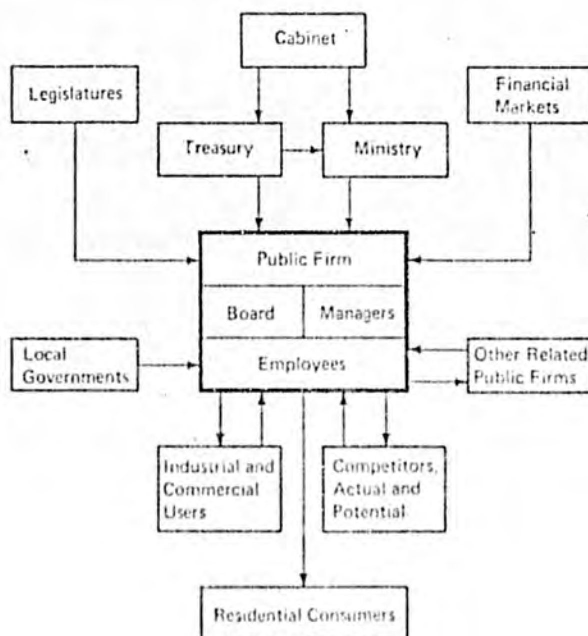


Figure 3-1. The Setting of a Typical Public Enterprise.

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.

Yet the accounts are inherently narrow, even if—as never happens—they comprehensively present every relevant fact about the public firm's activities. They show only what *has* occurred, not what might have occurred, or what might occur in the future. They do not present the range of social choices and trade-offs which society has had in the past and has now for the future. To that extent the accounts do not convey the genuine conditions for full social choices. Nor can they give a sufficient basis for evaluating what has happened. This is true even if the accounts are utterly complete and accurate.

In practice, the accounts often are incomplete, inaccurate, and have a checkered emphasis. Usually the financial aspects are treated as central in the enterprise's accounts. The commercial kinds of asset, income, profits, and pricing data take up most of the attention, and they are given as the main outcome of the enterprise's activity. This gives a basis for beginning to evaluate certain financial performance criteria. Yet even these data are controversial, since costs, depreciation, and productivity pose sophisticated measurement problems. Financial performance can be misrepresented in many ways—honestly or otherwise—by the choice of accounting definitions and methods. In any event, these magnitudes are often much too narrow to present the whole range of social effects of the public firms.

Accounts also include physical and social activities. The physical employment, production, allocation, and other outcomes naturally need exposure. In addition the pollutions, interactions, and other social effects of company activity are also part of an adequate social reckoning. Yet these are rarely reported fully or objectively. Also, such data suffer from representing only what *has* happened, without a full basis for comparing the possibilities. They also can be given in ways which slant their results or—as is often the case—simply omitted. Social effects are especially difficult to render in concrete measures, and they may be deliberately biased by the managers of the enterprise to fit their own purposes. Routinely, understandably, the enterprises will state their accounts so as to make their performance seem as good as possible. This is routine in the explanations which the firms give of their yearly results. These often match the tone, direction, and thinness of the annual reports of private companies. One understands why this happens: managers are human, and outside criticism is often paranoically hostile. Still, the fact remains that the accounts are often incomplete.

In general, the public enterprise's control over information about it is critical. Even when outside investigation is intense and sophisticated, the enterprise can influence the range and quality of what it must tell. The accounting requirements themselves often become a sensitive issue, part of the bilateral bargaining process between the firm and the supervising public agencies.

Fundamentally, full disclosure by the public firm is not efficient in any case. The enterprise's very being is premised on its carrying out social purposes without the full participation or expenditure of effort by the government itself. Therefore, outside review is bound to be partial. This usually tends to keep

supervision of the more sensitive items from being complete. Instead, outside review tends to become periodic and fitful, rather than steady and thorough. To repeat, the thinness of outside supervision is both desirable (so as not to inhibit the firm) *and* subject to abuse.

The Conditions Affecting Accountability

I will now analyze the bilateral monopoly conditions, in which each side has special advantages and powers. On the side of the public enterprise itself there are several factors. *First* is its control of data on its own operations and plans. As noted, this can be not only thorough but also purposive and manipulated to maximize the firm's independence and security.

A *second* power is, paradoxically, the firm's ability to fail or otherwise impose *difficulties* upon the government. The firm's failure itself causes stress and a loss of public support for the government, because the officials share responsibility for performance. Short of failure, the firm can still impose drains on funds and public resources, or it can impose other kinds of difficulties upon the government. These can grow large, as a share of public expenditure and budgeting. Such problems cater to the widespread fears–groundless or otherwise–that public enterprises are increasingly drawing on public resources. Like public regulators of private firms in the U.S., supervisors of public firms can be injured if their wards are seen to perform poorly.

Third, a public enterprise often can simply outlast the minister who is endeavoring to impose special authority upon it. To this extent, the firm has added bargaining strength.

As for the supervisors, they have three specific advantages. *First*, they have control over finances. It is widely believed that the public agencies' control over capital to the public firm may be a critical element of control, because if the public firm can–or must–go to private markets for capital, it becomes more independent of control by public authorities. To that extent, the power of the purse may be great. Indeed, many public enterprises–especially those that are subsidized chronically in some degree–are heavily dependent upon their financial sources. Yet this is strongest only for the more conventional types of public firms, especially type 1 as noted previously. When a public firm is *not* capital intensive and required to fund large loans, it may be nearly or entirely free of this element of control.

Of course private market influences can be as restrictive as public-agency ones, and so a public firm's shift to private bond markets may simply exchange one set of outside controls for another. Many conventional public firms which rely on private capital markets are subject to very tight commercial restraints indeed.[18] These limits are not so tight for the other types of firms, whose needs for capital–beyond what it can raise from its own cash flow–are relatively small.

Second, the government usually has other powers. These include the powers of appointment, of setting salaries, and of other kinds of sanctions. Some of these are political, taking the form of public reproofs, controversies, or assertions, rather than of directions or orders. But they can often be quite effective as economic levers on the firm, in forcing or inducing public firm managers to take the desired actions. Accounts may be a central vehicle for detailed supervision of the *firm*. But the supervisors have other, cruder tools, some of them very powerful indeed, in dealing personally with the *managers*.

Third, agencies usually have more authority when they supervise more than one public firm. This is clear from the parallel experience in regulating private firms, where one commission may find itself dealing only with one company.[19] In such cases mutual dependence or even passivity by the commissions is a common result. By contrast, an agency which deals with three or five or even more public enterprises is often relatively free to take a tough line with one or the other of them, since it is not so dependent on any particular one.

These are only some of the conditions which influence the bilateral monopoly outcome between public agencies and the public firms which they attempt to supervise. Yet they are sufficient to show that the optimum package of controls and results depends very much on the conditions of the specific case. Solutions that would give the optimal accountability for a public firm in a utility industry with structural problems of adjustment may be quite different from solutions for a financial public firm or a social enterprise. Therefore, one begins with a full appreciation of the variety of possibilities, rather than trying to settle on one or even several types of public supervision as being best.

Experience and the literature do not yet give full, precise guides for accountability. Each case will continue to involve a process of conflict and change, shared interests and mutual evasion. Total accountability is neither possible nor efficient; supervision itself is costly, and it can damage as well as promote performance in the public interest. Accountability continues to be a basic unsolved problem for public enterprise, as it is for other policies.

Notes

1. For discussion of these objectives, see especially Joe S. Bain, *Industrial Organization*, rev. ed. (New York: Wiley, 1968); Tibor Scitovsky, *Welfare and Competition*, rev. ed. (Homewood, Ill.: Irwin, 1972); F.M. Scherer, *Industrial Market Structure and Economic Performance* (Chicago: Rand McNally, 1970); W.G. Shepherd, *Market Power and Economic Welfare* (New York: Random House, 1970); and Shepherd, *The Treatment of Market Power* (New York: Columbia University Press, 1975).

2. For surveys of these criteria for public firms, see Ralph Turvey, *Economic Analysis and Public Enterprises* (London: Allen & Unwin, 1971); and P.W. Reed, *The Economics of Public Enterprise* (London: Butterworth, 1973).

3. For recent discussions of these difficulties, see James R. Nelson, ed., *Marginal Cost Pricing in Practice* (Englewood Cliffs, N.J.: Prentice-Hall, 1964); William Vickrey, *Micro-Statics* (New York: Harcourt, Brace Jovanovich, 1964); Ralph Turvey, *Optimal Pricing and Investment in Electricity Supply* (London: Allen & Unwin, 1968); and C.J. Cichetti and J.L. Jurewitz, eds., *Studies in Electric Utility Regulation* (Cambridge, Mass.: Ballinger, 1975).

4. For extensive analysis of these losses, see Scherer, op. cit.; Bain, op. cit.; and Shepherd, *Market Power* and *Treatment*, op. cit. The issues are complex and warmly debated, but the expert consensus is in the range of 2 to 4 percent loss of GNP.

5. Analysis of these choices is given in Shepherd, *Treatment*, op. cit., and Clair Wilcox and W.G. Shepherd, *Public Policies toward Business*, 5th ed. (Homewood, Ill.: Irwin, 1975).

6. See also Shepherd, *Treatment*, op. cit., for further analysis.

7. Also, their "utility" characteristics often are only temporary, as the industry evolves: see W.G. Shepherd, "Entry as a Substitute for Regulation," *American Economic Review*, May 1973, pp. 98-105; and R.A. Posner, "Natural Monopoly and Its Regulation," *Stanford Law Review*, Feb. 1969. "Utilities" often evolve toward normal competitive conditions.

8. See Shepherd, *Treatment*, op. cit.; Wilcox and Shepherd, op. cit.

9. This is true even if their management and economic performance are as good as the situation permits; see for example W.G. Shepherd, *Economic Performance under Public Ownership: British Fuel and Power* (New Haven, Conn.: Yale University Press, 1965) and Pryke, op. cit.

10. There is no good comprehensive source on the forms of public enterprise. But see William A. Robson, *Nationalized Industry and Public Ownership* (London: Allen & Unwin, 1960); M. Shanks, ed., *Lessons of Public Enterprise* (London: Jonathan Cape, 1963); and the *Annals of Public and Collective Economy*, successive issues.

11. Surveys of the public corporation include Robson, op. cit.; and Richard Pryke, *Public Enterprise in Practice* (London: Macmillan, 1971).

12. On British experience in these directions, see Shepherd, *Economic Performance*, op. cit.; Pryke, op. cit.; and Chapter 6 of this book.

13. Again, British experience with this type is illuminating; see Shepherd, op. cit. and Pryke, op. cit.

14. For a pioneering analysis of these possibilities, see W.C. Merrill and N. Schneider, "Government Firms in Oligopoly Industries," *Quarterly Journal of Economics*, Vol. 80, no. 320, August, 1966, pp. 400-12.

15. For more on the following examples, and many other types, see Wilcox and Shepherd, op. cit., Chapters 19 to 22; and W.G. Shepherd, "Alternatives for Public Expenditure"; Chapter 9 in Richard E. Caves and Associates, *Britain's Economic Prospects* (Washington, D.C.: Brookings Institution, 1968).

16. The literature includes Robson, op. cit.; Pryke, op. cit.; A.H. Hanson,

Parliament and Public Ownership (London: Cassell, 1961); and C.D. Foster, *Politics, Finance and the Role of Economics: An Essay on the Control of Public Enterprise* (London: Allen & Unwin, 1971).

17. For analysis of these regulatory and antitrust issues, see Shepherd, *Treatment*, op. cit.; Wilcox and Shepherd, op. cit.

18. Foster's discussion (op. cit.) is especially instructive on the comparison between these types of control.

19. See especially Wilcox and Shepherd, op. cit., Chapters 13 to 18; A.E. Kahn, *The Economics of Regulation*, 2 vols. (New York: Wiley, 1971); and Almarin Phillips, ed., *Competition and the Regulation of Industry* (Washington, D.C.: Brookings Institution, 1975).

6 British and United States Experience

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In both Britain and the United States, public enterprise has long been an active matter for debate and experimentation. Practical experience in the two countries has followed certain similar lines, but there are also important contrasts.

The common impression is that public enterprises are extensive in Britain but rare in the U.S. This is incorrect. Both countries have a large and growing variety of public firms, both in industry and in social sectors. Many of the public enterprises are of the conventional sort, but the variety is increasing on both sides of the water. Also, the literature evaluating the experience in Britain has been voluminous. This experience needs to be appraised with special care, and with attention to emerging trends.

Basic Patterns

Many readers will be familiar with the main outlines of public enterprise in these two countries. But after decades of evolution, the actual patterns are quite complex and often different from the usual image.[1] Therefore I will begin with several b. 'c points.

1. Both countries have had long experience with public enterprise, going well back into the nineteenth century. Yet the main growth in British public enterprise came just after World War II, while expansion in the U.S. since the 1920s has been more gradual and erratic. Partly because of this, public enterprise in Britain focuses closely on the "utility" sectors. By contrast, in the United States, the incidence of public enterprise is highly variable, and it approaches completeness only in a few of the utility sectors (postal service, water, and sewage). In utility sectors which offer a relatively even choice (e.g., other than urban services), Britain has chosen to have much public ownership, the U.S. to have little.

2. Both countries have had a low share of public enterprise in the mainstream of industry, finance, and trade. Yet both also have extensive *social* enterprises, in a variety of sectors.

3. In both countries, the public enterprises in utility and industrial sectors tend to be of the conventional type (recall Chapter 3), with total public ownership, a wide or even national monopoly of their industries, and a degree of

autonomy from direct government control coupled with funding directly from the public treasury. Social enterprises in both countries take a rather wider variety of forms. They too tend to be monopolies, but the degree of subsidy varies widely. Also the variety in the degree of monopoly and the geographical scope is great.

4. These two main types of public firms—conventional ones and social enterprises—usually display contrasting behavior. The utility firms tend to be run along commercial lines, being required to accrue enough sales revenues to cover all, or nearly all, their total costs (including a return to capital).[2] Social enterprises, by contrast, tend to be run with a high degree of public subsidy, often total subsidy, with little pretense at charging users amounts sufficient to cover costs. This contrast, between minimal and maximal subsidies, yields highly different patterns of behavior among the various enterprises. The middle range—of partial subsidies—which might be optimal for many of these enterprises, tends to be empty.

5. The main lines of management motivation appear to be relatively similar to those of comparable private firms. Also, the familiar managerial urges to grow and diversify seem also to operate in these public firms. In most essentials, the upper management and directors of these firms are identical to those in private firms. They are drawn from much the same pools of talent and are subject to much the same pressures on behavior. This is not to deny that there are some differences.

6. Perhaps what is most interesting to the readers of this book is that the economic criteria being applied to public enterprises in both countries have been improving markedly.[3] Also, the ability to equalize the competitive conditions of these public firms in line with those of their private competitors has also been improving. In both countries, public firms and regulated private utility firms are under constraints on profits and price structures. These probably influence the economic results which both kinds of firms (private and public) achieve. There are also interesting contrasts between the profit *ceilings* imposed on private American utilities and the profit *floors* set under public utilities both in the U.S. and in Britain.[4] The contrast between these two directions of limits gives some insight into the performance of public firms.

7. Public enterprises have a larger share of total national income and investment in Britain than in the United States. (This would be true of other European lands too; see Chapter 7.) Table 6-2, which we will discuss later, shows the main volumes. This flow of resources is often regarded as a burden on British economic performance, and it is true that total subsidies to public firms in Britain have been substantial, but the true volume of subsidies cannot be definitively measured. Complex opportunity costs (of capital, partially immobile resources, and public funds) must be arbitrarily estimated, and there are also unresolved accounting issues (of depreciation, capital write-offs, inventories, etc.). The main literature has grappled inconclusively with the problem,

clarifying the logic but reaching no reliable estimates. Yet close study suggests that a more efficient and equitable set of policies for these public firms would tend only to *revise* the patterns, rather than to shrink the total public firm share of national resources.[5] In the U.S., also, public firms do absorb substantial resources, but there is little or no scientific evidence that this share is excessive.

8. In both countries the common tendency is for public firms to evolve away from their original social purpose as time passes. The standard shift from "active" to "passive" behavior is common (recall the Introduction and Chapter 3), although there are exceptions. This usually means an evolving of the firm toward strictly commercial lines of behavior, trying to cover costs and set prices much as private firms would. This shift is largely caused by external rules and pressure. There is also the usual broad tendency for the distributional incidents of the public firms' operations to become more regressive—or less progressive—as time passes. Such trends are common to every public program, and there are some exceptions among the public firms. Yet the tendencies are there.

In short, public enterprises in both countries offer a variety of technical possibilities and experience. Their performance depends both on pressures from outside and on internal constraints.

British Public Enterprises

The historical origins of British public enterprises have not been fully chronicled, but some account is given in several other sources.[6] Here I have space to deal only with other main points. Table 6-1 includes the main public firms in Britain in utility, social, and other sectors. Table 6-2 summarizes their trends. They are an extensive group, although their role in the conventional manufacturing, financial, and service sectors is small. These public firms have become large users of capital resources, and they also draw certain subsidies. They are a significant element in the public finances of the country.[7] They draw an even larger share of political debate.

Before 1900, U.K. public enterprises included the Post Office and several other public authorities operating social programs or enterprises. A scattering of municipal operations had also evolved. There followed the Port of London Authority in 1908, the first true public corporation, and then the Electricity Commission and Forestry Commission in 1919. Despite decades of earlier political strife about public ownership, it was not until the 1930s that a few major public firms were fully established: the British Broadcasting Corporation and Central Electricity Board (for bulk electricity) in 1926, and the London Passenger Transport Board in 1933. The London Board was the incubator for much of the people and policies which later came to dominate the postwar public firms in utility sectors.

By World War II, other specialized units included the Racecourse Betting

Table 6-1
Principal Public Enterprises in the United Kingdom

Name of Enterprise	*Service or Product*	*Origin of Present Firm*	*Degree of Public Ownership*	*Approximate Market Shares in Its Main Markets*
Utility				
Post Office	Postal	before 1850	100%	100%
	Telephone & Telegraph	by 1900	100%	100%
Electricity Council, and Central Electricity Generating Board	Electricity	1948[a]	100%	100%
Gas Council	Gas	1949	100%	100%
British Railways Board	Railroad	1948	100%	approx. 10-60%
British Waterways Board	Waterways	1948	100%	approx. 30-60%
British Transport Docks Board	Ports	1948, 1963	100%	100%
National Bus Company	Bus Travel	1948, 1969	100%	approx. 50-100%
National Freight Corporation	Freight, Trucking	1969	100%	approx. 30-100%
London Transport	Transit	1933	100%	100%
British Airways	Air Travel	1946[b]	100%	approx. 10-100%
Financial				
Bank of England	Central Banking	1946	approx. 100%	100%
Industrial Reorganization Corp.	Finance Mergers	1967-1971	100%	approx. 5%
Industrial				
British Petroleum	Oil Products	1920	51-70%	30%
National Coal Board	Coal	1947	100%	100%

Industrial Reorganisation Corp.	Finance Mergers	1967-1971	100%	approx. 5%
Industrial				
British Petroleum	Oil Products	1920	51-70%	30%
National Coal Board	Coal	1947	100%	100%
British Steel Corporation	Steel Products	1967	100%	approx. [illegible]
Rolls Royce	Aircraft Engines	1971	100%	approx. 30%
British Leyland	Automobiles, Buses	1975	partial	30%
Social				
British Broadcasting Corp.	T.V., Radio	1928	100%	approx. 50%
Arts Council	Support for Arts	1946	100%	?
National Health Service	Health Care	1948	100%	90+%
Regional Hospital Boards	Hospitals, Related to NHS	1946	approx. 100%	approx. 100%
Council Housing Agencies	Low-cost Housing	1930s	100%	approx. 50%
Forestry Commission	Forests	1945	100%	100%

[a]The present divided structure was established in 1958.

[b]BOAC and BEA were combined into British Airways in 1972.

Sources: W.A. Robson, *Nationalised Industry and Public Ownership* (London: Allen & Unwin, 1960); annual reports of the public enterprises; and reports by the Select Committee on the Nationalised Industries.

Table 6-2
Trends of British Public Enterprise since 1950

	Years					
	1950	*1955*	*1960*	*1965*	*1970*	*1972*
Investment						
Gross fixed capital formation by public corporations						
Volume (£ million)	288	570	799	1,293	1,650	1,782
Share of U.K. total (%)	17.0	20.4	19.4	20.1	17.9	15.9
National Income						
Total factor incomes arising in public corporations						
Volume (£ million)	983	1,538	1,942	3,163	4,336	5,358
Share of U.K. total (%)	8.4	9.1	8.7	10.1	10.1	10.0
Public Expenditure						
Subsidies to various public firms and related programs						
Volume (£ million)	477[a]	347	462	574	859	1,133
Expenditure (%)	11.8	6.3	6.3	4.1	3.9	4.2

[a]Subsidies in 1950 went primarily to agriculture and food.
Source: U.K. Central Statistical Office, *National Income and Expenditure* (London: H.M.S.O., yearly), 1961 and 1973 editions.

Control Board (1928) and the British Overseas Airways Corporation (1939). Yet there was no public ownership or management of the core utility and manufacturing activities.

The war brought (1) extremely thorough public controls on industry, and (2) a marked deterioration of their physical capital. The wave of postwar nationalizations during 1946-1950 was politically long overdue, but it covered a series of devastated industries in a devastated economy. These firms had inherited a mass of direct controls and an extended, fresh experience in "coordination" from the war. The war made the act of nationalization more acceptable, indeed in such a rush that the other alternatives to the conventional public corporation--national corporations, monopolies, and Treasury-funded corporations--were scarcely mentioned. The aftermath of the war also ensured that there would be severe stresses on the operations of these firms.

Only utilities, plus the severely troubled coal industry, were included in this postwar extension of public enterprise. These firms have gone through three main periods since they were created during 1945-1948.[8] The first was the decade ending about 1958. This was an interval of stress and disequilibrium for the entire economy and particularly for the public firms. Their behavior was

...rely predictable. They were under pressure to maximize output, and most of them acquiesced. They also increased wages rapidly, and they began efforts at structural change and reorganization. The outcomes were mainly a degree of deficits, moderate rises in productivity, and debatable economic performance. As fuel and transport scarcities abated quickly in 1955-1956, the public firms were vulnerable because of their earlier stress on maximizing production. Therefore the first decade of public enterprise experience in Britain gave mixed results.

During 1958-1968 there were major changes. The coal, railroad, gas, and other industries accomplished important revisions in their allocation, structure, and economic criteria.[9] Productivity tended to rise more rapidly. New increases in demand brought higher profits and clearer signs of good performance. By 1969, public enterprises in utility sectors were performing much better than they had seemed to do during 1948-1958, and this improvement appeared likely to continue.

Understanding of the economic issues also grew, in research and government studies. The economic literature rose from a trickle to a healthy flow, probing the criteria and performance of the coal, electricity, gas, and railroad enterprises. Research capabilities in the firms themselves and in the supervising ministries also improved, especially with the work by Ralph Turvey on electricity and Christopher Foster on transport. At the House of Commons the Select Committee on the Nationalised Industries has since 1955 mounted a splendid series of hearings and reports on the firms and on general issues. By 1961 these had led the government to define the criteria for public firms much more rationally than before. The standards have evolved to include the opportunity cost of capital and price structures, closely fitting the best U.S. literature on utility pricing.[10] Indeed, British theory and–especially–practice are fully as good, under public enterprise, as one finds in any setting in the U.S.

This good practice required a nice balance between the firms' independence and outside guidance by the government. By 1970 a careful, even sophisticated, set of supervisory arrangements had been worked out between public firms and their ministries. There was autonomy but also a responsiveness to larger interests. Some "social" activities of the firms were even costed separately and compensated by the Treasury.

There followed a difficult period of erratic changes during 1970 to 1975, when new stresses were laid upon the public firms. These destroyed the previous balance. The most basic political intervention applied (1) strict price controls, and (2) additions to wage increases. Though these were politically helpful in the short run, they plunged the public enterprises into severe financial deficits. The firms' price structures and investment policies had been evolving towards more efficient patterns, but these gains were overwhelmed by the sheer size of the new financial stresses during this period. Only in 1974-1975 did sharp price increases in most of these enterprises move toward restoring the financial stability which

had been attained in the 1960s. Whatever the basic economic effects of this episode, it has demonstrated the vulnerability of the public firms to short-run political manipulations.

The public firms were frequently said to be investing too much.[11] The criticism was plausible: their volume of investment was large and growing, and the cost of investment funds to them was below private levels. There was indeed some tendency for the firms to invest their way out of difficulties. The "test" rates of return used in screening projects were often low, or were not met at all. Electricity officials, particularly, often leaned toward capital-intensive technologies (especially nuclear power) that were not economic.

Yet no such general waste of capital by the public firms has been reliably established. The greater bulk of the investment for reorganization and growth has probably been efficient by any valid criteria. Excess investment may, if anything, be a more serious problem in *private* regulated utility firms.

Both in its utility and social enterprises, Britain has been developing increasingly sophisticated price-structure analysis, some of which is now unequaled anywhere in the world. The French experiments in marginal-cost pricing have been developed and applied even more thoroughly in Britain.[12] By now, pricing in telephones, electricity, gas, much of the railroad system, and other public enterprises does follow marginal-cost—that is, broadly, efficient—patterns with reasonable fidelity. Moreover, it is backed up by a body of sensitive analysis of the basic principles.

The broad experience of British public enterprises is that performance can be equal or better than what private enterprises would probably yield. This has involved a complex set of guidelines, good managers in the firms, and a fairly delicate balancing of external supervision with autonomy for the public firm. Such a balance has been achieved over fairly long periods of time. It has been achieved despite the high complexity of relationships among public firms, such as among coal, electricity, and gas in the energy sector.

Most of the public firms have been created with extremes of (1) degrees of public ownership, (2) direct financing, (3) degrees of monopoly, and (4) national scope. They are the conventional type; indeed, they have served as a model for standard public corporations elsewhere.

Ownership is totally public in all but a few peripheral cases. Moreover, investment capital has mostly been supplied directly by the Treasury, particularly during the peak years of reorganization (about 1956-1965). There is now some selling of public enterprise bonds in U.K. and European markets, but this is recent and not complete.

The government has created and maintained complete intraindustry monopoly positions for most of these firms—just as regulation commonly does in the U.S.[13] This is especially extensive and vigorously defended in the case of the Post Office (telephone, telegraph, and postal service).[14] There are supplementary exclusions (e.g., of foreign coal) in some cases, yet some public firms—e.g.,

British Airways, and British Road Services (about 30 percent of trucking)–face intense competition in the major part of their activities.

The major public firms are also national in scope, as Table 6-1 shows. This includes the British Steel Corporation, which was made not only a dominant firm but also a "unified" national producer, capable of internalizing much of the structural problems in the industry. During about 1955-1965 there were experiments in decentralizing these nationally based firms, especially in gas, railroads, and electricity. The outside pressure to do this was largely ideological. It has abated, as the need for direct coordination within these small-nation firms has grown clear.

Many British public firms have tended to be loaded with social burdens, which limit their ability to exploit their monopoly positions. During the period up to 1970, this applied perhaps a healthy constraint, forcing the public firms to strain for good performance and efficiency in order to avoid deep financial deficits. During 1970-1975 the financial burdens have simply been multiplied too far, and the resulting financial stresses have showed signs of inducing demoralization in the public firms.

There has also been a continuing effort to separate "commercial" from "social" aspects of operation in these firms.[15] "Commercial" operations involve primarily the producing and selling of outputs under normal market conditions. The "social" aspects have involved such things as keeping unprofitable coal mines in operation in order to mitigate the social impacts of closure, and altering the price structure and wage levels in order to yield benefits elsewhere in the economy. In principle, drawing lines between the two is desirable, in order to isolate the public element for direct subsidy and to protect the integrity of commercial operations from erosion. In practice it has not been easy. The efforts to isolate the public elements for subsidy have had limited success. In coal, railroads, and electricity modest estimates for subsidies were developed in the 1960s. But these efforts have been swamped since 1970 by the deeper financial deficits (uncompensated) caused by the outside limits on the firms. The main technical problem is the difficulty of identifying (1) the difference between public and private policies, and (2) actual cost levels.

It has also emerged that diversifying has been important to the managerial success of the public firms. Until 1965, virtually no diversifying was permitted, even for public firms trapped in shrinking industries. Since then there have been modest shifts, especially by firms in static industries such as coal. These have tended to extend outward from pre-existing technical capacities of the firm. There has been little pure diversification for its own sake. But even these limited shifts have permitted the firms in shrinking sectors to develop new lines and to shift resources so as to improve appreciably the long-range health and incentives of the firm.

There was one marginal experiment with public investment banking during 1965-1971, and another is being considered in 1975. The IRC was allotted £150

million in 1965 to promote changes toward more efficient industrial structure and management. As a small, professional group, IRC mainly encouraged mergers, often by providing "soft" loans. Some of the mergers sharply increased concentration. IRC's visible activities and capital commitments were carefully held to the minimum, and it took no sizable shareholdings.

Therefore IRC did not even remotely explore the full range of investment bank activities (see also Chapter 8). And IRC tended more to increase the degree of monopoly than to reduce it. It also moved sharply to avert a takeover by a foreign firm in the bearings industry, but otherwise it did not treat sovereignty as a criterion. Altogether, IRC was a small, narrow, and debatable experiment.

A recently created National Enterprise Board would be a full investment bank, along lines of the Italian IRI. But its development and effects are still speculative, and it will be operating in a hostile industrial and financial setting.

In sum, Britain remains committed mainly to conventional public firm treatments. Their guidelines and performance have been markedly improved, perhaps about as far as their conditions permit. Prospects for a more flexible public investment bank are still unclear.

U.S. Public Enterprises

There has always been a variety of public enterprises in the United States, and the extent now is growing.[16] In the older times, a variety of public projects and support could be found in many cities and on the federal level. In the early nineteenth century there was a good deal of state support for economic development, including railroads in Michigan and other states and a variety of public works with commercial operations. From 1865 to 1910, a group of newer "utilities"–electricity, telegraph, telephone, railroads–came to maturity under fiercely protective private ownership. Telephones and electricity remain as the leading cases of private–or mainly private–utility ownership. This has made public enterprise seem peripheral, but it has been central in other sectors. River-valley development, social sectors, and nuclear power have involved public firms. More recently, urban growth and change have caused urban enterprises (e.g., transit, water) to become increasingly public and increasingly important. Therefore the growth of public enterprise has been weighted toward (1) certain special sectors, (2) urban enterprises, and (3) social enterprises of many kinds. There has been no coordinated or purposeful program of extending public enterprise, but rather a grass-roots evolution of many kinds of public firms and programs. In some cases the truly "public" element is small.

The basic patterns are reflected in Tables 6-3 and 6-4. Most public firms are in utility, industrial, and financial sectors. There is less public ownership in utility sectors than is common in other countries. Also, weapons production is largely private. Still, there is a wide and growing variety of public firms, ranging from

Table 6.3
Local, State, and Federal Public Enterprises in the United States

Local	Extent of Public Enterprise
Utilities	
Transit (bus, subway, trolley commuter lines)	Most large cities
Water and sewage	Virtually all large cities
Garbage disposal	Most cities
Electricity	Many smaller cities, several large cities (e.g., Los Angeles, Omaha)
Ports	Most port cities
Airports	All large cities
Social Units	
Schools	All cities and towns
Libraries	Virtually all cities and towns
Parks, golf courses, pools	Virtually all cities and towns
Sports stadiums	Many cities
Museums	Many cities
[illegible]	Some large cities
Cemeteries	Most cities and towns
State	
Prison facilities	All states
Insurance services	Unemployment: all states; Workman's Compensation: 18 states
Parks	Most states
Liquor retailing	16 states
Electricity	Nebraska, New York Power Authority
Ports	Port of New York Authority (transport and urban facilities); New Orleans; other ocean ports
Toll roads, bridges, and tunnels	29 states
Health care	Mental and old-age institutions
Federal	*Expenditures in 1973*
Electricity	Corps of Engineers, $1,803 million; Bureau of Reclamation, $519 million; Tennessee Valley Authority; others
Postal service	$11,679 expenditures; $1,391 subsidy
Lands	Forest Service, $320 million; National Park Service, $82 million
Commodities stockpiles	Value, $653 million

Table 6-3 (cont.)

Federal	*Expenditures in 1973*
Social Units	
Transport	Alaska and Panama Canal railroads; Military air and sea transport services; St. Lawrence Seaway
Loans and guarantees	About 100 agencies, includes housing, farming, rural electricity and telephones, Export-Import Bank, Small Business Administration
Insurance	Many agencies: banks, housing, crops, shipping, foreign investment, stock markets, veterans' life and annuity insurance, old-age pensions
Health care	Medicare, Medicaid, veterans hospitals
Industry	Various: Government Printing Office, Military production, etc. (World War II aluminum, steel, rubber, and other plants)

uranium enrichment plants, commuter train lines, the Port Authority of New York, public broadcasting, and public power in Nebraska and New York, to public universities and various medical and insurance programs. The continued spread of urban and social problems is likely to give public enterprises even more prominence.

Table 6-4 illustrates the variety of control and sponsorship of these public firms in the United States. Some have low subsidies and very high control; others are the reverse. There is quite a large variety of public firms toward the lower left hand corner of Table 6-4; these tend to have low public benefits relative to public costs. Yet there are also many public firms toward the upper right, where public net benefits are likely to be large.

Conventional Public Firms

Many U.S. public firms are of the conventional form (recall Chapter 3), with a high degree of public ownership and monopoly, a static or "sick" industry condition, some public utility aspects, and dependency on the state for much capital and current subsidy. There is also the common distinction between largely commercial public firms, on one hand, and social enterprises, on the other. Many utility public firms follow closely along commercial lines, in pricing and profit policy. The social enterprises, by contrast, tend to be highly subsidized and to have a variety of noneconomic objectives.

Competition by public firms is only infrequently used. Instead, most public enterprises are assigned special sectors or functions. Competition was deliber-

Table 6-4

Selected Public-Enterprise Activities in the United States, by Approximate Degree of Public Control and Subsidy

	Degree of Effective Public Control		
	Slight Control	*Partial Control*	*Full Control*
No Subsidy	Port of New York Authority	State liquor stores	Municipal utilities (water, sewage)
		National land management	
	Federal Reserve Board	Amtrak	
	FHA housing program	SBA programs (including minority support)	AEC enrichment plants
	Tennessee Valley Authority		
	Performing arts centers	FAA programs	U.S. Government Printing Office
	Sports stadiums	Airports	
Degree of Public Subsidy	Public housing	Highway construction and maintenance	
	Medicare		Social Security
	Medicaid	State courts	
	Public universities	Local courts	Municipal parking facilities
	SST program	Federal maritime program	
	Military R and D contracting	Mental hospitals	
	Veterans Administration hospitals	State and local law enforcement agencies	Municipal transit
	Weapons purchasing and management	Prisons	Federal courts
		Corps of Engineers	
		Census Bureau	Public law programs
			Child-care programs
Full Subsidy			Primary education

ately fostered during 1930 to 1940 in parts of the electric power sector. TVA and the Power Authority of New York sharply improved performance in contiguous private utilities, by forcing lower prices. This has been echoed in hundreds of small municipal systems. Such competition worked best when the public unit could threaten to enter the private firm's markets. When geographical limits were set on the public firms after 1940, most of the competitive effect disappeared.[17]

By and large, public enterprises in the U.S. reflect a national custom–arising partly from frequent corruption in local politics during 1865-1900–of relying mainly on indirect taxes and incentives to accomplish "public purposes," rather than on direct public ownership and operation. This is especially evident in weapons purchasing, in the oil industry, and in shipbuilding. It is widely influential, and it explains the limited extent of public enterprise in utility, manufacturing, and financial activities. Instead there is a maze of tax and incentive programs, many of which have dubious effects.[18]

The experience of the main body of public enterprises is mixed, and the variation is very wide. Many of them have a high degree of monopoly. Many of them sell primarily to the middle classes and to private businesses (the Tennessee Valley Authority has become a good example of this). Many of them have a residuary, "last-resort" role, in which they provide service to less lucrative customers whom private firms choose not to supply (Medicaid is one example).

Many public firms in the U.S. also tend to be passive rather than active (recall Chapter 3), and become increasingly so as time passes. Few of them apply deliberate price discrimination which transfers income from relatively rich users to relatively poor ones. Indeed, many public enterprises in the United States tend to have a regressive incidence, by providing subsidies mainly to middle- and upper-income users (the postal service and Amtrak are examples).

These negative patterns are not universal, and there are hundreds of remarkably efficient and innovative public enterprises in the United States. Yet the negative influences appear likely to continue. The reorganization of eastern U.S. railways, presently occurring, appears likely to involve a high degree of public subsidy and eventual public ownership for operations whose benefits go primarily to middle- and upper-income groups.

There are, however, instances of more favorable results.[19] The internal efficiency of most public enterprises has not generally been low. This fits experience elsewhere. There has also been no clear tendency toward abuse or deliberately inequitable policies under public enterprises. This contrasts with the more specific programs for such sectors as oil, shipping, weapons, etc. Many public firms have provided genuine public benefits in their initial years, during which their original objectives have been sharp and strong. Thus, the Tennessee Valley Authority accomplished major social changes during its first two decades, before more conventional tendencies set in. Also, many public enterprises do implicitly avert certain negative results which would probably occur under private enterprise, with or without regulation. Thus, there has been relatively

area of the general inefficiency and overuse of capital which may have occurred in regulated private utilities (under the "rate-base" effect) and in other enterprises under special government subsidies and incentives (e.g., shipbuilding and weapons supply).[20] Therefore many urban public enterprises, for example, have better relative social yields than may seem to be the case.

Many public firms have also adopted efficient pricing policies which are at least as good as their private counterparts. The Tennessee Valley Authority may not have led the way with marginal-cost pricing, yet urban public enterprises and other electricity systems have moved at least as fast as private systems toward efficient pricing under complex conditions of costs and market interactions.[21]

Social and Urban Enterprises

These have had generally more positive results. They have evolved despite an unfavorable climate of public understanding, rather than proliferated freely beyond efficient limits. They do usually have a high degree of monopoly and, often, extensive subsidies. Schools, jails, courts, and housing have absorbed a large share of public resources. Yet their performance has on the whole been relatively strong (prisons being perhaps the obvious partial exception). Their ability to supply direct public benefits is greater and has been more thoroughly effective. They have been involved more closely with social equity as an objective, and in many cases they have yielded clear gains. There have been errors and losses, but these are coming increasingly under clear analysis and changes are being made toward improved policies.[22] Urban enterprises in particular have begun to allow for interactions among the parts of urban transport and social systems. This has permitted an increasing degree of efficient pricing and system capacity. Forming an accurate impression of these changes is difficult, because certain inefficiencies are clearly evident. The enterprises also commonly have a high degree of monopoly, in many cases greater than would be optimal. Schools have particularly tended to suffer from monopoly characteristics at the primary and secondary level. Parts of the "correction" system have had pathological results. There have also been failures in charging equitable prices to the users of services.

On the whole, the range of public enterprises in the U.S.–especially the social enterprises–comprise a remarkably wide and changing set of experiments in public enterprise. Many of the results are predictable and similar to foreign experience. There is no clear pattern of defective results in U.S. public firms.

Parallels and Contrasts

One can draw several general lessons and contrasts. I will consider six of them and then offer some final remarks.

1. In both countries, the motivation and performance of managers appears to be roughly the same as it is in comparable private firms. This is most evident in the utility enterprises, but it is also generally true. This means not only that the general degree of efficiency in management operations has been about the same, but also that the directions in which public firm management can be expected to move are relatively steady and predictable. It is largely the differences in incentives and surroundings that may induce public firm managers to give distinctive results. As we have seen, these managers operate in a public firm setting which has a variety of pressures and limits. Many of these have had predictable results.

2. The special inducements affecting the cost of capital probably do have some influence on the outcomes. "Cheap" capital may marginally have encouraged some overinvestment, at some times. But such inducements are not working in isolation. Other inducements are also at work, often more strongly. It has been important for public agencies to get the cost and availability of capital as optimal as possible. But that is only the first step toward achieving an efficient and fair set of public firm results. In addition, public officials must deal with the personalities, the special technical conditions, and the changing social objectives affecting their public firms. The control of capital to the public firms is not a magic wand, nor a close lever of control.

3. The use of capital has been probably more closely limited and optimal in British public firms than in their U.S. counterparts. This partly reflects the fact that the United States has been more capital-rich than Britain, and therefore capital has been more freely used in every direction in the United States. Yet British public enterprises have also gone much further in developing efficient pricing structures and in minimizing the absorption of capital.

4. Another contrast is in the degree of public scrutiny. Most British public firms have been more closely monitored than most American ones. This too may reflect the differing relative scarcities, with British social interests being more closely limited by a simple scarcity of resources. Still the difference is there, and it has permitted a greater variety of experience in U.S. firms than of those in Britain. Yet this U.S. experience has been much less closely analyzed; the literature is very thin.

5. Neither country makes systematic use of public investment banking, or of public firms as competitors and "pace-setters," or of partial public ownership carefully set to minimize the commitment of public capital (see Chapter 8 also). This partly reflects the practical difficulties which arise in trying to fine-tune such a treatment in a rugged and hostile political setting. It also reflects a preoccupation with older concepts especially the equation of public enterprise with *ownership* and with *utility* sectors.

6. It appears that the degree of innovation by public firms is not systematically less than in private regulated firms. This holds both in the United States and Britain. It conflicts with the traditional notion that public firms are slow to

adopt new technology. But it does faithfully reflect the fact that regulation provides special inducements to private enterprises which differ in direction from some of those applying to public enterprises. Indeed, innovation may tend to be more rapid in public firms under certain conditions, perhaps even to excess.[23] At any rate, the older conventional belief about innovation does not appear to have clear support.

On the whole, British and American experience suggests that the tendency is for public firms to have more monopoly power than is appropriate, on economic and social criteria. (The same is true, of course, of many *private* firms as well.) There is also a tendency to have too high a degree of public ownership of the given firm, compared to the minimum amount necessary to achieve the public interest. Often partial public ownership will suffice or be superior. There is also a tendency toward less progressive pricing as time passes, as is also true of other policies. Not surprisingly, it has been difficult for public firms to develop deliberate price discrimination to reduce inequality. Also, public enterprises of the conventional sort tend to follow commercial lines more strictly as time passes. Whatever its value for achieving strict economic efficiency, this tendency toward commercial lines does tend to narrow and rigidify the social outcomes of public firms. This narrowing does not appear to be so true of social enterprises, in practice. They are much more readily subsidized, often beyond what is optimal.

In short, public enterprises in the U.S. and Britain are subject to the tendency of policies to become more passive, as time passes and the customer mix evolves. Many public firms have, however, avoided this shift. The bundle of public enterprises also evolves, partly in line with the changing set of social objectives. But there is no assurance that the evolution of public enterprises has closely fitted the public needs. Seen broadly, British and American experience may roughly approximate the optimum about as well as is done in other countries. But there is little clear evidence either way.

Notes

1. The British literature is extensive. Basic sources include: W.A. Robson, *Nationalised Industry and Public Ownership* (London: Allen & Unwin, 1960); W.G. Shepherd, *Economic Performance Under Public Ownership: British Fuel and Power* (New Haven, Conn.: Yale University Press, 1965); Richard Pryke, *Public Enterprise in Practice* (London: Macmillan, 1971); Ralph Turvey, *Economic Analysis and Public Enterprise* (London: Allen & Unwin, 1972); and the long series of reports by the Select Committee on the Nationalised Industries, House of Commons, various years. The literature on U.S. experience is much less thorough, but see Clair Wilcox and W.G. Shepherd, *Public Policies Toward Business*, 5th ed. (Homewood, Ill.: Irwin, 1975); Richard Hellman, *Government*

Competition in the Electric Utility Industry: A Theoretical and Empirical Study (New York: Praeger Publishers, 1972); the useful chapter by Albert S. Abel in W.G. Friedmann and J.F. Garner, eds., *Government Enterprise: A Comparative Study* (New York: Columbia University Press, 1970); and, earlier, John Thurston, *Government Propriety Corporation in the English-Speaking Countries* (Cambridge, Mass.: Harvard University Press, 1937).

2. The official criteria for profits in U.K. public firms are discussed in C.D. Foster, *Politics, Finance and the Role of Economics* (London: Allen & Unwin, 1971), and in other sources cited there, especially the Select Committee reports.

3. See Shepherd, op. cit.; Pryke, op. cit.; Turvey, op. cit.; Foster, op. cit., and the Select Committee reports for descriptions and critical evaluations of these criteria.

4. See. W.G. Shepherd, *The Treatment of Market Power* (New York: Columbia University Press, 1975), chapter 9, for a partial analysis of the contrasting effect on innovation. See also A.E. Kahn, *The Economics of Regulation*, 2 vols. (New York: Wiley, 1972), and Wilcox and Shepherd, op. cit.

5. One such estimate is in W.G. Shepherd, "Alternatives for Public Expenditure," Chapter 9 in Richard E. Caves and Associates, *Britain's Economic Prospects* (Washington, D.C.: Brookings Institution, 1968).

6. Including Robson, op. cit., and Thurston, op. cit.

7. Again, this is clear in Shepherd, "Alternatives for Public Expenditure," op. cit.

8. For evaluations of the conventional public firms during 1948 to 1968, see Pryke, op. cit., and Shepherd, *Economic Performance*, op. cit.

9. These improvements reflected both internal choices and research (especially in coal and electricity), and guidance from outside. The ministries' and Treasury's analysis improved. The Select Committee on the Nationalised Industries held extensive hearings and issued generally rational reports on the public firms, one by one (returning to each one about every 5 or 6 years). And the Prices and Incomes Board formally investigated, even more lucidly and critically, the pricing policies of most of the public firms during 1967-1971 (some of the reports are condensed in Turvey, *Economic Analysis and Public Enterprises*, op. cit).

10. This is reviewed in Kahn, op. cit., and Wilcox and Shepherd, op. cit., Chapters 13-18. See also W.G. Shepherd, "Marginal-Cost Pricing in American Utilities," *Southern Economic Journal*, July 1966, pp. 58-70.

11. The criticism was staple fare before the Select Committee, which explored the issue repeatedly and in detail. For these and other references, see Shepherd, *Economic Performance*, op. cit., and Pryke, op. cit.

12. See Turvey, *Optimal Pricing*, op. cit., and H.M. Trebing, ed., *Utility Pricing* (East Lansing, Mich.: Michigan State University Press, 1976, in press); J.R. Nelson, ed., *Marginal Cost Pricing in Practice* (Englewood Cliffs, N.J.: Prentice-Hall, 1964); and Ralph Turvey, ed., *Public Enterprise*, 2nd ed. (London: Penguin, 1971).

13 On this comparison, see Wilcox and Shepherd, op. cit., Chapters 13-23.

14 Yet there is little vertical integration, by comparison with the complete monopoly maintained by the Bell System in nearly all U.S. telephone equipment production; see Wilcox and Shepherd, op. cit., Chapter 16.

15 The Select Committee has considered this at length, in successive reports during the 1960s. See also R.S. Edwards and H. Townsend, *Business Enterprise* (London: Macmillan, 1958), Chapters 13-22.

16 See Wilcox and Shepherd, op. cit., for a partial survey. There is no comprehensive source.

17 See Hellman, op. cit., for a favorable appraisal of the effects of public [illegible] competition.

18 See Wilcox and Shepherd, op. cit., Chapters 24-26; Almarin Phillips, ed., *Competition and the Regulation of Industry* (Washington, D.C.: Brookings Institution, 1975); and U.S. Joint Economic Committee, *The Economics of Federal Subsidy Programs* (Washington, D.C.: U.S. Government Printing Office, [illegible]).

19 See Hellman, op. cit., for one favorable appraisal.

20 On the rate-base effect and other yields of regulation, see Shepherd, *The Treatment of Market Power*, op. cit., Chapter 9, and A.E. Kahn, *The Economics of Regulation*, 2 vols. (New York: Wiley, 1971).

21 See W.G. Shepherd, "Marginal-cost Pricing in American Utilities," op. cit.; see also C.J. Cicchetti and J. Jurewitz, eds., *Studies in Electric Utility Regulation* (Cambridge, Mass.: Ballinger, 1975), especially Chapter 3.

22 This is reflected in S.J. Mushkin, ed., *Public Prices for Public Products* (Washington, D.C.: Urban Institute, 1972).

23 See Shepherd, *Treatment*, op. cit., Chapter 9, for an analysis of the possible effects.

Chapter 2 JEROME W. MILLIMAN

Beneficiary Charges—Toward a Unified Theory

UNTIL more work is done on the theory of beneficiary charges in relation to the theory of demand generation for public services, empirical work on, and policy prescriptions for, user fees will lag and remain uncertain. This conclusion was drawn from an extensive review of the literature. The more I examined the literature, the more I realized that the issue of beneficiary charges and efficiency had not been worked out well in the theory.

The literature gaps have to be set alongside the many current opportunities for application of direct user charges. Possibilities for the application of beneficiary charges as an efficiency measure are literally everywhere—to ration airsheds, parks, water quality, highway use, city streets, urban public services, public housing and renewal, college facilities, hospitals, doctors, and so forth.

However, greater application of beneficiary charges to increase efficiency in the allocation of resources is still only a contingent possibility. It must wait on greater revenue sharing, and a clearer federal role in income maintenance. Until these large forward steps are taken by the federal government, the relation of beneficiary charges to efficiency will be subsidiary to questions of user charges and equity, or

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Note: This chapter is adapted from Milliman's article, "Beneficiary Charges and Efficient Public Expenditure Decisions," in *The Analysis and Evaluation of Public Expenditures: The PPB System*, Papers submitted to the Subcommittee on Economy in Government, Joint Economic Committee (91st Cong., 1st sess., 1969), Vol. I, pp. 291-318.

user charges and revenue growth. The literature is also deficient in its coverage of this linking of revenue sharing and income maintenance to both the equi.,· and revenue potential of charges.

Three major strands of economic literature deal with the question of beneficiary charges: that on public finance, on public utility, and on welfare economics relevant to marginal-cost pricing. To my knowledge, no one has pulled these three strands together to present a unified theory of beneficiary charges. The arguments advanced for such charges are quite varied, often fragmented, and sometimes inconsistent. Three major arguments have been used by advocates of beneficiary charges: (1) *equity*, that is, fairness in charging beneficiaries; (2) *revenue production*; and (3) *efficiency* in the use and production of public services.

The Public Finance Literature

The economic analysis of public expenditure decisions has advanced a great deal in the last two decades. Public finance, which earlier was largely concerned with problems of economic stabilization and with the "finance" problems of how to levy taxes and sell bonds, has gradually turned to these long-neglected topics: what public goods and services should be produced and how; how much should be invested; and how public goods and services, once produced, should be distributed. A large body of literature now exists on the evaluation of "systems" approaches to public investment decisions. The techniques of benefit-cost analysis, program budgeting, systems analysis, cost-effectiveness analysis, and operations research are becoming accepted as standard tools to aid public expenditure decisions.

With these developments, it would seem that analysis of production and distribution of public goods and services would have come of age. As one studies the theory and practice of the production and distribution of public goods and services, however, large gaps are apparent in the knowledge of demand and supply relationships. On the supply side, there has been trouble in measuring outputs, and therefore we have very few empirical production functions expressing the technical relationships between factor inputs and product outputs. We have even fewer cost functions with which to determine the optimal combination of factors to produce given outputs. As a result, we have

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often relied on expenditure functions per capita to describe relations between costs and outputs. Changes in expenditures are clearly ambiguous numbers in the absence of independent measures of outputs. Moreover, we often tend to count expenditures on inputs as measures of output.[1] It is also evident that the demand for public services is often an ambiguous concept, and that scanty information exists on how well political processes reflect preferences of consumers and voters.

These knowledge gaps on both the demand and supply aspects of the production and distribution of public goods and services are clearly related to the question of beneficiary charges. On the one hand, if we do not have solid knowledge of outputs, costs, and demands, then attempts to determine optimal prices, charges, and taxes for these goods and services are clearly in a precarious state. On the other hand, such prices and charges might be helpful as a form of consumer voting that may supply (in many cases) valuable information about consumer demand. For example, if a public good is supplied at a zero price, we can expect that excess demand will develop, with "cries of alarm" suggesting that more production is needed. Yet we may have little information about the value of this service and the legitimacy of its claim on resources versus alternative claims on the same resources.

With a few exceptions, the public finance literature on beneficiary charges deals primarily with the question of the benefit approach to taxation. The question of how to levy fees or user charges is largely ignored; some of the best-known public finance texts do not even treat the subject. In general, the stress is on the equity and efficiency gains of having taxpayers pay for benefits received. However, these gains are still considered within the context of how to finance expenditures, and benefit taxes are a "fair" way to do it. Problems of optimal resource allocation and efficiency are introduced only indirectly and are usually more concerned with the longrun questions of investment in public facilities, rather than with the efficient use of facilities.

The equity aspects of benefit taxes are viewed generally as a matter of simple justice; i.e., users of a public service should pay for its costs when the benefits do not spill over to other people. For example, the benefits of irrigation water service provided by the Bureau of Reclamation accrue to the irrigators, and it would be "unfair" to require the public at large to pay for this service. By contrast, free hospital service to the poor might justify subsidies because of indirect

benefits to the community at large. The usual textbook discussions do not elaborate on *which government community should subsidize the service*—federal, state, or local.[2] The answer would probably be: the community that receives the indirect benefits.

The principle that subsidies should be given on the basis of indirect benefits received is probably most clearly exemplified in relationships between local and federal levels of government. When benefits are provided to one group or region and the costs are borne by other areas or groups (who do not receive either direct or indirect benefits), income transfers are involved. Such redistribution must be justified on grounds *other than* the benefit principle of taxation. Yet it is very seldom argued in theory that local publics, for example, ought to share more fully in federal programs (such as flood control or urban renewal) because most of the indirect, as well as direct, benefits reside locally. The feeling seems to be that benefits which are widespread are automatically national in character.[3] The same point is made below in reference to collective consumption goods: the public character of such goods is often attributed to the nation as a whole when, in fact, collective consumption may be highly restricted to a given locality or user class. For example, how widespread is the collective consumption of the services of a lighthouse or those of a local police force?

In the traditional public finance literature, the efficiency aspects of benefit taxes (charges) are largely limited to the longrun questions of the "proper" investment in capacity or the optimal scale of service. Thus questions of how best to ration service from existing capacity are seldom discussed. The investment in public facilities is considered justified if consumer preferences (in the case of direct tolls) or taxpayers' preferences (in the case of benefit taxes) return funds to pay for the cost of the facility. The literature on cost recovery and cost reimbursement for public investment takes its rationale from the questions of equity and longrun efficiency discussed here. If the cost is not to be recovered from the beneficiaries, either an error has been made in the original investment, or (if the beneficiaries are not required to pay) there would be a transfer of income from other taxpayers to the beneficiaries of the service. If "profits" are earned, then the investment should be expanded.

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...ery from the beneficiaries, we will not *really* know whether the ...efits from the service exceed the costs. This argument is often made both in an ex ante sense and in an ex post sense. The require-ment of cost recovery from the beneficiaries as a precondition makes ...re that the beneficiaries will carefully consider the worth of the ...efits in relation to the costs during the plan-formulation period. Ex post calculations can point out past errors and serve as a basis for ...ture improvements in decisions for new investments. All this seems reasonable, except that emphasis on cost recovery may be inconsistent with the best shortrun use of existing facilities. In addition, excessive emphasis is often placed on the recovery of historical or "sunk" costs, which may not be efficient for new investment decisions.

The economic costs relevant at any one time are the opportunity costs of resources and the alternatives sacrificed now and in the future. Although cost recovery from beneficiaries has many obvious virtues, recovery of historical (or sunk) costs will be inefficient because they are not likely to coincide with opportunity costs. We are always faced with the possibility of change in the future and the possibility of not making correct projections, when constructing long-lived facilities. To insist on cost recovery of historical costs in the light of greatly changed conditions may clearly result in charging too little or too much. More-over, cost recovery tends to foster the idea that once facilities are "paid for," they should be free. More on this later.

The Public Utility Literature

The writings on public utility economics are the second maj... strand of the literature on beneficiary charges. The principles of public utility rate regulation are an uneasy blend of legal and economic princi-ples tied together within a framework of cost accounting. The legal principles tend to be concerned with the financial requirements of the utility and with the notions of equity and fairness to stockholders and consumers. In general, economic theory in this area has been forced to adjust to legal and financial constraints.

This is not the place to launch into a full-scale examination of the principles of public utility rate regulation (usually these principles have been applied to both publicly and privately owned utilities). How-

ever, to sketch out the basic features of the principles will be helpful because any study of the possible inefficiency generated from the failure to employ beneficiary charges must also come to grips with the possible inefficiencies from the use of improperly applied or incorrect user charges. I suspect that a thorough study of the matter would show that major efficiency gains could be achieved by a drastic overhaul of the system of rate regulation of public utilities (federal, state, and local).[4]

In large part, the level of public utility rates is determined by the following relationship:[5] $R = E + (V-D)r$, where R is the total revenue required to cover total costs; E is the full operation and maintenance expense; V represents the fair value when the facilities were new;[6] D is the depreciation allowed in the value of the facilities; and r is the fair rate of return to be allowed on the current fair value (V–D).

This method of rate determination has the following schematic properties:

$$\text{Total Revenue (TR)} = \text{Total Costs (TC)}$$
$$\text{Average Revenue (AR)} = \text{Average Costs (AC)}$$

In short, public utility rates are based in large part upon two principles that are questionable from the standpoint of efficiency in the use of resources: (1) rates tend to be based upon recovery of historical or original costs, and (2) rates tend to be determined by the average cost of service as opposed to the marginal cost of supply. This sort of price policy probably represents a nice balance between such multiple objectives as equity in the distribution of wealth between consumers and stockholders, fairness among classes of service, and the provision of the financial needs of the utility companies. Yet it is questionable whether such a policy deals adequately either with efficiency in the use of existing services or with the development of optimal criteria for new investment. On the one hand, the scope of public utility operations is quite likely to be expanded and applied to an increasing range of public or quasi-public services. On the other hand, the opportunities to change or overhaul present practices and accepted principles of regulation are not bright because of the long weight of legal precedents supporting the present structure and because marginal-cost pricing has some practical and theoretical difficulties of its own.

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The Marginal-Cost Pricing Literature

The third major body of economic literature bearing upon the ...ory and use of beneficiary charges is the writing of "welfare" econ... who have developed the theory of marginal-cost pricing. Al...ugh some of the principles of marginal-cost pricing are now being ...ribed or adopted in writings in public finance and in public utility ...nomics, as yet a full-scale synthesis has not been achieved. For ...ample, a public utility textbook will generally have a chapter on ...rginal-cost pricing, but then little is done to relate the implications ...r the theory and practice of rate regulation. Neither public finance ...or the public utility literature has succeeded in rationalizing the needs ...r reimbursement of financial costs with the efficiency rationale of ...rginal-cost pricing that may generate surpluses or deficits. The ...ory of marginal-cost pricing stresses that investment and operating ...cisions on social investments should be made *independently* of re...mbursement policies for individual lumps or units of productive ...pacity.

It seems clear that marginal-cost pricing is still a controversial ...pic, one on which economists have not reached a complete consensus. At one extreme are those who have accepted it as a major pillar of ...blic policy;[7] at the other extreme are those who have rejected it as ...valid or wholly impracticable.[8] Between these poles are many econo...mists who have advocated changes or modifications in the principle ...self or qualified the claims that its strict application will produce an ...ptimal allocation of all resources.[9]

In its most simple form, the cardinal rule of marginal-cost pricing ...ays that the demand price should be made equal to marginal cost, with ...arginal cost defined as the incremental costs of production (more ...chnically, as the derivative of the total cost-function with respect to ...tput). Since resources are drawn away from alternative uses, mar...nal costs should reflect accurately the social opportunities foregone. The equality of price and marginal cost ensures that consumers equate ...arginal benefits from this use of resources with the real alternatives ...regone elsewhere. In a world of pure competition the market mecha...sm would operate to ensure this equality.

For some types of public goods, production is characterized by ...ngrun decreasing costs or increasing returns to scale. Marginal cost

will lie below average cost in increasing return cases.[10] If demand p[illegible] is made equal to average cost (full-cost recovery), the price will exceed marginal cost. This result is inefficient because the value that consumers place upon extra output exceeds the cost of alternative production that could be sacrificed elsewhere to produce this extra output. It is therefore desirable to expand production to the point where price equals marginal cost. However, this solution will generate a deficit, and the goals of cost recovery come into conflict with efficiency. It is thus fair to ask why these costs should be borne by the general taxpayers when the benefits are seen by the users of the facility. [illegible] contrast, equating price and marginal cost when the average cost of production is rising will require restricting output to the point where price equals marginal cost, even though total costs could be recovered at larger outputs and lower prices. In this case, marginal-cost pricing would generate surpluses.

These simple-sounding arguments may hide a whole set of complicating circumstances and situations. As C. J. Oort suggests (as expanded below), answers can be made to most of the theoretical and practical objections raised against the marginal-cost pricing principle. In particular, a whole set of devices has been proposed to deal with the troublesome problems of surpluses and deficits.[11] Also, economists always point out that the case for marginal-cost pricing is based upon three important conditions:[12] (1) that there are no important spillover effects in production and consumption that are not reflected by P = MC; (2) that the current distribution of income be acceptable or certainly not biased toward the particular measurement of prices and costs; and (3) that deviations from P = MC elsewhere in the economy do not require compensating adjustments in this sector (the theory of the second-best).[13]

The efficiency arguments for beneficiary charges, although subtle and often complex, are the most persuasive and valid. To illustrate this point, I quote from a summary of a searching critique by Oort of the marginal-cost pricing principle.

> We have shown that many of the objections to the principle are either invalid, or irrelevant for policy, or require certain more or less important modifications rather than a rejection of the principle. Invalid are all those objections to the rule which are based on alleged or actual indeterminacies of the marginal cost function; in most cases, the correct interpretation of

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...principle, which requires in the first place the equilibrium of demand and supply, will lead to a perfectly determinate solution in terms of ...um prices and outputs even where marginal cost is indeterminate. ...particular, this holds for the cost of joint production in which separate ...rginal-cost functions generally speaking do not even exist, but in which ...marginal-cost pricing principle nonetheless applies without any ...ations. Irrelevant are those objections which apply to any and all ...of policy; this holds for the entire class of problems raised by the ...of "uncertainty." Of the many modifications to which the marginal cost ...principle must be subjected before it can be applied in practice, none ...ears to be so drastic as to actually imply the rejection of the rule as such. ...are in the nature of a compromise between the principle itself and ...other economic objective such as the minimization of the ...ministrative costs incurred by putting the proposed price and output ...y into effect.[14]

Cost-Recovery, Marginal-Cost Pricing, and Efficiency

Krutilla is one of the few writers who has worried about the diffi-...ties of determining the proper scale of facilities when no charge is to be levied on the beneficiaries:

> We have on the one hand dicta that the scale of a facility should be extended to the point at which incremental benefit equals incremental cost. However, unless user charges are levied to cover the cost of providing the marginal ...t of output, there will develop excess demand represented by those ...ers who would not find incentive to use the services of the facility if ...arges appropriate to the design criteria were imposed, but who will make use of the facility at zero price. If such use by any beneficiary at capacity output adversely affects the utility of any other, the design criteria result in a project inappropriately sized relative to realizing the benefits estimated for purposes of design. At any rate, *it is clear that design criteria as presently ...nced relate to the correct design for an irrelevant situation where ...bursement policies are at variance with design criteria.*[15]

Krutilla argues that the marginal-cost pricing doctrine makes the investment decision "independent of the reimbursement policy for in-dividual chunks of productive capacity." He says that initially there may be excess capacity in facilities, justifying a marginal-cost pricing policy of not recovering full costs. However, as use of capacity in-creases, prices should be raised "to ration scarce capacity until a point

is reached at which the revenue demonstrates a beneficiary willingness to pay for service sufficient to justify an expansion of facilities. If user-fees are raised to reflect congestion costs they will sooner or later equal the average cost of capacity: "In short, marginal-cost pricing under these conditions will result in exactly recovering costs of facilities of optimal scale and schedule of expansion."[16] All this seems to suggest that marginal-cost pricing, correctly applied, will provide for full cost-recovery and that cost-recovery is a desirable efficiency objective.

To make these relationships appear even stronger, Krutilla next points out the difficulties that may arise when criteria for project design and policies for cost reimbursement are not consistent. The design criteria require that the scale of the investment be extended to the point where marginal benefits equal marginal costs. Unless user charges are imposed to cover the costs of the marginal unit, he argues, excess demand will develop and use of the facility will be inconsistent with the design criteria. Therefore, reimbursement policies should be made consistent with design criteria.

I am not at all sure that the policies of cost recovery and marginal-cost pricing are nearly so compatible (as Krutilla suggests) when we apply the opportunity-cost concepts in a world of uncertainty and changing supply and demand relationships, especially when applying these concepts to long-lived facilities. Some difficult questions are raised when we ask about the relevant social costs, in terms of alternatives sacrificed the day before a project is built and the day after.

Even in a world of perfect foresight and with no unexpected changes in future supplies and demands, the day after a project is built most of the resources involved may be "sunk." The alternatives sacrificed from then on are usually only current operation and maintenance costs, which may be low. In such cases, prices should be set to ration supply and demand, and this may mean that deficits are the rule of the day. The common answer in the literature is that eventually prices will rise to ration demand as demand increases in the future, and that the later surpluses generated will balance the early deficits so that full costs will be recovered.

I do not find this line of reasoning convincing when the argument is placed in a context of uncertainty and unanticipated change.

the original investment costs the day after the project is constructed are historical costs—no more and no less—and they will not necessarily reflect changing supply and demand conditions and alternative social costs in the use of resources from that day on. Prices that correctly ration the use of capacity and deal with congestion may or may not return historical costs. Moreover, deciding whether the revenues generated justify an expansion of facilities should not be determined by covering the historical costs (even though such may be required for legal purposes), *but whether the revenues are sufficient to cover the costs of expansion or replacement costs at the time in the future when they are contemplated.* Clearly, future replacement or expansion costs may bear little relation to investment costs at an earlier period.

The Krutilla argument pointing toward consistency and compatibility of marginal-cost pricing and cost recovery would seem to hold only when the investment calculations are correctly made and when the future conditions are correctly forecasted. Not only can actual demands exceed or fall short of those originally forecast, but also the costs of future replacement or expansion may be greatly different from those that governed the cost of the original investment. What I am saying is that the costs that should be recovered are the opportunity costs sacrificed at any time.[17] And it is highly unlikely that opportunity costs in the use, replacement, or expansion of long-lived facilities will be identical to those incurred the day a project is constructed. Why, then, is recovery of original costs efficient?

If my argument has validity it would mean that the recovery of historical costs should be viewed with suspicion when questions of efficiency in a world of change and uncertainty are relevant. The argument would also imply that repayment contracts and price policy should be made flexible in light of changing conditions. In other words, what would promote efficient resource use in a future world is only dimly perceived at the time of project construction. The same logic would also apply to project operation. Sharp changes in operating rules and product mix of a multipurpose project may well be efficient and productive for the same reasons.[18] Although fixed repayment contracts, fixed beneficiary charges, and fixed operating rules may be necessary for legal and finance reasons, they may not be at all conducive to efficient resource use. These points may seem relatively

straightforward from the standpoint of the efficiency of resource use, but they have not, to my knowledge, been carefully analyzed in the literature on public expenditure decisions.[19]

Notice, however, that the argument has now been shifted from emphasis on cost recovery and repayment to the "rule" that public projects should be operated to maximize their net social product. The *"cost recovery" that takes place is the meeting of opportunity costs.* The covering of opportunity costs will recover "historical" costs only in a world where future opportunity costs coincide with historical opportunity costs. I think we can agree with Krutilla that evaluation policies and design criteria should be made consistent, as far as possible, with assumptions about future price policies. But no amount of ex ante rationalizing can deal adequately with problems of uncertainty and change regarding future opportunity costs.

In spite of all this, it might be important to note that the idea of cost sharing (as opposed to cost recovery) appears to have a great deal of merit and could perhaps promote efficiency in terms of the *behavior* of the parties at issue. Fox has suggested that (1) cost sharing provides valuable information on the demand for the public service to policy-makers, and (2) cost sharing tends to keep the claims of perspective beneficiaries in check.[20] Note that Fox is apparently talking about cost sharing and not cost recovery. The arguments that I posed earlier for user charges based upon marginal costs would imply some degree of cost sharing, even though "original" costs may or may not be recovered. The fact that user charges would equate supply and demand would (or could) provide information to decision-makers, as well as provide discipline against excessive claims of beneficiaries. It also seems to me that the correct argument is *not* that zero prices are opposed to cost recovery (or cost reimbursement), but that prices will be used to ration service and to equate marginal social costs and marginal social benefits. Costs thus will be "shared" and perhaps "recovered," but they will probably not be original costs.

Most of this discussion is couched in terms that may be convincing to economists. But how does it stack up in the real world of affairs? If the original (financial) costs of construction are not recovered from the beneficiaries they still must be paid for by someone. If not by the beneficiaries, who will return the costs of funds with interest? In the business world, when the future is incorrectly anticipated, losses of a

firm are borne by the suppliers of equity capital and occasionally by the suppliers of debt capital. In the public world, the state governments and local governments have the power to tax, and the federal government has the power to print money as well as the power of taxation. The facts of the matter are that taxes will probably be employed to recover the costs in this case. The efficiency questions should be concerned with the possible *adverse effects of these taxes upon resource allocation versus the adverse effects of the levy of beneficiary charges* that might return historical costs but still be inefficient.[21]

It is difficult to see a clear-cut answer to the issues posed here. As far as I know, they have not been given careful treatment in the economic literature. The legal question of how to make repayment contracts and project operating rules more flexible in light of changing economic conditions over the life of a project are also a source of major difficulty. Clearly, these problems of cost sharing and efficiency are most likely to arise in the construction of large chunks of investment capacity with long lives. When public investments are relatively divisible and small in relation to the size of the market, the problems of future uncertainty and the large divergencies between average and marginal costs will not exist. However, one point made here still stands: the future opportunity costs to be covered may be more or less than historical costs. It is likely that recovery of historical or original investment costs is inconsistent with economic efficiency both in the short run and the long run.

Public, Private, and Merit Goods

A great deal of confusion exists about the conditions under which beneficiary charges are desirable and feasible. At this point it might be helpful to introduce the concepts of *public* goods, *merit* goods, and *private* goods. It is technically possible in the case of private goods to exclude persons who are not willing to pay for the goods or service. In private goods, the benefit is received largely by the individual person or household. As a result, private production is technically possible and usually desirable. However, a number of private goods and services are supplied by governments, particularly public utility types of services.

By contrast, a public good, in its pure form, is equally available

to all, because (1) there are no feasible ways of excluding any consumer from enjoying the good, and (2) the consumption of one consumer does not interfere with the amount available to all others. Classic illustrations of a public good are national defense or a radio transmission that covers the whole area.

Merit goods have been defined in several ways, and admittedly this is not a clear-cut category. Perhaps it is easiest to say that a merit good is a private good that has been endowed with the public interest. From a merit good the individual receives more of a public service than he would have purchased on his own. Margolis states that:

> The initial attitude toward merit goods was to see them as imposed on the population by a group of moralists, or the intellectual elite, or a pressure group with power, but with a recognition that the imposition might be a legitimate activity in a democratic society.[22]

However, it now seems less restrictive to consider a merit good a private good that has some public good characteristics.[23] That is, part of the benefit is "seen" by the individual consumer and part by persons external to the individual or by the public in general. Although it is possible to levy user charges, total production could be subsidized to the extent that collective benefits were perceived.

If the subsidy were supplied by a tax on the general public, it could perhaps be thought of as the most general form of benefit tax. This would not necessarily mean that the good must be supplied free of charge to the individual consumer. A proper user charge to the consumer would equate marginal private benefits to marginal private cost, with the extra consumption and production justified by collective benefits being subsidized by general taxes.

In some cases the external or collective benefits are satisfied by the first amounts consumed. Thus, *at the margin*, the benefits received may be largely individual in nature. As a result, we must be careful to distinguish between all-or-none decisions and those involving a little more or a little less consumption. For example, we can plausibly argue that an urban water supply confers a collective benefit on the community in the form of public health, in addition to the benefit received by individual households. On this basis, one could also argue that some form of public subsidy might be justified in support of urban

water investment and consumption. Yet all of the public health requirements might be satisfied by a per capita consumption of 60 gallons per person per day so that a consumption rate of 120 gallons per person per day should reflect only the equation of individual marginal benefits and marginal costs. However, the generation of collective benefits at the margin for merit goods could justify prices at less than marginal costs for individual consumers.

Shortrun efficiency

The efficiency problem in public production is twofold: (1) the optimal level of investment in capacity (longrun efficiency) and (2) the best use of existing facilities (shortrun efficiency). Clearly, the longrun efficiency question is applicable to all forms of public production—public, merit, or private goods. But the shortrun efficiency question is not relevant to pure public goods nor to the collective (marginal) aspects of merit goods. The shortrun question refers to the need to ration private goods. For instance, my consumption may interfere with your consumption. The shortrun question also refers to relevant marginal costs that are positive. For public goods, then, not only is it technically impossible (or difficult) to exclude or to ration service, *it is also unnecessary and undesirable to do so*. The marginal cost of an extra consumer is zero (or nearly so), and there is no excess demand; there is therefore no need to ration. Even if it were possible to ration use, the correct price would be zero.[24] Sometimes this point is not well understood by students of public policy who want more cost sharing employed to achieve efficiency in public expenditure. As we shall see below, there are indeed many problems in trying to get the proper level of investment for public goods, but this problem should not be confused with the role or need for user charges in the short run.

For example, the Federal Water Project Recreation Act of 1965 was hailed by many as a laudable advance in providing for cost sharing by beneficiaries of recreation and fish and wildlife investments in federal water projects.[25] The provisions of the act with respect to cost sharing specify that non-federal agencies must bear 50 percent of the separable costs allocated to recreation, fish and wildlife, and all of the operation, maintenance, and replacement costs thereafter. The non-federal share of the separable costs can be borne in two ways: (1) pay-

ment, or provision of land, or facilities for the project; (2) *repayment with interest within 50 years, provided that the source of payment be limited to entrance fees and user charges.*

Notice that repayments were restricted to entrance fees and user charges. We have just seen that employment of such charges is feasible only for goods of substantial private character where the benefit is largely individual and where it is possible to apply exclusion. Moreover, I have pointed out that rationing is needed only when *my* consumption interferes with *your* consumption, and when the marginal costs of extra consumption are positive. Apart from the legitimate question of whether the state and local agencies for recreation and fish and wildlife do have the necessary legal powers to incur debt and to collect fees, it is clear that many types of recreation services and fish and wildlife services are public in character. It would, in many cases, not be feasible to collect entrance fees and user charges nor would it be desirable to do so as long as congestion did not develop and cause my consumption to interfere with yours.[26] I am not suggesting that cost sharing per se is undesirable in this case.

It is clear that the discipline of cost sharing by local agencies would keep in bounds all sorts of exaggerated claims of benefits for recreation and fish and wildlife. Moreover, having to bear only 50 percent of the separable costs would not seem to be excessive when many of the collective benefits probably reside or accrue to people within the state or region. All these points are certainly desirable in trying to achieve *longrun* efficiency in the proper scale of facilities.

However, the restriction of repayment revenues to revenues from entrance fees and user charges could well cause shortrun efficiency problems to arise. Although such fees might be justified on efficiency grounds to ration service in some instances, they clearly would not be applicable across the board. Imagine trying to collect user charges on a long river when there are numerous recreation benefits downstream. On the basis of the argument here, it would seem desirable to modify the Federal Water Project Recreation Act to remove the restriction that repayments for cost sharing be *limited* to entrance fees and user charges. We must not confuse the rationale for cost sharing to promote longrun efficiency with the proper role of user charges in promoting shortrun efficiency.

However, we should stress that an argument could and should be

made for user charges on recreation and fish and wildlife facilities *without any reference to cost sharing of original co[illegible].* Instead, as we argued above, user charges should be based on r[illegible] space and making the users see the congestion or pollution costs they impose upon others. A colorful statement of this point of view is provided by Gaffney:

> As I recall the summer roar of Seahorse motors on peaceful lakes, the oil slicks, the loud speaker radios, the boat toilet problem, and the beer can outrage, I lose enchantment with the notion that the marginal boater is an innocuous fellow who sheds no external costs. The marginal swimmer, maybe, but how much space is he allowed? The age of genteel canoeing is dead. Man has so magnified his powers to invade his neighbor's privacy, and placed such terrible engines of nuisance in the hands of so many barbarians and adolescents who are enjoined from releasing their aggressions in useful labor that the marginal curve of psychic pollution rises vertiginously. So long as we refuse either to civilize or employ our young, the only salvation is to tax their more destructive pursuits, and certainly not to pretend they aren't bothering anyone.[27]

Before I turn to a discussion of the efficacy of beneficiary charges for promoting longrun efficiency in investment in public facilities, it will be helpful to emphasize three points on the role of user charges as a means of rationing use of existing capacity.

1. It is clear that as congestion develops and as the marginal user imposes congestion or pollution costs on others, a public good or service may become "private" in the sense that there is a need for rationing to make efficient use of a limited facility, watershed, or airshed.

2. Here the question becomes how best to ration. It could well be that some administrative rationing devices could function effectively and at less cost. This is the place to indicate that the administrative costs of collection of beneficiary charges, especially user charges, may or may not be low. Clearly, this may be an important factor governing their use.[28]

3. Zero prices for some public services may not always result in excess demand and congestion if there is some complementary factor of production employed in the process which may itself be rationed. Perhaps some examples will clarify this point. The provision of flood control protection to lands in a flood plain is a public good. The service is equally available to all persons occupying the plain, and my con-

sumption does not interfere with your consumption. However, the service of flood control protection is rationed to the extent that, to enjoy the service, one must buy or rent land (a location). The price of land will reflect the value of the service and serve to ration demand for the limited supply of lands protected.

In fact, most of the benefit over the life of the facility will tend to be capitalized in land values the day the project is built. If the flood control protection is provided free of charge to the flood plain, the gainers will be the initial landowners. Subsequent land users will be required to pay land prices or rents that reflect changing opportunity costs and that equate supply and demand. In most cases, it would be difficult to claim that such landowners should be classified as a disadvantaged group, so that the case for benefit taxation based upon land values to recover marginal costs would seem to be especially strong.

However, the fact that such windfall gains have a long history of political acceptance is indicative of the general observation that attempts to implement beneficiary charges for efficiency reasons may not be very successful. For the politician and for the man of affairs, the efficiency arguments for beneficiary charges are likely to carry less clout than would arguments based on possible rising demands for equity or for the needs for revenue production.

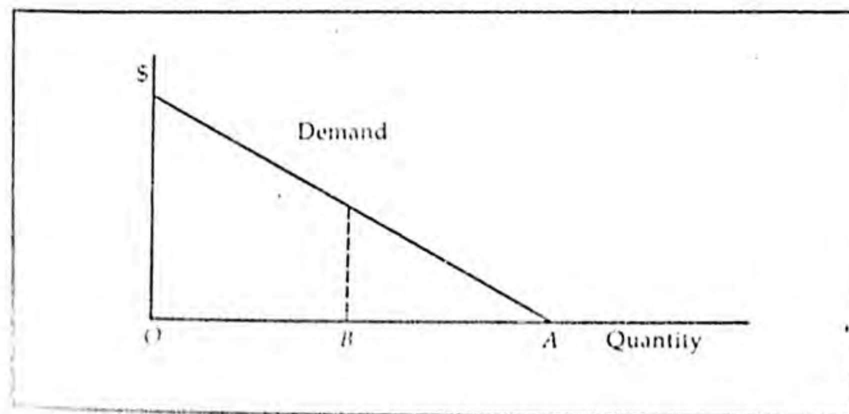
We might observe that rents for lands or houses may serve to ration the use of a public service but may need attention for another reason. In the case of merit goods we are presumably trying to subsidize a public service, e.g., public schools. If, however, excess demand develops, land values and housing rentals may rise so that the disadvantaged groups may be forced to pay the equilibrium price for the service in higher rent or else live elsewhere. Zero prices of services may thus generate shadow prices in complementary factors that are inelastic in supply. Although the rationing effect may be commendable from an efficiency point of view, we may not achieve the redistribution of income we sought in provision of the merit good. This perversity would be accentuated if the landowners and landlords received untaxed windfall gains in increases of housing and land values.[53]

Zero prices to users do not necessarily imply that there is no rationing involved in the consumption of the service. This fact leads to several interesting observations. One is that the real or shadow price to the user may be positive. It is therefore not always clear, as the

literature often asserts, that the marginal benefits will be zero, leading to waste because the service is "free" when marginal costs are positive. In fact, the effect of nonprice rationing or the rationing of auxiliary factors may serve to stop consumption far short of the point where marginal values in use are zero, even though user charges are zero.

A second observation concerns the conclusion we can draw from attempts to construct demand curves and to estimate benefits on the basis of revealed behavior (consumption data) at zero prices. Suppose, for example, that actual consumption of a service is Q_1 in a zero-price situation. Without additional information on the degree of rationing (administrative, congestive, or the indirect, as in the price of complementary resources) we do not know whether to place Q_1 at point A on the implicit consumer demand curve or whether it should lie somewhere to the left of point A, say at B in Figure 2.1. The nature of the judgments we can make about marginal benefits in zero-price cases, and hence what we can infer about waste, is thus not intuitively obvious. Greater consideration needs to be given to the possibilities of hidden or implicit rationing in the analysis of revealed behavior in zero-price situations.

Fig. 2.1 *Estimate of Demand at Zero Prices*



Clearly, this discussion does not refute the point made by Krutilla [illegible] subsidies for one set of producer goods may distort the [illegible] factors of production, so that the inefficiency

effects may be found in the use of other inputs and investments, not just in particular service provided.[30] But it does mean that the question of possible inefficiencies generated in zero-price situations is apparently much more complicated than the existing literature suggests.

Longrun efficiency

Beneficiary charges can stimulate efficiency through the promotion of proper scales and levels of investment in two ways: (1) by imposing discipline on investment decisions and (2) by providing information to improve those decisions. The fact that beneficiaries will be charged will provide some discipline on the claims of benefits and will tend to force beneficiaries to consider these benefits and costs (the charges) in relation to alternative uses of their resources. If the burden of costs cannot be shifted, there will be less inducement to puff claims of benefits, and the relative allocation of factors will be improved.

The arguments made earlier that historical costs are not relevant to price policy based upon opportunity costs clearly raise many troublesome questions when we leave the static world and view investment in public facilities as a continuing process. Costs that may not be marginal in respect to output do become marginal in respect to the total question of whether to produce at all. Are the longrun marginal costs that we should be concerned with merely the derivative of the longrun, total cost-function with respect to output when the question is one of whether to produce at all? Also, are there not serious behavioral implications stemming from the dictum of ignoring historical costs the day after a project is constructed? Can you tell beneficiaries and public agencies that costs are important before a project is built and then not require cost-recovery the day after?

Unless substantial payment for benefits is required from beneficiaries or from the jurisdictions in which they reside, the forces to discipline public investment decisions will be very weak. Clearly when the discipline of the market is absent, there are serious problems of how to obtain responsible public investment decisions. We lack measures to reward good decisions and to penalize poor ones.

The discipline argument appears to be a powerful one, but there is not much I can add here. Further study of this line of thinking

would accord with the suggestions to explore further political and behavioral models of the demand for public services.

Closely related to the discipline effect is the information effect cited above by Fox. That is, the application of beneficiary charges would provide decision-makers with valuable information about the benefit functions for public services. Provision of services at zero prices and failure to impose cost sharing makes it extremely difficult to estimate benefits received by users and to evaluate projects carefully.[31]

Just how difficult it is to estimate benefit functions in zero price cases is not usually appreciated. Some literature does exist on the problem of getting the public to reveal preferences, but the empirical problems of benefit estimation in zero-price situations are quite formidable. For example, suppose we have some revealed behavior on library circulation at zero price in an attempt to quantify some of the benefits of a public library. If the circulation is Q_1, we have to decide first whether to place it at point A or point B in Figure 2.1. But then how do we generate some sort of demand curve as a basis for benefit estimation? Unless we have another point, it is clear that we have little notion of the area to be measured and that points A and B could be consistent with an infinite number of demand functions. Benefit-cost analysis of public services supplied at zero prices is an incredibly difficult task, even when we have acceptable measures of the output unit. Revealed behavior at zero prices is extremely difficult to translate into meaningful benefit functions.

In general, I find the discipline and information arguments persuasive, yet I think that a great deal more study of the matter is required before we recommend the adoption of beneficiary charges for a greatly expanded range of public services. For goods that have substantial public content, the practical questions are: how do we get the public to reveal their preferences, and how do we collect beneficiary charges that may promote longrun efficiency and yet not cause shortrun inefficiencies?

For private goods, the problem is somewhat less. The people or consumers have to reveal their preferences because no other beneficiaries will do so, and "if I do not pay, I will not get the good." The efficiency problem with private good production in the public sector is

how to reconcile desire to recover costs with the need to meet opportunity costs. As I suggested above, the theoretical conditions necessary for the reconciliation of these two kinds of cost recovery are not likely to be found in actual practice. However, we would hope that revenues generated by "correct" pricing policies would still recover some or all of the original costs so that the users would be more likely to bear the costs (as well as enjoy the benefits) rather than shifting the burden to other groups.

As Brazer, Gaffney, and others have pointed out, many kinds of public goods are, in fact, not equally available to all, but available only to particular regions, areas, or user groups. Although it may be difficult to estimate the amount of a policeman's service used by a particular family on the beat, it is clear that the policeman on a given beat provides protection primarily to that beat and only secondarily to other parts of the city and to other cities in the same region. For that commonly used example of a public good, the lighthouse, the service is certainly not provided to all, but only to boats in the vicinity of a given lighthouse. Flood control protection provides benefits mainly to users of the flood plain, fire protection to one area is not fire protection for the whole city, television signals may benefit only a limited service area, and so on.[32]

All this suggests that it may be easier than many writers believe to identify beneficiaries of a particular public good. If this is the case, the classic ingenuity of the American political system could be called on to provide decision-making institutions through which people's preferences can be revealed as a prerequisite for determining what types of beneficiary charges are appropriate and desirable.

NOTES

1. Werner Z. Hirsch, "The Supply of Urban Public Services," and Richard A. Musgrave, "Discussion of Part III," in *Issues in Urban Economics*, Harvey S. Perloff and Lowdon Wingo, Jr., eds. (Johns Hopkins Press for Resources for the Future, 1968). Hirsch and Musgrave cite examples of this tendency; on the demand for services, see Julius Margolis, "The Demand for Urban Public Services," in the same book.

2. James Buchanan, *The Demand and Supply of Public Goods* (Rand McNally, 1968) offers an exception.

3. As Edgar Olsen (one of the helpful critics who read my paper in an earlier draft) has suggested, the benefits of flood control and urban renewal are viewed as widespread because many communities have projects. The relevant question from the viewpoint of beneficiary charges is the extent of benefits from any one project.

4. William J. Baumol, et al., "The Role of Cost in the Minimum Pricing of Railroad Services," *Journal of Business* 35 (October 1962): 357–366; Jack Hirshleifer, et al., *Water Supply: Economics, Technology, and Policy* (University of Chicago Press, 1960), Chapter 5 (hereafter referred to as *Water Supply*); and William S. Vickrey, "Some Implications of Marginal Cost Pricing for Public Utilities," *American Economic Review* 45 (May 1955): 605–620.

5. Eli W. Clemens, *Economics and Public Utilities* (Appleton-Century-Crofts, Inc., 1950), p. 127, uses this formulation.

6. "Fair value" can mean values other than original cost. A better alternative from an economic standpoint would be replacement cost. In actual practice, as James C. Bonbright says, "all commissions administer, with more or less efficiency or laxity, versions of, or minor deviations from, an actual cost or sunk cost standard of reasonable utility rates" (Bonbright, *Principles of Public Utility Rates* [Columbia University Press, 1961], p. 283).

7. Abba P. Lerner, *The Economics of Control* (Macmillan, 1944).

8. I. M. D. Little concludes, "The general case against marginal-cost pricing is clearly overwhelming" (Little, *A Critique of Welfare Economics* [Oxford University Press, 1950], p. 194).

9. Nancy Ruggles, "The Welfare Basis of the Marginal-Cost Pricing Principle," *Review of Economic Studies*, 17 (1949–50): 24–46; and "Recent Developments in the Theory of Marginal-Cost Pricing," *ibid.*, 107–126. These articles give an excellent review of early marginal-cost pricing literature.

10. Several of my critics have objected to this statement, asserting that cases where longrun marginal costs diverge from longrun average costs are not frequent or important. Because our knowledge of cost functions for a wide range of public goods and services is so skimpy, it is apparent that neither position is presently supported by much empirical study.

11. See Hirshleifer, et al., *Water Supply* (see note 4 above).

12. Most of these qualifications apply equally well to any system of beneficiary charges, particularly to policies based upon average-cost pricing.

13. William Baumol and David Bradford, "Marginal-Cost Pricing and the General Welfare Revisited" (unpublished manuscript). The paper contains a valuable survey of earlier work. It reaches the disturbing conclusion that systematic deviations through the economy from marginal-cost pricing will be required for an optimal allocation of resources because all taxes (except Pigouvian [illegible] taxes) to cover deficits will unavoidably make some prices depart from marginal costs.

14. C. J. Oort, *Decreasing Costs as a Problem in Welfare Economics* (Drak-

kerij, Holland, N. V. Amsterdam, 1958), Appendix on "The Marginal Cost Pricing Principle."

15. John V. Krutilla, "Is Public Intervention in Water Resources Development Conducive to Efficiency?" *Natural Resources Journal*, 6 (January 1966): 72.

16. *Ibid.*, pp. 66, 67, 68. Some of my critics think I have been unfair to Krutilla here; others agree with me. As I suggest below, Krutilla is correct only if he means recovery of new facility costs in an ex ante sense—not recovery of sunk costs.

17. Note the difficulties this argument implies for privately owned public utilities: investors must be paid, or the market for securities will be affected. Notice also that the argument has implications for all private firms—not just those with public utility status.

18. Maynard M. Hufschmidt (chairman), et al., *Report of Panel of Consultants to the U.S. Bureau of the Budget on Standards and Criteria for Formulating and Evaluating Federal Water Resources Developments* (U.S. Bureau of the Budget, June 30, 1961), p. 59. This report advances a similar argument.

19. One of my critics argued that more firms should be nationalized in the interest of efficiency to avoid the legal difficulties of deficits arising from the dictum not to recover historical costs. The deficits could presumably be paid for out of the general treasury. However, as Baumol has suggested, taxes *themselves* may introduce significant deviations from marginal costs.

20. Irving K. Fox, *Essays on United States Water Resources Policy* (University of Wisconsin, 1968).

21. My critics are of many voices on the questions raised here. Some say that recovery of historical costs involves no economic questions, and that my worries here are incorrect. Others see that failure to make beneficiaries share original costs will have dire consequences. Still others see beneficiary charges as second-best choices over tax levies. Finally, some worry about the meaning of the arguments for utility firms in the private sector.

22. Margolis, "The Demand for Urban Public Services," p. 541 (see note 1 above).

23. Several readers have argued that I ought to abandon the concept of merit goods. Considering both consumption and production externalities, almost all goods are part public and part private. Public and private goods are polar cases along a continuum.

24. Note that we must distinguish between the marginal cost of adding an additional TV set *once* the station is on the air and the marginal cost of changing the amount of production that is equally available to all. In the latter sense, each consumer is rationed to the quantity of the service that is actually produced. Here neither marginal utilities nor marginal costs are zero. Once the production decision has been made, the marginal costs of additional consumers are zero even though the amount and kind of service for each individual is fixed.

25. Public Law 89-72, passed July 9, 1965.

26. Robert Haveman (another of my helpful critics) suggests that if a local agency recognizes that user charges are not conducive to shortrun efficiency, it could choose to make the non-federal share in the form of an outright payment.

27. Mason Gaffney, "The Valuation of Public Goods—Discussion" in Morris E. Garnsey and James R. Hibbs, eds., *Social Sciences and the Environment* (University of Colorado Press, 1967), pp. 154-160.

28. Although many economists are sympathetic to Vickrey's plea for user charges to ration the use of city streets, they are skeptical of the proposal because the administrative costs of collection are likely to be high in relation to the efficiency gains perceived. Similarly, the desirability for underdeveloped countries to use water meters for rationing water supply may be doubtful if the costs of the meters themselves, their servicing, and the billing system are quite high in relation to the value of water saved and water investment avoided.

29. J. W. Milliman, "Land Values as Measures of Primary Irrigation Benefits," *Journal of Farm Economics*, 41 (May 1959); also, "Land Values—A Further Comment," *ibid.*, 42 (February 1960); and see Margolis, "The Demand for Urban Public Services," p. 546, and Gaffney, "The Valuation of Public Goods—Discussion" (see, respectively, notes 1 and 27 above).

30. Krutilla, "Is Public Intervention in Water Resources Development Conducive to Efficiency?" p. 69 (see note 15 above).

31. Roland McKean argues that admission charges supply important information about the nature of public demands and might be justified on the grounds of being the cheapest way for decision-makers to gain information about marginal evaluations by consumers. See McKean, *Public Spending* (McGraw-Hill, 1968), p. 73.

32. James M. Buchanan, "A Public Choice Approach to Public Utility Pricing," *Public Choice*, 5 (Fall, 1968). Buchanan advocates that a person have two roles—one as a taxpayer-purchaser and one as a consumer-purchaser, with separate marginal tax prices and marginal user prices. These suggestions have many attractive properties, but it is difficult to see how they could be implemented.

Back-Door Socialism

Reflections on TVA

by PETER BARNES

Once the center of controversy, the Tennessee Valley Authority is now middle-aged and well established. Its history shows the advantages and limitations of Washington-created "socialist [illegible]ands."

To its supporters, the Tennessee Valley Authority was never a "socialist prototype." It wasn't even a model for radical economic change. David Lilienthal, one of its first directors, described it simply as "democracy on the march." To others it was an example of America's genius for pragmatic problem solving. Only its detractors labeled TVA a socialist experiment—"creeping socialism," Eisenhower called it—and every time they did so the label was vigorously rejected by TVA's friends. But the detractors were not far off the mark, for TVA is, in fact, the closest the federal government has ever come to building an island of socialism in the American capitalist sea.

The agency has never had a coherent socialist ideology. But its operating premise—public ownership and development of basic resources—represents, or at one time represented, a genuine challenge to the capitalist ethos and to at least a part of the economic elite. TVA attacked and destroyed—through expropriation with compensation—a major privately owned industry, the electric utilities of the Tennessee Valley. At various times it was involved, or considered becoming involved, in the production of fertilizers, timber, aluminum, concrete, and coal. Using its eminent domain powers it built several parks and a new town. It could have engaged, though it chose not to, in agrarian reform.

The dream of many New Dealers was to blanket the nation with regional authorities similar to TVA—to create, in effect, a socialist archipelago. The dream was never fulfilled because there was never enough political support behind it. But it typified the strategic thinking of what might be called the back-door school of American socialism. The school has (or had) two major premises: (1) if socialism is ever to come to the United States, it can't be *called* socialism; and (2) the road to socialism lies in top-down institution building rather than in grass-roots political movements. TVA was the crowning achievement of the back-door school. If in the reflections that follow I emphasize some of the limitations of this approach, I do not do so unsympathetically; for it must be remembered that no other

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approach to socialism in America can claim much success.

During World War I the federal government built and operated a number of defense-related plants. Among them was a nitrate factory along the Tennessee River at Muscle Shoals, Alabama, built as a precaution against loss of Chilean nitrates. To provide power for the factory, a dam and a steam electric-generating station were also constructed. After the war scores of bills were introduced in Congress to sell the Muscle Shoals facility to private enterprise. One measure that passed the House would have given it to Henry Ford for $5 million (it had cost nearly $100 million to build). The Muscle Shoals controversy raged for more than a decade, with Senator George Norris of Nebraska, chairman of the Senate Agriculture Committee, repeatedly blocking a giveaway to private interests.

Norris's idea was to use the dam to generate low-cost public power, which then could be applied as a yardstick against privately owned utilities. He found support among farm-belt representatives—who, however, were less interested in public power than in the fertilizer that could be produced by the nitrate plant. In 1928 and again in 1931, Congress passed Norris-sponsored bills to authorize government operation of Muscle Shoals, only to see the bills vetoed by Presidents Coolidge and Hoover. Finally, in 1933, Roosevelt and Norris joined forces to create TVA, a public corporation governed by a three-man board. TVA would do more than operate the Muscle Shoals facility. It was given broad powers to develop a vast river basin, stretching from the mountains of Virginia and North Carolina to the cotton fields of northern Mississippi and Alabama.

There was virtually no "socialism" in TVA's origins. It was not conceived from scratch by a band of radical economic planners. Rather, it was the end result of a protracted 15-year controversy. The controversy got started only because the federal government had a "disposal problem" at Muscle Shoals, and it dragged on only because the payments offered by private bidders were so paltry. It was the reluctance of Congress to endorse wanton giveaways, rather than a disposition toward public enterprise—this was, after all, the Harding-Coolidge-Hoover era—that kept the matter boiling until, stunned by an unprecedented economic collapse, a newly elected Congress was willing to risk a relatively bold solution. TVA thus owes its creation largely to historical accident and too-blatant capitalist greed.

To be sure, historical accidents don't just happen; there must be forces present to take advantage of historical opportunities. In the case of TVA, these forces consisted almost entirely of the efforts of a single tenacious man, Senator Norris. Support for TVA from the Tennessee Valley itself was lukewarm at best. Farm groups in the area wanted something done with the Muscle Shoals nitrate plant, but they were ambivalent about public vs. private operation; their main interest was cheap fertilizer. When Ford offered to take over Muscle Shoals and mass-produce fertilizer, most farm groups supported him. A look at some of the old Muscle Shoals hearings shows that most farm group testimony was technical: about how much fertilizers cost, the processes involved in using nitrogen and phosphates, etc. When Senator Norris would ask farm spokesmen if they felt Muscle Shoals should be publicly operated, they'd either take no position or call for "public ownership with private operation," i.e., leasing the plant (and the profits) to a private company. They also tended to be neutral on the power question—they didn't care whether power from the dam and steam generating plant was sold to private utilities or not. Congressmen Lister Hill of Alabama and John Rankin of Mississippi *were* strong proponents of public operation of Muscle Shoals. But by and large TVA was an outside idea, an institution imposed on an indifferent region by absentee idealists. There's nothing inherently wrong with this procedure, given the general lack of popular interest in socialist undertakings. The trouble is that idealists of Norris's caliber are few and far between. When they do appear they generally don't have the power, in the absence of strong local support, to overcome the economic interests that are opposed to radical change.

Power and Land

TVA's outstanding achievements have been in the areas of resource development and electric power generation. It tamed the flood-prone waters of the Tennessee Valley and opened up valuable channels of navigation in the process. It reclaimed millions of acres of eroded land through application of fertilizers and reforestation. And it transformed an area in which only one farm in 30 had electricity into one of the most highly electrified regions in the world.

The politics of TVA's approach to electricity are worthy of note. TVA didn't just build dams, as federal agencies out West did. It decided early on that there was no place for private utilities in the Tennessee Valley. It encouraged farmers to set up

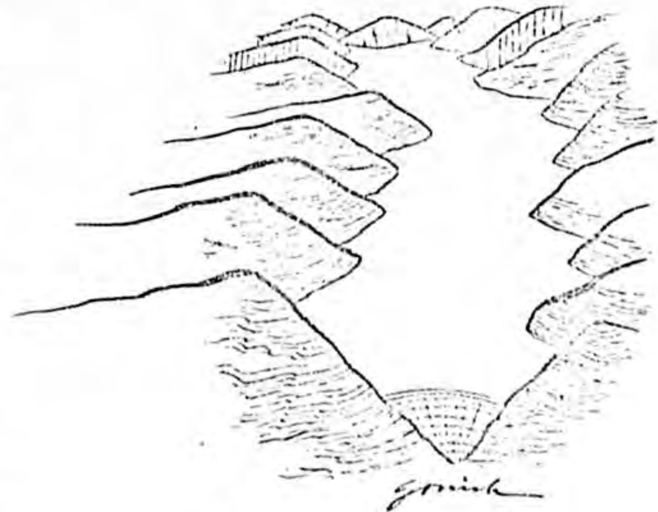
cooperatives to distribute cheap power from TVA dams; the success of this program prompted Roosevelt to launch the Rural Electrification Administration. It urged cities to establish municipal power agencies; they did so in rapid succession. During this period, Knoxville voted 5,124 to 2,602 to switch from private to public power. In Memphis the vote was 32,735 to 1,868, and the results were similar in town after town. TVA completed its rout of the private utilities by buying up the properties of Commonwealth & Southern, a holding company whose president, Wendell Willkie, fought TVA at every turn and lost. Today only a single small private power company is left in Tennessee. TVA-spawned cooperative and municipal distributors reach into six surrounding states. Along the way, electric rates that were as high as five cents per kilowatt hour in 1930 were cut to one-fourth of that by 1972, though rates are rising now.

There are some sad subplots to this generally upbeat story, however. In recent years TVA's commitment to low-cost electricity has made it the world's largest purchaser of strip-mined coal. Nearly 80 percent of TVA's power is now steam generated, the hydroelectric capacity of the river having been fully captured by the 1950s. TVA's critics find it ironic that the agency that so dramatically restored the valley is now causing, through its use of strip-mined coal, vast destruction of hills and farms (mostly outside the valley).

Another unhappy subplot involves financing. In the early days TVA financed its capital outlays for electric power generation almost entirely from congressional appropriations. After Lilienthal negotiated the purchase of Commonwealth & Southern's electric distribution facilities, Congress authorized, and TVA issued, $65 million in bonds to pay off Willkie's boys. The bonds, mostly at 3½ percent interest, were purchased by the Treasury and have since been paid back.

The massive expansion of the war and postwar years was also financed by congressional appropriations. But this practice was brought to a halt by President Eisenhower. (Eisenhower vowed to sell TVA if he could; if he couldn't, he at least would not allow any new projects.) For a brief period TVA was able to plod along on retained earnings and depreciation. This practice obviously could not last long, especially since TVA was committed to low rates.

In 1957, Eisenhower proposed that TVA be able to float bonds on the private market. In 1959, Congress agreed. Certain conditions had to be met: (1) TVA could not expand beyond its existing service area; (2) it would have to repay gradually almost all previous federal appropriations for power, so that eventually there would be no federal "equity"; and (3) until the repayment was complete, TVA would pay the Treasury a "return" on federal equity pegged to the average interest rate on marketable U.S. securities. This is the law under which TVA presently operates.



The effect of the 1959 legislation was both to quarantine TVA geographically and to convert TVA into something increasingly like a private power company. It now must borrow (at rising interest rates) from the same folks on Wall Street the private utilities borrow from, and its payments to Wall Street will grow as its payments to Washington shrink. Private utilities generally maintain a 50-50 balance between debt and equity. TVA must finance new growth entirely out of debt. One result already is that rising interest costs have forced up TVA rates and lessened its comparative advantage over private utilities. When the federal equity (past appropriations) is all paid back—2016 is the magic year—TVA's power operations will be, in a real sense, "owned" by Wall Street rather than by the public. Eisenhower may then be seen to have killed TVA, not instantly by sale, but slowly by financial strangulation. Such are the perils of back-door socialism.

From the public standpoint, TVA was a very good investment. The total federal appropriation for power came to $1.2 billion. TVA has already paid back more than $1 billion and is steadily working off the rest. On a year-to-year basis, TVA's payback to the Treasury now exceeds the congressional appropriation to TVA for non-power-related activities. Thus, the notion that Washington is subsidizing the Ten-

nessee Valley is no longer true; in fact the opposite may well be the case. In addition, it must be remembered that the federal government has saved hundreds of millions, if not billions of dollars, by buying power from TVA rather than private utilities for its Oak Ridge, Paducah and Huntsville facilities (which serve NASA, the AEC, and the military).

TVA has the power of eminent domain. How to use this power, and how to use the land, are questions that have been hotly debated since the agency began. Technically, the TVA act gives the agency power to condemn land only "for the construction of dams, reservoirs, transmission lines, power houses, and other structures, and navigation projects along the Tennessee and its tributaries." In practice, TVA has condemned (or claimed power to condemn) land quite some distance from dam sites for such purposes as malaria control, tree nurseries, industrial sites, recreational areas, game refuges, and new towns.

In addition to land under and immediately surrounding its reservoirs and power sites, TVA now owns a 170,000-acre park called Land Between the Lakes; about 50,000 acres in coal reserves; about 30,000 acres on which it plans to build, or rather let the Boeing Corporation build, a new town; and small amounts of land elsewhere. It has acquired, and subsequently disposed of, quite a bit of land that is now owned by states and local jurisdictions (mostly for parks) and by private parties (mostly for housing subdivisions and industrial sites).

Controversies have arisen over how much "extra" land TVA should acquire beyond what is minimally necessary to build dams. Generally speaking, the agency was boldest in its early days and has been increasingly conservative since. For its first project, Norris Dam, TVA purchased thousands of acres upstream from the dam site which it turned into parks. It built the new town of Norris originally as a very progressive "construction camp." Within the agency, the chief advocates of excess land acquisition were the foresters, conservationists, and planners; the chief opponents were those interested primarily in agriculture. As agriculturalists gained the upper hand within TVA, excess acquisitions were gradually reduced to thin strips around the reservoirs, and in some cases not even these were acquired. (Philip Selznick has a good chapter on this in his 1949 book, *TVA and the Grass Roots.*)[1]

For Tellico, one of its current projects, TVA has acquired some 30,000 excess acres that will be used for a new town called Timberlake, about 30 miles south of Knoxville. The Tellico Dam project is controversial for a number of reasons, of which Timberlake is the least so; indeed, Timberlake is one of the strongest justifications *for* the project. The agency's notions of how to build new towns are much less radical, or at least much less "public," than in the days when Norris was built. Having acquired the land for Timberlake, TVA will sell it to private developers (the master developer and coplanner with TVA is Boeing). The developers will in turn subdivide it and sell it to the new residents and industries. TVA will capture some of the increase in land value resulting from the development, which will be used to cover its land acquisition and other costs. Boeing and the other developers will also cash in on the land gains—without, of course, having paid for the dam that created the townsite with its lakefront values. When I asked TVA's chief planner, Mike Foster, why Timberlake wasn't being built as a cooperative or by a public corporation, without Boeing, he answered: "Our judgment is that you can't get the investment you need unless you get the private developer in there. We don't have a public new town philosophy like they do in England." As a specific example, he noted that they want to build golf courses in Timberlake, and you can't get federal financing anymore to build golf courses. Also, part of the town will be recreational second homes, and there's no public money for them either.

TVA never became greatly involved in agricultural land reform. Despite the urgings of radicals, it never tried to do what the Farm Security Administration was doing in the 1930s, i.e., making land available to tenants and sharecroppers. If a small farmer was displaced by a dam project, TVA would get him about the same size farm somewhere else. If a tenant was displaced, TVA would set him up as a tenant somewhere else. The reasons TVA never interested itself in agricultural land reform are well spelled out by Selznick. Those who ran TVA's agricultural department had come from land-grant colleges and were not concerned with social reform. The reasons TVA got hooked up with land-grant agricultural experts rather than reformers in the first place have to do with personalities and politics, and will be commented on below.

Economic Plan

At various times in the agency's history, various people proposed that TVA own timber, cement, aluminum, fertilizer, and coal facilities—in addition, of course, to electric power. Generally, these suggestions were not far-reaching, and they didn't lead to

any dramatic results. Yet the very fact that they were made is of some interest in light of today's timid approaches to public ownership.

Timber ownership plans were put forward by early TVA foresters. Edward Richards, chief TVA forester from 1933 to 1939, said in 1934:

To make possible the proper use of marginal lands, reforestation and erosion . . . ownership of the land in fee is necessary. This is for the reason that complete control of what is done on the lands necessitates full ownership.

David Lilienthal observed in his journal for 1941:

Private ownership of woodlands and timber lots was an important point in our agricultural program six or eight months ago, but my observation is that it isn't working and that in order that a few poor devils of farmers may get a miserably small amount of money, we may be loading up for the future a public expenditure of enormous proportions to heal the erosion on the hillsides now being cleared. That is wasteful and nonsense . . . . Isn't this the time for TVA to buy and put out of private hands enormous areas of timber and have it cut on some basis that will not ruin us 25 years from now?

Clearly, the motive behind public timber ownership ideas was conservation, not economic reform. I did not run across any proposals to build public pulp and paper mills and lease cutting rights to low-income woodcutters under a scientific harvesting and replanting program. In this sense the TVA ideas never went beyond the ideas of Gifford Pinchot and the U.S. Forest Service.

Interest in a TVA-owned cement operation flickered during the early days of massive dam-building, when TVA found itself confronted by cement industry price fixing. Arthur E. Morgan, TVA's first chairman, brought the matter to the attention of the White House. He recommended that TVA set up its own cement manufacturing plant. But FDR and Harold Ickes, secretary of the interior, favored forcing the industry to change its pricing practices, which is eventually what happened.

The interest in coal ownership arose in the 1960s for similar reasons. TVA's demand for coal was soaring, while competition within the coal industry was declining and coal prices were steadily rising. Consequently, TVA acquired coal land in Tennessee, Illinois, and western Kentucky. It apparently never seriously considered mining the coal itself; it simply wanted to get a guaranteed long-term supply at a price that could not be raised without some good excuses. It put the Kentucky land out to lease, and there was only one bidder—Peabody Coal, which now mines the property for TVA and produces about seven million tons annually, or one-fifth of TVA's consumption. At a 1972 hearing of the House Select Committee on Small Business, TVA Chairman Aubrey J. Wagner was asked if the Kentucky operation now gives TVA a pretty good yardstick on coal prices. The following dialogue occurred:

Wagner: *We hope that it will . . . . It is a contract operation. We are not doing the mining ourselves but we will perhaps–*

Rep. Neal Smith: *You will have access to all the figures though.*

Wagner: *I believe so–at least where the changes in price are involved.*

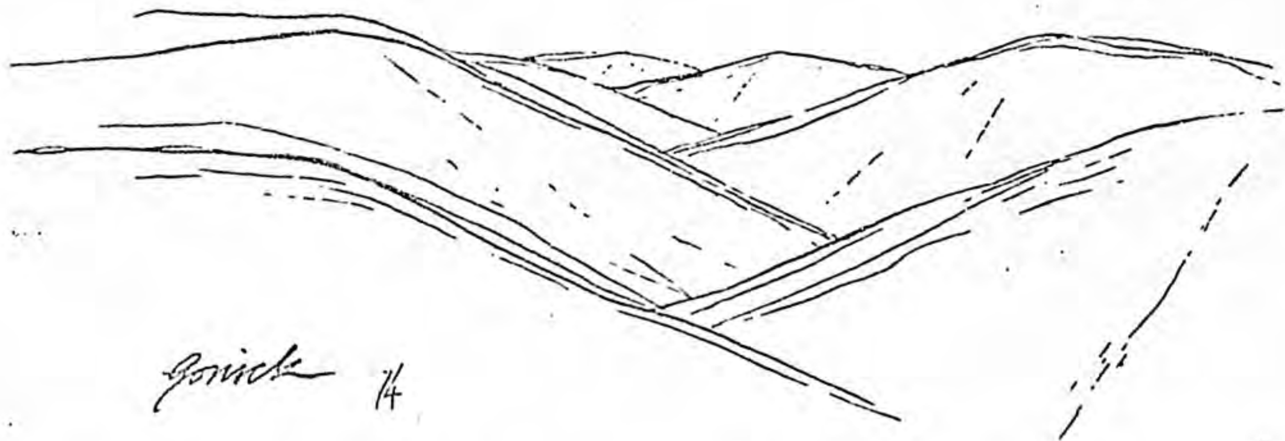
Smith: *Has TVA sought to acquire its own railroad to haul hoppers?*

Wagner: *We have not bought coal cars. We have considered it but the problem was solved for us before we had to do that.*

The idea of a government aluminum company was advanced by many New Dealers during World War II, when millions of public dollars were being poured into constructing aluminum plants. In terms of public enterprise, things had regressed a good deal since World War I. Then, under the Defense Procurement Act, the government took over the railroads, built and owned such facilities as Muscle Shoals, and held on to the facilities after the war. This time, despite the pleas of Lilienthal, Thurman Arnold, Lister Hill, Robert LaFollette, and others, the public investment in aluminum was turned over to the Reynolds and Kaiser families.

Lilienthal's journal for July 8, 1941, outlines his thinking:

I am pitching again on the TVA aluminum-alumina plant. Last night I met with Kenneth Galbraith, assistant to Leon Henderson (of the OPA [Office of Price Administration]). We spent a couple of hours discussing the whole matter. It seems that the OPA is preparing a memorandum for the President in response to his request for their comment on the TVA aluminum plant idea. The discussion revealed the weaknesses in the out-and-out yardstick idea as applied to aluminum. Without detailing, it is only necessary to say that the problem of ore supply complicates the matter; also the yardstick termi-



nology may be a tactical disadvantage . . . . The most troublesome feature of the whole business is that we have no legal authority. It is a little bit absurd, because now aluminum is entirely a defense product, since there is no civilian supply, and the government is the sole purchaser. But for us to seek special legislation would involve not only delays, but a terrible lot of punishment and no assurance at all as to the result.

In the one business other than power that TVA did get into–fertilizers–it quickly chose the role not of large-scale producer in competition with private chemical companies, but of experimenter and developer of new products and manufacturing processes. These are then licensed at nominal cost to private companies. In other words, TVA has assumed the risks of the fertilizer business while leaving the profits to the private sector. This is not what farm people had in mind during the 1920s when they wanted cheap, mass-produced fertilizer from Muscle Shoals. But it is in keeping with TVA's generally conservative policies in agricultural matters, which contrast with its more radical approach to electric power. TVA contends that its fertilizer program has made everybody happy–the agricultural extension service, the private chemical companies, and the farmers–because competition within the fertilizer industry has passed on the benefits of TVA innovations and kept fertilizer prices down.

Young Turks and Elder Statesmen

Almost any bureaucracy will, with age, lose its boldness, imagination, and lust for battle. This is a problem that has confounded liberals and radicals alike. There are no ready solutions.

TVA, now 41 years old, is no exception to the general rule. The TVA act created a three-man board, with board members appointed by the president and confirmed by the Senate. The contrast between the first directors and the present chairman reflects the differences between the young TVA and the middle-aged.

The first chairman, Arthur E. Morgan, was the archetypical "super-idealist" (and still is, at 96). An engineer, he'd been president of Antioch when that college was first challenging traditional academic concepts. He had visions of new towns and subsistence homesteads and regional planning and all kinds of sugarplums. However, for some reason he was "soft" on private utilities and soon clashed with David Lilienthal, a lawyer who had served on the Wisconsin Public Utilities Commission under La-Follette and was a hard-liner on public power. The third original board member was Harcourt A. Morgan, an agriculturalist who had been president of the University of Tennessee. H.A. Morgan was not exactly a super-idealist. Indeed, he is Selznick's chief villain for being the stalking horse of the conservative agricultural establishment. But Lilienthal got along grandly with him and thought him a noble, if not radical, character.

A.E. Morgan and Lilienthal attracted scores of young turks to the newly formed agency, mostly from outside the Tennessee Valley. One of those young turks is the present chairman, Aubrey J. ("Red") Wagner. He had just completed his engineering degree at the University of Wisconsin and headed straight for TVA. He rose in the navigation department, became general manager in 1954, and in 1961 was appointed by Kennedy to the board. Nixon reappointed him in 1969, a sign that by then he was none too bold or daring.

I had a fairly long talk with Wagner. He struck me as a well-meaning, totally nonideological but basically liberal man. His commitment is to low-cost power, not public power per se, and he doesn't think the

private utilities are particularly bad; he works with them closely on lots of things. His "broad vision" for TVA is that it can help bring jobs to rural areas and teach city folks about nature in Land Between the Lakes. When I asked Wagner if he thought a federal energy corporation was a good idea, considering how the private oil companies have forced up the price of fuel (including TVA's coal), Wagner replied—mainly, I think, to be friendly—that it was "worth looking into." The response was tepid. By contrast, Lilienthal actively pushed for a federal aluminum corporation and many regional TVAs.

The term of office for board members is nine years. The idea, apparently, was to span two presidential terms to make the job as nonpartisan as possible. There have been no real firebrands since the first board. Several appointees have been defeated politicians in need of jobs; some have come up through the ranks like Wagner; some have represented conservative interests; most have not been from Tennessee, though there has usually been at least one local out of three. There are really no checks on the board members' power, although the president can remove them if he sees fit. When the A.E. Morgan—Lilienthal feud got too troublesome, for example, FDR relieved Morgan of his post. Morgan sued, claiming the president had no such authority, but the courts upheld Roosevelt.

To staff the agency, the TVA act authorized the board to hire employees "without regard to the provisions of the Civil Service laws," and to remove employees at its discretion. The law also provided that, in the hiring and promotion of employees, "no political test or qualification shall be permitted or given consideration, but all such appointments and promotions shall be given and made on the basis of merit and efficiency."

These provisions have worked out well, at least with regard to competence and nonpartisanship. Everyone agrees that there has been no political influence on TVA hiring, little if any corruption or nepotism, not much incompetence, and generally a good performance for a government bureaucracy. The record with regard to race and sex is not outstanding, as TVA itself admits, but on the other hand it hasn't been blatantly racist, as some agencies in the South have been. In its dealings with construction workers, TVA gave early recognition to trade unions and engages in a kind of collective bargaining with them (ostensibly the issue is to determine what the "prevailing" wage level is). There have been a few slowdowns and brief stoppages but no long strikes.

Generally, local people are hired for the blue-collar and low to middle-level office jobs. The higher level and more skilled positions are, like the board directorships, often filled by outsiders. These higher level people tend to be "good," in that they are competent and dedicated. They don't, however, tend to be very radical or imaginative, as many were in the old days.

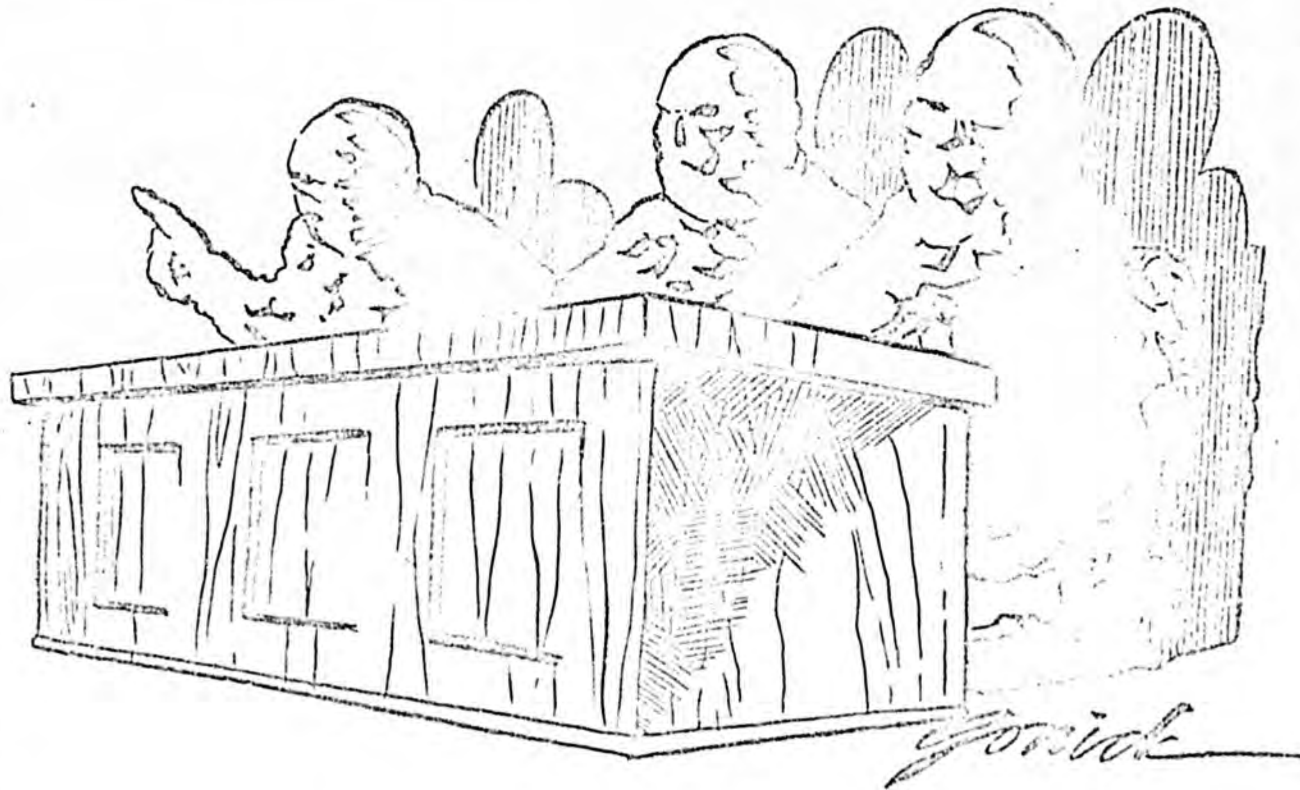
The absence of imagination in the 41-year-old TVA is reflected in many large and many little ways. It contracts out new-town development to Boeing. It has failed to launch a large-scale reclamation program, similar to the early farm and forest programs, to repair the damages wrought by its own quest for coal. It has continued to be obsessed with dam building, despite the fact that new dams contribute only marginally to hydroelectric power and flood control capacity while they destroy some of the few remaining wild water stretches in the region. And it maintains its faith in the "trickle-down" approach to development (discussed below).

In TVA's case, the decline in feistiness is more understandable than it might be for other bureaucracies. TVA spent its early years embroiled in controversy, chiefly over public power. It could not fight too many other battles simultaneously or subsequently. Those early struggles, writes John Moore of the University of Tennessee, were bound to take their toll "through a creeping exhaustion on the part of those who have fought a good fight for years but who, perhaps unknowingly, gradually tend to avoid further controversy by modifying their original objectives."

"Grasstops Democracy"

Making a government agency responsive to the people it ostensibly serves is as difficult a task as keeping a bureaucracy vital and imaginative. Though TVA's directors are chosen from on high in Washington, rather than by the people of the Tennessee Valley, TVA prides itself on its practice of "grassroots democracy." By this it means working wherever possible with state and local governments and civic groups, and sometimes—as with the rural electric cooperatives—stimulating the creation of new institutions where none had previously existed. All of this is well and good, given the generally Olympian detachment of federal agencies. But if an agency has radical goals, it must be careful in choosing which grassroots to water.

By and large, TVA has chosen the more progressive elements of the established business and agricultural communities, as well as the managers of the new



industries it attracted to the Tennessee Valley. It generally shunned the poor, the landless, and the black. Thus: one of TVA's favorite success stories involves Decatur, Alabama. Lilienthal visited Decatur in 1935 and met with a small group of what are usually called "public minded citizens" or "progressive business leaders." Among them was Barrett Shelton, publisher of the local newspaper, who years later told this story:

Dave leaned his chair back against the wall and the twinkle of a smile came into his eyes, as he said gently and firmly, "I'm not going to do anything. You're going to do it."

Our first step was to form our own Chamber of Commerce, formed at a time when most people didn't believe it could be done . . . . We then decided we were going to develop a cash market every day in the year for every farm product grown in the Decatur area. We were going to welcome industry, but not wait for it. We were going to develop our own farm processing plants.

We decided a packing plant would be the first venture and persuaded the local ice company to put in packing plant facilities when there wasn't as much as one wagon load of hogs in our whole county. We are now producing our own livestock to meet the demands of this market.

We then turned to milk, formed a little corporation with a paid-in capital of $15,000, telling every stockholder to forget his investment, that he would never receive any return from his money. What we were trying to do was establish a payroll every two weeks for the farm families in our section.

To make a longish story short, milk started pouring into the plant and the stockholders make a tidy profit. Then a big flour firm built a mill along the riverbank at Decatur. Farmers could sell grains to the mill, getting cash for products for which there had previously been no market. Soon other industries located in Decatur, and now the area is thriving agriculturally and industrially.

Nowadays TVA tries to repeat this process by getting "public spirited citizens" together to form local or regional planning groups, usually linked to some TVA project. These groups survey local resources and needs, aided by TVA experts, and then try to get something going. A good example is the Elk River Development Association in northern Alabama. The lower Elk valley is a rural area that is starting to get the population overflow from Huntsville and its aerospace facilities. People who want the area to retain its rural character came to TVA and asked for help. Together they came up with a plan for a series of planned rural villages surrounded by commonly

owned open space. TVA is now trying to get Washington to cough up $9 million to start a revolving fund with which the villages will be built.

In its agricultural programs, TVA's chief objective was to teach farmers how to improve their land and their yields by using fertilizers, switching to less soil-depleting crops, and generally adopting more modern techniques. Farmers who volunteered to become "demonstrators" would receive free fertilizers and technical assistance. In exchange, they had to show neighboring farmers the results of their newly learned practices.

A more radical approach to "grassroots democracy" might have led TVA to help set up low-income cooperatives, community-owned enterprises, and subsistence homesteads, and make its aid and expertise available to them. TVA chose to work primarily with established businessmen and farmers who already owned land for two main reasons: (1) it was politically safer, and (2) it produced faster results, if results are measured in terms of acres reclaimed and business revenues generated. In choosing this approach, TVA didn't see itself as ignoring the poor, the landless, and the black. It simply assumed that by working with progressive capitalists, growth would occur and benefits would "trickle down" to those without land or capital.

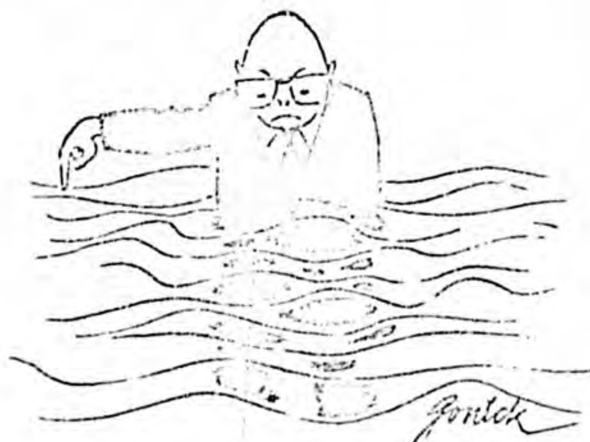
From a political standpoint, TVA's approach appears in retrospect to have helped it survive. TVA emerged unscathed from the 1938 congressional investigation in large part because it had the support of the farm establishment and the local bourgeoisie. By contrast, the Farm Security Administration, which pursued the more radical approach that TVA shunned, was destroyed in the early 1940s by the same farm establishment that was supporting TVA. It might be argued that now that TVA *is* firmly ensconced, it could be more radical than it is inclined to be. The problem here, as noted earlier, is that 41-year-old bureaucracies are almost never inclined to be radical.

A final point is that TVA has always seen its role—and properly so, given its congressional mandate—as *developmental* rather than *redistributive*. Thus, it naturally made alliances with those most capable of influencing development. Thus, too, it valued social harmony and had no desire to promote class conflict.

It may well be that the same agency, for political reasons, cannot be developmental and redistributional at the same time, at least not in the context of American capitalism. And since the problems of backward regions—the South, Appalachia, rural areas and inner cities generally—appear to most liberals and many back-door socialists as developmental rather than redistributive, the agencies they set up will almost always be developmental. Lilienthal's subsequent work is right in this pattern. He has gone around the world helping third world nations set up TVA-type development agencies, always working with the "progressive" ruling elements in those countries. This means, among other things, that liberals and back-door socialists must be re-educated to see inequality as more a distributional than a developmental problem, and that new techniques must be developed to redistribute and develop simultaneously.

Could TVA have played a more radical role than it actually did, both within the Tennessee Valley and nationally? As I read the history of TVA, its stance was pretty much determined by (1) the political limitations of applying radical programs in the South, and (2) the personalities of the first three directors. *If* Arthur Morgan had gotten along with Lilienthal, and *if* Harcourt Morgan had been more of a radical (or if a farm radical had gotten his job), then possibly, just possibly, things might have been different. As it turned out, there was a trade-off: a conservative farm policy was the price for a radical power policy. Given the lack of any significant local support for *either* a radical power policy or a radical farm policy, that may have been the best possible deal.

Then again, it may not. TVA's critics from the left—e.g., Selznick and Rexford Guy Tugwell—contend that less adhesion to "grassroots democracy" (Tugwell called it "grass-tops democracy") would have made TVA more radical.[2] "Grassroots democracy," they argue, was in reality a protective ideology designed to justify TVA's co-optation by conservative agricultural interests. It also gave the agency some degree of local legitimacy: as an absentee corporation it could have been subject to charges of "carpet-



bagging" and pushing people around. Tugwell concludes:

If we really want to make administration more democratic, we ought to regard the grassroots approach with suspicion .... In the South grassroots democracy can only mean the exercise of the powers of government by the white planters; elsewhere it must mean control by and for the prosperous farmers who have hired men to do their work while they go to committee meetings. The plain fact is that if most farm communities are to have democratic administration they will have to import it from Washington.

These observations shed light on another dilemma presented by TVA: could the agency have been made more responsive to low-income people by making it less of a top-down operation—for example, by having a popularly elected board? The rhetoric of the left, with its emphasis on "community control," automatically rejects the image of a socialist institution managed by presidentially appointed directors who are essentially nonremovable. Yet my guess is that a "democratically controlled" TVA would have turned out worse than the real one. Low-income people do not dominate the politics of the Tennessee Valley; they would have had a hard time gaining control of TVA.

The inescapable conclusion seems to be that if we want community-controlled institutions, we will have to spend a long time educating low and perhaps middle-income "communities" (and I'm not even sure that enough such "communities" exist). If we want public institutions that can play catalytic roles in redistributing wealth and building a radical political constituency, then at least for the short run we will have to accept a hard-nosed, top-down approach. TVA's failure as a beachhead of socialism is in large part a result of its failure to be hard-nosed enough, especially in building a political constituency that would support it on its own terms. The ultimate lesson of TVA may therefore be that back-door socialism in America must do more than build institutional islands. It must *use* those islands to nurture a popular movement so that eventually socialism can march in the front door.

FOOTNOTES

1. Berkeley: University of California Press.
2. See the review of Selznick's book by Tugwell and E. Banfield in *Public Administration Review* vol. 10 (1950).

I. DEFINING LAND BANKING

In the very broadest sense, land banking can be defined as any public program for the acquisition of a land reserve for future use.[10] To the extent that it has been proposed as a tool for dealing with urban growth problems, it has generally had two objectives: (1) providing a mechanism by which public agencies can direct where development can take place and the nature of that development, and (2) exerting an influence on land prices in order to keep them at a "reasonable" level. To achieve these purposes, a land bank must involve the advance acquisition of large tracts of undeveloped land by a public body for subsequent disposition to public

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[10] In an historical sense, the acquisition and disposition of the lands in the Public Domain can be considered a form of land banking and some commentators have suggested that this very significant national experience serves as an adequate precedent for contemporary efforts at land banking. In view of the fact that the programs for dealing with the Public Domain were only incidentally related to establishing urban settlements, and certainly had no relationship to the problems of urban growth as viewed today, the idea of using this as a precedent would seem to be dubious. Equally, it has also been suggested that the management of the federal public lands is an appropriate analogy to land banking. The Public Land Law Review Commission did consider the problem of using some of the public lands for urban purposes and recommended: "A new statutory framework should be enacted to make public lands available for the expansion of existing communities and for the development of new cities and towns." One Third of the Nation's Land, U. S. Government Printing Office, Washington, D. C., 1970, p. 226. However, all but the tiniest fraction of the public lands are remote from our major population centers. For the failure of one effort to use federal lands for urban problems, see Martha Derthick, New Towns in-Town: Why a Federal Program Failed, Working Paper No. 112-21, the Urban Institute, Washington, D. C., June 1970. Insofar as the potential use of federal lands for new town purposes is concerned, it remains to be established whether it is possible to foster the growth of such communities in remote locations except as an ancillary function in conjunction with the establishment of major new economic activities (e.g., Los Alamos).

[illegible] entities for a broad range of developmental purposes. Generally, [illegible] necessarily, the land involved is at the periphery of urban growth. [illegible] sense that this paper will generally deal with land banking ex- [illegible] the last chapter in which more limited forms will be considered.

[illegible] definition uses the phrase <u>undeveloped land</u> in order to clearly dif- [illegible] land banking from the urban renewal process which is primarily [illegible] with the acquisition and disposition of developed land--the proper [illegible] which is inhibited by the presence of slum structures or blighting con- [illegible][11] Since urban renewal achieves its price objectives through a sub- [illegible] write-down and tends to focus on relatively small areas within a sin- [illegible]diction, the problems of that program are significantly different [illegible] involved in land banking in the more general sense. However, [illegible] provide the only current significant American experience with [illegible]quisition and disposition of land, and this analysis of the prob- [illegible] land banking will be heavily dependent upon the experience of the [illegible] renewal program. It should also be noted that while urban renewal is [illegible] with reducing land <u>prices</u> within the specific project area, it is [illegible] with increasing land <u>values</u> in the surrounding area.[12]

[illegible] 110(c)(1)(iii) of the Housing Act of 1949, as amended, does [illegible] of urban renewal powers and funds in predominantly open or [illegible] subject to a number of restrictions which have severely in- [illegible] use. The precedent and authority of that Section might be [illegible] for a federal-local program of land banking, but considera- [illegible] of the urban renewal ground rules would be necessary to [illegible] effort on the scale being discussed in this paper.

[illegible]berg, <u>Economic Analysis of Urban Renewal</u>, Brookings Institute, [illegible] increase in land values in surrounding areas as one of the [illegible] of the effectiveness of urban renewal. On the inter- [illegible] of land value and price, Grace Milgram, <u>The City Expands</u>, [illegible] of Housing and Urban Development, 1967, comments on the [illegible] of increasing land values and the almost universal dis- [illegible] increasing land prices.

In many cases, private interests engage in the equivalent of land banking through the assembly of very large tracts for subsequent development. This often results in some of the desirable effects sought by land banking proposals--a far better and more efficient pattern of development than the more normal fragmentary development process and, to some extent, lower housing costs to the consumer.[13] However, it is dubious that such private activities are a substitute for public policy because under current conditions opportunities are severely limited. Indeed, where they have occurred, there is usually some fortuitous element of land assembly involved which limits the possibility of replication.[14] Title X of the National Housing Act provided federal mortgage insurance for land development in order to encourage large scale private land assemblies. Thus far, it has found very little use by the private market.[15] In any case, a public

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[13]The economists describe the beneficial effects of large scale development as "internalizing the externalities." In layman's language, this means that a large scale developer keeps within a single pot the values generated by the housing he builds and the shopping center built to serve the housing. It is difficult to say to what extent the benefits are passed on to the consumer, but it can be observed that large scale assembly when coupled with building efficiency seems to result in some of the best housing values to be found. See Eichler and Kaplan, The Community Builders, University of California Press, 1967.

[14]The Irvine Ranch in California represents the development for urban purposes of a large scale agricultural holding kept together from the time of an old Spanish land grant. Reston in Virginia is similar--although on a significantly smaller scale. The developer acquired the land intact from the former agricultural holder. The land for Columbia, Maryland, was put together from a brilliant "cloak and dagger" land assembly process. One observer has commented that a land assembly process such as that at Columbia can be carried out once in a metropolitan area, but never twice.

[15]Title X was enacted as part of the Housing and Urban Development Act of 1965. As of December 31, 1968, only nine projects had been insured for a gross mortgage amount of $5,348,000. Source: 1968 HUD Statistical Yearbook, U.S. Department of Housing and Urban Development, U.S. Government Printing Office, Washington, D.C. Section 119 of the Housing and Urban Development Act of 1970 attempts to deal with part of the problem by a partial waiver of the comprehensive planning requirement of Title X.

program for land banking must have very significant differences from similar private activities if for no other reason than that it must operate subject to general scrutiny and cannot depend on any single fortuitous finding of assembled land.

To a certain extent, a limited type of land banking is now carried on by a number of governmental units through the advance acquisition of land for subsequent public uses.[16] Highway commissions will acquire rights-of-way, and farsighted boards of education acquire school sites in developing areas, both well in advance of immediate need. In other cases, such policies may be extended to a wide range of public facilities. Section 704 of the Housing and Urban Development Act of 1965 provided financial assistance for such activities.[17] Also in the category of public use, we must consider the acquisition of land for open space and park purposes supported by federal financial assistance.[18] But for these programs there is built in an intent to prevent future development.

These public facility land acquisition activities must be differentiated from broader scale land banking proposals on a number of grounds. Their objectives are limited to optimizing the land acquisition process for very narrowly limited public purposes. They have no disposition problem

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[16] See Donald C. Shoup, Advance Land Acquisition by Local Government, U.S. Department of Housing and Urban Development, 1968.

[17] The assistance provided in Section 704 was limited to a grant equal to the interest cost on bonds issued for such acquisition for a period not to exceed five years. In general, land acquired with such assistance must be put to the specified public use within five years. No funds were requested for this program for fiscal year 1971 and it appears as though it is being phased out.

[18] These are the HUD open space program and the Department of the Interior's outdoor recreation program.

except insofar as there may be involved some procedural difficulties in intra-governmental transfers. They are relatively small in scale with very little spillover effects in the private market.

VI. FINANCING LAND BANKING

For a land bank to be operationally effective, it must purchase control of a significant portion of the land where growth is occurring or might occur. There are too many variables involved to quantify in any but the crudest fashion the finding required, but it is adequate, for present purposes to say that it will be very large.[37]

GENERAL OBSERVATIONS

Before going into the specifics of how this financing might be managed, a number of general observations should be made:

1. Because of the vast sums of money involved, it is hardly likely that a land bank would be expected to enter immediately into a fully operational phase through a "quick taking" of all needed property. Thus financing would be an incremental process.

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[37] Using heroic assumptions and dubious data, a crude estimate of the magnitude of financing required to start up a nation-wide land banking effort can be made as follows: The Kaiser Committee estimated that the achievement of the national housing goals will require the consumption of fringe land around major metropolitan areas of roughly one million acres per year. If we assume (quite arbitrarily) that land banks must have in their inventory the equivalent of five years' consumption, they will therefore have to acquire five million acres. Schmid, op. cit., p. 21, cites NAHB estimates for the national average price paid per acre for "raw usable land" in 1964 as $3,878. Using an inflation factor of 10% per year for land suitable for development (below the lowest estimates reported by Milgram in U.S. Land Prices--Directions and Dynamics, [illegible] p. 55) we would arrive at a current estimate for 1970 of roughly [illegible] per acre. Thus, the overall cost of the working inventory for a national land banking effort would be about $35 billion.

2. The financing of a land bank will have no direct net effect on the Gross National Product since all that will be involved is transfers of ownership from the private sector to the public sector and subsequent retransfers as land is released for development. There may be indirect effects: if more orderly urban growth patterns result in greater economic efficiency, there will be a positive effect on the GNP. Present land owners will have their relatively illiquid holdings converted to cash, which could provide an influx to the credit market to meet the financing needs of land banks.

3. In fairly simplistic terms, the financial planning for a land bank must be considered in two phases--the build up of operating inventory, and actual operations. During the build up phase there will be a continuing need for additional new investment with little, if any, offsetting revenue. The duration of this period is problematical. As previously noted, in the Swedish experience there was a thirty year gap between land acquisition and development. In American urban renewal experience with large projects, a ten year gap between the beginning of acquisition and significant disposition is typical.

4. Land banking may or may not be financially self sustaining (or even revenue producing) depending on the strategies and methods used. To the extent the bank sells land for development at market prices, it may generate substantial profits--if its holding costs are lower than those of other investors in land.[38] On the other hand, land acquired and indefinitely held out of production in order to shape development would constitute a net financial loss.

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[38] See footnote 24, p. 13.

5. Land banking must be conceived of and financed in terms of very long term goals, yet it must also be capable of rapid response to take advantage of unexpected opportunities for property acquisition. Because of this need for flexibility, a bank should not be dependent upon any single source of financing.

DEBT FINANCING

Because land banking will require very large financial resources on a long term basis, there is no question that the bulk of the funding involved will have to be raised through debt financing. The particular instruments involved are probably of little significance. What is far more important is the consequences flowing from the assumption of a large debt service burden and how these are likely to affect the freedom to make valid public policy decisions about the rate at which land will be released for development, the uses which will be permitted, and the prices to be charged.

Debt financing is only feasible when the investors in that debt believe that there is a reasonable expectation of future payment of principal and interest. For a land bank to obtain such financing, it would have to commit itself to policies which would assure that the bank would, in the long run, obtain enough aggregate income from the disposition of land to cover its acquisition and debt service costs.[39] Given this constraint, one may very well question how easy it would be for the bank to meet any significant social objective.

[39] A government guarantee may influence market decisions about the security of the debt, but the guarantee is not a substitute for an acceptable financing plan. Thus, the bond market still sets differential prices on various local housing authority and urban renewal bonds despite the existence of a uniform and unconditional Federal guarantee.

An alternative to a policy commitment to self-sustaining operations would be to have a government agency with adequate revenue resources prepared to provide sufficient subsidy to meet deficits which might be incurred.

APPROPRIATIONS

At least for its start-up costs, a land bank would have to be financed from direct governmental appropriations. Appropriations might also be required to meet any subsidy costs.

There are only a limited number of sources of governmental appropriations which have to be considered. At a local level--either that of a municipality or some metropolitan agency--fiscal problems are so great that there would appear to be little likelihood of significant revenues being available to provide much support to a land bank.[40] The states and the federal government would be the more likely sources of the initial funding as well as any continuing subsidy.

SPECIAL REVENUE TRUST FUND

One of the great dangers of a dependence upon appropriations is the possibility that the appropriations will dry up with changing winds of fiscal policy or politics. A traditional device for dealing with this problem is the establishment of a trust fund with some uniquely designated source of revenues.[41] For a trust fund to be politically acceptable, there

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[40] On the more limited scale of local urban renewal projects, the local share of the net costs is predominantly provided as non-cash contributions.

[41] Outstanding examples of such an approach are the federal and state highway trust funds in which revenues from gasoline taxes and motor vehicle registration are dedicated to the construction of roads. From a broad public policy viewpoint, there are many problems involved in establishing special revenue trust funds. This paper will not attempt to deal with them.

must be a reasonable relationship between the revenue source and the use to which it is put. In the case of land banking, some possible sources which might be considered include:

1. The imposition of transfer fees in connection with real estate transactions.

2. Allocation of capital gains taxes in connection with land transactions.

3. Allocation of increments in property taxes resulting from increased assessments in land values.

In connection with the last suggestion, Marion Clawson has proposed[42] that a land banking operation could probably be funded in a large measure from such a source if there were significant reform in the taxing system to rapidly and accurately reflect increasing land prices resulting from land banking itself. This would be feasible only if public policy so valued orderly development that it was indifferent to the price inflationary effects.

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[42] Marion Clawson, Suburban Land Conversion in the United States, Resources for the Future, Washington, D.C., 1969. Unpublished manuscript.

VII. LAND ACQUISITION

The first function of a land bank is to acquire an inventory of undeveloped land. How big that inventory would have to be in order to achieve its purposes, the methods used in selecting the land, and the procedures for acquiring the land all involve significant policy problems which could affect both the feasibility of achieving its objectives and its acceptability to the body politic.

THE PROBLEM OF CORRUPTION

It should be noted that the public acquisition of land has been a traditional source of corruption in this country. Venal official and venal landowner can conspire all too conveniently about which parcels are to be acquired and the valuation involved.

A comparison of the experience of two major federally-assisted land acquisition programs can give us some idea of the factors which tend to encourage or inhibit corruption. One of these, the federal highway program, has had its share of land scandals--it is a program characterized by a relative degree of freedom from public scrutiny in making right-of-way decisions and comparatively relaxed policies on acquisition and valuation methods. By contrast, the federal urban renewal program has been amazingly free of any land scandals. Partly, this is due to the inherent nature of the program, which requires tightly defined boundaries and close public scrutiny; and partly to the application of rigid policies with respect to acquisition and valuation.

For land banking, the implications of this experience would seem to be clear: if relative flexibility is felt necessary to achieve its purposes,

there must be a willingness to accept the possibility of corruption and scandal.

NEGOTIATED PURCHASE VS. CONDEMNATION

In Chapter IV, it was indicated that under current judicial criteria, the use of condemnation powers in connection with land banking could probably be sustained only if it were coupled to a fairly definite plan for the area involved together with expectation that the plan could be carried out in a reasonable time. For the purpose of analyzing the comparative merits of negotiated purchases and condemnation, we will ignore that legal complication and presume that a public land bank could choose between the alternatives without legal restriction.

Given this choice, it would seem clear that, from a public relations viewpoint, a land bank would have to make the maximum feasible use of negotiated purchases. Condemnation is essentially a brutal process which is bound to alienate the person whose land is taken, as well as others who may fear the same process. Where condemnation has been applied on any large scale, it has been in connection with activities which not only have met the judicial test of public purpose, but also the political test of public acceptance.

But even if the maximum use is to be made of the negotiated purchase approach, there must surely still be available the threat of condemnation. Where assembly of specific sites is needed the land bank must be able to enforce its will even though the present land owner is unwilling to sell to the bank. Furthermore, without the threat of condemnation, the bank would be subject to paying exhorbitant prices.

USE OF FEE OR LESS-THAN-FEE ACQUISITIONS

Ownership of land is sometimes characterized as control of the "bundle of rights" relating to the land. It has been suggested a number of times that public purposes relating to land can be achieved through control of some of those rights--and presumably at costs less than that involved in acquiring fee simple title.[43] From the point of view of a potential land bank, such an approach is certainly worth careful consideration, particularly insofar as it would minimize the costs of keeping some land out of productive use.

The most successful use of less-than-fee acquisitions has been through scenic easements in connection with highway development. This device has been used on a fairly significant scale in both California and Wisconsin. However, in almost all cases the land over which the scenic easement was acquired was in agricultural use with little prospect of attaining urban values in the foreseeable future. For all practical purposes, experience with scenic easements has been as a defense against billboards rather than development. Whether the same success could be achieved in an urbanizing area remains to be established.[44]

The other mechanism for less-than-fee acquisition which has been frequently suggested is the purchase of development rights. This approach has been tried once on a significant scale and foundered on the rock of

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[43] See William H. Whyte, The Lost Landscape, Doubleday and Company, Inc., Garden City, New York, 1968, for an extensive discussion of the use of less-than-fee acquisitions for conservation purposes.

[44] The Department of the Interior did successfully change the nature of development of the Merrywood estate in Virginia through the acquisition by condemnation of a scenic easement. However, this situation was so specialized, tinged with political overtones, and costly, as to make it of very little use for generalization.

public acceptability.[45] As to why this particular plan failed, Allen Schmid[46] suggests the following hypothesis (which also casts useful insight on the general limitations of less-than-fee acquisition):

> The area selected was in the very early stages of conversion from rural to urban use. At the outset of development, the development value has a very minimal present value. Development is coming, but it is far enough in the future to have only a small effect on present values. While the planners estimated that the development rights could be bought for three million dollars, this would not mean much for an individual propertyowner. This puts the propertyowner in a position of indifference. If he gives up his development rights now, he receives only a small amount above the agricultural use value of his land. While he may agree that this is all it is worth, the payment is just not a large enough sum to get excited about one way or another. If he sells, he gives up the hope that he might get a lucky break and become a millionaire when his land is wanted for a motel sometime in the future. While the motivations of landowners have never been systematically explored, it is the old question of the small immediate gain versus the uncertain, but large, future gain.

Conservationists have successfully used a number of acquisition methods involving the granting of residual right to present owners. Two such methods are acquisition subject to a life estate for the present landholder, and acquisition and leaseback. These, and related methods, are not panaceas and must be handled with great sensitivity. However, they are tools which should be available to a land bank.

While any land banking proposal must consider the potentials of less-than-fee acquisitions, they are still only potentials whose

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[45] John C. Keene and Ann Louise Strong, "The Brandywine Plan," AIP Journal, January, 1970, p. 50.

[46] "Suburban Land Appreciation and Public Policy, AIP Journal, January, 1970, p. 43.

usefullness still remains to be proven in the type of situations which would be encountered in acquiring control in an urbanizing setting.

ACQUISITION PAYMENTS

Most public acquisition of land has been carried out on the basis of payment in cash for the full consideration involved. Strangely enough, the little evidence we have on how the private market operates indicates that immediate cash payment is rarely used. The freedom a land bank has in tailoring its payment methods to the needs of a specific situation may very well have a significant effect on the prices it will have to pay and the ease with which it operates. (Conversely, the greater the freedom, the greater the potential for corruption, or charges of corruption.) The variety of ways in which the consideration can be varied to meet the differing needs of buyer and seller are almost infinite, but the following are some of the more common devices used, together with some of their advantages and disadvantages:

1. Cash: During periods of tight credit, a land purchaser who can offer immediate cash payment may be in a position to obtain substantial price concessions. From the point of view of the seller, this does have the disadvantage that any profits are then immediately subject to capital gains taxation[47] (unless the sale is the result of condemnation or is made under the threat of condemnation). From the viewpoint of a purchasing land bank, a cash purchase means the early commitment of financial resources and the burden of the carrying charges on the amounts committed.

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[47] Milgram, op. cit., points out a case where a land seller demanded a higher price if the transaction was to be in cash.

2. Installment Purchase: This is a method normally used by large-scale developers who stage their building activities and prefer not to put their resources into land ownership until they are actually prepared to build. From the point of view of the seller, it also has the advantage of permitting him to spread his profits over several years for tax purposes. While the motives of a land bank using this approach may not be identical with that of the builder, there is no reason why it should not use the installment purchase approach both to defer its own need for capital and to provide leverage in negotiating with a seller.

3. Credit Purchases: A number of observers of the operations of the land market have suggested that a very large proportion of the purchases are made on the basis of credit provided by the seller. Since we have presumed that a land bank will receive a large part of its financing from the credit markets, there is no reason why such land bank should not use its own instruments of indebtedness as a direct medium of exchange for land purchases. Whether this mechanism could be effective, or how much it would affect the prices the bank had to pay, would very much depend on the desirability of those securities from the viewpoint of the seller. If, for example, an exchange of land for land bank securities were exempt from capital gains taxation so long as the securities were held by the original land owners, the securities might assume a value to the seller beyond their face amount. Other similar tax incentives might facilitate land bank operations.[48]

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[48] However, it should be pointed out that tax incentives do constitute a form of subsidy which should be costed out.

ACQUISITION CRITERIA: HOW MUCH?

Just how much of the undeveloped land in a metropolitan area would a land bank have to control in order to achieve its objectives? This is probably an unanswerable question in any general sense. There would be immense variations depending on the strategies employed, it would vary from area to area depending on its physical and economic characteristics and the dynamics of its growth process, it would probably have significant variations over time. The only general answer which can be given is: just as little as possible in order to achieve its objectives.

Most people who have suggested land banking have viewed its potential benefits from the position of an institution in being--few have weighed the costs of creating the institution as an operational entity. The very process of acquiring a sufficient inventory of land can be immensely disruptive to the development of an area. Insofar as supply and demand are significant determinants of land prices, the actions of the land bank in acquiring its inventory (or preventing use when undesirable) would drive up prices. Insofar as the expectations of land owners are a significant price determinant, the presence of a large, well-financed acquisition agency in the market would cause them to raise their asking prices even higher than supply and demand might dictate. All of this would end up being reflected in higher costs for new housing, public facilities, and all other economic functions which require land.

But wouldn't this be only a temporary effect which would be more than offset when the land bank reached an operational status in which it was disposing of land at a rate at least equal to that at which it was acquiring it? This is not at all clear because the bank would itself

have been caught in the inflationary spiral it had generated. In its attempt to corner the market--and this is what its net function would be--the bank would have been paying higher and higher prices for each incremental piece of property it acquired. To the extent to which a land bank had to be financially self sustaining, it would have to reflect these higher prices in its own disposition activities. If, on the other hand, we are talking about a land bank which would be receiving public subsidies, we would have to ask whether those subsidies could not achieve the desired public purposes more directly than through the operation of a land bank.

ACQUISITION CRITERIA: WHICH PARCELS?

No matter what the decision about the total amount of land which should be acquired by a land bank, it must go about acquiring that land parcel-by-parcel. What criteria should guide the bank in carrying this out?

If we presume a land bank guided principally by a concern for the control of prices, its approach to parcel-by-parcel acquisition would be that of any speculator--attempting to obtain the best bargains so as to have the greatest ultimate leverage at the time it is ready to begin its disposition activities. It would have to be acutely aware of the directions in which growth is likely to occur and sensitive to pricing patterns or to special opportunity situations. Aside from these factors, its selection of individual parcels of land could almost be random since it would make no pretense as to guiding the direction of growth. As with any other speculator, its greatest danger is making incorrect judgments as to the direction and timing of development activities.

If we presume a land bank guided principally by a concern for directing the pattern of growth, then we must assume that its parcel-by-parcel acquisitions are closely related to a plan for the area. This presents a number of problems:

1. The state of the art of planning is such that few metropolitan area plans deal in any precise form with the dynamics of the growth process to the extent that would be required to guide land banking. Perhaps the existence of a land bank might serve as the appropriate goad to the planning arts, but this must be treated as something which might occur in the future, rather than a present reality.

2. Close adherence to any public plan only makes the acquisition process more difficult and costly. It causes the land bank to operate in a restricted market (that defined by the plan) with all of its cards in the open. It is to avoid this situation that Swedish land banks carry out their acquisitions in advance of any public revelation of a plan.

3. If land bank operations are closely guided by a public plan, it will be forced to resort to greater use of condemnation powers than might otherwise be politically desirable. However, the very availability of the condemnation powers may be dependent upon the existence of a fairly tightly defined plan which can be carried out in a reasonable time period.

4. Since a land bank would be making very substantial investments based upon a specific plan, it would have to operate with some considerable assurance of the continuing political viability of that plan--as well as the commitment to provide the associated public facilities to carry it out.[49] To achieve this might require isolating the land bank, the planning

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[49]This is somewhat of a problem in the urban renewal program, but the latter operates on a smaller scale and shorter time frame than any land bank could.

agency, and the public works financing process further from the political process than is either feasible or desirable.

Buying Back the Land

A Proposal for California

by PETER BARNES

An idea for a land trust fund, which may be re[illegible] to other states as well.

The land problem in California, as elsewhere in America, is both environmental and economic.

Open space in urban and suburban areas is fast disappearing. The last major open space area in the Los Angeles basin—the Santa Monica Mountains—is threatened with imminent development. The San Francisco Bay area is in better shape, but developers have marked large chunks of Marin, San Mateo, Santa Clara, Alameda, and Contra Costa counties for subdivision.

As the cities lose breathing space, people flee to the countryside for relief. But the unspoiled wilderness is also vanishing. Over half a million acres of California's mountain and desert land have been committed to second-home subdivisions within the past decade. Farmland is being gobbled up at the rate of 134,000 acres per year. And the oases set aside by the government for parks are being crowded to the bursting point. The larger state parks now require reservations weeks in advance. During 1968 and 1969, over 360,000 people were turned away from state parks and beaches. Public parks are getting so crowded that a San Diego syndicate is buying land for private parks and selling memberships for $1,800 down plus $96 a year.

Degradation of farmland is also part of the problem. Intensively irrigated areas of the Imperial and Coachella valleys are becoming so saline that they may soon be impossible to farm. On the west side of the San Joaquin Valley, the "mining" of underground water by large corporate farms has caused the land to subside by several dozen feet. Giant corporate and tax-loss feedlots are beginning to create substantial [illegible] disposal problems in many parts of the [illegible] [illegible] most serious threat to man and [illegible] [illegible] a vicious ecological circle of toxic [illegible] [illegible] extensive use of single-crop cultivation, [illegible] [illegible] inorganic fertilizers depletes the soil [illegible] [illegible] the variety and resistance of pests [illegible] these problems large absentee-owned [illegible] [illegible] more chemicals onto the land. This lea[illegible] [illegible] depletion, more pests, and more chem[illegible] [illegible] resident farmers, while often trapped on [illegible] chemical treadmill, are more inclined to [illegible] land. They live and work on it, may [illegible] on to their children, and can't affo[illegible] [illegible] sums into the pockets of oil and che[illegible] [illegible][1]

[illegible] concentration of land in a few hands [illegible] human problems. Since the day in 1848 [illegible] discovered in the Sierra Nevada foo[illegible] land has been a monumental sour[illegible] This wealth comes from assets that once [illegible] owned but are now controlled by a fe[illegible] land itself, minerals such as gold and [illegible] surface and underground water (geoth[illegible] and timber. The story of how these [illegible] public to concentrated private own[illegible] related elsewhere.[2] Today a few [illegible] and corporations—mostly railroads, [illegible] timber companies, and corporate [illegible] the state's land and resources in a wa[illegible] be described as feudal. The recent [illegible] that investigated California land own[illegible] the ten largest landowners in the [illegible] than 12 percent of the privately hel[illegible] On a county-by-county basis, the [illegible] that the top 20 landowners in [illegible] i.e., a fraction of 1 percent of the p[illegible]

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...n) generally own 25 to 50 percent of the land. ...en in a compact urban county such as San Fran...o, the ten biggest real estate owners (.0013 per...nt of the population) own about 8 percent of the ...essed valuation. And the trend toward concentra...on continues.[3]

TABLE 1: The Top Ten

Corporation	Acres Owned in California
Southern Pacific Co.	2,400,000
Newhall Land Co.	1,600,000
Shasta Forest Co.	479,000
Tenneco	363,000
Tejon Ranch	348,000
Standard Oil of Calif.	306,000
Boise-Cascade	303,000
Georgia-Pacific	278,000
Pacific Gas & Electric Co.	250,000
Occidental Petroleum	200,000
Total	6,527,000
Total Private Land	51,200,000

The principal victims of this concentration of landed wealth are the rural and urban poor. Working family farmers are steadily being driven off the land by large corporations and tax-loss syndicates. In 1950 there were 137,000 farms in California, mostly under 250 acres. In 1969 there were only 77,875, a drop of 44 percent in 20 years. Landless farmworkers–89 percent of whom are employed by the top echelon of commercial farms (sales of $40,000 and up)–are among the lowest paid workers in America. They too are steadily being displaced from the land by expensive new harvesting machines developed by the University of California for the state's corporate farms. In many parts of the Central Valley, small towns are literally dying.

The exodus from rural California intensifies the plight of the urban poor as well as that of the working and middle-class taxpayer. The job and housing markets stay tight, and welfare rolls increase. As poor people congregate in cities and suburbs, land values rise, in turn driving up the cost of housing. James Davis, vice-president of the Real Estate Research Council of Northern California, calculates that, on the average, land acquisition costs account for 27 percent of the total cost of new single-family houses in San Francisco (and a slightly lower percentage in the suburbs). Elliott Maltzman, a Los Angeles developer who tried building federally subsidized single-family houses for less than $24,000, found that "with today's land costs and the costs of quality materials, you could produce nothing but instant slums."[4]

Buy Back California

What can be done to protect and share California's land?

Environmentalists have approached the problem in three ways. They've pushed for lower taxes on undeveloped land, higher appropriations for open space acquisition, and adoption of land-use plans and regulations. All three approaches have serious limitations.

The first led to passage in 1965 of the California Land Conservation Act, more commonly known as the Williamson Act, which permits assessment of undeveloped rural land at use value rather than at market value. The act has given million-dollar property tax breaks to large landowners but has done little to deter development. A study by the State Board of Equalization in 1972 found that more than 25 percent of the land assessed in accordance with the Williamson Act is owned by 12 large corporations. Together these corporations enjoyed reduced property tax assessments of more than $44 million. All are actively involved in the development game.

The second approach–public acquisition of open space–has reached a fiscal dead end. The legislature's Joint Committee on Open Space Lands reported that the cost of purchasing imperiled open space land that cannot effectively be protected through zoning is about $4 billion at 1970 prices. Given the competing demands on existing state and federal revenue sources, it is highly unlikely that anything near that amount will be allocated to open space acquisition. The Nixon administration is already cutting back the miniscule (approximately $100 million in 1972) federal Land and Water Conservation Fund, as well as the urban open space program.

The third approach–land-use planning and regulation–is limited by the fact that landowners have considerably more clout with planning departments and zoning boards than do environmentalists. Moreover, a landowner or developer has the advantage of staying power: he may lose a variance appeal two or three times, but sooner or later the zoning board will change and he'll win. The creation earlier this year of regional zoning commissions for the California coastline was hailed as a great environmental victory, but it already appears that a substantial number of commissioners are hostile to the environmental viewpoint.

Limited as the approaches of environmentalists to the land problem are, they are well ahead of the approaches thus far developed by low-income groups. Generally such groups have confined themselves to seeking small parcels of surplus federal land, or filing lawsuits to compel enforcement of decades-old laws

and treaties. Thus, the Pit River Indians have sought the return of land they assert is theirs under a nineteenth-century treaty; landless farmworkers in the Imperial Valley have sued to compel enforcement of the 160-acre limitation and residency requirement of the 1902 Reclamation Act; a coalition of migrant farmworkers is seeking enforcement of the 1864 act granting land to the Southern Pacific railroad on the condition that it sell the land to settlers at no more than $1.25 per acre. None of these legal efforts has much prospect of success. Nor is there much hope among low-income groups that the land problem can ever be resolved in a manner beneficial to them. The history of government land giveaways–from the railroad grants of the 1860s to the urban renewal write-downs of the 1960s–is too one-sided to offer much encouragement.

Yet it is just within the realm of possibility that low-income groups, by joining with environmentalists, labor, and other progressive forces, could bring about a favorable distribution of land ownership in California. The mechanism for doing this could be a state government trust fund which, for purposes of public salability, might be called the California Land Conservation Fund (CLCF). The CLCF would make land acquisition funds available to public agencies and others for uses consistent with environmental protection and economic justice. It would do so without imposing new levies on most taxpayers. It would thus be a much stronger political device than presently is available for land acquisition and control. With relatively minor modifications, the CLCF model–described below–could also be adopted in other states, or at the federal level.

The operating premise of the CLCF is that land and resource redistribution can be a means to several ends, the principal ones being greater economic opportunity for low-income families, a more decentralized economy in which the role of absentee corporations is diminished while that of locally owned enterprises is increased, preservation of open space, and better care of the land. The CLCF itself would not own or zone land, operate farms, or set up local enterprises. These functions would be filled by other public and private institutions, some of which already exist, many of which still need to be built. The CLCF would be a *politically salable transfer mechanism* that would make *financially possible* the objectives cited above. It would provide only one of the many ingredients (albeit an extremely important one) needed for economic and environmental change: large and steady inputs of money for land purchase. Its uniqueness is that it would do so in a way not dependent upon the diminishing willingness of the legislature (or Congress) to tax the working and middle classes for the benefit of the poor.

Here's how the CLCF would work. Like the highway, social security, and other existing trust funds, the CLCF would be a separate government account into which money would pour from special taxes–in this case, taxes that fall not on the average taxpayor but on the wealthy few who profit most handsomely from land and resources. Revenues from these taxes would be allocated for carefully specified purposes and to particular recipients: half would go to cities, towns, counties, and regional park districts for the purchase of open space land, while the remainder would be granted to low-income cooperatives, community development corporations (CDCs), public utility districts, and nonprofit land trusts for the purchase of productive land. Like the other trust funds, the CLCF, once established (and especially if established by a ballot initiative) would be self-perpetuating and relatively immune to political sabotage.

Funding the CLCF

The principal taxes feeding the CLCF would be a severance tax on the extraction of oil, gas, other minerals, and timber, and a tax on the unearned increment in land value. The severance tax is a well-known tax applied in many mineral-rich states, including Texas, Louisiana, Oklahoma, and Alaska. The unearned increment tax is a kind of capital gains tax applied to land. It has been used in England, South Africa, Australia, Denmark, and other countries, though never in the United States. Its name derives from what John Stuart Mill called the "unearned increment"—the rise in land value brought about by public expenditures (highways, sewers, irrigation projects, etc.) and by economic and population growth. Capturing the unearned increment for private gain is what land speculation is all about. Recapturing it for the public good is the objective of an unearned increment tax.[5]

A state severance tax would fall most heavily on the holders of working interests in oil, natural gas, cement, sand and gravel, other mineral properties, and timber—i.e., the major oil, timber, and landowning companies. Since these companies benefit from a wide variety of federal and state tax preferences—and since the resources they extract are a gift of nature to all, not to just a privileged few—a severance tax is a highly appropriate levy. From an environmental standpoint, the severance tax is an excellent one because, unlike the *ad valorem* property tax, it encourages conservation rather than depletion of resources. For added effect a differentially high rate might be applied to the severance of resources (such as virgin redwoods) deemed particularly worthy of conservation. A basic rate of 7 percent would yield approximately $150 million annually.

To some extent a severance tax could be passed on by oil, cement, and timber companies to consumers in the form of higher prices. However, since California companies would be competing against out-of-state producers who would not be affected by the tax, it is doubtful that a significant portion of the tax could be shifted.

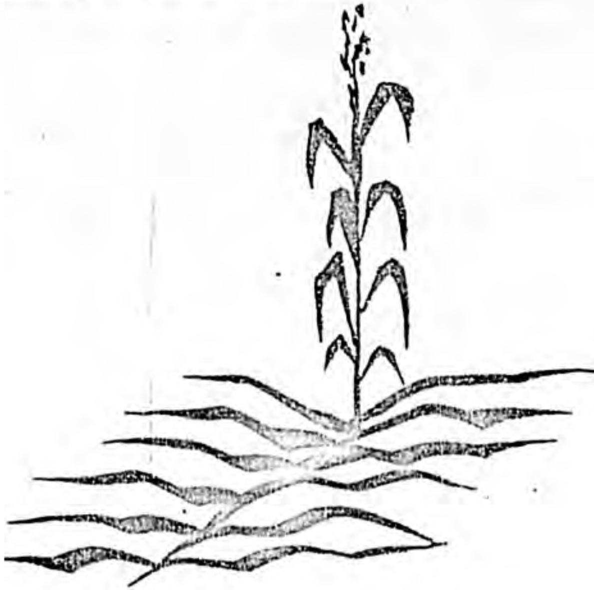
The unearned increment tax, if universally applied, would be borne by all owners of land that is appreciating in value. It would be politically wise, however, to exempt land immediately related to most residential property, small farms, and small businesses. The tax would then be borne almost entirely by large landowning corporations and real estate speculators. Its impact would be greatest on large owners of urban and urban fringe land.

In practice, an unearned increment tax could take a variety of forms. The National Commission on Urban Problems, chaired by former Senator Paul Douglas, described several, ranging from a total shift to site value taxation to a transaction tax on land value increments. I favor tacking on an annual land gains tax to the state income tax. This would be similar to the ordinary capital gains tax except that it would be payable while gains accrue, rather than at time of realization—a necessary difference since one objective of the tax is to induce large absentee landowners to sell.

Collection of an annual land gains tax would be relatively simple. Local assessors, when mailing out their annual property tax bills, would make two extra carbon copies; one would be mailed to the property owner, the other to the State Franchise Tax Board for verification purposes. Each nonexempt property owner would then submit a self-declaratory land gains schedule along with his state income tax return. He would attach to this schedule copies of all appropriate tax bills, much as employers' W-2 forms are attached to the regular income tax form. His tax liability would be calculated in the following fashion: from the total assessed value of his nonexempt California real estate as of a given date in the current year he would subtract the total assessed value of his nonexempt California real estate as of the same date in the preceding year. The difference, representing the total gain in *assessed* value of land and improvements, would be multiplied by four to obtain the total gain in *fair market value* (assessed valuation in California is set by law at 25 percent of fair market value). Then the property owner would subtract the amount expended on capital improvements during the preceding year, and add the depreciation (if any) claimed elsewhere in his return. This would yield the land value increment for the previous year—i.e., the increase in value not attributable to the owner's own improvements—which would then be taxed at an appropriate rate.[6]

Exemptions might be structured as follows: the first $40,000 worth ($10,000 in assessed value) of a taxpayer's owner-occupied home, plus the first $40,000 worth of owner-operated farm or business property, plus the first 1,000 acres of owner-operated farmland covered by the Williamson Act, plus an equivalent value for each rental unit owned, would be excluded in computing the land gain. In addition, the first $1,000 in gain would be exempt. Californians who owned no property (or only owner-occupied homes worth less than $40,000) would not even have to file a land gains schedule. Over 95 percent of

households would thus be spared direct contact with the tax, while the rental exemption would avoid a shifting of its burden onto tenants.



The revenue potential of a land gains tax would be considerable. Consider the following data. Land in California is now worth about $95 billion, and has been rising in value at about 8 percent per year. That creates an initial tax base of about $7.5 billion. Approximately half of that would be excluded under the residential, small farm, and small business exemptions. That leaves about $3.7 billion that could be subject to uniform, progressive, or differential tax rates. A flat 10 percent rate would yield $370 million annually; a 15 percent rate would yield $555 million. A differentially higher rate for increases of value in property that had been rezoned for higher use would bring in added revenue.[7]

Besides raising money to buy back the land, an annual land gains tax would, by itself, have several desirable consequences. By diminishing the tax advantages of investing in land, it would encourage the wealthy to put their money elsewhere, and perhaps prompt present large owners of land to begin selling. This would create a downward impact on land prices–downward enough (if the tax rate were reasonable) to slow the natural rate of increase but not to depress land values below their current level. To some extent this downward pressure would diminish the revenues raised by the tax, but it would also make buying land cheaper for CLCF recipients.

Another consequence of a land gains tax would be the creation of jobs and housing. This would occur because the tax would fall only on the rise in land values, not on improvements. Since the supply of land doesn't diminish, a tax on land gains does not discourage productive investment. In fact, it encourages construction of income-producing improvements on land, especially in the central city and on the urban fringe. Because of the exemption for low and middle-income homes and rental units, the greatest incentive would be to build low and middle-income housing, as opposed to luxury high-rises, shopping centers, and office buildings. If a differentially high rate were applied to land rezoned for higher use, the incentive would be to construct new housing in areas already zoned for it, rather than to sprawl into still-unspoiled areas. If the housing were built by low-income co-ops or CDCs that received land acquisition funds through the CLCF, total costs could be cut by as much as 25 or 30 percent.

Three objections to the land gains tax might be that (1) it does not allow for appreciation attributable to inflation; (2) it taxes unrealized gains; and (3) it constitutes double taxation, since gains would be taxed by the CLCF while accruing, then again by the state and federal governments when realized. These objections are readily answered. (1) No correction for inflation is allowed in taxing inflation-induced increases in wages, dividends, interest, or ordinary capital gains, and there is no reason that landowners should be entitled to special treatment. (2) Concern with taxing unrealized gains might be valid if low and middle-income homeowners and small businesses were not exempt from the tax. Any large landowner who did not have sufficient cash to pay the land gains tax could easily sell a portion of his holdings without hardship. In any case, the ordinary *ad valorem* property tax, which constitutes a heavier burden than would a land gains tax, is worse than an unrealized gains tax because it taxes property values annually even when gains are not accrued. (3) The double tax argument is unconvincing because the "double tax" is no more than a higher rate of taxation on capital gains, a rate that in toto would still not equal the rate of taxation on wages (barring significant reform of the federal tax code). Moreover, taxes paid to the CLCF would be deductible from federal income taxes.

Allocating the Land

Assuming the CLCF generated annual revenues of $500 million to $700 million (which could be increased further by giving it bonding authority), it could finance the outright purchase of several hundred thousand acres per year. Who would get the money to buy land and how would allocations be made?

The law establishing the CLCF would contain a formula for allocating funds by purpose, type of recipient, and location. Thus, 50 percent of the revenues might be allocated for open space acquisition. These funds would be divided among state agencies, cities, towns, counties, and regional park districts in accordance with population density, quality and quantity of open space available, and other factors. Some funds would be used for preserving wilderness and wildlife refuges, some for recreational areas, some for urban parks and suburban greenbelts (in which land might be leased back to small farmers and co-ops). Grants from the CLCF would cover up to 100 percent of land acquisition costs.

The remaining 50 percent of CLCF revenues would be divided among the following types of recipients:

- Cooperatives of low-income families, for the acquisition of land for agriculture, related enterprises, and housing–for example, farmworkers might wish to buy out a corporate farm and run it cooperatively;

- Community development corporations in rural and urban areas, for the acquisition of land for housing and nonpolluting industries–for example, a chain of CDC's might buy back the west side of the San Joaquin Valley, now almost wholly owned by a handful of absentee corporations;

- Public utility districts, for the acquisition of land, water, or energy resources–for example, a district in the Imperial Valley might acquire geothermal energy sites;

- Nonprofit land trusts, similar to the Jewish National Fund in Israel, for the acquisition of land for lease to family farmers and rural cooperatives, or of common land for Indian tribes and Mexican-American communities (*ejidos*).

As with open space funds, grants to private recipients would cover up to 100 percent of land costs. Recipients would thus be free of debt burden on their land, and could use their land as collateral to borrow money for farm equipment, housing supplies, and other capital outlays. The debt-free gift of land would be in the tradition of the Homestead Act. It would, of course, be a subsidy, but one that would barely match the subsidies and tax breaks given to railroads, cattle barons, timber companies, energy corporations, wealthy tax-loss farmers, real estate developers, defense contractors and the like.

Grants by the CLCF to private recipients would be subject to a number of restrictions and conditions. First, carefully drafted language in the law would assure that recipient corporations, cooperatives, and land trusts would either be genuinely nonprofit or owned in major part by persons of low or moderate income who lived and worked in or near the enterprises involved. (In other words, the Irvine Foundation, the Southern Pacific in its various guises, et al., would be ineligible to receive grants.) Second, nonprofit trusts receiving grants would be permitted to lease only to resident family farmers and cooperatives. In no event could a trust lease farmland to an absentee operator, nor could it lease more than 320 acres of irrigated farmland, or 1,000 acres of unirrigated farmland, to the same family, or double that amount to the same cooperative. In leasing farmland the trust would give preference to people with farm work experience and low incomes. Violation of any of these conditions would be cause for revocation of all grants, with grant money repayable (with interest plus a penalty) to the CLCF. Co-ops and CDCs would be subject to similar restrictions. Third, all recipients would be barred from resale of CLCF-funded land for at least 15 years. After that time, the CLCF would retain first option to purchase at a price not greater than its initial grant.

A particular danger stemming from CLCF grants is that valuable pieces of land (e.g., in the Santa Monica Mountains) would rapidly rise in price once it was known that funds were available to buy them. This might result in windfall profits for a few landowners, as has happened in many public park and urban renewal projects. The problem is probably not as acute as it might seem. The land gains tax would recapture at least a portion of any unearned windfalls, while exerting a downward pressure on land prices generally. Where publicly designated open space areas were involved, legislation could be adopted that would fix payment at full market value as of the date of designation. (Language to this effect was contained in the recent Redwood National Park Act.) With regard to land sought for its economic rather than its scenic potential, there would be enough of it on the market to prevent price-gouging by owners of more valuable parcels. Pressure to enforce the 160-acre limitation and residency requirement in federal irrigation areas could help hold down prices in the Central and Imperial valleys.

Prospects and Problems

What would happen if something like the CLCF were adopted today? Would co-ops, CDCs, and nonprofit land trusts be able to handle half a million acres if they received them, free of debt burden, next week or next year? Sadly, I suspect that the answer is no. There is an immediate, desperate need to improve the management capabilities of community and cooperatively owned enterprises, and to increase the readiness of low-income families to participate meaningfully in such undertakings. Government, university, foundation, and other private resources should be poured into this task.

Politically, however, I think we are much further along than many people realize. Voters in California, their sensitivities heightened by smog, sprawl, and environmental activism, approved a statewide coastal zoning initiative last year as well as numerous local open space bond issues. (School bond issues, meanwhile, were generally going down to defeat.) In the legislature, a bill to create an open space trust fund financed by a transaction tax on land value increments has been introduced by Assemblyman John Dunlap and co-sponsored by Speaker Bob Moretti. The California Tomorrow plan, supported by a cross-section of business and political leaders, envisions a substantial amount of public land ownership. In other parts of the country, interest in open space preservation and land reform of a conservative sort has been growing. The Republican county executive of Suffolk County, New York, recently proposed that the county buy up farmland threatened with subdivision and lease it back to the farmers who are using it. A 1972 report financed by Laurance Rockefeller recommended creation of "public corporations" to acquire land for new town development. Robert Wood, former secretary of Housing and Urban Development and now president of the University of Massachusetts, has said that "public ownership and public planning are probably the essential components for a genuine land reform program."

Many if not most of these "land reformers" see public land ownership as beneficial primarily to profit-seeking new town developers, bankers, and well-to-do farmers, rather than low-income groups, as Geoffrey Faux points out.[8] In my view, public land ownership is not a very promising device for helping poor people, although it's fine for open space preservation. Helping the poor requires that they have more direct access to the land than public ownership per se has provided or can provide. The point, however, is that people are ready, or almost ready, to accept the notion of buying back sizable quantities of land from its present owners. The political task is to make sure that "buy back the land" programs are not used solely for parks and commercial developers, but are also designed to benefit low-income and community groups.

What is necessary over the next few years, it seems to me, is a two-front strategy. On the political front, we must deal with the fact that voters are prepared to spend public money to purchase land for migratory birds, but not yet prepared to do the same for migratory workers. While lamenting and fighting this reality we might as well take advantage of it; there are no other sources of large-scale money for community economic development on the horizon.

I said earlier that a land transfer mechanism such as the CLCF would be politically salable, especially as a ballot initiative. I believe it would be salable because it could be supported by a coalition of low-income minority groups, middle and upper-income people interested in parks and open space, and labor. Its appeal would lie in the fact that it would preserve and create jobs and protect the environment—all without adding a single penny to the sales tax, property tax, or income tax on wages.

The second front involves developing the psychological and managerial capabilities necessary for running new economic structures such as cooperatives, CDCs, and land trusts. This is a much more difficult front than the political one, and a persistent problem over the next few years will be that of timing—how to develop social structures fast enough to keep up with the political gains I believe are possible.

It would be wrong to conclude on too optimistic a note. The forces opposed to genuine land reform are powerful—in Sacramento, in Washington, and in the marketplace. If locally owned economic institutions are to survive, much less to flourish, there must be more than a redistribution of land. There must also be far-reaching changes in federal tax, subsidy, and anti-trust policies. Such changes will be extremely difficult to bring about. It can only be said at this time that the possibilities are there. It is up to us to work strenuously for their attainment.

FOOTNOTES

1. According to the 1969 *Census of California Agriculture* (Washington: U.S. Department of Agriculture, 1972), pp. 106 and 114, Class I commercial farms (annual sales of over $40,000) accounted for 66 percent of the state's farm acreage but used 64 percent of the pesticides.

2. See, for example, Carey McWilliams, *Factories in the Field* (Boston: Little, Brown, 1939); Peter Barnes, "The Great American Land Grab," *New Republic*, June 4, 1971; and the Ralph Nader Task Force Report *Politics of Land* (New York: Grossman, 1973).

3. California is not unique in its concentrated land ownership; the same pattern prevails in other parts of the country. For example, a 1970 study of 14 coal-producing counties in West Virginia found that the top 25 landowners owned or controlled over 50 percent of the land in the majority of those counties. The 7 largest landowners in the 14-county region were all out-of-state corporations: Pocahontas Land (a subsidiary of the Norfolk and Western railroad), Consolidation Coal (a subsidiary of Continental Oil), the C&O/B&O railroad, Georgia-Pacific, Eastern Associated Coal, Island Creek Coal (a subsidiary of Occidental Petroleum), and Bethlehem Steel. Note that 2 of the 7–Georgia-Pacific and Occidental Petroleum–are also among the top 10 landowners in California. For a more complete discussion of land ownership patterns nationally, see Peter Barnes and Larry Casalino, "Who Owns the Land?" *Clear Creek*, December 1972, available as a reprint from the Center for Rural Studies, 345 Franklin Street, San Francisco, California 94102.

4. Davis interviewed by the author. Maltzman quoted by Art Detman, Jr., "Lessons from the National Housing Act," *Saturday Review of the Society*, April 1973. An analysis of the way rising land values inflate the cost of privately developed housing can be found in Edward Kirshner and James Morey, "Controlling a City's Wealth," *Working Papers*, Spring 1973. The two housing experts calculate that if land were owned by residents of a new community rather than by a profit-seeking developer, the cost of new housing could be cut by 23 percent.

5. Additional revenues for the CLCF might be raised through an excise tax on campers, snowmobiles, motorboats, and other recreational equipment, on the theory that purchasers of such equipment are likely to be primary users of recreational land acquired by the CLCF. Similarly, state park entrance fees and concessions rentals could be channeled into the fund. These revenue sources would be considerably more regressive, however, than would the severance and unearned increment taxes.

6. Since not all property in California is reassessed every year, a landowner who had not been reassessed might show a zero or negative increment. If this happened he would not incur a land gain tax liability for that year. In a year or two, when reassessment did occur, he might show a substantial land value increment. He would then have the option of spreading payment out over a three-year period in a manner somewhat analogous to income averaging.

7. The question of what might be an optimum rate schedule would need to be studied carefully. Theoretically, a rate of about 70 percent would be justifiable since, when coupled with state and federal capital gains taxes, a 70 percent tax would fully capture for society what society itself had created. A 22 percent rate would be the equivalent of closing the capital gains loophole with respect to land. This can be seen by considering the example of a land speculator in the 50 percent tax bracket. He buys a piece of land for $1,000 and sells it for $1,200, producing a capital gain of $200. He pays a federal capital gains tax of $50 (half of 50 percent of $200), and a state capital gains tax of about $5. With a 22 percent land gains tax he would pay an additional $44 to the CLCF, bringing his total tax to $99, or nearly 50 percent of his capital gain–the same rate that a wage-earner in his tax bracket would pay.

   In determining the optimum rate level in California or any other state, it would be extremely important to evaluate the effect of the tax on land prices. Any tax on land value increments would automatically slow down the increase in land values. If the tax rate were too high, land values might actually decline, thereby wiping out, among other things, the revenue base of the tax. Whatever the rate structure chosen, it would probably be advisable to phase the tax in gradually.

8. See "Reclaiming America" in this issue.

Preface:

Praxis: Research Institute for Social Change was established in 1969 as an institute committed to social change. The close link of research and action is the core of the *Praxis* approach.

The conference on *Workers' Control and Community Control* held in the autumn of 1970 represents in a way a follow-up to an earlier conference on *Industrial Democracy* sponsored jointly by *Praxis* and the *Ontario Woodswork Memorial Foundation* held in the spring of 1970.

In a very real sense, the work of the second conference took place in workshop. Under the general heading of workers' control and community control, participants to the conference met in workshops dealing with specific areas and functions relevant to their workplace and community: Health; The Media; People and Planning; Education; Workers' Control and the Unions; Workers' Control and Collective Bargaining; Community Control and Social Welfare; Cooperatives — these were some of the worshops which met during the weekend of October 30 to November 1, 1970.

Several of the workshop have been instrumental in giving birth to ongoing projects.

We want to express our gratitude to the many organizations and individuals who assisted us in organizing and planning this conference. We wish to thank, in particular, the International Forum Foundation and several trade unions for their generous donations.

Whatever success this conference can claim for itself is due to the active involvement of the participants, the resourceful people and the speakers.

Note: *Organizational affiliations of contributors are listed for identification only.*

WORKERS' CONTROL IS MORE THAN JUST THAT

by André Gorz

WHEN we speak about workers' control we usually have some very different things in mind. Some of us see workers' control as an end in itself, i.e., as something that can and that must be won within the framework of the capitalist system, so as to improve the situation of the working class. On the other hand, part of us look at workers' control as something that will never be won as long as capitalism prevails, and that must be fought for precisely that reason. According to this second view, which I personally share, workers' control is not an end in itself: it is mainly a means or method, a means which foreshadows more farreaching aims and aspirations, a means whose true significance can be understood only if we place it in a strategic perspective of social and political revolution.

In one word, you probably have deeply diverging views about workers' control. Some may want to fight for it because they are reformists; others may want to fight for it because they are revolutionaries. I think there is no point trying to hide conflict. It is a conflict which must break out openly and be openly discussed. Only by open discussion and confrontation will we be able to find out which is the right method of struggling. Indeed, it must become quite clear that workers' control as seen by reformists is not at all the same thing as workers' control as seen by revolutionaries and that the methods of the reformists and of the revolutionaries are in complete contradiction.

I'm saying these things because I want to be quite frank from the start. I do not intend to deliver a theoretical lecture about strategy. I'll

rather start by giving a few examples to illustrate why and how the issue of workers' control has become so relevant in recent class conflicts all over Europe, and also to show why long drawn out struggles for control have never and nowhere led to complete success.

There were times when the working class could act on the assumption that there were heaps of ready cash in the bosses' safes or the corporations' banks. Traditional union action rested on the hypothesis that the empoyer, if pressed hard enough, will eventually give in and grant higher wages and better working conditions. Traditional working class action assumed the corporation's finances and the system as a whole to be flexible. But this assumption no longer holds true. Flexibiilty has been organized away and replaced by rather rigid planning of all the factors on which production depends. Thus :

— the quickened pace of technological innovation calls for advance planning of the corporation's future investment;
— the greater weight of fixed capital compels long term financial planning of amortization, depreciation, reserves and financial costs;
— increased international competition forbids unforeseen higher costs to be offset by higher prices;
— rigid financial planning also calls for rigid predetermination of labour costs.

This overall rigidity of modern management policies tends to jeopardize the traditional bargaining power of labour unions. Wages nowadays tend to be predetermined; and not only wages, but also the working process itself. Therefore, management tends to react very sharply to unforeseen wage demands that would jeopardize the corporation's financial planning. Unplanned wage demands tend to be considered as a direct attack on the logic and the balance of the capitalist system. Both management and the State tend to fight such demands by accepting a trial of strength and head on clashes with the working class.

Of course, if we fight hard enough, we can force the corporations to give us a little more than they would like; we can temporarily throw the capitalist system out of balance and make small inroads into the plans and the profits of corporate capital. But experience has taught us that this kind of success can be temporary only. Within a relatively short time, one of two things will happen :

(a) capitalists may consider that the profits which the new wage rates leave are not attractive enough and that they, the capitalists, have not sufficient power to take away from the working class what it has just won. In such a situation, the bourgeoisie will close down plants, fire part of the workers, organize a recession : capital will go on strike and wait until the working class is sufficiently weakened to become submissive again.

(b) the alternative to this extreme solution is more common : within a relatively short time, capitalists will restore what they consider to be attractive rates of profit taking away at least part of the wage increases which were won.

There are various ways of taking them away. For example :
— rising prices will reduce real wages;
— work will be intensified and part of the workers laid off :
— those who remain will have to work faster and harder;
— the work process will not only be increased, it will be "rationalized", which means : new equipment will be installed, skilled work will be replaced by unskilled work, the evaluation of skills and of jobs will be made according to new criteria.

In a word, workers will be made to pay dearly and heavily for their increased wages. Their subjection to the so-called scientific organization of the work process will become more and more rigid.

As you know, the new time and motion measuring systems break down the act of working into minute motions and don't allow for individual variations in work speed, nor for any kind of individual bonuses of any importance. Wage rates are negotiated when the system is introduced and are not open to revision. Management is intent on making long term deals with the union and on using the union as a kind of police that will see to it that the workers fulfill their part of the bargain. Wage increases are planned in advance as part of the deal and shop floor rebellion against working conditions tends to be answered by lock-outs.

Thus scientific management is closing the trap on the workers. We are now finding out that in the past the process had an artisan quality to it : work speeds and piece rates could be tampered with to a certain extent. But no longer. Management policy has become global and so has the subjection of the workers. Working conditions tend to be rigidly predetermined and cannot be influenced any longer by individual meddling.

Workers thus will remain at the complete mercy of despotic and arbitrary managerial decisions unless they win sufficient power on the factory floor to refuse new work speeds, new definitions of skills and of rates : **unless, in other words, they win direct power over the work process.** That is what workers' control is mostly about, at first sight. We need control over the working process in order to prevent managements from taking away from us with one hand what they grant with the other hand. We need control, of all, for strictly economic reasons, so as to counteract the power of management to impose more and more exhausting work and deteriorating working conditions in exchange for some meager wage raises. But if this is so, then it also must be quite clear that the struggle for control will be even fiercer, even more merciless

than the struggle for wages. The struggle for control, even more than the struggle for increased wages, aims at checking the profit which capital can make on labour. Therefore management will fight demands for control with all overt or covert means. In the same way as management will grant higher wages when they can't help doing so, only to try and take them away at a later stage, in the same way management may grant, at certain moments, powers of control only to try and destroy these powers at a later stage, either by force or through manipulation. Control is not something that can be won once and forever. It is something which, once won even partly, will have to be defended in ceaseless fierce battles, or lost again. Genuine workers' control is something intolerable to capitalist management, however enlightened it may pretend to be, because genuine workers' control attacks the very source of domination and exploitation of labour by capital.

An important point, for the moment, is to emphasize that the struggle for workers' control is of necessity an extremely bitter struggle which cannot be won and which cannot even be waged within the traditional frame work and ideology of the Unions.

To make this point clear, I'd like to submit a few critical considerations about the history and the limitations of the Union movement. Originally, the Unions developped out of the workers' need for self-defence and self-organization. At their beginnings, when they were still genuine organs of the workers' self-organization, Unions tended to be quite radical. We still witness this radicalism wherever a new Union is built up from scratch through the initiative of rank and file militants. This happened in recent years in Detroit with the DRUM and the Revolutionary Black Workers' League.

This type of revolutionary and politically radical union movement, however, has become something exceptional. Overall, the big national Unions everywhere are nowadays institutions who see it as their task not to overthrow nor even to question the capitalist system, but to defend the interests of the working class within the frame work of the capitalist system. This change of attitude, of course, can be historically explained: for decades, there was no concrete prospect for a proletarian revolution in the West. The working class proved incapable of overthrowing the system. Top union leaders understandably felt that it was pointless to insist on revolutionary demands that could not be pushed through in the absence of a revolutionary situation. Though some of them did not completely discard the hope that such a situation might arise again, they thought it was realistic in the meantime to fight for things that could be won right away, such as better wages and some improvements. The intelligent capitalists openly or discreetly encouraged this realistic attitude: bargaining over demands is cheaper than fighting over them. Fundamentally, then, corporate capital became reconciled to the existence

of labour unions and showed willingness to recognize them officially, but on two conditions:

1. Unions must voice demands only that are realistic, that do not call capitalism into question, that are **negotiable.**

2. Once an agreement has been bargained out, unions must stick to it and prevent the workers from breaking it.

Wherever these two conditions have been accepted, labour unions have turned into permanent institutions holding legal rights and responsibilities: they have become permanently structured and therefore hierarchical and bureaucratic organizations; they hold tremendous bargaining power, but they also hold the power to discipline and to police reluctant workers. As institutions holding institutionalized power within the capitalist state, union bureaucracies of course showed less and less inclination to jeopardize their self-interest by stimulating demands and aspirations that are incompatible wth the logic and the power structure of the capitalist system. Demands that could not be won by bargaining and by juridically defined forms of action, were considered pointless. Demands that have no chance of being accepted by capitalist managers were thus eliminated from the outset. They were eliminated because top union leadership would not engage in risky and losing battles. Realism thus led union leaders to translate all demands that sprang up from the rank and file into propositions that would prove acceptable and negotiable by the representatives of Capital. The objective function of labour unions has thus become a function of ideological and political mediation.

Union leadership has become a conservative force.

Now, the question which we must ask ourselves is: can this type of centralized and bureaucratized unionism wage an effective struggle for workers' control? The answer to this question is an emphatic "No". Labour unions that feel responsible for discipline at work; labour unions that feel responsible to the capitalist managers for keeping the factories going; labour unions that commit themselves not to resort to strike action as part of the bargain they have entered; in one word labour unions that behave as institutional mediators within the capitalist society, are inherently incapable of leading an effective struggle for rank and file demands for control — except if control itself can be institutionalized and controlled by and subordinated to regulations that will make it ineffective. This is a point which has been well documented in Western Europe as well as in the United States.

Of course, some people will object that the labour unions' leadership has become conservative and timid only because the working class itself is apathetic. Union bureaucrats everywhere, including my country, like to assert that the masses would not understand and accept a more

aggressive and combative union policy. Facts prove these assertions to be false. The truth is that the bureaucratic machines of institutionalized labour unions are very much afraid to lose control over the working class since the unions draw their institutional force and bargaining power from their ability to keep the labouring masses under control. Most top union leaders are frightened at the wild and uncontrollable demands and outbursts that would explode from the rank and file if the workers were free at any moment to gather and to discuss and decide what their grudges are, what they wanted to do about them and how. And this is precisely what would happen if genuine workers' control were fought manently from below without control and mediation from above.

At present and as long as the centralized and bureaucratic structure and organization of the big unions will persist, it is practically impossible to know how the working class really feels about its condition in the factories, offices and in society. The impressive number of wildcat strikes which have been developing in recent years do however point to the fact that an untapped potential of combativeness and of radicalism exists, a potential which the traditional structure of labour unions tends to repress. Let me give you a few examples of this.

In Great Britain, e.g., more than 80% of all strike actions in recent years were wildcat. These strikes were and are called by shop stewards, not by the unions themselves, on issues relating to wages and to workers' control. Some people of course will say that these issues are always specific and do not prove great radicalism and class consciousness. Quite true: after all, more than half of the British working class vote Conservative.

The question we must ask, however, is: what political and class consciousness would the working class have if their national organizations were as democratic and as aggressive as the elected and revokable militants on the shop floor? We have no idea about this, but there is an interesting story which I'd like to tell you about the dangers of taking so-called working class apathy at face value.

In the early '60's, a British professor of sociology by the name of Goldthorpe made an extensive investigation of the Vauxhall workers at Luton. He wanted to find out what class consciousness they had left, how they felt about their work, about wages, about life generally and what chances there were that acute conflicts should break out in a well-managed and advanced factory. Professor Goldthorpe had about 80% of the Vauxhall workers interviewed individually. His investigation lasted two years. His conclusions were very optimistic: he found the Vauxhall workers to be completely integrated into the system. They had, so he said, no deeply felt grudges. They were rather satisfied with their wages.

They neither liked nor disliked their work; they looked at it as a rather boring but inevitable part of their life. They didn't want to give it much thought. Their general attitude towards work, according to Professor Goldthorpe, was to perform it so as to get rid of it; they wanted to forget about it at the end of the working day, to go home, to watch television, to grow vegetables in their garden, to fiddle around in their homes. Their working life was rather marginal to them and what really mattered to them, was their life at home, which was their real life.

Therefore Professor Goldthorpe concluded that class consciousness was practically non-existent at Vauxhall's, that the workers were behaving according to middle class patterns and that class struggle belonged to the past.

The Goldthorpe report was still at the printer's when a few militants got hold of a resumé of Professor Goldthorpe's conclusions. They had this resumé mimeographed and handed out a few hundred copies. A week or so later; the Daily Mail printed a report about the profits that had been made by Vauxhall. The net profit for that year amounted to about F900 on each worker, and this net profit had been sent back to General Motors in the U.S.A. This piece of news also was circulated among the workers. The next day, something happened which the **Times** reported as follows:

"Wild rioting has broken out at the Vauxhall car factories in Luton. Thousands of workers streamed out of the shops and gathered on the factory yard. They besieged the management offices, calling for the managers to come out, singing the 'Red Flag' and shouting 'string them up'. Groups attempted to storm the offices and battled the police which had been called to protect them." The rioting lasted for two days."

Now this is what happened in an advanced factory where the union was strong and where 80% of the workers had been interviewed and been found to lack class consciousness. What does it all mean? Does it mean that Professor Goldthorpe was stupid? It certainly means that Goldthorpe made a major mistake: he interviewed each worker separately and found each worker to be individually resigned to, if not reconciled with, his condition. And then he concluded that all these thousands of individual resignations made for a collective apathy. And then something happened which he had not thought of: all these workers who had said individually "that's how life is, there is nothing much that can be done about it", all these workers started to discuss things among themselves. They started to discuss them because the conclusions of Mr Goldthorpe were circulated in the factory. And as they discussed things, they found out that all felt alike: they felt apathetic but frustrated; they were apathetic because, as individuals, in their individual isolation and loneliness, no one could do anything to change things. But when people

start talking about their loneliness, their frustration, their powerlessness, they cease to be isolated and powerless. They start melding into a group which holds immeasurably greater power than the added up power of all those who compose it.

In other words, it was the very investigation of Mr. Goldthorpe about the lack of class consciousness which helped tear down the barriers of silence and of isolation that rendered the workers apathetic; it was the Goldthorpe investigation which stimulated an explosion of class consciousness and combativeness.

This is by no means an isolated example. As a matter of fact, wherever extensive interviews and investigations have been made inside factories, these investigations have been followed within a very short time by violent outbreaks and spontaneous strikes. What happened at the Vauxhall works in Luton also happened at the Firestone plant in Oslo, (Norway). It also happened at the Ford plant near Cologne (Germany), where the head of the local union had complained for years that wages, working conditions and labour relations were so good that there was nothing much that the union could do in the factory. It so happened that the head of the Ford union died and was replaced by an inquisitive young militant. This new man decided to have a more thorough look at things. He handed out questionaires, inviting the workers to say freely how they felt about a variety of issues: about working conditions, about working speeds, about piece work, about the foremen. The replies were devastating. The immense majority of workers complained bitterly about the working speeds, monotony, nervous exhaustion, about the lack of breaks, about the despotic behavior of the foremen. A summary of the replies was circulated. And a week later, when management announced that the assembly lines would have to be sped up provisionally, just for two days, the whole factory broke out into a strike for the first time in fifteen years.

The same kind of story could be told about the Alfa Romeo car factory at Milan (Italy), about the shipyards at Genoa (Italy), about the Pirelli tire factory at Torino (Italy), about the steelworkers at Dunkerque (France). What does it all mean? First of all, it shows that when workers are given a chance to discuss and decide among themselves in open gatherings, the grudges and the claims which they want to voice, their demands and their methods always prove more radical than what top union leadership has expected. Free discussion and exchange within the rank and file about factory life almost inevitably lead up to violent outbursts of protest and to unforeseen strike action.

What lesson are we to draw from this? The lesson, I suggest, is that a potential of frustration and of revolt lies permanently dormant within the working class and that, in so-called normal periods, no one knows

how deeply the working class feels oppressed, exploited, frustrated, and dominated. No one knows about it normally: neither the union leadership, nor the workers themselves. We do not know about it because there are no words to convey and to make clear how we feel. We have no words to speak about our oppression, our distress, our bitterness and our revolt against the exhaustion, the stupidity, the monotony, the lack of meaning of our own work and of our life; against the contempt in which our work is held; against the despotic hierarchy of the factory: against a society in which we remain the underdogs and in which goods and enjoyments that are considered normal by the other classes are denied to us and are parcelled out only reluctantly, as though they were a privilege. There are no words to say what it is and how it feels to be workers, to be held subject, to be ordered around by people who have more and who pretend to know more and who compel us to work according to rules they set and for purposes that are theirs alone. There are no words to say all this because the ruling class has monopolized not only the power of decision-making and of material wealth; they have also monopolized culture and language. They are not only taking away from us our strength, our health, our labour and the meaning of work; they also take away from us the means to communicate, including the words, the language we speak. There are no papers, no movies, no books about factory work and life. The work and life in the factories — and also in the huge offices — is something this society doesn't want to hear about. For decades the ruling class has sentenced the working class to live in terrifying silence. They have sentenced the working class to be prisoners not only of rules and laws that cannot be discussed or questioned, but also to be prisoners of an estranged language, of a language which is pervaded with values and with an ideology in which there is no room for working class feelings and values.

It is because the working class is silenced that explosions of discontent always come as a surprise and always are violent. It is because there are no words to express desires and no means to make them come true that a resort to violence is a way of saying: enough is enough, we won't play by the rules any longer, we won't take any more of it. Violence is the first and necessary step by which the oppressed refuse their oppression. Violence expresses effectively a total and immediate refusal of the established order and of its discourse. But sporadic violence remains a substitute for the effective destruction of this order. Last year, after days of violent strike action and street riots, the Fiat automobile workers at Torino invented a magnificant slogan. It said: "What do we want? Everything." All right: we want everything right away, we want to overthrow capitalism, abolish all inequality, build a society of equals, we want to change life. But how do we go about it? Outbursts of violence are but the first and indispensable step toward it. But they are not enough. They liberate us momentarily but they don't

change things. Changing things requires effective and sustained action, and sustained action requires a method and an overall view as to the ends and means of struggling.

So then, we have to ask again, what are we really fighting for? What does workers' control really mean to us? I submit that it means much more than improving working conditions in this or that factory without changing anything else. To make this clear, let us assume that we work in plants and offices that produce napalm for the war in Vietnam, miniature radio transmitters for the C.I.A., canned food containing chemical additives that may damage peoples' health, pornographic magazines. Are we capable of saying something like: "I don't mind producing napalm and pornography as long as it pays and as long as the job is not too hard"? I suggest none of us is capable of saying such a thing, though many of us are actually engaged in doing such things. How can this be explained?

The explanation, I submit, lies with the division of labour. Labour is divided both socially and technically. It is divided socially insofar as there are those who have wealth, power and higher education and who make the decisions; there are those who have only a higher education and who loyally serve the powerful and get certain privileges: and then there is the mass of those who have no wealth and no education, or a technical or specialized training only, and who fulfill the sharply defined and rigidly predetermined tasks which they are given. There can be no question about not fulfilling the task: the worker must take it or leave it. He is compelled to do it not because someone is ordering him to do so, but because the process of production has been organized in advance so as to give each labourer one precise and narrowly limited job to do without any possibility of change. This sharp limitation and narrow specialization of jobs does not mean that there is no place for initiative and responsibility; the job may call for inventiveness, hard thinking and sustained concentration. But things are organized in such a way that no one knows enough about the other aspects of the process of production to be able, at his job, to wonder what he is really doing; things are organized in such a way that no one, at his job, is capable of taking initiatives and making decisions that would call the overall process of production into question. In other words, every job holder is a cog in the machine; every job holder is responsible only for the work that is assigned to him and not for the overall product that will grow out of it. Responsibility for the overall product lies with a handful of top managers only; and once they have made their decisions, they organize and divide the work process in thousands of fragmented and predetermined little jobs so as to have everyone comply with their decisions without really knowing what they are all about.

In one word, the technical division of labour, that is, the way in which the jobs are parcelled out, is not only an organization of production: it is also a technique of domination, a device to keep workers ignorant and to keep them in subjection. This is ever more true nowadays than fifty or one hundred years ago. Nowadays, the tremendous increase in the productivity of labour and the potentialities of automation make very possible a total and radical transformation of the work process: repetitive jobs could be abolished in most places; where they cannot yet be abolished, they could be perfomed alternatively and for short periods only by everyone; multilateral training and comprehensive education could be made accessible to all; the barriers between manual and intellectual work could be torn down; rotation of jobs, collective debate on and responsibility of the methods of production and the quality of products could be made the rule. Free time could be tremendously increased and become socially creative if waste, parasitism and militarism were eliminated. All over the advanced capitalist world, the working class as a whole has and each worker individually has much more insight, skill, knowledge, know-how and creative capacities than they are allowed to show in their jobs. All over the advanced capitalist world, an unbearable discrepancy develops between the stupidity, fragmentation and irresponsibility of jobs and the actual or potential creativeness of job holders. It is an obvious fact that capitalist management cannot call upon the creativeness of the working masses: this would be incompatible with the right of hiring and firing people, to which management clings. Why should the masses put their creativeness at the service of bosses who will make the workers unemployed if they become more efficient and more productive? Why should reduced costs and increased efficiency be our concern if what we produce is wasted, if there aren't enough jobs for all, if our right to earn a living is made dependent on our willingness to make useless and destructive things like weapons, fin tails and moon rockets? Why should we want to be creative in our work if it doesn't serve the needs of the people, but only the need of Capital for growing profits?

Capitalist management dare not call upon the creativeness of the masses for fear of having all these questions explode. To prevent them from exploding, the division of labour is so organized as to make people feel more ignorant and incompetent that they are, so as to keep them in subjection and to divide them by arbitrary barriers and differentiation of status and salary. The difference between skilled and unskilled workers, between workers and technicians, between technicians and engineers, is arbitrarily created as a technique of domination and of fragmentation of the working class. Everyone knows from experience that this hierarchic division is irrational and senseless, that there is no such thing as a hierarchy of competence, that the competence of a worker is not **smaller**, but only **different** from the competence of a technician, that

wage differentiation does not rest on merit, on performance, on efficiency, but on social criteria, and that education serves much less to increase a man's competence in production than it serves to breed social attitudes and conformity to the values and ideology of capitalist society. It is not only from certain famous and inspiring Chinese examples that we know workers can be even more helpful and efficient than engineers in improving the quality of machine tools or the process of making steel.

In my view, when we speak of workers' control, we speak of the capability of the workers to take control of the process of production and to organize the working process as they think best. To organize the work process in such a way as to stop it from being oppressive, mutilating, soul-destroying and health-destroying; to organize it so as to allow for the maximum display of each worker's initiative, responsibility, creativeness; to organize it so as to replace forced labour and authoritarian division of labour by free cooperation.

Ultimately, there is no difference between workers' control and workers' power. Workers' control is one step, a first and partial step towards seizing power within and over the process of production. The struggle for workers' control is a struggle for power and therefore it can be waged effectively only if it demonstrates in itself our capacity of exercising power over the process of production. To demonstrate this capability, there is no need to wait for anyone's approval or agreement. There are recent examples, in France and Italy, where workers started rotating and swapping jobs which they considered to be interchangeable, though 14 different wage rates were applied to these jobs. And they demanded equal pay for all. There is the famous example of the Pirelli tire factory at Torino where the 5000 workers of a huge complex plant established new work speeds without any technician's or engineer's help and had the whole factory run clockwise at varying speeds, just to prove that they were capable of making it function smoothly their own way and that piece rates were nonsense. The notable "reverse strikes" in Western France and in Japan, showed that public transport workers on strike could make public transportion a free service.

In all these and many other instances, the workers did not demand control as something that can be granted to them by the bosses; they struggled for control by simply taking control of the factory or of the shop and by having it function their way. Indeed, control is not something to be asked for and given : it is something to be taken.

Therein lies the great superiority of struggles for control over traditional trade unionism. A strike for control is different from all other strikes because strike action in itself is already an exercice in workers' power. It is different from traditional strikes because the workers don't go home and wait until their spokesmen have made a bargain with management. In a strike for control, the separation between spokesmen and workers,

between the delegates and the masses tends to disappear. In a strike for control, the masses themselves, the workers' assembly decide what can and must be done here and now. Such strikes are exercices in workers' democracy, in workers' self-government and self- determination. They produce their organs of self-government, like workers' councils and workers' committees, committees that are responsible only to the general assembly of the workers, delegates that can be recalled at any moment. All forms of bureaucracy, of representative democracy, of delegation of power are liquidated in these moments of self-organization and of direct democracy. In such moments, repressed needs and aspirations explode; the working class experiences its ability to master and modify the work process. It refuses domination by management and by the State as well as by Union or Party bureaucracies. It undergoes, in one word, a revolutionary experience; and if action lasts long enough; if it is not stifled by bureaucratic control from above; if the workers who gather and debate freely in open assemblies have time to produce new leaders and vanguards, workers' councils will spring up which are the specific organs of collective, revolutionary self-organization and of collective power.

But neither the workers' councils, nor the factory or shop committees, nor the workers' power they stand for can prevail unless the political power of capitalism is broken, unless the capitalist state itself is overthrown and the capitalist relations of production and division of labour abolished. The struggle for workers' control must develop in an all-out attack against all forms of hierarchy, against all forms of monopolization of power and of knowledge, against all forms of domination and of bureaucracy, including the so-called socialist state bureaucracy, or whatever power the workers have won in action within the factories will be broken and rendered meaningless in a very short time.

The workers' councils and committees that spring up during mass action and wield effective power over the production process, these councils and committees cannot become lasting organs of dual power within the present system. They cannot coexist for long with the power of capitalist management and of the capitalist state. They can coexist with them only antagonistically, in periods of acute struggle that must take the form of a trial of strength. If such a trial of strength is not rapidly won by the working class; if it is not carried forward by political vision and organization; if it does not tanscend itself into a generalized all-out offensive for a completely new society, then the organs of workers' power or workers' control must inevitably degenerate.

As we have seen recently again in Italy, there can be no protracted draw, no uneasy truce between organs of workers' power and the power of capitalist management. There can be no coexistence between these two opposed and unreconcilable powers because their trial of strength, if it is not won all-out by the working class, must end up in bargaining

and in a settlement. And a settlement will only be accepted by management if its terms fit into the logic of capitalism and allow management to win back undisputed power. Moreover, settlements are necessarily compromises, compromises must be negotiated and negotiations cannot be conducted by the workers themselves, but only by delegates speaking on their behalf. These delegates may win some improvements and some new rights for the workers. They may win token rights of control on behalf of the workers. But the right of workers' control by the workers themselves will never be won within the present system. It will never be won because, as I said above, the present division of labour splits up the workers of any factory, differentiates them hierarchically, isolates each group from all the others, prevents the free flow of communication, plunges each individual in harrassed loneliness. All the capitalist firm may be willing to grant is control by appointed delegates on behalf of the workers. But delegated power of control is something totally different from direct collective power. Delegation gives rise to a new group of mediators who will tend to be offered privileges, bureaucratic and institutionalized status, so as to keep the workers under their control.

You may then ask : what then is the point of fighting for workers' control if it is realizable only in a different social system ? The answer is twofold :

(1) As Max Weber said, it is only by pursuing the impossible that we will make what is possible come true. It is only by fighting for genuine workers' power as we see it that we will corner management into granting us rights and conditions that would never have been granted if we kept asking for it politely and reasonably. Token rights of control are better than nothing if we are able to use them to keep the fight going for full genuine rights. Improvements such as job enrichment are better than nothing if we are able to use them to keep questioning and fighting the division of labour everywhere. And they are better than nothing because workers who are not intellectually, morally and nervously destroyed by work will be ready for more advanced struggles involving their way of life inside or outside the factories.

(2) And an even more important point is the results of the struggle for workers' power cannot be measured by its immediate outcome. The main result of this struggle is that it changes people, it changes ourselves. It is something like a self-educational process. Through it, we discover the working class' capability of self-organization, of self-determination, of control over the production process. We discover that workers are by no means as incompetent as the division of labour wants to make them feel, that competence is, to a large extent, a myth maintained by those who rule us and by an educational system which is instrumental in dividing people, not in educating them.

Every struggle for workers' power that involves large numbers of people; every struggle that results in the formation of workers' councils

and committees, in open assemblies, in free debate, in the exercise of direct democracy and of collective power, every such struggle prepares the working class to become the ruling class and to abolish all extraneous forms of power from above.

Of course, the genuine organs of workers' power that spring up during struggles will not and must not outlast every struggle. They will wither away when the battle is over, when a compromise has been made. But they will spring up again more powerfully at the next opportunity. They will have formed new militants and new natural leaders. They will be indispensable organs of dual power during and after a socialist revolution. They will be necessary if we want to build a socialism in which the state withers away, in which political power is checked and balanced by the direct democracy of the councils.

All this, of course, leads us far beyond the question of workers' control proper. But I think we have to look beyond and put the struggle for control in a strategic perspective. Without such a perspective, without a political instrument that will link the struggle for control to the struggle for workers' power in and over society, this struggle cannot go beyond the stage which it has reached in Great Britain and in which it has been blocked for years : an uninterrupted chain of wildcat strikes which effectively paralyzes production and effectively weakens British capitalism, but without changing the pattern of production and the class nature of society.

If we want to go beyond this stage, we need a political, strategic and theoretical vision and an instrument for producing it and for co-ordinating struggles.

INDUSTRIAL EFFICIENCY UNDER MANAGERIAL VS. COOPERATIVE DECISION-MAKING: A COMPARATIVE STUDY OF MANUFACTURING ENTERPRISES IN ISRAEL

The development of industrialism has been accompanied by managerial-hierarchical control over industrial work. Indeed, it has been generally assumed that industrialism and managerialism are necessarily linked, that each is in some way necessary for the other. It is not only of historical interest to know whether this association merely reflects parallel development or involves a necessary interrelation. In contemporary social thought, a mystique of technological determinism is often seized upon to explain or criticize social phenomena. Thereby, responsibility for the character of the industrial corporation and its consequences is assigned to technology (e.g., the computer). Man, individually and in groups, is viewed as the servant of the machine, the latter being endowed with initiative and direction of its own. The machine Golem dominates the scene, shapes society, and leaves to each man only the task of adapting himself to the social forms that are machine-dictated. Since the managerial mode of industrial organization is seen as a prime example of technology-determined social form, the intelligent man's problem is, essentially, how to adapt to managerial organization. One aim of this paper is to challenge the mystique of technology-determined social form in the organization of production.

Engineers and administrators in modern industry have a different perspective from that of the mystique of technology. They have a well-developed tradition for selecting among alternatives in production methods and hence know that men shape technology by the criteria that are applied in designing technology. With respect to modes of decision-making, however, the concept of major alternatives is underdeveloped. The textbooks and handbooks on the organization of production give no instruction on other than managerial styles of administration.

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*Professor of Industrial Engineering, Columbia University. This article originally appeared in Studies in Comparative Economic Development (Beverly Hills: Sage Publications, Inc., 1969).

Little attention is paid to the possibility that alternatives to managerial control may compare favorably in economic efficiency and/or be desirable on other grounds. Yet, in American industry the number of administrators has risen steadily, per 100 production workers, from 10 administrative employees in 1899 to 38 by 1963. Moreover, this growing cost of decision-making has not been necessarily correlated with growth in productivity.[1] Hence, it is reasonable to expect that as the rising cost of managerial decision-making becomes onerous, someone will be interested in developing less costly ways of making production decisions.

Also, managerial control has included qualities of competitiveness and expansionism that are disliked by many people as ways of interpersonal relations. But if these qualities are integral to managerialism which, in turn, is viewed as essential to modern industry, then there would seem to be little choice - except to discard industrialism itself.

A related issue occurs in the developing countries where there are options with respect to the selection of types of industry and industrial processes. What are the options, if any, with respect to the organization of production, with respect to decision process? Or, are there substantially none? Does the introduction of industrial production require the use of the managerial-hierarchical mode of decision-making? This paper is intended as a contribution toward broadening perspectives on options for organization of production.

Managerial vs. Cooperative Decision-Making

Apart from relatively primitive societies, the managerial mode of organization is clearly the dominant one, worldwide, in private as well as publicly owned enterprise. The managerial mode of decision-making may be identified by three primary features. First, there tends to be an occupational separation between decision-making and producing. Especially in firms beyond the workshop size, those who mainly do decision-making have distinctive occupational roles from those who primarily do production work. This differentiation is reinforced and formalized by unionization, for then the "bargaining unit" differentiates those who do the production work from those who do decision-making. A second feature of management is the hierarchical organization of decision-making. At the peak of successive layers of fewer and more powerful decision-makers, there is the final decision-maker, the person whose decision cannot be vetoed by anyone else. A third feature of managerial organization is the built-in criterion of enlarging the scope and intensity of decision-making as the priority objective for the enterprise. In this perspective, money making is the form

of profit is a necessary, but not a primary objective in its own right.

What sort of alternative is conceivable--as against the managerial mode of decision-making so defined? First, decision-making could be done by those who also do production work. This is feasible especially as decision process is differentiated between particularized decisions concerning details of work, and condition-setting decisions which define major goals, criteria for design, or limits (like product class) within which an enterprise is to operate. Thus, decisions about the choice of class of products, or decisions about major capital expansions are made infrequently. All persons in an enterprise have a stake in such choices and can conceivably participate in making them. Once defined, such condition-setting decisions become the boundaries within which detailed operating decisions can be made by administrators and technicians. In a non-hierarchical organization, work assignments, including the administrative and technical posts, can be subject to final decision, including removal and replacement, by the general body of persons engaged in an enterprise. Finally, it is conceivable to operate industrial facilities according to primary criteria like providing useful work and regulating volume of output to serve specified social priorities--instead of profit maximization or extension of managerial control.

These analytically abstracted constrasts in types of decision process define key elements of a cooperative as against the conventional managerial mode of production organization.

A Comparative Study in Israel

Such variation in mode of decision process is found within Israel where, in addition to a considerable population of industrial firms under managerial control, there is also a population of 170 industrial enterprises that are operated under a cooperative decision process. The latter group of enterprises are located in the cooperative communities called Kibbutzim. There are 230 such communities in Israel* of which 170 operate industrial enterprises with 20 to 250 persons working in each unit. These cooperative enterprises use modern machine technology and techniques and are engaged in a broad

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*Total Kibbutz population: 1949-63, 500; 1964-80, 900. Annual Statistical Abstract of Israel, Central Bureau of Statistics, Government of Israel, Jerusalem, 1949, 1965.

array of manufacturing industries: metalworking, chemicals, various types of machinery production, tools, home appliances, woodworking, food processing, instruments, electrical goods, plastics, and others.[2]

In view of the wider theoretical interest in the problem of alternatives for decision-making on production, I decided to inquire into the comparative industrial efficiency of enterprises operating under managerial as against cooperative control. How efficient can an industrial enterprise be under cooperative control? In terms of accepted criteria of labor and capital productivity, and profitability, can there be an efficient alternative to managerial control over industry?

In Israel, such an analysis could be performed within one country. Thereby two sets of industrial enterprises could be examined, differing markedly in organization, but all operating under similar conditions of language, government, currency, markets, prices, types of population engaged in the enterprises, and the like. Accordingly, after 1963 I did the necessary field work in Israel with the cooperation of the Israel Institute of Productivity and the Kibbutz Industries Association.

It is well-appreciated that there is some degree of variation among nations in "styles" of industrial administration. However, average national industrial efficiency, as in productivity of labor and capital, is determined decisively by relative costs of labor and machinery to industry, which, in turn, regulate the cost-minimizing intensity of mechanization. It is significant that Israeli industry is permeated with personnel trained in the United States and Western Europe, and the Israel schools of business and technology emulate the same models, as do industrial associations and others who have continuing access to the literature of modern industrial management. From this standpoint, therefore, Israeli industry shares in the knowledge and practices of western industrialism.

The criteria for the selection of enterprises for this study were that each should represent a technically modern industrial operation, including substantial capital investment, and producing standard products for sale in an open market. Of course, it was essential that the enterprise administrators in each case should make available the required data for analysis. In the case of the Kibbutz enterprises a special criterion was applied: Kibbutz enterprises that involved more than about 10 percent of hired employees were not to be included in the sample. During the last years, numbers of Kibbutzim, endeavoring to enlarge their industrial output, sought to employ persons on a temporary basis. This

arrangement sometimes continued. Since this introduced an employment relationship in what was formerly a cooperatively operated enterprise, industrial units that had this characteristic were excluded from the sample.

Procedure

About 25 industrial enterprises were contacted, and it was possible to develop a paired sample of 12 enterprises, 6 of them under managerial control and 6 under cooperative control. These enterprises were matched with respect to industry and product. It seemed important to include in each group enterprises that produced similar products, hence using similar raw materials, similar manufacturing technologies and processes, and selling their products in similar markets.

The list of industries represented by these two groups of enterprises, and the capital investment in each enterprise are shown in Table I. The plants manufacturing tools mainly made metalworking tools. The manufacturers of instruments produced equipment for commercial and home use. The diecasting shops in the sample were mainly engaged in zinc diecasting. The plastic plants produced diverse products by plastic moulding. The two machine shops in the sample were mainly operating batteries of automatic screw-machine lathes. The canning factories both processed comparable sorts of locally grown fruits and vegetables.

In terms of capital invested, each type of enterprise led in three industrial pairs. However, the median capital investment was £I, 847 for the managerial firms and £I, 1,866 for the Kibbutz factories. (The large size of the managerially-controlled diecasting plant produced a substantially larger mean value for capital investment in the managerially controlled enterprises as a group.)

The enterprises under study were selected by a purposive, stratified sampling method. It was necessary to "pair" the enterprises by industry (product class) thereby requiring a selective dropping of "unpaired" firms. The resulting sample represented a variety of industries, industrially important product classes, and diverse technologies and skills. This sample was selected solely on the basis of industrial type and without any _a priori_ knowledge of operating characteristics of individual enterprises. Each enterprise is an independent entity. The data from each enterprise came from the ordinary records of operations which were checked for comparability of definition of data categories. Moreover, the data came from unpublished records, which were examined after the sample was

Table I

Capital Investment of Each Matched Enterprise in This Study

	(ЬI 000's)	
Industry	Managerial Decision-Making	Cooperative Decision-Making
Tools	942	647
Instruments	753	8,393
Diecasting	20,953	461
Plastics	330	2,656
Machine Shop	335	1,077
Canning	6,746	4,148
Media.	ЬI 847	ЬI 1,866
Average	5,010	2,897
Ranking	3	3
No. sets where each type enterprise leads		

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No. sets where each type enterprise leads		

selected. Prior to the analyses for this paper, there were no data on the comparative input-output behavior of the sampled firms.

In each of the sampled firms it was possible to obtain parallel sets of data from the financial and production records.* These data were all for the same year, between 1963 and 1967. The actual year is not disclosed in order to shield the identity of the enterprises.

There are special features of accounting data for the cooperatively administered enterprises. The cost of labor in the managerially controlled enterprise is measured by wages paid. In the cooperatively administered enterprise no wages or salaries are paid, there being no internal money exchange within the framework of the cooperative community. (Money is used in the economic relations of the cooperative community to the rest of society and for recording inputs and outputs in the component enterprises of the cooperative community.) The cost of labor, as part of the cost of production in the Kibbutz enterprise, was measured by using an accounting category which the Kibbutzim calculate regularly and carefully: the "cost of a day of labor." This means the average cost of maintaining a person in the cooperative community per day of labor worked. This statistic reflects the sum of all expenditures for consumer goods and services during a year divided by the total number of man-days worked in the various production sections of the cooperative village economy. The resulting figure is the best available estimate of the cost of using labor by a Kibbutz enterprise and was accordingly used for accounting purposes in these calculations. (The Kibbutz "cost of a day of labor" has tended to equal or exceed industrial wages in

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*For each of the sampled enterprises I secured the following data from their balance sheets and profit-and-loss statements: capital invested, value of fixed assets, sales and profits. These data categories are the ordinary sorts of financial records that are kept by industrial firms. In each instance, the financial statements were private, unpublished data. The following employment data were also obtained: administrative personnel, production man-hours per year. The accountants or bookkeepers made the data available, being directed to do so by the responsible administrators of each enterprise. In each instance I checked for consistency of definition of the data categories, and in several enterprises I found it necessary to reclassify the data in order to assure consistency. The data, arrayed for all the enterprises, were altered by an unstated factor--thereby shielding the identities of the cooperating firms while retaining proportional relationships.

managerial enterprise.)

In the cooperative enterprises, "capital investment" and "fixed assets" do not include the cost of land. The land used is rented, not purchased. Therefore, the rent appears as a current expense in the annual costs of operations. This feature has no determining effect on the main results of this investigation.

The cost of capital is a significant factor in all industrial enterprises and has special importance as it affects capital investments, degree of mechanization and availability of working capital. The cooperative and the managerially controlled enterprises must obtain capital from essentially the same sources. The Israeli government facilitates low interest rate loans to certain new enterprises, especially to preferred industries locating in development areas. Foreign investor, managerial enterprises have been the main beneficiaries. For the rest, however, both the managerially-controlled and the cooperative enterprises obtain capital from the ordinary private capital market. A check on the structure of loans in a number of firms showed that the sampled firms were paying ordinary capital market interest rates. In this respect, however, the cooperative enterprises may gain an advantage insofar as they are a part of a larger cooperative community. Thus, the industrial enterprise that is part of the Kibbutz has the automatic standing of being backed by the population and assets of the entire cooperative community. This gives the cooperative enterprise an advantage in credit ratings, apart from other considerations that a banker uses to decide on lending his money. This is akin to the credit advantage of a borrower enterprise that is part of a large firm with diverse assets.

Industrial efficiency is measured here in terms of: productivity of labor, productivity of capital, profit generated per production worker, and the cost of administration. Labor and capital productivity reflect on the efficiency with which key industrial inputs are utilized. The general competence of enterprise administration in optimizing outputs in relation to inputs is reflected in the profit that is generated per production worker. Lastly, the manpower used for administration measures the outlays made for the productionally necessary function of decision-making: Who can do it at lesser cost?

Results

The comparative productivity of labor in managerial and cooperative enterprises was measured by contrasting output (net sales) to inputs (production worker manhours). These data

(Table II) were calculated for the sampled enterprises on an equal weighting basis. This procedure is significant for the purpose of the investigation. If the total sales in each set of enterprises were divided by total production worker man-hours, the result would assign substantial weight to the enterprises in each group that were larger than the others. The present objective, however, is to contrast types of enterprises. Therefore, the enterprise is necessarily the unit of observation, and the productivity of labor and other measures of efficiency were calculated separately for each enterprise, then grouped with median and average values shown for the managerial and cooperative groups.

The results appearing in Table II show that the cooperative decision-making enterprises had median sales [illegible] tion [illegible] of [illegible].61, [illegible] percent higher than the ЫI 10.76 for the managerially controlled enterprises. It is important that the sales statistics do not simply reflect undifferentiated money-valued sales. They represent quantities of similar products sold in similar markets, and therefore at similar prices, for each set of enterprises.

A second measure of productivity was that of productivity of capital (Table III). This was measured in two [illegible] put [illegible] as percent of input [illegible], and output (sales) as a percent of input [illegible]. [illegible] co[illegible] enterprises median [illegible] 12.9 percent of capital [illegible] against 7.7 [illegible] c[illegible] assets for the cooperative enterprises and 2.7 for the managerially [illegible] these measures of capital productivity reflect the overall effectiveness of the use of fixed assets for generating output for sale. In this respect the cooperative enterprises outperformed the managerially controlled firms--by [illegible] percent greater profit/investment, and by 33 percent greater sales/fixed assets.

In order to gain another view of the overall effectiveness of the administration of these enterprises, I measured net profit per production worker (Table IV). In these terms, the cooperative enterprises showed a median profit per production worker of ЫI 1,912, 115 percent greater than the ЫI 899 for the enterprises under managerial control.

A further contrast for these two sets of enterprises is given in Table V, showing the comparative cost of administration. This is measured in terms of the number of [illegible] tive employees [illegible] per hundred production workers. [illegible] the cooperative enterprises, the median value was [illegible]; the

Table II

Productivity of Labor
(Sales Per Production Manhour)

Industry	Managerial Decision-Making	Cooperative Decision-Making
Tools	ЬI 7.88	ЬI 6.31
Instruments	13.64	12.67
Diecasting	15.48	14.71
Plastics	5.40	14.26
Machine Shop	5.66	13.26
Canning	14.08	13.97
Median	ЬI 10.76	ЬI 13.61
Average	10.36	12.53
Ranking	1	2
No. sets where each type enterprise leads.	,	3 - almost equal

Table III

Productivity of Capital
(a) Profit as Percent of Capital Invested
(b) Sales as Percent of Fixed Assets

Industry	Managerial Decision-Making	Cooperative Decision-Making
Tools	a) .659 b) 2.9	a) .021 b) 3.7
Instruments	a) .300 b) 2.5	.0195 b) 4.7
Diecasting	a) .038 b) 1.1	a) 1.125 b) 3.6
Plastics	a) .024 b) 3.4	a) .095 b) 4.3
Machine Shop	a) .117 b) 2.5	a) .200 b) 2.6
Canning	a) .026 b) 2.96	a) .164 b) 2.6
Median	a) .077 b) 2.7	a) .129 b) 3.6
Average	a) .194 b) 2.6	a) .271 b) 3.6
Ranking	2	7

No. sets where each type enterprise leads: 3 - almost equal

Table IV

Efficiency of Management
(Net Profit Per Production Worker)

Industry	Managerial Decision-Making		Cooperative Decision-Making	
Tools	ЪI	3,190	ЪI	118
Instruments		2,880		556
Diecasting		1,335		4,350
Plastics		74		2,771
Machine Shop		463		2,287
Canning		461		1,537
Median	ЪI	899	ЪI	1,912
Average		1,401		1,937
Ranking		2		4

No. sets where each type enterprise leads.

Table V

Cost of Enterprise Administration
(Administrative Staff Per 100 Production Workers)

Industry	Managerial Decision-Making	Cooperative Decision-Making
Tools	12.1	19.2
Instruments	24.0	15.4
Diecasting	21.5	21.2
Plastics	26.5	24.1
Machine Shop	11.1	13.3
Canning	18.3	14.2
Median	19.9	17.3
Average	18.9	17.8
Ranking	2	2

No. sets where each type enterprise has lower value — 2 - almost equal

same relationship for the managerially controlled enterprises was 19.9.

In sum: the cooperative enterprises showed higher productivity of labor (26 percent), higher productivity of capital (67 and 33 percent), larger net profit per production worker (115 percent) and lower administrative cost (13 percent).

The relative performance of the two types of enterprises may also be viewed by ranking the position of each of the firms in the study with respect to each criterion. In Table VI, there is an entry M (managerial) in the Tools industry row under the Labor Productivity column. This means that for the labor productivity criterion in the Tools industry, the managerial enterprise was the better performer. Again, under Labor Productivity for the Instruments industry, the managerial and cooperative firms were almost equal, with the managerial unit being somewhat better than the cooperative, hence the designation in the Table as M-C. Similarly for the rest of the Table.

Discounting the 8 almost-equal performances (M-C or C-M), in 15 [illegible] criteria cases the cooperative units were [illegible], [illegible] where the managerial units led. By industry type, only in the Tools case was there a clear first for the managerial type in more than two criteria. In ranking under efficiency criteria, the cooperative units led in capital productivity and profit per production man-hou[r], were ahead in labor productivity and broke even in cost of administration.

Analysis of Results

The data assembled here bear upon three widespread assumptions: first, that there is no workable alternative to the managerial form of control [illegible]; second, that even if there were an alternative, the [illegible] mode of organization [illegible]; and finally, that technology itself sets the requirement for managerialism. Whatever constraints may be assigned to the [illegible] of this paper, it is evident that they do not support these familiar themes. Evidently, there is a cooperative mode of organization that is a workable alternative to managerialism for industrial operations, and the use of machine technology does not itself exclude the use of cooperative decision making.

However, some reservation is in order for interpreting the data of this study for the second proposition. It is not warranted, given the characteristics of the data, to infer any general statement as to the degree or predictability of relative

Table VI

Summary Ranking of Managerial (M) vs. Cooperative (C) Enterprises By Criteria of Efficiency

Industry	Labor Productivity	Capital Productivity	Profit per Production Worker	Cost of Administration
Tools	M	M C-M	M	M
uments	M-C	M C	M	C
Diecasting	M-C	C C	C	C-M
Plastics	C	C C	C	C-M
Machine Shop	C	C C-M	C	M
Canning	M-C	C M-C	C	C

Note: The M,C designations in this table may be used as rank values in the sign test of significance of difference, single-tailed. Were the Cooperative enterprises, as a group, significantly more efficient than the Managerial enterprise, with 15 of the former and 7 of the latter emerging first in the various measures of industrial efficiency? Chance factors alone would produce the Cooperative lead at probability .067. This gives confidence in the inference that the sampled Cooperative enterprises, as a group, were significantly more efficient than the others. See S. Siegel, Nonparametric Statistics for the Behavioral Sciences, McGraw-Hill, New York, 1956, pp. 68 ff.

efficiency of cooperative vs. managerial decision-making in industrial operations. Thus, while the enterprises examined tend to show greater efficiency for the cooperative units as a group, the limitations on the data (number of units, single time and single locale of observations) point to the following as the relevant inference: cooperatively administered industrial enterprises can be as efficient, or more efficient, than managerially-controlled units. This, albeit qualified, inference suggests that the cooperative organization of industry can be a workable option for some societies. What characteristics of cooperative organization account for its apparent effectiveness in industry?

The main differentiating features of cooperative organization of production include the following. (1) Authority for major decisions is vested in all the participants; there is no occupationally-codified separation between those who decide and those who do the work. (2) The mode of internal decision-making is based upon mutuality and is essentially democratic, as against the hierarchical organization of managerial control. (3) In the cooperative organization there is formal, institutionalized equality and anti-inequality in decision-making and in consumption through the pervasive system of sharing final authority in decision-making and in consumption. This contrasts with the managerial pattern of differential, competitive individual gain (i.e., one man's gain, to be a competitive gain, must include another's relative loss). (4) Finally, the cooperative enterprise is oriented toward enlarging its output and affording participation in useful work for members of the cooperative community, rather than profit maximization or expansion of managerial control.

The above-mentioned characteristics of the cooperative organization have not been ordinarily linked to industrial efficiency. Indeed, some of these features are often presumed to lead to industrial inefficiency. It seems appropriate at this point to examine each of the above features of the cooperative system in light of their possible consequences for industrial efficiency.

Participation and Democracy in Control: In the cooperative industrial enterprise, final authority over basic decisions -- products, capital investment, number of workers -- is vested in the general body of workers in the enterprise and in the cooperative community as a whole. Responsibility for organizing implementation of basic decisions is the task of democratically elected enterprise administrators who are required to report regularly to the general body and to justify their decisions and proposals.

As a consequence of cooperative control, the workers in these enterprises tend to have interest and concern about technical conditions of work which is rare in the managerially controlled enterprise. Thus, instead of the suggestion box and individual money rewards for particular technical suggestions, the cooperative industrial enterprise operates with a fairly sustained free flow of communication among all members of the enterprise, both in production and administration.

The cooperative enterprises deal with mechanization and automation of production in ways that contrast with the managerial firm. Thus, the elimination of a manual work task by mechanization benefits all concerned in the Kibbutz-managed enterprise since the gains are shared by all. Also, the Kibbutz industrial enterprises usually operate under conditions of labor shortages relative to goals for enlarging production. As a result there is little problem of having useful work available for people whose tasks have been mechanized. Furthermore, each person knows that the members of the cooperative care for each other. There is little likelihood here of producing a situation where a particular work skill, no longer required, could cause a person to be discarded, no longer needed or wanted. Such an event contradicts the essential conditions of mutuality and cooperation in the Kibbutz.

Equality in "Income:" In the cooperative enterprise, the principle of equality in major decision-making is paralleled by a code of consumption equality--more exactly, consumption without money exchange and on the basis of need, community capability, and in accordance with mores of anti-inequality and material non-ostentation. There are no problems of wage systems administration since there are no wages. The cooperative enterprise has no trade union relations problems or costs in the absence of an employment relationship. Production workload problems are usually resolved by the working group in terms of mutual understanding of what is an acceptable day's work, taking into account the capabilities of production equipment and the requirements of the enterprise.

Instead of individual financial incentives, the people in the cooperatively controlled enterprise receive an acceptable level of living, the right and duty to participate in mutual decision-making, mutual care and esteem--especially for carrying group decision responsibilities. For example, the Kibbutz enterprise gets the benefit of wide-ranging cooperation among its members owing to the use of extra-workshift hours on behalf of the enterprise. Frequently, when some of the administrators or workers of an enterprise eat dinner together in the community dining room and discuss the problems of the work place,

this is not an "overtime" task that requires special payment as would be the case in a managerially controlled enterprise where work is done by employees. Though discussions on enterprise problems in the dining hall of the cooperative can be lengthy, it is unthinkable to "charge" for this, for there is no theory, category, or procedure by which such a "charge" could be made.

It is commonly assumed that the presence of individual money incentives combined with opportunity for rising in a managerial hierarchy comprises a very powerful incentive system for efficiency in industry. In the Kibbutz there is no differential income reward for varied work. Therefore election to a post of administrative responsibility confers status only. Also, it is ordinarily assumed that the managerial decision process, because of the attraction of individual gain, uniquely produces a major incentive to minimize costs in production and to maximize net return to the enterprise. The administrator of the cooperative enterprise does strive for efficiency, and meeting enterprise goals of profit, output, and employment, for that is the requirement for his status. However, in contrast with the managerial system, success in Kibbutz industry administration does not necessarily bring accretions of decision-power. For rotation of administrative personnel is a general policy in cooperative [illegible]. This produces a sophisticated administrative cadre because people with these talents are moved among administrative tasks within and among enterprises. The unwritten code of the cooperative community often requires that administrators do manual production work as one of their rotating responsibilities.

Among the administrators and technicians in the cooperative enterprise, there is considerable pressure to have good personal relations with the other men in the workplace. This is owing to the fact that only by mutual agreement are major decisions made and effectively implemented.

None of this is to say that in the Kibbutz community all men are equal. Work tasks differ. Differences of ability make for inequality of responsibility, and those who bear it receive the esteem and attention of their fellows while having to devote typically more than average hours to their work. In the cooperative community one's standing, the degree to which others take you seriously, means a lot. The use of a vehicle often goes with some administrative jobs and that gives a fringe-benefit of mobility as a result of simply doing the work. But the vehicle goes with the job not with the man. Identification of the individual with the wider community, and cooperation to achieve its goals, are the main operative incentives

of the cooperative enterprise--in contrast with the individual competitive incentive pattern of managerially controlled production.[3] The apparent workability of the cooperative form of organization in production suggests the importance of greater understanding of the worth of non-monetary and other than direct-work-efficiency factors in influencing productiveness in industry.

Useful Work and Increased Output as Goals: Historically, manufacturing industry was introduced into the Kibbutz communities as a way of providing productive work for men and women who were no longer physically able to work in agriculture. This resulted in selection of industries of a highly capitalized and mechanized sort. In recent years, the design of work places has often been performed with a special eye to human engineering considerations so as to allow older (gradually retiring) members to put in all or part of a day's work in a factory. Among the factories visited by this writer, four of the cooperatively run plants included significant technical innovations in production processes that were developed by the people on the spot. These ranged from unusual sets of jigs and fixtures to special-purpose multi-station machine tools.

A diverse literature in industrial administration, during the last decades, has repeatedly emphasized the factor of integrated operation, especially by securing cooperation among employees, as an efficient means for inducing conditions of stability.[4] The combined effect of the main features of cooperative organization, summarized above, is to induce automatically a pervasive pattern of detailed cooperation in the performance of work. Such cooperation is the crucial element for stable, hence optimal, operation of a given production system. This is a key factor, in my judgment, for explaining the efficient performance of cooperatively controlled industrial enterprise.

Optimum input-output performance in modern industrial facilities is expected, on both theoretical and empirical grounds, when the unit functions as a stable system.[5] A stable system is one whose output varies within predictable and acceptable limits. When operations are, in this sense, "under control," there is an optimum production result from the combined inputs of machines, men, and services that constitute the principal inputs of an industrial facility.

The sort of cooperative pattern of workaday functioning that is found in the Kibbutz enterprise is rarely found, or even approximated, in the managerially controlled enterprise. This is owing to the conditions of competitive individual

incentives and competitive bargaining between managers and employees within the managerially operated enterprise. Beyond a certain level of intensity these competitive incentive factor produce conditions which work against stable operation of the production system. Stated differently: competitive managerial rule over production often interferes with the optimization requirements of modern production technology.

This is not to say that stability in production is not obtainable under managerial control. However, the price is usually costly managerial control over production workers (one foreman to ten workers), or the creation of conditions which induce cooperation among production workers, and between production workers and management. The latter can significantly alter the competitive incentive factors that differentiate the managerial from the cooperative mode of decision-making.[6] Having considered the efficiency effects of features that are unique to cooperative decision-making, we now turn to other factors that may bear on the findings of differences in efficiency between the two types of organizations.

<u>Size, Environment and Ideology</u>: In manufacturing industry it is widely appreciated that large enterprises operate with significant advantages over small enterprises. Larger firms have superior access to capital and technical talent, and usually operate with higher rates of profit.[7] Also, investigations of administrative costs[7] show that larger enterprises, on the average, have lower administrative to production rati than smaller enterprises.

The managerially controlled enterprises of this study were all located within or near large urban centers. Therefore, the managers of these enterprises had access to a large and diverse labor pool. By contrast, the cooperatively run enterprises in this study were, in each instance, located on the premises of a particular cooperative community and could draw their labor supply only from the members of that community or from neighboring ones. The cooperative village populations vary in size within a range of 300 to 2000. This is, at maximum, a significantly smaller labor pool than the one that is open to the management of the managerially run enterprises.

In some ways, however, the cooperative enterprises can get advantages that ordinarily accrue to enterprises of large size. For example, the cooperative enterprises have formed joint purchasing and marketing organizations for buying raw materials, machinery and various industrial supplies that are used by many factories. Thereby they get benefits of quantity purchasing and expertise. Similarly, the Kibbutz industries

have set up common marketing arrangements for diverse products.

In the present study, advantages of size for the paired enterprises are substantially balanced out since in three industries the managerial enterprises are larger (tools, die-casting, and canning) and in three the cooperatively controlled units have larger investments (instruments, plastics and machine shop). Therefore, the average differences in enterprise efficiency that have appared here must be explained primarily in terms of factors that are specific to, and associated with, the contrasting types of decision-making among the paired enterprises. These associated factors include conditions of environment (integration of the enterprise in a wide community), ideology, and motivation.

There are definite relations between the mode of functioning of an organization and the social structure of its wider society. The Kibbutz enterprise is sharply differentiated from the managerial unit by its total integration into the surrounding Kibbutz community. Thus the individual does not differentiate sharply between his role in the [illegible] enterprise and his role in the community. [illegible] enterprise, an "employee" -- while being a "citizen" of a [illegible] community, [illegible] conventional firm is a work organization, formally unconnected with the family, home, consumption activities, and the provision of various community services. In the Kibbutz, all these functions are integrated and the individual sees them as related parts of one community. As a result members identify with and have a strong commitment to the whole community of which the enterprise is a part. This is a central characteristic of Kibbutz organization, apart from variation in individual behaviors owing to all manner of reasons.

The operation of the cooperative enterprise is strongly influenced by the [illegible] operative [illegible] where it is one [illegible] "branch" of the economy. [illegible] for component [illegible], for [illegible], when [illegible] enterprise [illegible] say to make up for persons away for military training, then, depending on community priorities, manpower from other branches of the community can be temporarily assigned to the industrial enterprise.

When a Kibbutz factory needs the use of special equipment like a tractor for moving heavy machinery, then this equipment and its driver are borrowed from their normal work to do the special task. Thereby, there are no problems of renting heavy equipment, billing, paying for transportation time of the

equipment to and from the industrial location, etc. Similarly, when Kibbutz vehicles go to town the drivers are able to do chores that are helpful to the industrial plant, like picking up or delivering materials or machine parts. Also, the cooperative community often includes manpower for particular tasks needed by industrial administration. For example, if a letter has to be written in a foreign language which someone in the community knows, he is easily asked to do this job and would normally do the task of letter translation and writing during an off hour. A similar task in the managerial enterprise usually requires hiring a secretarial service.

However, integration and commitement of the individual to the enterprise is by no means unique to the cooperative enterprise. The professional behavior and life style of modern corporate executives includes extensive involvement of the individual with his occupational role: work is carried home at night, to the golf course and to the dinner table. As in the Kibbutz enterprise, it is unthinkable to "charge" for this "overtime" (not counting the expense account). This sort of integration of occupation with other facets of life is ordinarily appreciated as contributing to the effectiveness of the managerially controlled enterprise.

It may appear from the above that the managerial and cooperative organizations are more alike than different with respect to commitment of members to the enterprise. The similarity, however, lies particularly in the commitment and integration of individuals who are decision-makers. In the managerial enterprise this means the management. But in cooperative organization this includes the total work group. To the extent that involvement of the individual in responsibility for the enterprise and its purpose affect morale and work efficiency, then the cooperative organizations have an inherent advantage in this respect.

Even allowing for the built-in strengths of cooperative organization, it would be erroneous to infer its competence from the structure of decision-power alone. An important contribution to its competence is the support that comes from the explicit ideology and moral values of the community: mutual care, responsibility, and cooperation. This is different from the ideal value system that permeates the managerial organization, with its affirmation of individualism and competitiveness--values that contradict the operational efficiency requirements of modern productive systems. The conditions of involvement of the individual in the Kibbutz enterprise, and accompanying ideological factors, are important in motivating the individual.

The people working in the Kibbutz enterprise are motivated to feel needed and wanted within the context of the total community. Such feelings, among people who share in a common task, are powerful motivating forces for individuals to give their best in the performance of shared responsibility. The entire social system of the cooperative reflects voluntary participation, voluntary cooperation, and mutual control: these are democratic communities that operate internally without coercion (no courts, no police, no jails), and without money. The Kibbutz approximates--within community capabilities and priorities--the principle "from each according to his ability, to each according to his needs."

The prospect for industrial enterprises in the Kibbutz is reflected in the fact that in a number of cooperative communities the value of industrial production equals or exceeds that of agriculture. This is a turning point for the general development of the Kibbutzim, which began with agriculture as their economic base. Manufacturing industry, even along sophisticated technical lines, can become a new frontier for the further economic development of cooperative communities.

Is there a feature of cooperative decision-making that may, automatically, restrict the size of such enterprises? From the experience of managerially controlled enterprise, it is evident that the size of a unit factory is a separable issue from size of firm. A large firm can be the sum of many factories or divisions, each of "medium" size. The size of a factory, with an array of technology options and markets, can be varied according to the size of a workable decision-making sub-unit, and the capability of acceptable planning and control techniques for regulating the activities of many sub-units.

When cooperative enterprise is organized to take into account the separate function of condition-setting as against particularized (detailed-specified) decisions, then there should be, theoretically, broad limits for conceivable size of enterprise. This expectation is abetted by the known capability of modern data-handling techniques for integrating varied and even far-flung industrial operations. At this writing, I learn that about 50 Kibbutzim are making use of modern data processing facilities for economic, including production, planning, and for control of operations. Computers, appropriately programmed to suit the criteria of integrated economic planning, can be put to work on behalf of the cooperative community, as well as (with differing programs) for the managerial enterprise. This expectation is consistent with the data of this study which are at variance with the idea that the main alternatives for society are either value-oriented or

technology-determined. The assumption is that the latter means individual incentives, inequality, social stratification, and elite rule in the name of technological advance and efficiency. Value-oriented is taken to mean egalitarianism, humanism--meaning, necessarily, anti-technology.

All this, however, is based upon the erroneous idea that technology has a direction or initiative of its own. This theory does not survive close scrutiny. Technology is shaped by using knowledge about nature to satisfy social criteria: hence, change the criteria (durability vs. cost, safety vs. style) and the resulting technology is changed. Several lines of evidence converge on the point that technology can be fashioned to suit man's requirements for life or for war-making, for industrial production to serve private profit-making or adapted to man's sensory-motor abilities. Plainly, technology is man's servant, bearing the imprint of who decides on technology and the sort of criteria that are applied in the process of design. Accordingly, industrial technologies under managerial control bear the imprint of managerial criteria. As cooperative control continues, then, to the extent that its criteria are used to control production, some technology is bound to be fashioned, increasingly, in its image.[8]

Summary and Conclusion

The data of this comparative study in Israel of six managerially controlled enterprises and six cooperative administered enterprises indicate the following:

1. Industrial enterprises of a modern technical sort can be operated under various modes of decision-making. Factory production with powered equipment and division of labor can be efficiently performed without parallel use of managerial decision-making. These findings contradict the mystique of technology-determined form in organization of production.

2. Cooperative decision-making is a workable method of production decision-making in the operation of industrial enterprise.

3. The equal or greater efficiency of operation found in the cooperative, as against the managerially controlled enterprises, is not anticipated from conventional knowledge in economics and industrial management.

4. This investigation does not establish the probability by which cooperative decision-making in industrial production may be, systematically, more efficient than managerial control.

It is demonstrated that cooperative decision-making in modern industry can be as efficient, or a more efficient mode of decision-making than managerial control. This capability is linked to the pervasive motivational and operational effects of cooperation in decision-making and in production, pressing toward stability in operations, and thereby toward optimal use of industrial facilities.

The findings of this comparative study suggest that social scientists, and others engaged in research on organization, ought to explore the problems of cooperative vs. managerial decision-making within various economies and cultural contexts, as well as in laboratory and field experiments. Diverse approaches to these problems, exploring the variability of performance of diverse modes of organization, should add to knowledge and have operational importance--insofar as variation in organization can produce meaningful differences in economic efficiency, or enlarge the available array of options for viable social organization. How much of the experience of cooperative decision-making is relevant to managerial organization, and vice versa, is an open and interesting question.

Footnotes

[1]S. Melman, "The Rise of Administrative Overhead in the Manufacturing Industries of the United States 1899-1947," Oxford Economic Papers, 1951; Dynamic Factors in Industrial Productivity, John Wiley, New York, Basil Blackwell, Oxford, [illegible]; Decision-Making and Productivity, John Wiley, New York, Basil Blackwell, Oxford, 1958.

[2]A Directory of Kibbutz Industry is published by Kibbutz Industries Assn., 13 Tiomkin St., Tel Aviv, Israel. For background, see E. Kanovsky, The Economy of the Israeli Kibbutz, Harvard University Press, 1966. This volume includes a bibliography (pp. 155-160) that covers principal books and articles on the organization and economy of the Kibbutz.

[3]Among the relatively few organizational studies that are relevant for a comparison of managerial vs. cooperative decision-making, two are noteworthy: Stephen C. Jones and Victor H. Vroom, "Division of Labor and Performance Under Cooperative and Competitive Conditions," Journal of Abnormal and Social Psychology, 68 (March 1964), pp. 313-320; Bernard M. Bass, "Business Gaming for Organizational Research," Management Science, 10 (April 1964), pp. 545-556, esp. fn. 3.

[4]A fairly extensive bibliography in the field of

organization is found in James G. March (ed.), Handbook of Organizations, Rand McNally, 1965; also, the unusual volumes James L. Price, Organizational Effectiveness, Richard D. Irwin, Homewood, Ill., 1968; and Amitai Etzioni, Complex Organizations, Holt, Rinehart & Winston, New York, 1961.

[5] S. Littauer, "Technological Stability," Transactions of the New York Academy of Science, December 1950; S. Littauer, "Stability of Production Rates as a Determinant of Industrial Productivity Levels," Proceedings of the Business and Economic Statistics Section (Washington, D.C.: American Statistical Association, 1955), pp. 241-8; S. Melman, Decision-Making and Productivity, op. cit., pp. 165-6.

[6] This is one consequence of bilateralism in production decision-making. See diagnosis of bilateralism in L.B. Cohen, "Workers and Decision-Making on Production," in L. Tripp (ed.), Proceedings of the Eighth Annual Meeting, Industrial Relations Research Association, 1956, pp. [illegible]-312; also see data on impact of bilateralism on management in S. Melman, Decision-Making and Productivity, op. cit.

[7] S. Melman, "Administration and Production Cost in Relation to Size of Firms, Applied Statistics," (Journal of [illegible]), [illegible].

[8] See S. Melman, Who Decides Technology?, Columbia Forum, Winter 1968; Dynamic Factors in Industrial Productivity, op. cit.

Co-ops and Net Margins: Retention vs. Cash Payment

The following is part of a chapter on start-up problems in production and marketing co-ops. This chapter, in turn, is part of a larger work-in-progress on poor-people's cooperatives which will cover organizing, planning, financing and start-up. It is written from the perspective of an organizer.

Producer co-ops have traditionally been plagued by the members' demands to distribute most of the year's earnings in cash. This demand becomes critical in the second or third year after the initial—and hardest—repayments of start-up capital have been made. The desire to distribute net earnings frequently brings the membership into conflict with the management.

Net margins is the portion of earnings in cooperatives which belongs to the members, the patronage refund. It does not include operating expenses, losses, depreciation or debt service. Part of the net earnings will be distributed to members in cash, and part of it must be temporarily retained for the co-op to use as internal financing. This much is a foregone conclusion; everything beyond it presents problems.

The problem of capital retention forces a co-op to answer three general questions: how much; how; and for what? The amount retained and the amount paid out is a decision to be reviewed and authorized every year. The financial instrument to be used, and its terms, is a decision that should first be studied at the same time the by-laws are drafted. The *use of retained capital*—the funds, accounts, or investments—is determined by policy decisions that will take shape even before the co-op gets underway.

AMOUNT RETAINED

There are two distinct problems at work when the co-op decides how much to retain. In one respect, the problem of capital retention reflects the members' need for education in business finance. It's not enough to say, "In a co-op, the profits belong to the members." If members refuse to acknowledge the co-op's financial needs and the limits on how these needs can best be met, no one will be able to manage the business—the members included. Their refusal leads management to react by treating the problem in strictly technical—rather than human—terms. From this perspective, the decision about how much may be distributed in cash can be determined by reviewing a series of limiting factors: the amount of working capital needs for the next year; fixed commitments for financial contribution; requirements imposed by the co-op's tax status; etc. These limiting factors cannot be ignored, and members must be able to speak the same language as management when it comes to business finance. But confronting the question on this technical level alone ignores the force of the issue.

The second problem at work when members resist capital retention is an inadequate regular income. Members of most co-ops receive their income in the form of periodic advances against the year's patronage earnings. If members cannot earn a good living as working members, something's wrong. The problem may well be caused by illusions based on unrealistic or incomplete feasibility planning. Inefficient operations or true mismanagement may also be the culprit. The problem might be intensified by differing opinions about what constitutes a good living. Whatever the causes, if members feel their "wages" during the year are too low, they will rightfully pressure to pay out net earnings.

Since *some* working capital is a nonnegotiable need, members will probably accept retention of a substantial amount of patronage earnings. The search for ways to raise "wages" then moves in other directions, which can damage organizational stability. One way is to increase earnings by expanding the scale of operations (e.g., members of a farm co-op increasing their acres-per-member). The other way is to cut costs by cutting out waste (e.g., members might reason that they don't need a manager). As well-intended as such actions might be, the object of attack should be the source of the problem—anticipated income. The course of actions used as examples above presume an anti-expansion policy. An alternative approach would be to strengthen the membership and integrate new activities.

Some people argue that co-ops are not economically viable and *cannot* increase members' income significantly. Even if this charge were true (and experience overwhelmingly shows it is false) many co-op advocates insist that the importance of co-ops is not their ability to increase the private income of members. These advocates contend that it is more sensible in the long run and more stable in the short run for members to develop their standard of living as a group by initiating new services to members and/or expanding the group. Of course, this approach will never work unless the members themselves initiate it, as many community developers can attest. Some implications of this strategy for financial operations will be covered below.

FINANCIAL INSTRUMENT

The device that the co-op will use to retain net margins can be selected from a number of financial instruments. This choice will be limited to those devices which are legally permitted for financing out of the business done with patrons. The most common instruments for this purpose are shares of stock, revolving fund certificates, and book credits. External capital, by contrast, is obtained by altogether different devices (such as long

loans, mortgages, bonds, etc.). The ways by which members might invest their own private savings in the co-op would be limited to yet other devices.

Whatever instrument is used for internal finance, three variable characteristics must be decided:

First of all, how will the amount retained be calculated—per hour of work, per unit produced, per dollar of each member's gross earnings, or per capita? This can only be decided after (or in conjunction with) an analysis of the methods of production and/or marketing arrangements the co-op will use. In order to calculate retains, it is further necessary to know the co-op's capital needs and to be assured that they can be met adequately. The method of calculation will also be related directly to the members' regular income.

The second variable is the length of time the co-op can use the retains before they must be repaid. Fixing the term at a set number of years can be risky. But some repayment policy should be established which limits the maximum number of years and which guarantees a minimum number of years. The latter insures *some* internal resources; the former insures that active members will be the main source of internal financing. The revolving fund cycle for retained patronage capital commonly ranges from three to eight years. When co-ops have no fixed term for revolving patronage capital back to members, the board of directors each year has the flexibility to retain or revolve out an earlier year's retained patronage capital. By-laws frequently empower the board to make an early payment if a member requests it. Early payments are usually discounted, so that the member receives less than was actually retained.

The final variable which is especially important for members is whether they receive interest on retained patronage capital. Paying interest gives members a special incentive to keep their earnings in the co-op. Annual interest is limited in most co-ops to a maximum 8%. Some co-ops that do not pay a fixed rate of annual interest nevertheless pay interest when the retained earnings from a given year are revolved back to the members. The interest rate under that system is decided at the end of each year in which a retain is paid out, according to how much the co-op can afford.

These three characteristics—the method of calculating the amount, the term, and the rate of interest—of the financial instruments used for retained net margins must be provided for in the by-laws (or other appropriate corporate documents). Once they are fixed, they can be changed; but the process of amendment and revision can be an expensive, time-consuming nuisance. Consequently, these variables are often left for the board of directors to decide. The root problem, as usual, is to clarify and structure the goals and objectives of the co-op; the task then becomes a more technical one of structuring the financial instrument to reflect and enhance those goals and objectives.

USE OF RETAINED CAPITAL

The most immediate and non-controversial reason co-ops need to retain patronage earnings is short-term financing. This applies particularly to the next year's working capital for operating expenses. A second need is long-term financing to expand the services or size of operations and be able to increase the membership. Expansion nearly always calls for outside financing, but the co-op itself commonly provides at least half of the amount required.

The reason it is so essential for the members to provide the financing for these two purposes receives extensive treatment in an earlier chapter. It usually costs less to pay for member financing than to pay for external financing. More importantly, what it does cost comes back to members. And the thinner the co-op's finances, the more it must depend on external financing—a vulnerable position any business wants to avoid.

Another need for retained patronage capital is financing services to support business activities. Support services may be directly related to business (such as education in a co-op whose members haven't been in business before; or childcare when the parents work). Or the support services may be *indirectly* related to business (such as health care, housing, or a retirement income plan).

Programs for support services in co-ops remain largely underdeveloped. It is commonly argued that they are a good idea but they don't work. This is not a sound argument against support services but rather a reflection of the unsystematic and inadequate attempt to implement them. The dominant ideology and economic surroundings encourage members to meet common needs individually rather than cooperatively. Consequently, the problem of support services must be understood as not just technically determined and limited by internal finances; it is also politically determined.

The fourth area of need for retained earnings concerns the context in which the co-op does business. This involves not only competitors, suppliers, buyers, creditors, but also the broader economic and political environment. Isolated co-ops have tended to lose their cooperative and participatory thrust; they are short-lived or they get assimilated into their business surroundings.

One way to change this is to foster the organization of similar co-ops, to help finance them if possible. A cooperative of "social" sector of the national economy has been developed in some capitalist countries by capital accumulation for social rather than private interests. Such a process could have an important impact here if practiced by cooperatives which were committed to supporting other co-ops as well as community and regional organizations whose interests coincide with those of the co-op. This approach contrasts with the conservatism and local chauvinism of many community-based economic development groups. But when business opens its eyes wide enough, it sees that survival and growth has a higher priority than momentary profit margins. Co-ops would do well to foster the expansion of other poor-people's and worker-controlled business, community-based development, and other projects intending change in the superstructure and infrastructure related to social interest and local control. Many different activities can contribute to the creation of a favorable climate of development.

AFTERWORD

The four uses for retained capital which have been glossed here could pose a drain on the co-op's capital resources without cautious financial administration. But since public funds are so unreliable, the allocation of even token amounts could have a significant long-range impact. There are three conceivable alternatives for co-ops to develop along the lines sketched here. The co-op itself could expand its scope to that of a CDC. Or the co-op could link-up and coordinate with a separate entity which already exists (e.g., a CDC; a labor union; FEDO). Or the co-op could spin-off a separate organization (such as Técnica Inc., the training vehicle for new co-ops started by the the Co-op Central in Salinas, CA). To pursue any of these alternatives clearly raises questions beyond the scope of this article.

—*William R. Greenwood*

At IGP, It's Not Business As Usual

by Daniel Zwerdling

IGP, a modern, high technology insurance company in downtown Washington, has developed the most important experiment in worker self-management in North America.

For sheer political drama, the board of directors elections last February at the Consumers United Group, Inc., beat the Carter-Ford election cold.

Consumers United — usually called International Group Plans, or IGP* — is the $60 million, worker-managed insurance corporation just ten blocks from the White House in the financial heart of Washington D.C. Its 340 secretaries, accountants, file clerks, salespeople, and other employees own half the corporation and elect half the board of directors.

The results of the national presidential campaign meant no more than minor political variations. But the outcome of the IGP elections promised a dramatic difference. For the incumbent board was staging a coup of sorts, trying to impose more traditional corporate work styles. Board members were proposing widespread layoffs in a company that forbids laying workers off.** The board wanted to bring back worker attendance records in a company where keeping track of attendance is forbidden. And the board wanted to give management the power to fire workers in a company where firings are controlled by a worker court.

But the entire board was ousted — and the workers elected a new board with "democratic" views. "It was a major showdown, a turning point," one insurance clerk told me. "The people — and democracy — won."

The board elections at IGP went unnoticed in the press. But in just five years this insurance corporation has developed the most important experiment in worker self-management in North America. It's an ongoing experiment, not a finished model; the democratic decision-making structure changes so often, as workers grapple for the "best" system, that by the time this article is printed some of the information may well be obsolete.

Self-management advocates in the United States have never before had a good home-grown example to learn from. While collective groceries sell plenty of brown rice, and democratically too, they're too small for most people to take seriously. The plywood cooperatives in the Northwest have held on for 20 years, but now many are selling out to conglomerates. The Vermont Asbestos Group proves that workers can take over their company and run it profitably, while keeping the decision making as traditional and autocratic as ever.

IGP, by contrast, is a modern white-collar company using advanced computer technologies in a competitive market. It's a successful corporation that earned about $1 million in profits last year. Workers at IGP aren't leftist college graduates like workers at so many collectives. Instead they are a typical assortment of middle and lower income office workers — 46 percent white, 43 percent black, two-thirds female, and only a third with college degrees.

Most important, IGP is a firm where rank-and-file employees really do exert fundamental powers. For example, 85 percent of the workers turned out for the board of directors election, an enviable turnout in any political campaign. "Look, just say we are completely in charge of our own jobs from day to day," a claims clerk told me. "I mean that individuals like myself, making close to [IGP's] minimum wage, make decisions on our own that could affect a whole insurance plan, such as whether certain people are eligible to receive claims or not — decisions which only a manager could make at any traditional insurance company."

*Consumers United Group, Inc., is the official name for a holding corporation with three subsidiaries: Consumers United Insurance Company, which underwrites the insurance; International Group Plans, which sells the insurance; and International Group Plans Administrators, which services the insurance clients. In practice they operate as one company, and employees refer to the whole operation as "IGP."

**The policy would be to institute across-the-board pay cuts, rather than layoffs, with the highest percentage cuts for those with the highest salaries. The cuts would be considered loans, to be repaid by the company at 6 percent interest.

DANIEL ZWERDLING, a Washington-based freelance writer, has written on workplace democracy for publications including the *Washington Post*, the *Progressive*, and *New Times*. A shorter version of this article appeared in *New Times*.

The lessons IGP offers are not all about success. It faces some serious problems and has made some tactical mistakes from which self-management activists can also learn. The experience at IGP suggests that the road to self-management will be a difficult and painful process — but then, so is any social change.

The self-management system remains wobbly and sometimes embattled, plagued by managers who resist giving up their traditional powers and by production clerks who don't know how to assert their newfound powers. And despite the dreams of some advocates of worker self-management to the contrary, there are employees at IGP who say they could not care less about making important decisions about their work lives.

"I would love to go back to a traditional company, punching time clocks and being told exactly what to do, when and how to do it," one clerical worker told me. "I just can't stand the confusion anymore."

James P. Gibbons, the current president, founded IGP in 1964 with three partners and an IBM 1401 computer. Gibbons had earned a reputation in New York as a spectacular insurance salesman, and now he wanted to try a new marketing concept. Instead of using a sales network to sell insurance door to door, IGP would sell group health insurance by computerized mass mailings to members of groups — from the Air Force Sergeants Association to the staff of *Family Health* magazine. The idea took off, and in five years Gibbons had 100 employees handling $10 million in premiums.

Gibbons says he considered business just a way to make a living while he pursued more cosmic visions of social and political change. He marched — and was twice arrested — in antiwar, antipoverty, and civil rights protests, and says, "I was marching for the power of people to control their own lives.

"I had always thought I'd sell the business and use the money to set up some sort of foundation, like the Stern Fund or something, and give money to political causes," Gibbons says. He's sitting at his desk, which is one among many in a large room; there are no executive offices at IGP. "But then I started thinking, 'What's the point? Set up another foundation that is trying to change the very people and system that gives us all our money?' It occurred to me what we really had to do was create an economic institution that was self-sufficient. And that," Gibbons says, "is when I became consciously committed to making this company a self-sustaining, living model of social change."

"What I've done," he says, "is to create the first corporate power structure in this country which the employees have the power to change as they want. I'm not talking anything short of a total revolution."

The birth of democracy at IGP was a paradox. Gibbons imposed self-management on the workers as the enlightened monarch of a tiny nation might liberate the masses by beneficent dictate. One day in spring 1972 he announced he was transferring half the company ownership to the employees in a nonsalable, profit-sharing trust. Six months later he announced that employees would begin electing half the board of directors (Gibbons appoints the other half). And then he began creating a network of employee committees which, he decreed, would gradually make the corporate decisions traditionally reserved for executives.

To understand the evolution of self-management at IGP, you have to appreciate one point: Gibbons never pursued self-management for self-management's sake. "Hell no, self-management isn't the end objective, the end objective is maximizing humanness," Gibbons says, "creating an environment of justice, equity, equality, beauty, truth — an environment where each member of the community has the opportunity to grow and develop in his or her own unique way, to self-actualize."

The whole reason for self-management, Gibbons says, "is to give workers the power to protect themselves against arbitrary uses of power by management. But if we achieve self-management without achieving these other goals, I'll consider the experiment a failure."

Most companies around the country that have instituted some form of worker participation have used it as a tool for making the business more successful. The worker participation scheme at Procter & Gamble is so profitable

that management considers it a trade secret, like the method for manufacturing Pringles. But in Gibbons' revolution, the business itself has become the tool — the tool for creating a radical society, "a utopian community," as he puts it. He has proclaimed his goals in a credo, emblazoned on a silver poster and taught to new employees on their first day on the job:

> Goal I: To build a lasting economic institution which helps satisfy the real needs of our client organizations ... and to provide quality service ... [while] making enough profit to keep the corporation in existence....
>
> Goal II: To build this institution on a foundation which maximizes the humanness of everyone involved, and which creates a new ethic for economic institutions — an alternative model for business.

"The very idea of creating a humane society within a business institution," Gibbons acknowledges cheerfully, "is an enormous paradox."

Who decides

Gibbons and IGP employees have spent five years groping for a sensible decision-making structure. There have been so many committees created, modified, abolished, then resurrected again that even veteran employees can't remember them all. Today the basic structure at IGP is this:

The *worker teams* are autonomous work groups throughout the company, each with about six to a dozen employees who perform the same job. Clerks who pay claims to military clients, for instance, work on the military claims team. Although team power has never been defined on paper, in practice the teams are responsible for organizing and managing the company's day-to-day work, and for handling staff hiring and firing.

Each *department* is composed of several teams. Department-level decisions, such as staffing levels and budgets, long-range objectives, and coordinating the work of the teams, are made democratically by a *department operating committee.* The committee includes the *team leaders* (a worker representative elected from each team) and a *department coordinator* whom the team leaders help select. A department coordinator doesn't have the powers of a traditional corporate department head, but he or she is supposed to guide the staff and carry out the decisions of the operating committee.

Each *division* includes several departments. Division-level policies are made by the *division operating committee,* which includes the department coordinators, a representative elected by the workers, and a *division coordinator* elected by the department coordinators. The division coordinator — called a "center forward" in IGP's lingo — is supposed to carry out the decisions of the committee, not give orders like a boss.

The *corporate operating committee* is made up of the handful of top managers who run the corporate business from week to week. It's the least representative committee of all. Except for one member directly elected by the workers, the members are hired by the board. The corporate operating committee reviews all major policies and corporate operating strategies devised by the lower committees before sending them for approval to the board.

The *board of directors* is half chosen by Gibbons and half elected. The board is supposed to be the ultimate decision-making body, the final vote on major policies from investments to sick leave to wage scales.

I've left two of the most important committees until last, because they operate outside this chain of responsibility. The first is the *personal justice committee,* the worker-elected court. "All decisions of the Personal Justice Committee shall be final," company policy says, on disputes over pay, promotions, leave policy, job transfers, anything. The only exception is firings, which employees can appeal beyond the court to a special committee of three worker representatives and three managers.*

The committee that created the court is the *community relations assembly* (CRA), the worker congress. Its 20 representatives are elected by popular vote. At least one CRA representative sits and votes on virtually every committee in IGP, which ensures that at least

*Official IGP policy also guarantees "full protection of your individual rights as a citizen of these United States, in particular freedoms articulated in the Constitution and known as the Bill of Rights."

one direct representative of "the people" votes on every decision.

But the guts of the CRA's job is to formulate all the workplace policies that directly affect employees, from vacation rights to production standards, from hiring guidelines to wages. The CRA doesn't have final say, according to corporate policy, but sends its recommendations for "review" by the corporate operating committee and "approval" by the board.

When I first visited IGP in 1974, I began by asking the employees, "But does it *really* work?" It was a simplistic question that reduced the complex power relationships to an absurd yes or no. For instance, how much power can employees exert over their day-to-day work life? How much power over corporate finances and business? How much power can employees exert over financial questions that directly affect them, such as wages and benefits? And just as important: no matter how much or how little power the employees have available through formal voting, how much power do they actually assert?

When it comes to the day-to-day life in the "economic community," as Gibbons calls it, the rank-and-file employees have enormous power available — and they use it. File clerks making under $10,000 a year hold an impromptu meeting one morning and vote to revamp the entire central files system, the heart of the corporation. Clerks churning out new insurance policies take a break to decide who should answer the telephone; they vote to rotate the hated task. A team of researchers, who answer clients' questions about their insurance policies, vote to hire a job applicant they interviewed the day before. The department coordinator hasn't even met her. "A department head," one researcher says, "shouldn't stick his nose into team business."

The worker teams also wield effective control over firing fellow employees, although the power is slightly ambiguous since team leaders and department coordinators also have the power to fire; the company has never firmly resolved just whose power should take precedent. In practice though, the rank-and-file employees have made firing a rare event in this company. A small drama flared one day in the life insurance department, when the team leader tried to fire a worker he said "wasn't producing." He backed down when her teammates marched angrily to his desk and declared he had no right to dismiss a teammate without consulting the team first.

Some employees at IGP complain that it's becoming *too* hard to get rid of troublesome and unproductive employees — "it's kind of scary to stand up to someone you've been friends with and say, 'sorry, you're not working out, you've got to go,' " one claims clerk says. But workers do it. "We fired a dude last week," a mailroom clerk says. "When he didn't carry his load we had to do the extra work. We warned him, had meetings with him, put him on probation — he wouldn't listen." He appealed to the personal justice committee, but the court upheld the team's decision.

The clerks paying insurance claims and peering in the microfilm machines don't exert direct power over department and division-level policies, since they don't have a direct vote on the operating committees. But most employees I talked with say they aren't interested in worrying about long-term planning and budgeting.

They can, however, exert considerable informal power over department and division decisions when they feel the issues touch them directly. For one thing, there's a company commandment called the "IGP Decision-Making Model": it declares that no decisions may be made until all the workers directly affected have been consulted first. But more important, the workers exert power because there is an assumption at IGP that leaders are supposed to act on behalf of the employees and to watch out for the employees' interests.

"We don't assert ourselves very often by taking initiative," says one claims examiner, "but people resist because they know they have the right to resist." When one department announced it was installing a new computer system to keep track of claims, for instance, the claims team announced they didn't like the system and would refuse to use it. "The computer people were forced to sit down with us and design it the way we liked," one team member said.

Managers who don't respond to the rank and file don't survive in their positions very long. "We called our department head before a meeting of the entire department to air a lot of grievances," one researcher says, "and one of the big issues was, do the people have confidence in the top man? We were terribly, painfully honest with him. We gave him a vote of confidence only to give him another chance."

IGP employees also wield considerable power over the broad policies that govern their work life through their community relations assembly. On paper, the CRA seems like a glorified employee sounding board — one that has the empty "power" to *recommend* policies — since all CRA policies must be submitted for "review" and "approval" to the corporate operating committee and the board. Many employees at IGP have never taken the CRA seriously for precisely that reason. Since Gibbons created the committee four years ago, CRA representatives have suffered occasional periods of inertia, paralyzed by self-doubt as they ponder whether they really have any power.

"We've had a problem trying to figure out what our role is and what our limits are," one representative told me. "Look, none of us have really believed we could ever have the power to do anything important," another says. "I mean, how many of us have ever been on a company committee like this before and been asked to make corporate policies?"

But however powerless these representatives may feel, last year's CRA — workers say it was the strongest they can remember — revised all the major workplace policies and got the disciplinary system working. Gibbons and several board members have consistently prodded the CRA to assert itself more. "The CRA acts like it's asking permission from the [corporate] operating committee," says board member George Allen, a professor in the school of business at the American University. "But I'd like to see the CRA become equal in power to the operating committee."

Viewing IGP through descriptions of the CRA, the teams, and other committees misses the spirit of employee power and freedom there — a spirit that contrasts dramatically with employee feelings at traditional white-collar firms. A claims examiner at Geico, a major insurance company with headquarters in Washington, tells what it's like at her office. "A bell rings at 8:30 and if you're five minutes late they reprimand you," she says. (She is speaking at home

Benefits

Tired of your current job and frustrated by its meager benefits? Apply for any job at IGP and enjoy the kinds of benefits that most of America's 86 million workers only dream about. Formulated and passed by the employee-elected congress and then approved by the board, benefits include:

- ☐ minimum annual wage: $9,450 plus profits.
- ☐ flexible hours: set your own hours between 7 A.M. and 7 P.M. Some employees work four days a week.
- ☐ no attendance records: everyone leaves a few hours early or takes a whole day off from time to time. As long as you get your work done, no one minds.
- ☐ vacations: no less than two weeks a year, and "no more than the job responsibilities, team, and team leader will agree to." Some workers take a month off.
- ☐ unlimited sick leave: the company pays your full salary for 90 continuous days, then you go on disability. You're guaranteed a job with the same salary whenever you come back.
- ☐ maternity leave: three months at full pay.
- ☐ tuition paid: take a course at a local university that relates somehow to your work, and the company will pay you back. "I'm taking psychology and philosophy," a files teamleader says, "so I can better understand the 'girls.' "
- ☐ first crack at job openings: all vacancies are offered to IGP employees first.

If your team votes to fire you, you're not yet out in the cold. You can appeal to the employee court while receiving full pay. If you do leave, you can start over at a new company with good will and a clean slate. IGP won't put any negative information in your personnel file. ■

because "I'd get fired if I talked to you at the office.") "Clerks aren't supposed to drink coffee at their desks and they're not supposed to talk, unless it's about business. Supervisors assign us our work each day, and if we ask questions they tell us 'It's not yours to wonder why, just do as you're told.' I ask questions anyway, and they've classified me in my personnel file as an 'insubordinate.' "

At IGP clumps of workers sit on their desks, drinking coffee and chatting about a recent CRA vote to reimburse workers for meals, transportation, and even babysitting fees if they work after hours or on weekends. Work in one department comes to a noisy halt when the research team throws a baby shower for one of the teammates; the department coordinator doesn't scowl, he takes some wine and a piece of cake. There's no morning bell at IGP. "I've been coming to work at noon lately because I'm training some horses every morning at a stable," a researcher in the life insurance department says. "I stay and work until 8 o'clock."

My Geico acquaintance has "never even met the company president" — but Gibbons and three top managers take 45 minutes one morning simply to meet with an angry IGP employee who has questions about disciplinary procedures "which just can't wait." And workers at Geico are afraid to speak out. I dropped by the IGP board of directors campaign assembly last year and heard one candidate, a 24-year-old claims clerk, declare that "Gibbons has been feeding us a lot of bullshit and it's about time the people bring it to a halt." He received some healthy applause; then everyone adjourned to a conference room for a wine and cheese party and the vote.

Ups and Downs

There's a sharp dichotomy at IGP between the daily world of work and the world of business. When it comes to making decisions about what insurance packages to market, what strategies to use, and what investments to make, the rank-and-file employees have little voice.

The theory behind the structure at IGP has been that "employees don't have any business making decisions about finances if they don't have financial expertise," one researcher explains. Instead, representatives accountable to the rank and file are supposed to make such decisions. Until a couple of years ago, financial decisions were handled by a finance committee, most of whose members were elected from each department. But it didn't work. For one thing, in the effort to be as democratic as possible, membership was rotated so often that individual representatives couldn't build up enough knowledge of the committee to play a meaningful part. To make matters worse, many of the representatives had little financial background, and the company made no effort to provide training.

"Frankly, the meetings were terribly frustrating," one elected representative told me. "Half the time I didn't know what they were talking about." Both these factors increased the tendency of the chief financial officer, the chairman of the committee, to "play the cards close to his chest," as one finance committee member recalls. "He controls the books, he controls the figures — so he'd make a recommendation and we had little choice but to nod our heads. We should have been more forceful, I know," the representative says, "but we were intimidated."

Since then the finance committee has faded away. Now most of the power to make financial and marketing decisions rests with the corporate operating committee, far from the rank and file, although there are still a few possibilities for direct worker involvement. The chairperson of the CRA votes on the committee, but so far none of the chairpersons have learned enough about the business to take an active part. And the board of directors, which is half elected by the employees, does have the power to reject operating committee decisions. A few years ago, the directors acted like a rubber stamp — "one year the Board hardly even met," recalls board member George Allen. Recently the board has been asserting itself more and more as the voice of "the people." When managers on the operating committee insisted that they should control wage scales, for example, the board insisted that *it* would make the final decisions. "The operating committee is mostly managers," one board member explained, "when the people should have a large say in deciding wages."

Workers at IGP do exert substantial power over financial issues that touch them directly. The CRA drafted the last major wage scale revision, after consulting with "the people"; it was changed little by the board. CRA representatives also selected the company-paid health insurance plan, one of the most generous packages at any company in Washington.

And when really crucial financial policies come up, the board turns over the decision to the entire work force for a vote. It was the rank and file who voted to establish the $9,450 minimum annual wage, and it was the workers who decided how to divvy the profits. Most managers, not surprisingly, wanted to apportion profits as a percentage of salaries. But the rank and file, the two-thirds earning under $11,000 a year, voted to split the profits equally, to president and mailroom clerk alike.

Now the caveat: despite the successes at IGP, the self-management system does not work as well as it might. For every team that asserts its autonomy and power, employees point to a team that shrinks from responsibility. For every decision that a committee reaches by democratic vote, workers point to a committee that waffles and submits to the decision of a self-styled boss. "There isn't one department in this community where the philosophy is even half working," Gibbons says with frustration. "This place," says Larry Bonner, a former member of the top operating committee, "is a mass of contradictions."

And the contradictions are nourishing worker discontent. The corporation preaches trust, maximizing humanness, and a new quality of work, yet the absentee rate is increasing, turnover is high (up to 15 percent during the last few years), and some departments are mired in chronic backlogs and sloppy work. You can read the discontent in managerial memos that float around, talking about "tremendous tensions, anxieties, character assassination, and balkanization." And you can read the mood in the only graffiti scrawled on the men's room stalls. "IGP employees need to organize a union to protect and increase their working conditions," a dissident wrote in bold blue. "Self-management is a clever farce to keep wages low." About 25 percent of the work force apparently agrees — and told a company-wide survey in 1975 that IGP needs a union.

Workers at most companies, the social surveys tell us, are discontent with the status quo — their lack of power, their isolation, their alienating role as a cog in a vast corporate machine. But at IGP, the workers' discontent stems from change; normal corporate power relationships have been turned upside down. Self-management at IGP has put power and responsibility up for grabs; and neither the managers nor the rank and file have ever been trained by this society to handle it.

What training and skills are needed for a self-managed enterprise to fulfill its potential? Advocates who have worked with democratic decision-making institutions emphasize some characteristics that make a self-managed enterprise strong. To begin with, workers need a sense of personal confidence, responsibility, and autonomy to manage their work and to make decisions on their own. An IGP employee, formerly a telephone operator, explains her plight: "At Bell Telephone we had to raise our hands just to ask permission to go to the bathroom. But at IGP we're supposed to do everything on our own. No one tells us anything." "The fact is," says a file clerk who used to work at the post office, "a lot of people need a boss standing over them, telling them exactly what to do."

While workers in a self-managed firm need independence, they also need to feel responsible to the collective. "I thought self-management meant you can get your work done whenever you want," one policy issue clerk told me. She was angry that her team reprimanded her for taking three days off during a hectic week. "That's not self-management," Gibbons writes in one of the two-page philosophical treatises he occasionally passes among the employees, "that's anarchy!"

And if committees are made the cornerstone of decision making, employees must master the art of listening to others, sharing opinions openly, and hammering out a consensus acceptable to the whole group. In some of the countless IGP committees, members talk at

once and can't hear what the others are saying, or they shrink from saying anything at all and let one or two members dominate. I attended CRA meetings that accomplished nothing because representatives straggled in 45 minutes late, and team meetings that wasted time because workers felt too nervous to say what they really felt. No wonder two-thirds of the workers told the 1975 survey they think most committees are a waste of time — "God so loved the world," reads the sign on one worker's desk, "that he didn't send a committee."

Yet, "The problem is not in having committees," George Allen writes in the company newspaper, "but in how they operate." Committees of top managers aren't much better off. I watched managers on the corporate operating committee spend an hour trying to figure out why they tended to ramble instead of focusing on specific topics. They finally realized they had never prepared an agenda.

Many employees do plunge into the democratic decision-making process — over 40 percent of the workers at IGP have served on at least one committee. But as in any organization, from the PTA to SDS, when a minority of the participants take on most of the burden they get exhausted before long. "After six months here, you just burn yourself out," says Jane Suppan, a researcher who has belonged to the CRA and many other committees. "And you still have your normal work to put out."

(Continued on p. 76)

The Employee Trust

When IGP's founder and owner, James P. Gibbons, decided to give away half the corporate stock to the employees, he discovered it wasn't all that easy. Worker ownership and control are so rare in this country that there aren't any legal structures set up to achieve them. Gibbons couldn't just give away his stock, it turned out, without paying astronomical gift taxes.

"It took us almost two damn years just to work out the arrangement," recalls George Allen, a veteran member of the board of directors. "There just weren't any models to follow." What finally emerged: Gibbons doubled the shares of IGP stock from 250 to 500. Then he — technically, the company — "sold" half the stock, or 250 shares, to a special employee trust. Any employee who works at IGP more than six months is automatically a member of the trust until he or she leaves.

The trust didn't give the company any cash for the stock; instead it gave the company an IOU to pay back the value of the stock, plus 6 percent interest, over approximately a decade. The value of the stock was fixed at around $1.7 million, based on an independent appraisal of the company's book value.

Now, each year, the board of directors votes to distribute a certain amount of the corporate profits to the workers, by transferring it to the trust. Under IRS regulations, the company can give the trust a maximum amount of profits each year equal to 15 percent of the corporate payroll. Last year, for instance, the corporation made about $1 million profit, and the board voted to transfer half a million to the employee trust, which was somewhat less than 15 percent of the payroll.

But since the employee trust is still paying off its IOU for the stock, it immediately pays back 50 cents of every dollar of profits that the board transfers to it. The company doesn't pay taxes on the profits that it gives to the trust, nor on the money it gets paid back.

Each employee gets credited with an equal share of the profits each year; a manager earning $30,000 a year gets the same dollar amount as a mail clerk earning a third as much. Employees don't actually get to take their profits home although they may borrow up to 25 percent of the profits they've accumulated at merciful interest rates — 8 percent compared to the more than 11 percent they'd pay at a bank. When employees leave IGP, they will get their share of the profits in one of three ways: all at once, spread over five to ten years, or in the form of an annuity purchased from a life insurance company. They'll also get a portion of the current book value of IGP's stock — based on how long they've worked there. ■

I met one young claims clerk who serves on so many committees that she occasionally does her insurance work over night, and gets no sleep. She's an extreme case, but reflects the dilemma. "Even if we wanted to participate in decision making," says a woman with two children, "we can't afford the time. We've got to get home and put supper on the table."

While many employees feel overwhelmed and confused by their sudden rise to power, managers at IGP feel uncertain about their fall from it. Consider the qualities that mark a good manager in a self-managed enterprise — "Damn it, don't think of yourselves as managers, think of yourselves as leaders," Gibbons fumes at an operating committee meeting. "*Manager* implies control; *leader* implies government with equal rights." As self-management advocates emphasize, a good leader shares information with the rank-and-file employees, delegates power as much as possible, inspires and motivates workers rather than giving orders, and, most important, sees his or her role as working on behalf of the workers, not over them.

"Now you tell me," Gibbons says with a sigh one day, "where you can find leaders who have administrative and insurance experience who also believe in these democratic values? Right — nowhere."

"Managers are afraid and confused here because they lose the power of being the boss," says Del Clark, a former member of the corporate operating committee. More than a dozen top managers — *leaders* — have come and gone since I first visited IGP in 1974, largely because they couldn't handle democratic-style leadership. "At my last job if a secretary so much as talked back to me I could have said, 'Shazam, you're fired, finished,' " one department coordinator says. "But now at IGP if I try to boss someone around *I* could be fired, or at least deposed. After 20 years in the cutthroat business world, it's hard suddenly having to accept a secretary or mailroom clerk as equals."

And most leaders at IGP complain that group decision making takes too much time in a business that demands quick action; and unless all the members of a committee are doing their required part, they're right. Some leaders have become so afraid of crossing the line between providing leadership and imposing dictatorship that they shrink from exercising any initiative at all. "And then," one division center forward says, "inertia sets in."

"I'm telling you, it's absolutely impossible to make every decision democratically," says Del Clark, who used to be center forward of the largest division in the corporation, with 200 employees. "Our committee would take three weeks trying to solve a problem I could have solved like that" — he snaps his fingers — "in a couple days, and we'd get 99 problems a week. The department heads on the committee would all agree to do certain jobs during the week, and then at the next meeting they'd say they didn't have time. So if I took action on my own I'd be accused of being a boss. If I didn't the work wouldn't get done and as division head I'd be blamed for it. I got so frustrated and confused," Clark says, "I just had to resign." Now Clark works in a nonleadership position, doing what he calls "busywork."

Put employees together with managers who are equally unprepared for self-management and you have a vicious circle. Teams, the CRA, and other committees don't meet their responsibilities, and the work falls behind. Tensions rise as people sense the system isn't working; instead of asking themselves how to solve it they blame their leaders for failing them. The leaders blame the rank and file for dragging their feet and withdraw in defensiveness and secrecy. The workers become more hostile ... "and then we all ramble along in no real direction," one researcher says.

The stalemate inevitably ends when a strong leader, usually Gibbons — impatient and furious at the breakdown, frantic for the system to work — plunges into the power vacuum and imposes his own solutions. I watched Gibbons undercut his own carefully nurtured democratic structure many times, pleading, "This is a business, we've got to go on." He solves the immediate crisis but contributes to a more profound crisis in the long run: cynicism.

"We have no power to do anything, really," a team leader scoffs after Gibbons has intervened in her department to solve a work backlog. "Uncle

"God so loved the world," reads the sign on one worker's desk, "that he didn't send a committee."

Jimmy tells us we have the freedom to do what we want, but then he just goes ahead and does what he wants anyway."

"I feel like I'm really suffocating here, we've got no influence over anything," a claims clerk told me. Then she paused — "well, I guess it depends on a person's initiative. I'm the type of person who doesn't ever do anything. I mean, they *say* you can do things here, but I don't believe they really feel you can do it."

"Lots of us come from such uptight work or school environments that it's hard to eye a less structured situation without suspicion," one employee wrote in the company newspaper. "Knowing only gross manipulation by employers or instructors, we expect it.... We look for the fine print, sure that we're being had.... At least the old system clearly defines the enemy. Are we strong enough to risk a system where there may not be an enemy, other than our own cynicism?"

Many employees do acknowledge that when the system doesn't work as it should, they are at least partly to blame. "The mechanisms are all here, the freedom and power are all here for us to really take control and run this company the way we want," a young claims examiner named Kurt Carr told me — before he became elected department coordinator. "Why don't we? I don't want to call it ignorance. Let's call it lack of education — lack of education in democracy."

Learning self-management

Education in democracy is one area where IGP has failed the employees. The transition to self-management is expected to be difficult, but Gibbons neglected to make it smoother by creating long-term training programs to teach employees self-management values and skills. True, IGP has made some attempts at education: new employees take orientation courses in the philosophy and finances of the business, and at one time the board of directors held seminars with workers to teach them how the employee trust works. Over the years the company has hired various consultants to help committees work more effectively — and now the company has its own in-house team of troubleshooters who float from crisis to crisis, attempting to teach employees how to tackle problems and solve them on their own.

But these sporadic attempts to spread a little democratic or financial knowledge among the work force have failed, as Gibbons acknowledges: "I'm tired of these ad hoc, hit or miss, part-time efforts to solve problems. We need a long-term training program, and I want someone to get to work on it full time." But he adds in the same conversation: "People don't understand that we don't have the luxury of time for all this training. We're not an educational institution, we're a business, and we have economic problems that have to be solved." But that may be a deception. The time the workers would divert to self-management training, say a couple of hours each week, may be vastly outweighed by the time they now waste in ineffective committees and in complaining.

What kinds of training programs could IGP develop?

1 Regular seminars for all employees on the history, philosophy and experiences of self-management. If workers at IGP learned there were historical roots to Gibbons' visions — if they knew that workers in Yugoslavia as well as plywood cooperatives in the Northwest were grappling with the same sorts of problems — they might feel more grounded in a movement, rather than alone and adrift.

2 Regular seminars on how the business operates, from marketing insurance packages to investment finance.

3 Regular forums, perhaps once a month, where top leaders could discuss the current financial status of the business, key issues up for debate in the corporate operating committee or the board, and could answer questions from the employees.

4 Weekly meetings between CRA representatives and their "constituents," to share more immediate information about possible grievances or problems, policies pending in the CRA, and new policies that employees would like to propose.

5 Methodical training in the art of group decision making, for every committee from the work

teams to the board. The training should be handled by full-time employees skilled in group dynamics.

6 Special training for every leader — teaching techniques from the art of chairing a meeting to demystifying technical information so the rank and file can understand it.

What are the prospects for long-term education and training at IGP? The question is synonymous with a more fundamental one: What are the long-term prospects for self-management at IGP? For although the tensions are healthy — they indicate the corporation doesn't squelch people but nourishes intellectual and emotional ferment — they are reaching a stage where they will move people in one of two directions: toward a more stable and smoothly working self-management structure, or back to a more traditional corporate hierarchy.

"We're at a critical turning point in this community," Gibbons acknowledges, "where the experiment is up for grabs. The people here have the power to throw me out, throw out all the values I stand for, even piss on me if they want."

For a time last year it seemed as if Gibbons' values would be thrown out. The company, like the nation, is constantly swinging through varying political moods, and last year was the year of the conservatives. To begin with, IGP

Selecting Managers

For two years starting July 1974, the 340 employee-owners of IGP conducted an astonishing experiment: they elected most of the top managers. From the time Gibbons transferred half ownership of the company to the workers, the community had been debating how to make its leaders more accountable to the rank and file. The board of directors had suggested forming an employee-elected committee to nominate a slate of candidates for each management spot, leaving the final choice to the corporate operating committee. The worker congress (the CRA) had suggested forming a committee composed of management to recommend a slate, leaving the final choice to employee elections. But the policy that became company law was Gibbons' idea, and it gave workers the most power: the workers would nominate the candidates, a joint worker-and-management committee would certify which ones were professionally qualified, and then the rank and file would select the final choice.

In one department, the 30 production clerks who process insurance policies for clients like the National Council of Senior Citizens, a $2 million account, elected an affable former supermarket cashier as department head. He trounced a candidate who knew far more about the insurance business but who, one clerk explained, "was always stepping on the people's toes."

In the military department, which handles insurance for members of the Air Force Sergeants Association, the former department head, a retired military officer with a reputation for barking commands, wasn't even nominated. "Sure I would have liked to continue as department head," he said. "But if the people here don't like you, you don't have a chance in hell to succeed."

Over the next two years, employees at IGP elected and deposed numerous team leaders, department heads, and even division coordinators (called center forwards). The elections were embroiled in controversy from the start — partly because some workers were opposed to the principle, partly because the elections were not always handled well.

"The elections have become personality contests," a proofreader in the advertising department told me. "We've elected some very nice idiots to run some of the departments." Employees did not elect any "idiots," but they did elect some leaders more for their personalities than for their administrative abilities. Some of these leaders floundered badly, contributing to low morale and "chaos," as many workers put it.

In some departments, competent, experienced leaders became

faced considerable financial pressures: after ten years of spectacular growth the company's income began leveling off, partly because of the national economy and partly because, after years of dominating the mail order health insurance market, IGP began to face some stiff competition.

Although the corporation was making a profit, some employees felt it wasn't making enough, especially at a time when some long-term debts were coming due. And employees were tiring of the constant changes in Gibbons' experiment. "People tend to be a lot more conservative when things keep changing," one researcher says. "They need something secure and stable to hold on to. And here," he laughs, "what you write about us today will be totally different six months from now."

The rank-and-file employees voted their mood in last year's board elections: they defeated the "liberal" candidates and elected a Washington bank president and an IGP manager known for his traditional, straight-line approach to business. Gibbons, who in the past had appointed such people as a Marxist economics professor and a civil liberties lawyer, picked three top managers with conservative fiscal reputations. "I figured it was time to put some financial knowledge on the board," he recalls.

To a point, most employees seemed to approve of the new cli-

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scapegoats for deep-rooted problems that weren't their fault. And the election process suffered from inconsistency: in some departments a leader was elected as soon as the spot became vacant, while in others the top operating committee installed a leader with little explanation and without an employee vote. Some teams and departments were leaderless for months if the employees couldn't find a candidate whom they were willing to elect.

"The elections came too much, too fast," says a former board member who helped set up the process. "It was an awful lot of political activity all at once for a place that's never had it."

"I just don't think most people here are qualified — I don't think *I'm* qualified — to decide which people are qualified to serve in top leadership positions," a researcher added.

So last summer the worker congress, the top operating committee, and the board all voted to revamp the leadership selection process. Here's how it now works:

The rank-and-file workers still elect their team leaders by popular vote. But their direct participation ends there. To select a department coordinator, a joint worker-management "search committee" certifies a slate of candidates who are professionally qualified for the post; then the team leaders in that department and the other department coordinators elect one from the slate to become department coordinator. Division center forwards are chosen by the same process: after a search committee picks a slate, the department coordinators in the division and the other division center forwards make the final selection.

If president Jim Gibbons leaves the company, the board of directors, the corporate operating committee, and the CRA will elect a new president.

"It's a good system," one claims examiner told me. As the community policy says, the people doing the electing now are "completely informed about the expected duties and performance of the leader." Every six months, each leader will be "evaluated" — and ratified or deposed — by essentially the same process. If the workers in any department or division think their leader is doing a bad job, a majority can petition for a special evaluation any time they want.

"I think the people should elect all the leaders some day in the future," a team leader said, "but not until they're all really educated and informed. And that kind of education hasn't been dealt with. You can't allow people to vote who don't understand what the effect of their decisions will be." ■

mate. The CRA and the board revamped the election process so rank-and-file employees had far less power in selecting top leaders; and workers started putting more pressure on fellow employees who took too much advantage of liberal leave. "The place has the feel of a Republican administration," said Kurt Carr at the time. "The company is really cracking down now and become more conservative, and putting emphasis on the bottom line. But I think it's a healthy thing for democracy here in the long run. Things were getting too chaotic. We just have to be careful that it doesn't swing too far in a conservative direction."

But the climate did swing too far — as top managers began to argue that IGP's obsession with democratic values and workplace freedoms was damaging the corporate profits. When a board resolution called for the end of some of IGP's basic workplace freedoms, however, the political mood swung back. The managers were ousted from the board, and now a new group of directors known for their "liberal" and democratic outlook sits in control of the corporation. Gibbons' new appointees will be especially important. One is Dr. Michael Maccoby, a self-management specialist who helped design the joint United Auto Workers and Harman International Industries shopfloor democracy project. The other two are rank-and-file workers. "I'm saying, 'let's put people on the board again who will implement people policies, and not just think about profits,' " Gibbons says.

The events at IGP last year — the widespread conservatism, culminating in the effort by top managers to toss out fundamental worker powers and freedoms — suggest that the firm confronts a difficult paradox: As the workplace democracy grows stronger and employees feel more assertive, workplace democracy itself may come under increasing attack. For until last year most employees, including top managers, went along with Gibbons' visions even if they grumbled under their breath. "Nobody in this company comes right out and says to Jim's face, 'democracy sucks,' " a former board member told me. But as more and more employees feel assertive, those who oppose Gibbons' goals are boldly speaking out. And the strongest opposition is among the leaders, who feel they have the most to lose.

"I came to IGP hoping to make vast sums of money," a former member of the corporate operating committee told me, "but I've finally accepted the truth. This is not a company where any of us will get rich. Do you know that Jim could make $1 million a year if he wanted, yet when the board tried to raise his salary from $50,000 to $100,000, he threatened to quit? There are no stock options for us; a guy making $25,000 a year will leave with the same money after 20 years as a mailroom clerk making less than half as much. We don't get power here, or prestige — most of us don't even have a private office. Democracy is nice," he said, "but I'm not sure I want it at my business." A few months after we talked, he quit.

Ironically, one of the major obstacles to full self-management at IGP will continue to be its most dynamic force — Jim Gibbons himself. The employees at IGP never asked for self-management. Most probably never even dreamed of it. Gibbons alone dreamed the self-management vision, imposed it on the employees, and with his charisma made it work. But now Gibbons' role is starting to stunt self-management's growth, for the employees can't quite shake the notion of Gibbons as the beneficent monarch, themselves as grateful subjects.

"I know I've got to go," Gibbons says, "because this experiment won't really have worked until it can function without me." He talks about giving his half of the stock and his board of director seats to a trust, which would be controlled by IGP's clients, making the corporation jointly controlled by the workers and the "community" of clients. So far, the plan is little more than a dream, primarily because the clients have shown little interest.

IGP faces questions that every self-managed enterprise must ask and answer. Can a workplace democracy survive if some of the employees don't care to participate? According to the extensive but unscientific 1975 survey, less than half the employees who responded wanted "a lot of say" over selecting management, and not even one-third said they wanted "a lot of say" over hiring and firing fellow workers and deciding how corporate funds should be spent. The company

confronts serious problems because not enough workers take an active part, yet some employees argue that demanding worker participation is itself an anti-democratic rule. "Participation does not mean that everyone *must* participate," writes George Allen. "It only means that each person is given the *opportunity* to do so."

Can a workplace democracy survive if some employees, including its leaders, actively oppose it? Should the company hire only job applicants who swear they're committeed to Gibbons' goals? Must every employee share the same values for the structure to survive? Some employees suggest careful screening of job applicants: "We certainly don't want to hire people here who are opposed to the whole idea," says one veteran IGP employee. But others argue that rejecting workers who don't embrace the democratic and humanitarian vision in effect *sabotages* those visions.

"What some people are demanding is that we all have to share the same goals," says Fran Heaps, an administrator, "and I say horseshit. As a citizen of this country I don't have to have the same values as my next door neighbor, do I? We have systems and safeguards in this country which give me the right to be who I am. We have systems and safeguards at IGP too. Yes, some managers tried to toss out the system, but the people stopped them — which shows that the system works."

The system does work — better than any other self-managed enterprise in the country, and, I would argue, better than any other corporate system in America. Despite the problems and tensions at IGP, 340 rank and file workers and managers are operating a $60 million corporation — and making a profit — with a degree of freedom, democracy, and equality never before achieved by a major corporation in the United States. If they're facing problems, every corporation faces problems. The difference is that workers at IGP can shout their complaints and problems if they want, without fear of getting fired. More important, they've got the power to change the corporation. ■

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What makes them think they can run the mine?

Vermont asbestos miners promise EPA and financial backers that their employee-owned operation will turn a profit on higher demand, lower overhead.

Sam Hemingway

The stockholders arrived early for the annual meeting. Slowly they filtered into the auditorium, some walking stiffly in newly-pressed suits, others ambling casually toward empty seats, waving hello to friends in the aisles. It was a day everybody in the room would never forget.

Fourteen months earlier, in February, 1974, the same group had met in a similar hall, in a much different mood, to discuss General Analine & Film Corp.'s decision to close down its 90-year-old asbestos mine in Lowell, Vt., rather than comply with a $1-million anti-pollution program demanded by the Environmental Protection Agency. The mood of the crowd, most of whom were lifelong employees at the mine, was one of shock and despair.

Half-heartedly someone proposed the workers buy the operation "and run it ourselves, by God!" Someone else suggested they elect a committee to look into the possibility. Half of the people nominated for the committee declined and, embarrassed by the idea, sunk lower into their seats. Finally, 15 persons were chosen and the meeting was adjourned.

Possible dream. The idea that seemed so farfetched to the dejected workers that winter became a reality this spring when the miners bought the GAF operation for $400,000. Along the way the employees not only secured a year's extension from the EPA, satisfied the demands of seven banks, and won the full faith and credit of the state's bonding authority, but also convinced themselves that they weren't going to fall flat on their faces. Four asbestos price increases within a year hadn't hurt, nor had a jump in demand following cutbacks by two competing Canadian mines, one gutted by fire, the other damaged in a mudslide.

Appraised at $3-million, Lowell workers paid bargain $400,000 for 2,300-acre mine and equipment.

The reward the miners received for their efforts was a 2,300-acre facility grossing $7-million a year, complete with machinery and enough accessible asbestos ore to last seven years. In return, the EPA will finally see the required pollution control equipment installed, and the banks will get their money back in five years. And if the now-confident mine owners follow through on their words, the economy of northern Vermont will be boosted by new industry in the area, financed by the profits of their unique employee-owned business.

The workers have reason for confidence. Their new company, Vermont Asbestos Group, Inc. (VAG) already has orders for 57,500 tons for the remainder of 1975, 8,000 tons more than the mine produced in 1973, from major customers such as Dow Chemical, Georgia Pacific and GAF. Furthermore, even after years of research, a synthetic substitute for asbestos used in the textile, construction, and electronics industries, is still on the back burner.

Bought 80% of stock. No wonder, then, that the first annual meeting of VAG was a joyous occasion. Some 180 employees saved their jobs and, in the process, secured a share in the corporate profits from the rock they mine. Once as unfamiliar with the ways of big business as they were with coats and ties, the workers own 80% of the stock — an investment of $80,000 — in a business that should easily show a net profit before taxes of $1-million in its first year of operation.

"We will have some problems along the way," admits John Lupien, "but so far they have been minor." Lupien, a maintenance supervisor who headed the original committee, is now chairman of the board of directors.

One of the problems surfaced at the annual meeting. Hourly wage earners, especially the younger workers with low job classifications, were worried that they would be overruled by the "white hats," or salaried personnel. Despite the fact that they hold seven positions on the 15-member board of directors, the workers decided to keep their union affiliation with United Cement, Lime & Gypsum Workers. Their union spokesman has said, however, that it would be hard to strike a company in which members are stockholders.

When the miners first set out to save their jobs, serious misgivings centered around the question: What does GAF know that we don't? And subsequently: Why did GAF agree to sell for a mere $400,000? Although no one has come up with satisfactory answers, the best guess is that GAF simply wanted to get out of the the business.

GAF blames EPA. GAF's stance throughout was that the cost of EPA compliance made future operation of the facility financially prohibitive. "We are a big company," explained Vice President Thomas Dent, "and this is a small division that we acquired 10 years ago in a merger. When we did a cost study to compare profit if we closed down in two years versus profit of continuing operations for at least seven years, adding in the cost of EPA compliance, we found that the price of our continued investment in the plant at that time was higher than the worth of the asbestos. It made sense for us to get out, just as it now makes sense for VAG, with its low

was EPA that forced the decision."

Cost studies and corporate planning were far from the minds of Lupien and his committee in the early days of 1974. "We felt helpless and we hated that feeling," Lupien recalls. "We didn't know what GAF's real reasons were for leaving, or what we could do about it. Our instincts told us that the mine should not be shut down and we formed the committee to tell everyone we weren't going to give up our jobs without a fight."

First stop for the group was Montpelier, where they told their story to Governor Thomas P. Salmon and asked for help persuading EPA and GAF to keep the mine open. Salmon moved quickly, directing Development and Community Affairs head Donald V. Webster "to do everything in the state's power to keep the mine in business." A representative of the state's Economic Development Dept., Richard B. Hamilton, began working full-time on the miners' case and soon came up with an economic impact study.

Closing to cripple area. Hamilton's study showed that the mine had at least a seven-year reserve of asbestos ore that could be profitably mined, if GAF did not high-grade most of it prior to closure. It also predicted that closing the facility would render two communities ghost towns, thrust a whole county into massive depression, cripple several supportive industries (including a state-owned railroad), and cause the loss of nearly $1½-million in property, income, and sales tax revenues.

The health danger, it appeared, was not as imminent as the EPA had expected. The miners in Lowell were relatively free from the lung ailments often associated with asbestos mining, and doctors in the area backed this up with affidavits submitted to the state's health department. One explanation for this was that the long, stringy fiber mined in Lowell is much different than the type, mined elsewhere, that the EPA based its regulations on — a fine, needlelike fiber that sticks to miners' lungs when inhaled.

Still, knowing that the EPA would be highly unlikely to grant GAF another extension beyond the two that the firm had already exhausted, state officials proposed that GAF apply for a special presidential waiver. The case for a waiver was to be based on economic arguments — averting a national product shortage (Lowell produces over 25% of U.S. demand for asbestos) and widespread economic depression in the area. But GAF, ostensibly reluctant to release data on the Lowell operation, pulled out of the deal before the proposal went to Washington.

"We were apprehensive that another firm would take over and run the mine just as GAF had. Who would stop them if they decided to pull out? One company offered to buy 51%, but there were too many strings attached." — ***John Lupien***

A search for a mining concern to replace GAF came up emptyhanded. A state feasibility study evaluating GAF's engineering data found that the operation could show a moderate profit, if not outweighed by the liabilities of a "shoestring operation."

Gun-shy on new owner. "We were apprehensive about another firm taking over and running things exactly as GAF had," says Lupien. "Who would stop them if they decided to pull out, like GAF did? One company did offer to buy 51% of the business, but there were too many strings attached."

By then it was mid-July and the miners, realizing the only option left was to take the plant over themselves, took a long hard look at the feasibility study and decided it had overstated costs and understated profit potential. Lupien went to state development officials Webster and Hamilton and announced that the group had decided to ask for their own EPA extension, to give them time to raise the funds to buy the operation and install the EPA equipment themselves.

The decision could not have come at a better time. Webster, conscious of the fact that the EPA was worried about the threat of a chlorine shortage, pointed out to the agency that specialty hooker fiber, used in the manufacture of chlorine, was produced almost exclusively at the Lowell mine. (The plant provides 96% of the world's hooker fiber.) Shortly thereafter, at the end of August, Lupien had his extension, and the miners were on their way to the second stage of the effort: financing.

Ken Huntley, hourly wage earner at the mine and member of Lupien's committee, walked into the Sterling Bank in Johnson, Vt., and asked to see the president, Norman Rolband. Huntley carried with him a list with the signatures of every miner at the plant pledging money to VAG for purchase of the mine.

Rolband, who lives in Eden, Lowell's sister town, took a look at Huntley's list. "Great," he said. "What do you want from me?"

"$100,000," said Huntley, and gulped.

Sterling banks on miners. Rolband, familiar with VAG's financing problems and that the group had been turned down on similar requests by banks in Boston, New York, and Vermont, was receptive to the idea of Sterling, which has assets of just over $1.1-million, going to bat for the workers.

"I'm not promising anything, but maybe we can help," he told Huntley. "First, you should get some legal help. You're going to need it."

VAG hired an investments attorney, Andrew Field, of Montpelier, and what followed were five months of hectic, sometimes bitter negotiations. For the banks, the issues were: Where will the initial working capital come from? How do we know what EPA will do next? Who is going to manage the operation? Who will guarantee the loan?

Eventually, with Sterling acting as the lead bank throughout the negotiations, seven banks agreed to a $1.5-million loan. The First National Bank of Boston and State Street Bank, Boston, put up $1-million; five Vermont banks — Sterling, Union Bank, Franklin-Lamoille Bank, Chittenden Trust Co., and Passumpsic Savings Bank — came up with the rest.

To seal the deal, VAG, through Hamilton, began negotiations with the Vermont Industrial Development Authority (VIDA), which has the power to insure loans up to 80% of their value. From the beginning,

From farfetched idea to ownership: John Lupien, maintenance supervisor and chairman of the board who led workers' 14-month struggle to acquire mine, estimates they will make $1-million before taxes during the first year of operation. (Photos: Ted Creighton)

however, the banks had demanded 100% backing on the agreement. VIDA finally consented, with the provision that the Assn. to Boost Lamoille Enterprises (ABLE), a local development corporation, handle the funds and oversee the operation until the loan is repaid.

Lenders want sure thing. "When we first got involved, I really didn't think it was worth the risk," Rolband admits. "We knew that if the deal went through the miners would be getting a bargain. But there was no management track record, no guarantee that the EPA wouldn't mess things up again. Even when the state guaranteed the loan, we still had doubts. No bank wants to be forced to foreclose on a loan, especially if it's the state you are foreclosing on. No, the loan had to be bankable; we didn't want it unless we thought the thing could fly."

To find out if it could, the banks had initiated their own feasibility study, the most extensive of four conducted on the operation. Still, at several points, the banks threatened to pull out of the deal — when the EPA issued new dust emission standards for asbestos tailings, when a dispute erupted over the loan's interest rate, when the banks' insistence on approval of VAG's management was challenged, and toward the end, when a $200,000 subordinated debenture plan that Field had promised fell through a month before closing. A $400,000 working capital loan, secured with 90% backing of the Small Business Administration, replaced the debentures and kept the agreement afloat.

Final coup. The seesaw struggle to nail down the final package created one last headache for the workers. Closing date was scheduled for March 12, just three days short of GAF's final deadline, and GAF suddenly announced it would begin shutdown procedures to avoid an EPA non-compliance suit if the deal were not consummated. Acting quickly, the state won an unprecedented two-week extension on GAF's deadline from EPA, and it was a weary group of miners who saw their year-long dream of running the mine themselves come to pass.

Despite the potentially radical manifestations of a company owned and operated by employees, mine management to date shows little deviation from the practices followed by GAF. Lupien, however, has noted a change in the workers' attitudes. Pilferage of small tools and supplies from the mine and mill are now almost non-existent, he reports. "Everyone seems to be trying a little harder. Work is done more carefully and more efficiently. There's an extra effort being made, and you can see it."

There are some variations from previous management procedures, however. The most significant change is a set of monitoring controls whereby the banks and ABLE are regularly apprised of the plant's financial progress through a series of marketing reports and cash flow statements. Otherwise, general policy for VAG is set by a 15-member board of directors comprised of seven hourly wage earners, seven salaried personnel, and one outsider; day-to-day decisions are made by an executive committee, weighted four to one towards salaried employees.

As VAG settles into its role as one of the largest U.S. industrial concerns controlled by workers, two additional advisory boards will be formed. Both staffed with experienced business executives, one will oversee worldwide marketing efforts, the other will recommend investment policies.

Workers become 'businessmen.' But it was up to Jerome Hammang, VAG's new president, to remind the Lowell workers of the significance of their new role. "We are a profit-oriented business," the former president of Vermont American Corp.'s Tap & Dye Div. told the VAG stockholders at the annual meeting. "We are all involved in a unique venture here. But do not forget that our first priority is that we are in business to make money. The whole country is going to be watching how we do."

Lupien, VAG's sparkplug and enduring figure throughout the 14 months since that dismal first meeting, responded to Hammang's message with a sense of pride shared by all those in the room. "A great thing has happened here," he beamed to fellow miners. "I hope it will happen again and again in this country. After all, what better way to fight a recession and make your work meaningful at the same time? All of us have become businessmen today." ■

The author is a freelance writer residing in Waterville, Vt.

Development Finance Is Under Way in Massachusetts

"Money is incestuous," a banker candidly explained to a conference of potential users of the new Massachusetts Community Development Finance Corporation (CDFC). "It tends to go after itself." So those areas that have a high level of economic activity tend to attract additional capital, while those regions experiencing a relative economic decline often lose it. Massachusetts, an old industrial state that earlier benefited from this capital mobility, is now learning that this process has its drawbacks too. Capital that was once routinely reinvested in the state's economy is now flowing to the boom states of the Southwest. In part, then, CDFC represents one effort by the state to keep some of that capital in Massachusetts to finance business development.

One feature particularly distinguishes CDFC from more conventional state efforts to promote industrial development: the corporation will provide equity and debt financing only to ventures controlled by community development corporations in depressed communities. In this manner, the state is also acting to correct the destabilizing effects of private capital movements within the state from poorer neighborhoods and communities to the more prosperous suburbs.

The state legislature passed the law establishing CDFC as an independent public agency a year ago. This past October the legislature approved the sale of ten million dollars worth of general obligation bonds, thus removing the last legislative obstacle to implementation of this unique development finance institution. With the proceeds from the sale the state will purchase all one million shares of CDFC common stock at $10 a share. In anticipation of that sale, the governor recently named and swore in CDFC's nine-member board. Barring unanticipated problems, CDFC could actually be making investments in a matter of months.

The significance of CDFC is that it represents a new approach to the financing of community economic development. It also means that Massachusetts has joined Minnesota (whose legislature has authorized planning and venture grants to CDCs in the state) as the only states sponsoring community-based economic development programs.

HOW IT WILL OPERATE

CDFC As Venture Capitalist

CDFC will operate somewhat like a private venture capitalist. The corporation will make investments in and seek a profit from young ventures (as well as acquisitions and expansions) that financiers typically consider too risky or unprofitable. Unlike private venture capitalists, who rarely finance such projects, CDFC will only assist CDC-controlled ventures in depressed communities. And where private investors in peak economic periods tend to seek a 25 to 40 percent return (and actually hope for more spectacular profits) to compensate for the high risk associated with any new business, CDFC can assume even greater risk and accept far lower returns. More about that later.

Despite these important differences, CDFC has more in common with the venture capitalist than with grant-giving programs (like the Office of Economic Development's Special Impact Program) that depend on direct governmental appropriations. The state's initial $10 million capitalization of CDFC represents an investment, not an appropriation. In theory, because of continuing though modest returns on CDC venture investments, the new corporation can operate indefinitely without any future infusion of public monies. Its ability to make new investments, however, will inevitably decline as its capital becomes committed to various projects.

CDFC can use the state's $10 million investment for two purposes: (1) to invest in various government and corporate securities from which CDFC will derive its operating revenues, and (2) to purchase a broad range of debt and equity instruments from eligible CDC ventures. The latter, of course, constitutes the essential purpose of CDFC.

That part of the corporation's portfolio invested in relatively secure market securities should generate at least a 7 percent return. Thus, a $3 million investment would produce $210,000 per year—more than enough to pay staff salaries, overhead, consultant fees, and other operating expenses of CDFC. Any remaining surplus will increase the corporation's assets and, consequently, its ability to finance CDC-controlled ventures.

Investing In CDCs

To qualify for the remaining CDFC funds, a CDC must be a quasi-public nonprofit corporation whose membership is open to all residents of the target area

18 years of age or older. Its boundaries must coincide with some set of existing political boundaries—ward, precinct, municipality, and so forth. A majority of the CDC's board must be elected by the membership; others, if any, must be appointed either by elected state and local government officials or by other nonprofit organizations that share the CDC's purpose of promoting the target area's development. Most of these provisions ensure that the CDC is sufficiently public to overcome the state constitutional bar against the use of public monies for private gain. To ensure accountability, one-third of the CDC board must be elected annually for three-year terms. Finally, the population of a target area must not exceed 115,000 people, it must be considered a blighted area, and the most recent census must indicate that the average household income is at least 15 percent below that for the entire Boston Standard Metropolitan Statistical Area.

Chart 1: Organization of Massachusetts Community Development Finance Corporation

Unlike OED Special Impact grants, CDFC capital will not go directly to CDCs. Instead, CDFC will actually purchase securities in ventures controlled by CDCs rather than invest in the CDCs themselves. The same would be true if CDFC were to make loans to ventures. However, the CDC must act as a go-between in any transaction; it is a conduit for CDFC funds. It is mandatory that the ventures be controlled by a CDC, to "ensure that public benefits and public purposes are maintained." The most substantial control exists if the venture is a wholly owned subsidiary of the CDC, but as a minimum requirement, a CDC must have the power to approve all major venture transactions if the venture is to qualify for CDFC financing.

Despite the wide variety of venture forms that will be possible, most will undoubtedly be organized for profit. However, CDFC could finance nonprofit ventures, such as day-care centers, providing they generate a positive cash flow.

The Role of the CDFC Board

The nine people who sit on the CDFC board are to make all investment decisions. Besides three of the Governor's state cabinet secretaries, the board includes two individuals experienced in investment finance, three CDC members who live in eligible target areas, and one representative of organized labor. All are gubernatorial appointees who serve staggered five-year terms.

The statute establishing CDFC gives the board a great deal of discretion. The dangers and opportunities inherent in such an untested institution, therefore, can appear unlimited,depending upon public faith in the board members and upon the institutional mechanism itself.

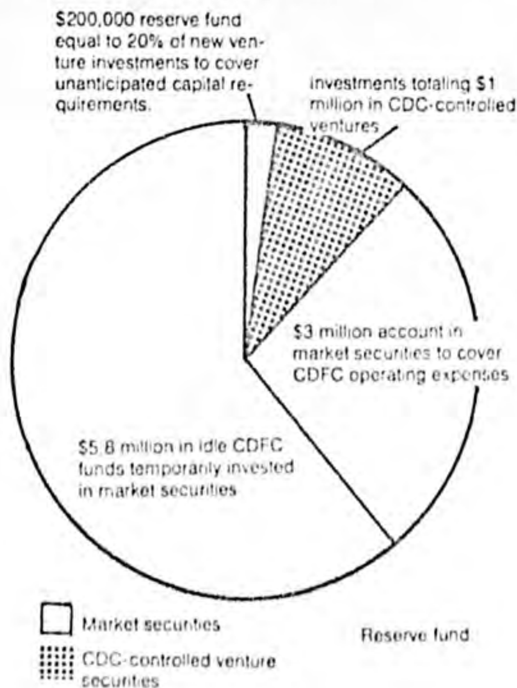
The board could thwart CDFC either by failing to make any investments in CDC ventures or by making bad investments. Both are potential dangers. On the other hand, the board has the flexibility to devise ways to support and sustain with CDFC capital what otherwise would have been chancy ventures. Ideally, it will be true to its mandate and accept lower rates of return if the project has the potential to create permanent, reasonably well-paying jobs in poor communities and increase local capital ownership.

THE CAPITAL STRUCTURE: A HYPOTHETICAL ILLUSTRATION

To continue to operate as a development finance corporation, the board must conserve its capital base. The following is a simplified example of the

kinds of assumptions advanced by the bill's sponsors when they went before a legislative committee on behalf of CDFC.

Chart 2: Hypothetical First Year Allocation of Massachusetts CDFC Funds.

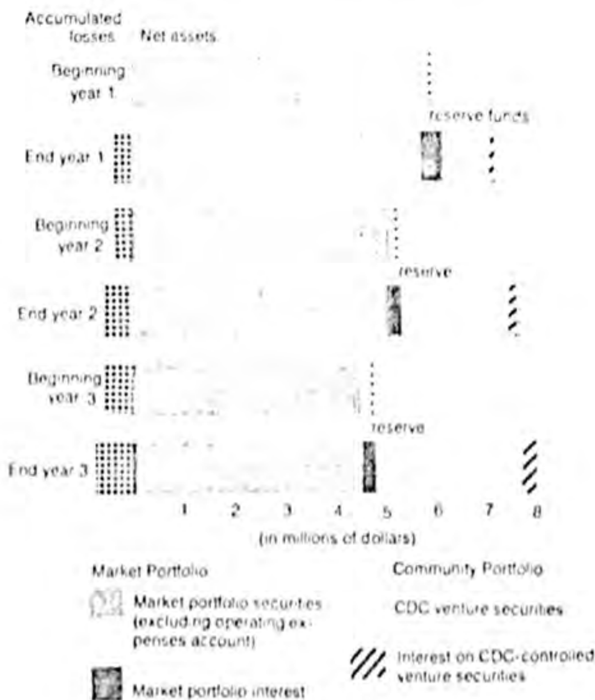


The corporation would begin to operate with the state's investment of $10 million. From this investment CDFC would have to generate sufficient interest to cover its operating expenses, such as salaries, office rent, and equipment. Consequently, the board might set aside and invest $3 million in government and corporate securities at the outset, the annual interest from which would pay for these expenses and leave a surplus. In successive years, the initial $3 million investment should expand enough to cover increasing operating expenses without depleting the corporation's capital base. This initial $3 million can be pictured as being in a separate account where it would not affect the level of other investments.

During the first year the board might decide to invest $1 million among five CDC ventures, making $200,000 available to each. Every time the corporation financed a CDC venture, it would set aside a reserve equal to 20 percent of the investment since new businesses often develop unanticipated capital needs. The reserve funds would permit CDFC to intervene if necessary, both to protect its own investment and to save the venture itself. To simplify the calculation, we can assume that CDFC placed the 20 percent reserve into the venture immediately. That would bring the first year's investment in CDC ventures to $1.2 million.

The corporation could expect venture performance to vary considerably. Supposing that one venture completely failed during the first year. CDFC's original $1.2 million community portfolio would then decline in value to $1 million. If the four remaining ventures earned 1, 3, 6, and 14 percent, respectively—a 6 percent average—CDFC would realize a $60,000 return at the end of the year, leaving the corporation with a net loss of $140,000 on its CDC venture investments.[1]

Chart 3: Massachusetts CDFC Investments, Net Returns and Accumulated Losses, Years 1 through 3.



[1] One of two alternative assumptions is hidden within this calculation: either that CDFC's investments have characteristics of both debt and equity — a convertible debenture for example — so that the venture would be paying interest charges, or that the firm could afford to distribute earnings its first year.

The market securities would include all CDFC funds that have not been invested in CDC-controlled ventures. Excluding the separate $3 million account for operating expenses, the market portfolio would equal $5.8 million during the first year. If the corporation received 7 percent interest on this account, it would gain $406,000. After subtracting the community portfolio loss at the end of the first year from the market portfolio gains, CDFC would have produced a $266,000 surplus despite its one business failure.

Based on its first year's success the board might shift another $1 million from the market portfolio to back five new CDC ventures in the second year; this would necessitate an additional infusion of reserve funds into the community portfolio. The first-year community portfolio, after the loss of $200,000 owing to one business failure, would equal $1 million. Thus after the second round of investments, the community portfolio would equal $2.2 million, with a corresponding decrease in the market portfolio to $5,066,000. If the first year's performance was repeated, by the end of its second year (notwithstanding the failure of another CDC venture) the corporation's net worth (excluding once again the operating expense account) would amount to $7,540,620—a net gain of 3.8 percent over the previous year.

Similarly, in the third year, with $1 million more of its reserves being shifted from market securities to CDC venture securities, and with one more business failure, the CDFC's net worth would climb again—this time to $7,824,463.

Of course, these figures ignore the effect of inflation which will reduce the real value of CDFC's capital over time. Also, CDC ventures will undoubtedly perform more inconsistently than described here. Nonetheless, in three years, despite the loss of three ventures, CDFC would have slightly more capital than it had to begin with. Besides illustrating how CDFC might theoretically operate, the example highlights the most fundamental characteristics of this type of institution. Conserving its capital obviously constitutes an important operating principle. Otherwise, like any bank, the CDFC would be forced to make fewer and fewer loans and equity investments and ultimately fade out of existence.

Another important institutional requirement indicated in the above example is full initial capitalization. Should the state so decide, because of its own pressing financial requirements, it might deposit some of the $10 million in its own bank account rather than capitalizing CDFC in full, in order to accumulate interest on CDFC's uninvested funds. But those funds constitute CDFC's market portfolio. Without the interest realized from that portfolio, CDFC would have to draw upon its capital base to cover its operating expenses; it would lose its ability to absorb business failures and tolerate low rates of return from its community venture portfolio. Should the state deny CDFC full use of its market securities portfolio, it would curtail the corporation's ability to take the high risks necessary to launch ventures in depressed areas. Worse still, by forcing CDFC to spend its capital on operating expenses the state would frustrate the development finance concept. Eventually, CDFC would exhaust its capital, forcing the institution either to liquidate or seek operating subsidies from the state.

The above example illustrates still another point: the CDFC must exercise caution in making initial CDC venture investments. But even when it manages a full portfolio of these investments, the corporation would have to continue to maintain a market securities portfolio. This would consist of the corporation's operating-expenses investments, accumulating idle funds, and, realistically, some reserve funds (this latter would be more realistic than the assumption that all the reserves would be invested in CDC ventures). Intermittently CDFC would be doing some buying and selling of CDC venture securities. These too would constitute idle funds that would be temporarily available for investment in short-term treasury notes and the like.

ISSUES AND CONCERNS

Can Success Spoil CDFC?

There is always the possibility that returns from the community portfolio will exceed the planners' expectations. This fortuitous development would increase the corporation's assets and provide even greater capital for CDC venture investment.

Given the public character of CDFC and its special high-risk mission, this sort of success would also justify careful scrutiny. If it was achieved because CDC ventures proved to be better investments than anyone had anticipated, fine. But what if the corporation's success reflected its practice of underwriting what were essentially private businesses that accepted only the most minimal CDC control—the power to pass on major decisions? The law states that this constitutes sufficient control to qualify for CDFC participation even

though the CDC has no ownership in the enterprise. Under these conditions the community might still gain some benefits, such as full-time, year-round jobs paying 150 percent of the minimum wage plus fringe benefits (an objective stipulated in the statute). The venture might also increase the level of local employment, sales, and personal income through multiplier effects. But this low level of CDC control would conflict with another objective of the statute: "to enhance development of capital ownership in the target area."

This apprehension reflects the very real danger that Massachusetts CDCs will lack the resources to develop venture proposals that are strong enough to justify CDFC financing and that under such circumstances the CDFC board might be tempted to participate in ventures with only tenuous CDC involvement. The reason for this is a serious and well-recognized deficiency in the state legislation itself: the absence of financing for the planning and technical assistance necessary to the development and packaging of high-quality venture proposals. CDFC can only finance self-liquidating activities. Unfortunately, few pre-equity planning costs fall into that category even though they are necessary expenditures. Unlike other production inputs (a piece of equipment, for instance) a market survey or a consultant's services are not tangible physical assets: they have no resale value. Thus, if CDFC dispersed pre-equity planning funds for business ideas that later proved unworkable, the corporation would have depleted its capital base. If CDFC actually recorded spectacular profits from its various investments, it would be able to devote funds to pre-equity planning and still conserve its capital base. But the whole idea of the corporation revolves around the board's willingness to finance ventures that offer the promise of only modest returns. As a consequence, pre-equity planning and technical assistance will have to be sought elsewhere—through direct governmental appropriations, foundation grants, or other sources.

Although the governor has consistently opposed new appropriations, his Capital Formation Task Force is expected to recommend pre-equity planning and technical assistance financing for potential CDFC users as part of a broader package of economic development programs. In the meantime, however, CDFC supporters continue to be concerned about the quality of CDC venture proposals that will be submitted to CDFC.

The omission of a strong planning and technical assistance component in the legislation takes on greater significance when CDFC is specifically compared to existing development finance corporations. Despite CDFC's uniqueness in being state-run and exclusively for CDC-controlled ventures, this sort of public or quasi-public financing corporation is used throughout the world to develop or perfect capital markets. Typically, the task involves three functions: (1) technical assistance, (2) the provision of debt and equity, and (3) the creation of primary and secondary capital markets. The processes which have denied poor communities access to capital have also denied them some of the technical skills and resources necessary to develop good business plans. Thus technical assistance and the initial capital to carry out venture planning represent essential ingredients for the creation of a viable capital market in depressed communities. The political decision to omit this function from the CDFC act will impair its effectiveness by giving a competitive edge for CDFC's limited funds to better established community groups and, possibly, to private business interests.

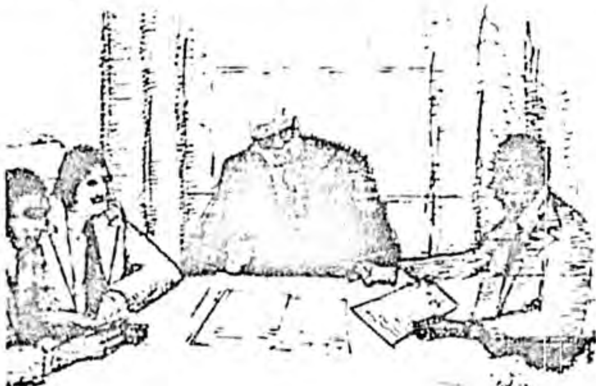
By comparison, CDFC is well designed to fulfill the function of supplying debt and equity. Only time will tell whether its financing will create further private capital investment. But it is fair to assume that with adequate equity, private debt financing will be forthcoming. For example, if CDFC made an equity investment in a CDC venture, a bank might then be willing to make a loan secured in part by the venture's CDFC-financed assets. If the venture proved successful, CDFC would be able to sell its interest in the concern, thereby introducing CDC-controlled ventures to a secondary market. The enabling legislation provides some protection for the CDC in the event CDFC decides to sell its stock in a CDC venture. The act gives the community corporation 120 days to exercise the right of first refusal and subsequently the opportunity to meet any third-party offer to purchase CDFC's securities in the CDC venture.

Margin for Error: The Need for Control

The intent of the CDFC legislation is clear: It was enacted to spur development of the state's most depressed areas by the residents of those communities. Government programs rarely perform as well as their planners anticipated, and antipoverty programs in particular are subject to subsequent efforts by politically dominant interests to dilute or even subvert the original goals. Already the state's Department of Commerce and Development is promoting the program in these words: "Private companies,

with sound business plans in need of front end financing, which are starting or expanding in high unemployment areas, are eligible to apply through any licensed, not-for-profit Community Development Corporation. . . ."

That assertion is technically correct. CDFC supplies numerous opportunities for private business to benefit from the state's capital. The corporation's board is supposed to be responsible, however, for seeing that any benefits enjoyed by private interests result from their more important contribution to depressed communities and neighborhoods in the form of increased capital ownership in the target area, new jobs, and strengthened CDCs.



In some cases CDCs might participate with private entrepreneurs in joint ventures, with the entrepreneur bringing a product and management skills to the partnership. Kentucky Highlands Development Corporation (formerly Job Start) has successfully pioneered this sort of joint venturing. But the CDFC legislation leaves the door open to less advantageous CDC relationships with private business and even leaves room for outright abuse.

As mentioned earlier, the law states that a CDC's ability to pass on major venture decisions provides sufficient, though minimal, influence over the firm to satisfy the requirement of CDC control even though the community organization would not share in the ownership of the venture. The danger that the CDFC board might sanction these kinds of deals has been increased by the absence of pre-equity planning and technical assistance funds. With few good CDC venture proposals coming before it, as stated earlier, the board might be tempted to finance ventures in which CDCs have no ownership.

The wary might also raise some questions about the legitimacy of participating CDCs. A great effort was made to ensure that eligible CDCs would be democratically run. But the law makes no provision to ascertain whether the CDC really represents the residents of a target area. For one thing, while the CDC must be open to all residents of the area, the law fails to exclude nonresidents from joining eligible area CDCs. This is a matter that the CDFC board could clarify with more rigorous guidelines. Otherwise, there is some risk that phony CDCs (community "fronts" for private business interests that hoped to tap into CDFC's financing) could proliferate. These interests could organize a CDC, propose a slate of sympathetic board candidates, solicit members — some of whom might not even have any connection to the target area — and hold an election. It might all be legal. After their venture was well under way, the corporate parent might arrange to buy back the CDC's share of the business from its hand-picked community board. CDFC would then become a minority partner in an otherwise private business venture.

Of course, such a scenario is contrived. It would be difficult for a businessperson to execute a coup of this scale in Roxbury, for instance, where the local leadership is alert and well informed about developments in the community. However, because of the legislative definition of an eligible target area, it would appear that certain locales could be identified that would be unable to fend off this sort of corporate flimflam. One characteristic of an eligible target area is an average household income at least 15 percent below that for the Boston Standard Metropolitan Statistical Area (SMSA). The legislation's drafters used that criterion because it would include all the areas they felt the CDFC should serve and would remain a good relative measure over time—better, for example, than unemployment statistics.

But the criterion also enables a lot of areas that should have a relatively low priority to qualify for CDFC funds. In 1970, a median family income of $9,732 would have qualified an area for CDFC involvement.[2] Obviously, by this standard,

[2] According to recent HUD statistics, the equivalent (median family) figure for 1976 is $14,620. However, in determining eligibility the CDFC will use the most recent census, which is currently 1970. It is not yet known how the CDFC board will interpret the legislative language "average household income." They could use median or mean income for either families, families and unrelated individuals, or households.

the wealthiest suburbs would be ineligible. However, opportunists might try to establish phony CDCs elsewhere in the state where community development is not a public concern but where commercial interests instead promote private business development. The statute seems to give the board the latitude to establish alternative statistical criteria consistent with the general intent to serve depressed communities.

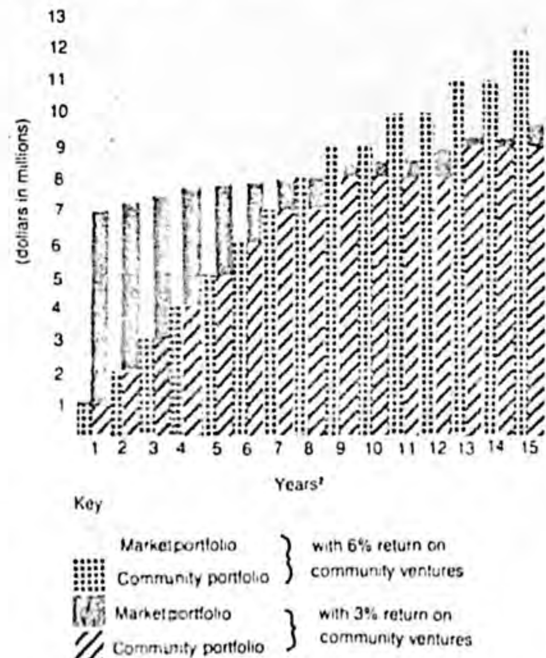
Only the CDFC board—and possibly the courts if it ever comes to that—can keep CDFC funds from being used for unintended purposes. Although the members are all gubernatorial appointees, the initial board appears to be quite sympathetic to community interests. However, CDCs have no guarantee that in future years a governor might not make less appropriate appointments or might not encourage the board to misuse its discretionary power in order to leverage other state efforts to help particular private businesses. In the final analysis, the last line of defense against CDFC abuses will have to be a well-organized group of CDCs that will scrutinize all CDFC investment decisions and fight politicizing the agency and any other questionable CDFC activities.

CDFC's Liquidity and Benefits to the State

If, as we hypothesized, only one in five ventures produces a market return in excess of 9 percent, the corporation will be forced to leave its assets in most CDC ventures unless it is prepared to sell its interest at a loss. Thus CDFC is, to a large extent, locked into its investments. This feature of CDFC has been poorly understood up to now.

There are actually two types of development finance corporations: those that back businesses that have good profit potential and those that back ventures primarily to promote economic development even if the ventures may just barely manage to survive. CDFC belongs in the latter category. The CDFC planners assumed that in only one out of five cases—the business reporting a 14 percent return—would the capital market have failed to invest in a good venture because of prejudices against investing in depressed neighborhoods and the like. With the remaining four out of five, CDFC could recover its assets only by accepting a loss or through some prior buy-back arrangement with the CDC or the venture itself. If in fact CDFC fails to keep capital liquid in such a manner, it will reach a point where its annual injections of capital into new CDC-controlled ventures will diminish year by year.

Chart 4: Growth of Massachusetts CDFC Community and Market Portfolios (excluding operating expenses account).[1]



[1] Assumes the failure of one out of five new ventures each year and that the entire $200,000 annual reserve fund is invested in ventures at the beginning of the year in which the primary CDC venture investment is made.

[2] Showing the position at the beginning of the year with the $200,000 loss on the venture failure and the $200,000 reserve fund investment off-setting each other. Thus a $1 million dollar community portfolio investment plus $200,000 in reserve funds appears as $1 million because the business failure has already offset the reserve funds.

If the corporation proceeded as projected earlier, in the tenth year it would have $760,000 in its available market securities account—too little to invest another $1 million in community ventures with the requisite 20 percent reserve. If it thus made no new investments that year, in the following year it again would have accumulated enough to invest in five ventures. Thus after nine years the rate of new CDFC investment in community ventures would decline by 50 percent, from $1.2 million per year to $1.2 million every other year. If returns from successful ventures were actually 3 percent rather than 6 percent, the corporation would have to reduce its rate of investment after 7 years and after 9 years would be compelled to wait another 4 years before it accumulated enough interest to place another $1 million in community ventures. Thus, to maintain the level of activity

sustained during CDFC's early years, it would have to return to the state legislature with a request for additional capital, although it could continue to operate at a lower level without further state involvement.

What Does the State Gain?

After eight years, the legislation allows the state treasurer to sell the state's interest in CDFC. Still, even if the corporation proved to be highly profitable, who would find CDFC attractive as an investment? There is no provision for the distribution of profits, and CDFC's stockholders would lack any control over the corporation's behavior; the state, through gubernatorial appointment powers, exercises sole control over the corporation's board.

Given the low level of anticipated returns and the inability of the state to share in them, one wonders what might motivate even the state to make a $10 million investment—one, in fact, it cannot even get out of—and then, ten years later, to provide additional capital?

The state receives its return on the "dual balance sheet." By targeting new employers into depressed communities the CDFC will create jobs for people who now receive public assistance. That will save the state money. Individual and business incomes will also generate state tax revenues. One estimate indicates that for every $15,000 invested in an export manufacturing venture, one job will be created which will in turn represent a total $3,000 annual return to the state. In the case of an export service, the CDFC investment needed to produce a job and the same return to the state might be as low as $5,000.

It is this rationale that justifies the development finance approach. Private investors will never take the kind of risks that CDFC can for a 6 percent return because they cannot capture the positive externalities—the savings to the state in reduced welfare and unemployment payments and the growth in tax revenues associated with CDFC's investments. But because of the security offered to traditional private capital sources following CDFC's risky front-end investment in poor communities, the state may succeed in plugging some of the capital leaks that have developed in the state's economy, which would foster both a more equitable distribution of jobs and income, and greater economic stability within the state.

Carl Sussman

Women and Finance Institutions

Discrimination against women in the financial world both in services and in employment has long been a reality. Although women in the U.S. represent 43 percent of the labor force and control through their role as household buyers between 70 and 75 percent of all consumption, they have traditionally been excluded from participation in the world of finance.

The enactment of the Equal Credit Opportunity Act, which became effective in October 1975 and made it unlawful for any creditor to discriminate against any applicant on the basis of sex or marital status, did not erase the bitterness that discrimination had produced. It is the desire to fight it on a productive level that has provided the incentive to establish financial institutions created by and for women.

The idea that women could competently and competitively manage their own funds, and the desire to provide certain services not furnished by the established financial community but valuable to a particular, female clientele, have motivated women over the past few years to form banks and feminist credit unions that specialize in services for women. Like minority banks before them, which have a 73-year-old tradition in this country dating back to 1904 with the founding of the Citizens Savings Bank and Trust Bank and Trust Company in Nashville, Tennessee, the women's banks (which some may not consider minority institutions in the strictest sense) are operating under similar principles of providing access to capital and credit — as well as management opportunities — to a segment of the population that has been denied them for years. This article will discuss the organization of these banks from the perspective of how ideology has been combined with practice.

As of this writing, there are 4 new women's commercial state banks operating with a specific emphasis on serving women, and 18 federal feminist credit unions across the country. Among the variety of innovative services the banks offer are flexible hours, personalized financial counseling services, SOS programs for women in financial difficulties after a divorce or husband's death, and seminars and lectures on financial management. The credit unions offer many of the same services but to a different clientele. All of these are aimed at both easing the knowledge gap between the depositor and

State governments must establish a state manpower services council to review the plans of prime sponsors and make recommendations for coordination and for the cooperation of state agencies.

Title II provides funds to hire unemployed and underemployed persons in public service jobs in areas of substantial unemployment. *Title III* provides for direct federal supervision of manpower programs for Indians, migrant and seasonal farm workers, and special groups, such as youth, offenders, older workers, persons of limited English-speaking ability, and other disadvantaged. This title also gives the Secretary the responsibility for research, evaluation, experimental and demonstration projects, labor market information, and job-bank programs. *Title IV* continues the Job Corps. *Title V* establishes a National Manpower Commission. *Title VI*, added in December 1974 under the Emergency Jobs and Unemployment Assistance Act, authorizes a one-year appropriation of $2.5 billion for a public service employment program for all areas, not just for areas of substantial unemployment. *Title VII* contains provisions applicable to all programs, such as prohibitions against discrimination and political activity.

*From the Interim Report on CETA of the National Research Council of the National Academy of Sciences.

For a more complete description and analysis of CETA, see the report of the National Economic Development Law Project, Earl Warren Legal Institute, 2313 Warring St., Berkeley, Calif. 94704. Also, for action strategies, write the Center for Community Change, 1000 Wisconsin Ave., N.W., Washington, D.C. 20007 for publications on CETA.

Massachusetts Local Initiative Program

In an adaptation of the Canadian Local Initiative Program to U.S. unemployment problems, 27 Massachusetts community groups and local government sponsors have been awarded over $1 million in CETA funds to implement innovative job-creation programs in their communities. The Massachusetts Local Initiative Program (MLIP) will operate on a six-month experimental basis beginning this summer, under the sponsorship of the Executive Office of Economic Affairs. Projects expected to employ some 300 persons in such diverse activities as cultural summer programming and a community canning project will operate in areas as varied as metropolitan Boston, rural western Massachusetts, and the rock cliffs of Martha's Vineyard.

Utilizing special provisions in CETA legislation that give the Governor the opportunity to fund special employment-creating projects, the Executive Office of Economic Affairs designed the experimental program this spring on the recommendation of, and with assistance from, the State Manpower Services Council (which consists of the chief administrative officers of the state's larger cities and representatives of business, labor, government, and community groups). Individuals, community organizations, and local governments were invited to apply. More than 1,200 Requests for Proposal were distributed throughout the state, and 487 applications were submitted for funds to hire the unemployed on short-term projects that would "contribute in some special way to the quality of life in the community."

Description of Projects

Awards for community service projects range from $25,000 to $50,000. One grant will be used to train mildly retarded adults to serve as teachers' aides to seriously retarded youngsters; another will help establish a Cape Verdean Cultural Center for southeastern Massachusetts' Portuguese-speaking community. Other projects selected include a

$31,000 program to convert an unused three-story synagogue in the Chelsea area of Boston into a bilingual day care center to serve the city's sizable Spanish-speaking population, and a $42,000 grant to assist the city of Lawrence in fire prevention by hiring special "fire monitors" who will be trained in these techniques as well as in evacuation procedures. Most projects are designed to last the entire 26-week period, and some have the specific goal of becoming self-sufficient by that time.

Among the other grants:

- A Community Hypertension Screening Referral and Information Service project in Roxbury has received $39,000 to employ 9 persons to screen more than 10,000 residents—at shopping malls, stores, and homes of the elderly—as well as to provide referrals and educational services.

- The Allston-Brighton Residential Improvement project received $32,581 to employ 7 persons to offer home improvements, at low or no cost, to senior citizens or financially burdened small homeowners.

- A $44,743 grant to the Jamaica Plain/Roxbury Food Cooperative Community Outreach Project will help establish a neighborhood food co-op and supply food at little more than wholesale prices; it will also provide a center for community activities.

- The Wareham Historical Society plans to hire 8 persons on a $42,000 grant to finish reconstructing several old historic buildings in the New Bedford area and provide necessary staff to open the sites to the public, hoping eventually to keep the sites open year-round and to train local residents to maintain them.

- With a $32,000 grant, the Chester Bicentennial Committee proposes to teach several hundred residents traditional handicrafts (crewel embroidery, rug-hooking, and handweaving) as well as to provide marketing training and services to participants.

- A $44,000 grant to the Gay Head (Martha's Vineyard) Economic Development Project will help train 12 resident Native Americans of the Wampanoag Tribal Council of Gay Head in various aquaculture procedures—shellfish management and water quality maintenance among them—and expects these trainees to be absorbed later into the Tribe's ongoing aqauculture program.

- Women in Agriculture, Food Policy, and Land proposes to hire 13 persons to stimulate local, small-scale farming in central/western Massachusetts. The project intends to create a community canning center with its $48,000 grant, which will serve as a model for other such centers throughout the state. Anticipating contracts with local public service food-providers (schools, elderly nutrition programs), the organization hopes to establish a firm economic base for continuing the canning center beyond the MLIP grant period.

MLIP Goals and Requirements

MLIP incorporates many of the concepts of the Canadian Local Initiative Program (see the February 1976 *CCED Newsletter*), which is designed to provide short-term, seasonal employment opportunities, and is meant to encourage individual and community initiative rather than simply to add money to existing state (provincial) or local government services—or even to duplicate these services. Hiring will take place through local Division of Employment Security offices, with employee wages not to exceed the prevailing community wage scale for similar work.

Projects were selected for funding on the basis of their experimental value, as well as the extent to which they met MLIP objectives of providing a good or service to a community that in some way improves the quality of life, is currently needed but unavailable, and at the same time offers productive employment to those certified as eligible for participation in CETA programs. Other criteria for project selection involved human development potential, services to the disadvantaged, lack of duplication of existing programs, significance to the community, linkages to other programs and/or service networks, and the possibility of the project's continuing on an independent basis after the expiration of the MLIP grant period.

Overall program administration will be conducted by the State Manpower Services Council and is designed to be minimal; one of the most attractive features of the Canadian model, in fact, is its reduced bureaucracy. Evaluation of the program by an outside, independent evaluator will begin with the inception of the experiment; a report on the status of specific projects will be issued by the sponsoring agency after three months, with an overall report upon completion of the program in February.

Prospects for Success

The Canadian program has attracted a good deal of attention in this country because of its simplicity, ease in administration, and low overhead

costs, as well as for its unique approach of encouraging project initiation outside of government agencies. But the very nature of the Canadian model that makes it attractive to some is at the same time a drawback in the eyes of advocates of community economic development strategies who view building an institution and establishing a financial base as crucial to having any significant effect in combating joblessness or changing the nature of job creation from a top-down to a bottom-up procedure.

The restriction of the MLIP to short-term, nonprofit ventures, although it does meet some of the more strident demands for jobs, does not offer hope for any long-range effect on unemployment statistics. The grants that were awarded are disappointing in certain respects; only a small number of projects are truly innovative or have any possibility of self-sufficiency, and few provide any primary sector employment. MLIP thus appears to be just one more form of public service employment, even though a small number of the grantees are community-based organizations who have taken their constituency's needs into consideration in submitting their proposals.

Moreover, the MLIP requirement that any revenues generated during the grant period (although not afterward) be returned to the Office of Economic Affairs for use in furthering CETA objectives reduces the ability of the project to generate any degree of self-sufficiency. It likewise limits the possibility for continued employment of participants, since their chances of being absorbed into already swollen municipal payrolls are slim, and no effort will have been made to create an institution to perpetuate these jobs.

(The Canadian LIP is similarly limited, and, with this in mind, officials are contemplating an "Entrepreneurial LIP" for more permanent, profit-making enterprises. In addition, there already exists a long-term job-creation program, the Local Employment Assistance Program (LEAP), whose major objective is the development of employment alternatives for the chronically unemployed through funding projects that have the capacity to become self-sustaining, thus providing more stable employment possibilities.)

Results of the Canadian LIP have been encouraging within the limits of the program goals. A successful experiment in Massachusetts, however limited, could well set a precedent in the United States for community involvement in job development efforts. Other programs utilizing the Canadian model are under way in North Dakota, Montana, and Utah. Taken all together, these local initiative job-creating programs represent a start to attacking unemployment at a level where the community gets to determine some of the priorities. However, community groups must be wary of some of the other dimensions, such as where the actual control lies, since this is what will distinguish "local initiative" from other, run-of-the-mill government programs.

Cynthia Rose

Projecting Capital Requirements

With all due respect to its other aspects, poverty is essentially a lack of income. Transfer payments—unemployment, welfare, social security—must continue year after year if there is no other program to alleviate poverty. Putting productive capital in place, however, requires an expenditure only once, at the beginning, from which income will be generated over time.

We can therefore relate an amount of income (per year) to an amount of capital (once only) required to generate that income. In this way, we can ask how much money in the form of capital would be required to eliminate poverty among residents of a given area. Similarly, we can ask how realistic are the appropriations made under the Title VII program with the intent of having a "significant impact" on the poverty in selected areas.

Income Deficit

To determine how much income is "needed" in an area, we must have a level of income to which the population is "entitled." Let us assume that amount

Barrocci

INTRODUCTION

With almost 8 million Americans officially counted as unemployed and the likelihood of a return to near-full employment before the end of the decade very doubtful, there are few who question the need for expansion of public jobs programs (PJP'S). Many are calling for a revision of the presently used method of funding and administering of Comprehensive Employment and Training Act (CETA) programs.

PJP's have, in the past, demonstrated substantial employment and economic impact, especially when compared to alternative fiscal tools. Thus, they are likely to be included as at least one component of any countercyclical policy program initiated in Congress. It is equally probable that even the most avid proponents of PJP will argue strongly for revision or complete change in the processes of funding, administration and implementation of the present programs. It is to this "reconstructing" problem with special reference to the Canadian "model" of job creation that this report is addressed.

This report consists of three parts:

1. The legal, philosophical and economic foundation of the presently operating job creation programs in Canada.
2. A brief evaluation of the first three years of the operation of the Canadian programs.
3. The applicability of the Canadian models for use in the United States with special attention given to the problems in operation of current Public Service Employment (PSE) programs in the United States.

The third section also discusses revisions needed to incorporate the Canadian "model" under the existing Titles II and VI of CETA and two optional pieces of legislation.

As a cautionary preface, several relevant differences between the United States and Canada should be pointed out. First, the population (and labor force) of Canada is approximately one-tenth the size of the U.S. Thus, when discussing implementation, funding and administration we must keep in mind that it would take much larger amounts of money and administrative effort to launch a program of similar effectiveness in this country. There are, of course, possible economies of scale to be realized. Secondly, the authorization and funding levels of the Canadian job creation programs are determined by Cabinet decision made as often as twice yearly. Consequently, the funding levels and rules governing the projects (and their administration) are infinitely more flexible than is presently possible under the job creation model we are working with in the United States. The Canadian system is almost elegant in its simplicity while the system under CETA tends to be crushed by its own bureaucratic weight. This problem is addressed in the text.

In 1971 the unemployment rate in Canada was about 6 percent. In response to this situation, the Cabinet made a decision to launch the first of the programs discussed in this study, Local Initiatives Program (LIP), under the aegis of the Department of Manpower and Immigration. The Local Employment Assistance Program (LEAP), the second program described in this study, followed one year later.

THE LOCAL INITIATIVE PROGRAM

As its name implies, the LIP program sponsors projects which originate with the project sponsors themselves. Thus, from the start the various undertakings must have importance and purpose for at least one person in the community and are then subject to approval by a variety of governmental agencies.

In addition to project initiation outside of government agencies, there are two other (and possibly more important) objectives of the program. First, the initial design was to create a program that would reduce the seasonal, regional and area specific unemployment in Canada. Because of certain geographic and industrial characteristics of the Canadian economy, Canada suffers a disproportionate amount of seasonal unemployment. It was at this problem that the LIP program was initially aimed. Secondly, the projects must in some way "enhance the quality of life" in Canada. This is loosely interpreted to mean that the projects must provide a good or service which was previously not available (or unavailable at a reasonable cost) or must utilize facilities which were available but untapped. Projects range from the obvious, such as day care centers, to the innovative, such as provision of tutoring centers for newly arrived immigrants. (A summary list of the types of projects is supplied in Appendix A.)

LIP projects are limited only in that they are not to be profit-making endeavors—any revenue generated from the project is charged against project expenses.[1] Projects can be aimed toward self-support either through revenues generated or support from other funding sources.

Each project application submitted must allow for the provision of at least 15 man-months of employment for persons who would otherwise have been unable to find a job. Projects are accepted only if the type of skill needed on the project is already available among the cadre of unemployed workers in the community. No provision for training is involved—primarily due to the short time span and the availability of alternative training programs through the Canadian Department of Manpower and Immigration.

Every person hired on a project must be referred through the Canadian Manpower Centers—the U.S. equivalent is the Division of Employment Security—and priority is given to those who are receiving unemployment benefits or welfare payments.[2] Any person who is a citizen or landed immigrant is eligible unless that person is a member of the immediate family of a project sponsor (in this case special permission from the Minister is required.)

[1] There have been, however, proposals to initiate an Entrepreneurial LIP Program so that certain projects with profit making ability and long-range prospects can be funded for longer periods of time.

[2] The Unemployment Insurance System in Canada differs from the U.S. system in that the employees, government and employers pay into the system. It is not completely employer funded as in the United States.

The LIP wage schedule aims at paying participants the going local wage for similar work (not interpreted as the "Davis-Bacon" wage rate as it often is in the United States). The sponsors and/or project managers can earn up to $140 per week, while employee participant earnings must average $115 per week. In addition, the government contributes $22 per week to cover administrative costs and "employer" contributions for unemployment insurance benefits.

The maximum funding level provided by the government is presently at $75,000 for an entire project. This has been reduced from a 1971 maximum level of $500,000 and a 1972 level of $200,000.[3] The funding levels for the first four "seasons" of the LIP project are shown in Table 1.

TABLE 1.—LIP FUNDING, NUMBER OF PROJECTS, MAN-WEEKS OF EMPLOYMENT, JOBS CREATED, AND COST PER MAN-YEAR

	Total funds (millions)	Number of projects	Jobs created	Man-weeks employment	Amount per man-year
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1972-73	[1] 206.0	5,818	85,426	1,824,400	[illegible]
1973-74	72.8	3,401	30,358	626,880	6,038
1974-75	85.0	4,191	30,362	624,563	7,073

[1] Includes extra money appropriated for project extensions: $40,000,000 in 1971-72, and $36,000,000 in 1972-73.

It has not been made clear why the overall funding level was lowered substantially between 1971-72 and the present program. Representatives of the Canadian Manpower Office indicated that the decision was political and not based on the "worth" of the program. Apparently it was a step taken to eliminate the large efforts communities were proposing as a means to increase their "revenue sharing" pot. Decreasing the maximum for any one project insured the funding of more and smaller projects.

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The agency responsible for the administration of the LIP program is the Job Creation Branch of the Department of Manpower and Immigration. The application form consists of *one* page (the flip side is optional) to be filled out by the applicant and forwarded to one of the ten branch offices of the Job Creation Branch. (A copy of the application form is shown in Appendix B). The application sheet asks only for a reasonably detailed budget of salaries and other expenses, along with the expected number of man-weeks of employment and the extra revenues (if any) that the project might generate. The assumption is that the project's justification will come out in the review process and in the active support of the project by the community or province in which it originated.

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INTRODUCTION

With almost 8 million Americans officially counted as unemployed and the likelihood of a return to near-full employment before the end of the decade very doubtful, there are few who question the need for expansion of public jobs programs (PJP'S). Many are calling for a revision of the presently used method of funding and administering of Comprehensive Employment and Training Act (CETA) programs.

PJP's have, in the past, demonstrated substantial employment and economic impact, especially when compared to alternative fiscal tools. Thus, they are likely to be included as at least one component of any countercyclical policy program initiated in Congress. It is equally probable that even the most avid proponents of PJP will argue strongly for revision or complete change in the processes of funding, administration and implementation of the present programs. It is to this "reconstructing" problem with special reference to the Canadian "model" of job creation that this report is addressed.

This report consists of three parts:

1. The legal, philosophical and economic foundation of the presently operating job creation programs in Canada.
2. A brief evaluation of the first three years of the operation of the Canadian programs.
3. The applicability of the Canadian models for use in the United States with special attention given to the problems in operation of current Public Service Employment (PSE) programs in the United States.

The third section also discusses revisions needed to incorporate the Canadian "model" under the existing Titles II and VI of CETA and two optional pieces of legislation.

As a cautionary preface, several relevant differences between the United States and Canada should be pointed out. First, the population (and labor force) of Canada is approximately one-tenth the size of the U.S. Thus, when discussing implementation, funding and administration we must keep in mind that it would take much larger amounts of money and administrative effort to launch a program of similar effectiveness in this country. There are, of course, possible economies of scale to be realized. Secondly, the authorization and funding levels of the Canadian job creation programs are determined by Cabinet decision made as often as twice yearly. Consequently, the funding levels and rules governing the projects (and their administration) are infinitely more flexible than is presently possible under the job creation model we are working with in the United States. The Canadian system is almost elegant in its simplicity while the system under CETA tends to be crushed by its own bureaucratic weight. This problem is addressed in the text.

In 1971 the unemployment rate in Canada was about 6 percent. In response to this situation, the Cabinet made a decision to launch the first of the programs discussed in this study, Local Initiatives Program (LIP), under the aegis of the Department of Manpower and Immigration. The Local Employment Assistance Program (LEAP), the second program described in this study, followed one year later.

THE LOCAL INITIATIVE PROGRAM

As its name implies, the LIP program sponsors projects which originate with the project sponsors themselves. Thus, from the start the various undertakings must have importance and purpose for at least one person in the community and are then subject to approval by a variety of governmental agencies.

In addition to project initiation outside of government agencies, there are two other (and possibly more important) objectives of the program. First, the initial design was to create a program that would reduce the seasonal, regional and area specific unemployment in Canada. Because of certain geographic and industrial characteristics of the Canadian economy, Canada suffers a disproportionate amount of seasonal unemployment. It was at this problem that the LIP program was initially aimed. Secondly, the projects must in some way "enhance the quality of life" in Canada. This is loosely interpreted to mean that the projects must provide a good or service which was previously not available (or unavailable at a reasonable cost) or must utilize facilities which were available but untapped. Projects range from the obvious, such as day care centers, to the innovative, such as provision of tutoring centers for newly arrived immigrants. (A summary list of the types of projects is supplied in Appendix A.)

LIP projects are limited only in that they are not to be profit-making endeavors—any revenue generated from the project is charged against project expenses.[1] Projects can be aimed toward self-support either through revenues generated or support from other funding sources.

Each project application submitted must allow for the provision of at least 15 man-months of employment for persons who would otherwise have been unable to find a job. Projects are accepted only if the type of skill needed on the project is already available among the cadre of unemployed workers in the community. No provision for training is involved—primarily due to the short time span and the availability of alternative training programs through the Canadian Department of Manpower and Immigration.

Every person hired on a project must be referred through the Canadian Manpower Centers—the U.S. equivalent is the Division of Employment Security—and priority is given to those who are receiving unemployment benefits or welfare payments.[2] Any person who is a citizen or landed immigrant is eligible unless that person is a member of the immediate family of a project sponsor (in this case special permission from the Minister is required.)

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[3] The majority of the projects are funded at a level considerably less than even the reduced maximum of $75,000. See Appendix A.

Other Federal departments which might have an interest,
The Constituency Advisory Group, and
The applicant, indicating official acknowledgement of receipt.

Each of the above parties submit their opinion of the project to the Job Creation Branch which then forwards all comments to the Constituency Advisory Group (CAG).

The CAG's were first set up with the 1973–74 program in order to insure local consultation on the proposed projects. Each CAG is composed of 11 members (changed from 9 members in 1973–74) nominated by the local member of Parliament, to represent a broad base of community interests. The CAG's take the inputs of all the parties sending comments and arrange the projects in order of priority for funding. The Federal Government has approved approximately 95 percent of the CAG-recommended projects. It should be pointed out that the Member of Parliament does not have to set up a CAG—if this is the case then the project selection is the responsibility of the program officials (usually in consultation with the Member of Parliament).

Sending the proposals to the other Federal agencies that might be interested is done in order to avoid overlap and conflicting projects in an area. For example, the Interior Department may have been planning a fire road, while the local group who proposed a LIP project to do the same was not aware of the plans.

All plans, due to the seasonal design of the program, must be submitted by Oct. 1 of the year and be ready to begin as early as Dec. 1, but not later than Jan. 31. The maximum length of funding for any one LIP project is 26 weeks, although some have been granted "special circumstance" extensions.

If a project is approved, the sponsor officially becomes an "employer" with all the responsibilities for accounting and payment into the Unemployment Insurance fund (for all participants but the sponsor). The sponsor must then use the Canadian Manpower Centers for the recruitment of all staff and make sure the project is in compliance with all Federal and provincial laws in reference to building permits, licenses and wages. The Job Creation Branch offers help on any and all administrative problems.

The funding of the project is made in installments with an initial payment, covering the first two months of operation, sent with the award. The remainder of the payments are made on a monthly basis depending on whether the monthly reports are received and approved by the Job Creation Branch (and sometimes checked in the field by a member of the Job Creation Branch staff). All of the rules and regulations are carefully laid out in a sponsor's handbook, distributed when the project is approved.

The termination of LIP projects is automatic at the end of the 26-week period, unless the project has become self-supporting or the community (or provincial government) includes it permanently in the budget. The participants do not expect to be retained, as the design of the program is to take care of seasonal employment problems. The participants are, however, eligible for unemployment insurance benefits in that the project sponsor has paid into the fund during the 26-week period.[4]

[4] It is w[illegible]hile to point out that the Job Creation Branch figures out the appropriate rate for e[illegible]oject and takes care of the Workman's Compensation premiums for each project par[illegible]pation.

In sum, the administrative procedures employed in the LIP program appear to be as simplified as possible, while still retaining enough control and review to minimize the possibility of fraud. There are no elaborate rules and regulations, but rather a simple set of guiding principles which are interpreted *ad hoc* when necessary by the staff of the Job Creation Office of the Department of Manpower and Immigration.

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to eval[illegible]

ASSESSMENT OF THE PERFORMANCE OF LIP

The information upon which the brief evaluation of the activities of LIP is based is all of a secondary nature. The author has not conducted nor has he been involved in the data gathering. Much of the information used in this section is provided by the Canadian government in the form of published data on participant characteristic and program costs and should be reliable. Value judgments presented are the sole responsibility of the author and not the "official" word from the Canadian Department of Manpower and Immigration.

ALLOCATION OF FUNDS UNDER LIP

The allocation and distribution of funds under the LIP program is a very simple procedure. An estimate of unemployment is made for each of the 41 economic regions. The difference between this number and the expected number of unemployed persons at a 4 percent "full" employment level is calculated. The number of persons counted as "excess" unemployed is then multiplied by the national dollar allocation per unemployed person. In 1974–75, this figure was approximately $262. Each of the regions is to receive a minimum of $75,000, enough for at least one LIP project. This system contrasts with the present allocation system employed under CETA which resulted from compromises reached in Congress over rural versus urban areas and States with high versus States with lower population and unemployment.

PROJECT SPONSORS

As indicated above, there are no special provisions for project sponsors—any individual or non-profit group or agency may apply. Following is a list of the 1973–74 project sponsors cross-tabulated with the type of project activity.

TABLE 2.—LIP ACTIVITIES BY PROGRAM SPONSORS, 1973-74

[Percent distribution]

Activity	Sponsor										
	Local government bodies	Other government agencies	Indian and Eskimo groups	Cultural groups	Religious groups	Service and welfare organizations	Business and labor organizations	Citizens committees	Recreation and leisure organizations	Individuals	Total
Building construction	3.5	1.3	3.2	0.9	2.3	2.3	0.4	2.8	3.5	1.6	21.8
Nonbuilding construction	5.7	.9	1.3	.2	.2	.4	.3	1.5	2.6	2.4	15.5
Lands, parks, and forestry	3.1	.8	.8	.4	.1	.2	.3	.4	1.2	1.2	8.5
Artistic and cultural	.1	.2	.3	1.9	0	.2	.1	.2	.2	1.7	4.9
Education	.2	1.2	.2	.5	.2	2.3	.3	.7	.4	2.5	8.5
Information	.1	.1	.1	.2	0	.3	.2	.9	0	.9	2.8
Social services	1.0	.7	1.5	.7	.7	6.4	1.1	4.4	1.1	10.7	28.3
Health services	0	.2	0	0	0	.5	.1	.1	0	.2	1.1
Sports and recreation	.7	.4	.1	.2	0	.1	.2	.4	1.9	.9	4.9
Research	.6	.3	0	.6	0	.4	.3	.4	.2	.9	3.7
Total	15.0	6.1	7.5	5.6	3.5	13.1	3.3	11.8	11.2	23.0	100.0

Source: Canadian Department of Manpower and Immigration.

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Artistic and cultural	.1	.2	.3	1.9	0	.2	.1	.2	.2	1.7	4.9
Education	.2	1.2	.2	.5	.2	2.3	.3	.7	.4	2.5	8.5
Information	.1	.1	.1	.2	0	.3	.2	.9	0	.9	2.8
Social services	1.0	.7	1.5	.7	.7	6.4	1.1	4.4	1.1	10.7	28.3
Health services	0	.2	0	0	0	.5	.1	.1	0	.2	1.1
Sports and recreation	.7	.4	.1	.2	0	.1	.2	.4	1.9	.9	4.9
Research	.6	.3	0	.6	0	.4	.3	.4	.2	.9	3.7
Total	15.0	6.1	7.5	5.6	3.5	13.1	3.3	11.8	11.2	23.0	100.0

Source: Canadian Department of Manpower and Immigration.

The data on the 1973-74 programs shows that individuals are the most frequent sponsors and social services the most frequent activity. A recent conversation with a Canadian LIP official revealed that in the 1974-75 project year, 35 percent of the projects were sponsored by individuals. The stark contrast between LIP and CETA is that only about 21 percent of the LIP projects were sponsored by government agencies. Of those sponsored by government agencies, the majority were related to construction activity. This reflects the fact that LIP funds cannot be used for capital equipment and materials. Governmental units were most able to supply the necessary additional resources. A University of Calgary study of LIP projects showed that 38 percent of the sample projects were receiving funds from other sources—a tangible expression of the willingness of the communities to become directly involved in the LIP projects.

In 30 percent of the cases studied it was found that a public or private agency provided the same or similar services as the LIP project. However, this may not indicate an oversupply since the Calgary study also showed that 81 percent of the users of LIP services knew of no alternative in the community. The bulk of the duplication was in large cities and most of those who were involved in organizations which supplied the same or similar services did not view the LIP projects with disfavor.

An accurate measure of community attitudes toward LIP is difficult to obtain, but a sample cross-section of the communities surveyed showed that about 69 percent were favorable, 25 percent were unaware of the project and 6 percent registered unfavorable opinions.

Economic Impact of LIP

LIP, by design, is a program to reduce seasonal unemployment in Canada and thus its economic impact cannot be judged by simply listing changes in the overall unemployment rate.

About 70 percent of the LIP jobs lasted 24 weeks or less while 30 percent had a tenure exceeding the "regular" seasonal unemployment span in Canada. Estimates made by Prof. Fred Lazar[1] at York University indicate that the LIP program increased the overall level of employment during the winter months between 1 and 1½ percent and reduced the total level of unemployment by approximately 5 percent. These figures assume that each job created under LIP is a net addition to the employment pool. This may not be true if any of the projects would have been undertaken in the absence of the program. Unfortunately, there is not a direct method of measuring this.

One of the most remarkable aspects of the LIP program is the fact that it has created and filled such a large number of jobs in so short a period of time. For example, in the 1972-73 year there were some 86,000 jobs created and filled in less than two months. The program is not as large now but still operates effectively in the given time frame. In order to duplicate this effort in the United States we would have to create and fill almost 1 million jobs in 2 months.

The LIP projects created one man-year of employment for each $7,000 expended (see Table 1). There are several reasons for this low figure. First, the wages paid must average $115/week—about 10 to 20

[1] Fred Lazar, unpublished, untitled paper, Dept. of Economics, York University, January, 1975.

percent less than Canadian national full-time average. Secondly, the administrative costs are minimal, since there is no large public bureaucracy set up to deal with and plan the programs. Thirdly, the projects are labor intensive, and thus only a small percentage of the government funds were used for materials and other operational expenses.

Since the LIP program is specifically designed to take up the seasonal slack in employment, one would expect that most of those who obtained the LIP jobs would come from the ranks of the officially unemployed. The only data the author could obtain relating to employment status prior to a LIP job refers to the 1972-73 year. The information shows a favorable picture, in that 72 percent of the participants were either unemployed or expecting layoff in the immediate future. Table 3 shows the characteristics of the participants by sex and labor force status.

TABLE 3.—LABOR FORCE STATUS AND SEX OF LIP PARTICIPANTS, 1972-73

LABOR FORCE STATUS OF LIP WORKERS IMMEDIATELY PRIOR TO LIP (1972-73)

[In percent]

	Male	Female	Total
Employed steady, full time	7.2	6.3	6.9
Employed steady, part time	1.7	4.2	2.5
Employed full time, expecting lay off	9.8	6.6	8.9
Employed part time, expecting lay off	2.1	2.8	2.3
Unemployed	67.1	46.1	60.6
Housekeeping	.7	22.4	7.3
Retired	1.1	.5	.9
At school	4.7	5.1	4.9
Other	5.6	6.0	5.7
Total	100.0	100.0	100.0

The classification "at school" might also indicate a favorable employment addition in that these persons were likely to be entering the labor force and certainly all would not have been able to find jobs in the absence of LIP. Further, the housekeepers and part-time workers who came to the LIP projects may have really needed the full-time positions. These "new entrants" may simply have been discouraged by the job market prospects, and therefore part of the "hidden" unemployed.

Although LIP was not designed as an antipoverty program, it disproportionately benefited those most in need of employment and earnings. Some 67 percent of the males in LIP were collecting unemployment or welfare benefits and 43 percent lived in families who had income levels below the poverty line. Drawing persons from public assistance programs has the additional advantage of savings to direct government transfer payments plus the taxes paid by these persons while they are working. The exact amount of savings to the government in the form of reduced unemployment insurance (UI) benefits and welfare costs is extremely difficult to calculate. Some may return to UI after the program and others to welfare. It is, however, safe to assume that the net costs are substantially less than the full appropriations.[2]

[2] Estimates of the net costs of job creation in the United States have recently been supplied by the Congressional Budget Office. The estimates run from 61 to [illegible] percent for the initial impact and 54 to 72 percent after [illegible] months. See "Temporary Measures To Stimulate Employment: An Evaluation of Some Alternatives," Congressional Budget Office [illegible]

The University of Calgary study found that 62 percent of the males and 70 percent of the females became unemployed after LIP in 1972–73. This suggests that LIP did not really fulfill its goal of getting to the seasonally unemployed, since one would expect them to return to their regular job at the termination of LIP. However, this finding does not diminish the efficacy of using this model as a countercyclical device.

SUMMARY

The above discussion only points out some of the highlights of the program characteristics and employment accomplishments. It is not meant to be a detailed evluation but rather an aid in understanding the model for consideration as an "export" to the United States.

It is fair to say that, with the amount of money available and the time span given, the Canadian Department of Manpower and Immigration set up an efficient network for the creation of jobs. In addition, the projects are visible and undertaken at the suggestion of the community. Before discussing the possibilities for the LIP model in the United States, the LEAP program is discussed and briefly evaluated.

THE LOCAL EMPLOYMENT ASSISTANCE PROGRAM (LEAP)

One year after the initiation of the LIP program, the Canadian Department of Manpower and Immigration launched another program (again without specific law but at the mandate of the Cabinet). This program, designated the Local Employment Assistance Program, is aimed at the problems of chronically unemployed persons rather than the seasonal disparity goal of the LIP program. The program is described by the Job Creation Branch as "low profile" since, rather than solicit proposals from the public, it employs LEAP agents in the various Job Creation offices to take the lead role in project initiation. This process is usually undertaken with the assistance of any private or governmental agency in the area that is concerned with the problems of the disadvantaged population.

Once target groups and a project are identified, the LEAP staff immediately attempts to integrate participants into the final stages of planning and start-up. This period includes the solicitation of additional funds or other support from both private and not for profit agencies. In some instances the LEAP projects have involved the startup of a small business specifically designed to offer a needed good or service and, often, with the intention of the project to become self-supporting. The LEAP staff members have indicated that they turn over management to the participants as soon as possible.

Any person who participates in a LEAP project has access to any of the training programs offered through the Department (analogous to the training programs offered under Title I of CETA).

The target group for LEAP projects is similar to those defined as "disadvantaged" under present U.S. poverty and manpower programs (that is: people who would likely remain unemployed under "normal" labor market circumstances). The brochure for the LEAP program indicates the following:

> ... the program focuses on the support of a limited number of projects which demonstrate ways of creating long-term employment for persons who are unemployed because—
>
> 1. They have limited job skills;
> 2. They live in a geographic area where job opportunities are limited;
> 3. They are the subject of racial or cultural prejudices; or
> 4. They have physical, social or mental disabilities which create barriers to employment, such as chronic dependency, a criminal record, alcoholism, retardation or physical handicaps.

It is obvious that the definition of possible participants for the program can be interpreted as loosely as the Job Creation Branch sees fit. On this count, LEAP is similar to Title II of CETA eligibility criteria.

Administration of LEAP

Once the Job Creation Branch identifies a geographic area or specific target group, they then work with a local group, a non-profit organization, community or citizen group, voluntary agency, or even an individual is designing a project proposal.[1]

The funding level of the LEAP projects cannot exceed $200,000/year, with a maximum funding of three years: In some instances a startup time of six months and up to $100,000 is given to the project if longer planning is deemed necessary. The maximum funding level for any one project is $350,000, although most of the projects are funded at a level considerably less than the maximum allowed.[2]

Wages paid to participants can be no higher than those prevailing for similar occupations in the area. Federal funds are used for the payment of wages, fringe benefits, employer contribution to unemployment insurance and "reasonable" administrative costs. In some cases, the cost of expert supervision, counseling, evaluation or special training is allowed, as long as it doesn't exceed 20 percent of the total project costs.

Proposals may be submitted at any time of year and the person or group designing the project is encouraged to take time to plan carefully. The project staff of the Job Creation office are assigned to projects to aid in the development as well as participate in the monitoring after the project begins. Close attention is given to each project and a maximum ratio of one monitor to eight projects is maintained.

The LEAP program is basically experimental and funded at a level of approximately $12 million for the 1974–75 season. This would be equivalent to a funding of approximately $120 million in the United States—a very small program compared to other social expenditures.

[1] In some instances, spontaneous proposals from groups or committees not identified by the LEAP staff will be considered for funding. This, however, is the exception rather than the rule.

[2] See Appendix C for a sampling list of LEAP projects and their funding levels.

LEAP SUMMARY EVALUATION

LEAP, as mentioned above, is a small program with an allocation for 1974–75 of only $12 million, enough to create about 1,700 jobs. LEAP is aimed primarily at the "disadvantaged" and the data available shows that over 70 percent of those hired in a non-managerial role were earning less than the official poverty line. About 14 percent of the non-managers were employed full time prior to LEAP.

The LEAP projects are divided into two categories: "preparation" and "retention" projects. The latter are designed to retain the original participants over the life of the project (up to 3 years) and the former to prepare the participants as soon as possible for re-entry into the regular job market. The funded projects were split about half and half, although the preparation projects had a much larger proportion of managers. This reflects the emphasis on training and transition of the "preparation" projects. The majority of the "preparation" projects were sponsored by community agencies, while the "retention" projects were divided somewhat randomly among native groups, cooperatives, citizen groups, service clubs and the like. Of those who left the projects, over 40 percent immediately secured other employment. The next largest category of turnover shows 13 percent in the "dismissed" classification.

Reflecting the "investment" nature of the LEAP program is the fact that over 70 percent of the projects were expected to become commercially viable over the funding period (i.e., to become revenue producing and independent of outside financial resources). Whether this will happen is not certain since none have been in operation for the full three-year funding period. The "retention" projects are more likely to become financially independent, while the "preparation" projects, almost by definition are not, since they lose their most experienced and able workers as soon as they can place them in other jobs.

LEAP operates on a community development model, in that these "businesses" are funded in the initial stages by government money. They have neither the credit rating nor the certainty of success that is needed to obtain funding in the private market. The outcomes should be watched closely, since this type of project is being proposed in many States in the form of a State-funded development bank. Many models of this have been put forward, but none have been put into operation in the United States.

PUBLIC EMPLOYMENT PROGRAMS IN THE UNITED STATES AND THE EFFICACY OF THE CANADIAN MODEL

This section of the paper discusses the current efforts in the United States to use public employment programs as a counter-cyclical tool. Special emphasis is given to the problems encountered since the passage of the Emergency Jobs and Unemployment Assistance Act of 1974 (Title VI of CETA). The problems are discussed in reference to the possibility of substituting the Canadian job creation model (LIP) for the present structure.

Although antipoverty job creation models with "transition" goals are important and (in the author's opinion) in need of expansion, this discussion centers on counter-cyclical strategies. In addition, it is possible to at least partially achieve the goals of anti-poverty job creation in the context of a counter-recessional program.

The main goals of a counter-recessionary jobs program are: (1) to provide as many jobs as possible for those out of work as a result of cyclical changes in the economy, and (2) to provide stimulus to the economy through increases in purchasing power. There are several secondary but important considerations. Job creation should be done in a manner that will best stabilize the rate of inflation and result in the least displacement of workers already funded under the current State, local and federal budgets. Also important is that the output of the jobs is needed and visible.

Other considerations of PJP's center around the structure and cost of the administrative network and the categories of persons hired. In terms of administration, the simplicity and cost of the operation are most important. In reference to the target groups, the countercyclical strategy considerations are not clear cut since they may conflict with inflation stabilization goals, need criteria and the possibility of prolonging a return to "normal" labor market activity. This will depend on the wages paid and the duration of public jobs. Although detailed discussion of all the above aspects of countercyclical PJP programs is out of the purview of this paper, the factors mentioned above are discussed in reference to the possible use of the Canadian LIP model.

Much of the confusion and criticism of the present PSE programs is misplaced. Those who look at the programs as an antipoverty effort are disappointed. The guidelines are "loose" enough and the pressure for speed of implementation was strong enough to point the program away from an antipoverty stance and in the direction of a purely counter-cyclical posture. On the other hand, those who viewed it as a form of counter-cyclical revenue sharing designed to ease the burden on UI rolls criticize PSE for the attention given to "transition" requirements and selection of those most in need of earnings. The problem originates from the lack of explicit goals offered in the various titles of [illegible] legislation. Further, even if the purposes of various

titles of CETA were explicit, the Act allows the option of transferring funds from one title to another. Any additional piece of legislation or additional funding should certainly make clear exactly what the "intent" of the program is, and to whom the positions should be directed. Presently, the water between Title I's goal of assisting the disadvantaged through training, Title II's anti-poverty job creation and Title VI's countercyclical intention, is very muddy.

The main criticisms of the CETA PJP titles center around the administrative framework, the target groups, the "output" of those hired and the "maintenance of effort" provisions. Each of these is considered in turn.

Administrative Framework of CETA Jobs Programs

The manpower and anti-poverty programs of the 1960's created an alphabet soup of programs, strategies, delivery systems, and target groups. All were designed with the intentions of providing needed services, income supplements and training while at the same time guarding against duplication and emphasizing coordination. One would be hard pressed to find a student of these programs who would defend keeping the initial format.

The attempt to coordinate categorical programs under the umbrella of "manpower" was carried through in the form of CETA and its amendments. The basic idea behind CETA was that local governments have a better grasp of the problems and needs of their constituents than does the Federal Government. This premise, however, left unanswered the question of administrative capability. Local governments simply lacked sufficient numbers of staff skilled in manpower program management. As a result the initial CETA programs took much time to get underway. Just as the process was gaining some momentum, new funds were appropriated by Congress. The CETA Title II money came available about July 1, 1974, the same time that the $250 million additional funds authorized under the Emergency Employment Act of 1971 extension came available. Within another 6 months, the allocations under Title VI of CETA were appropriated. The result of this sudden influx of Federal dollars was enormous pressure on local governments to hire PSE enrollees, often in excess of local agencies' capacity to manage.[1]

Several points are important:

1. The sheer size of the legislative provisions, guidelines and regulations literally made it impossible for the Prime Sponsor staffs to interpret whether they were to operate by the "law" or under the Labor Department guidelines—often different in "intent" if not in letter.
2. The time frame not only disallowed the possibility of careful planning but also "forced" many public administrative units to come up with "need" immediately.
3. The amount of money available under Titles II and VI and the EEA extension completely overwhelmed the Title I "training" aspects of CETA—designed to be its central focus.

[1] Many Prime Sponsors were not able to "spend" the appropri[illegible] within the period of time mandated by the Department of Labor. Many newspaper [illegible] around the country mentioned this fact as an indication of the failure of P S E programs.

4. Following from numbers 1 and 2 above came the problems of inability of the sponsoring agencies to allocate or raise additional money to supplement the wage costs paid by the jobs programs. This simple fact precluded, almost entirely, the use of projects and instead concentrated almost all of the effort in "add ons" to civil service or quasi-civil service rolls. In many cases this led to charges of violation of the maintenance of effort provisions of the law.

The administrative framework of the LIP program offers an attractive alternative to these problems. First, the application forms are one or two pages long and the planning work is done entirely on an *ad hoc* basis by those who will be involved directly in the project. There are no volumes of rules and regulations nor is the likelihood of duplication of effort strong, since all projects go through a Constituency Advisory Group.

Essentially, the LIP program puts the burden of finding community support and other funding on the persons who are proposing a project rather than on bureaucracies already straining under the problems of implementation of CEA titles I and II.

If the U.S. adopted the LIP "public initiative proposal" approach, it would have to be decided whether existing Prime Sponsor administrative networks could or should handle this type of system for PJP. The U.S. Department of Labor would be a logical possibility to be the fiscal agents of the projects. Due to their experience under categorical programs, Labor Department offices already have the expertise necessary for fiscal management and monitoring procedures. In the author's opinion, Prime Sponsors could best carry through their main function—the planning, design and implementation of training programs—in a much more effective manner if they did not have to deal with the temporary burden of counter-recessionary job creation. They should, however, retain the responsibility for the anti-poverty job creation programs, since this is a direct part of the training and placement efforts of their operations.

The simplicity of administration of the LIP program is due to the application itself, to the approval procedures and to the rules and regulations in general. Thus, LIP operates more efficiently than the current Title VI administration network.

Another administrative function is that of transferability of money under one Title to another Title of CETA. In response to the problems of money for tools and equipment in many of the Prime Sponsor networks, the allocations under Title VI were transferred to Title I programs, usually the "work experience" section. (Title I allows 20 percent administrative costs and Title VI, only 10 percent.) The lawmakers, with all good intentions, indicated that if a Prime Sponsor wanted to engage in more training and work experience programs (including OJT) they could transfer the allocations under Title II to Title I. These provisions were in turn used in the transfer of Title VI funds. The two accomplishments of this transfer were both of dubious value. First, it allowed the Prime Sponsors to allocate a larger percentage of money for administrative purposes. In some instances, this was effective in that it enabled the purchasing or leasing of uniforms, tools and equipment, thereby increasing the likelihood of visible and concrete accomplishments under the program. The option was also made

possible to simply hire more staff to administer the program. No explicit evaluation of this can be made. Secondly, if a Title VI hired person is classified as a "work experience" participant under Title I (and is usually performing the same jobs as those created under Title VI), then that person is later categorized as a "former training program participant" and, under current guidelines, is near the top of the list for participation in any other public job program. In extreme cases, a person hired under EEA in 1971 could have been on the payroll in a Title II program, then transferred to a Title I work experience program and then be placed in line for a Title VI slot. There are documented cases of this occurring in Massachusetts. Although this program-hopping is not against the letter of the law of CETA, it certainly does not conform with the spirit.

Separation of the countercyclical job creation programs from CETA would eliminate this problem. The LIP program gives no priority to previous participants. Again the confusion over the counter-recession or anti-poverty nature of the programs of CETA becomes important.

A final administrative problem in CETA was that of "over-hiring." It is not yet clear how common this has been, but a specific case in Massachusetts will bring the problem to light. In the initial stages of Title VI implementation, the "sub-grantees" (a smaller unit, under the Balance of State Prime Sponsor, left over from the administrative network of EEA) were hiring people at a rate in expectation of full year funding, without awareness of funding overlaps and available lag money. As a result, one of the sub-grantees hired 660 persons when in fact the accounting procedures later indicated that there was only enough money to hire about 550. Thus, the Balance of State Prime Sponsor had to supply—and where they got the extra money is not certain—an additional $100,000 to keep those people on the payroll. The newspapers called it mismanagement, while the Prime Sponsor defended it with the explanation that the director of the subgrantee's office had been overzealous in response to the mandate to hire. Again, the LIP framework circumvents this problem by giving a specific grant for a specific period of time for a specified number of people. Over-hiring simply could not be a problem.

Target Population

For all intents and purposes, the restrictions on entry into public job programs became operationally insignificant with the advent of Title VI. The reasons for this are twofold. First, the "transition" requirements were essentially dropped from the guidelines and, second, the entry requirements for unemployed persons were dropped from 30 to 15 days. The bill gave preference to those who had exhausted their UI benefits (up to 65 weeks in some states) and the long term (15 weeks) unemployed. The lifting of restrictive requirements on entry was directly in line with the countercyclical intent of Title VI. However, even though a countercyclical program is specifically designed to aid those out of work due to the recession, other considerations are still important. Persons out of work are not all in the same situation. Some have assets, eligibility for up to 65 weeks of UI, supplemental unemployment benefits, regular seasonal lay offs, and so on. In the extreme, one could say that all the persons who are unemployed, save a fractional 3 or 4 percent, would be working if the economy were operating at full

capacity. Thus, the issue of who among the unemployed should be hired is not as simple as it may seem. Methods of selection among the unemployed are tangled with problems. Some are worthy of elaboration, regardless of the model of public job creation.

Nationwide, unemployment insurance benefits average about $65 per week, with a maximum duration of up to 65 weeks, depending on the state laws. In the United States, UI benefits are paid from state trust funds maintained by employer contributions, and this tax is based on their "experience rating." In addition, employers pay a fixed tax rate to the federal government. This money is used to partially fund federal extensions to the UI program. In the areas of the country which were hit hardest by the recession, the employers' rates are all at or near the maximum possible under the present schedule. Thus, we have witnessed many States which have had to borrow money from the federal trust to pay even the regular state-mandated benefits.

The portion of UI benefits which are funded from the Federal UI trust can be saved, in part, by the funding of a PJP. This represents a net savings to the trust. This "savings" should be considered for use in the funding of PJP slots, possibly by using the Williams amendment to the Social Security Act which allows for use of the federal portion of UI payments to subsidize training endeavors.

Finally, consideration should be given to allowing persons eligible for UI to take their "entitlement" and apply it toward a salary in a PJP slot, if they so choose. If this is not legally possible with the state portion of UI funds, we might conclude that on the basis of *need*, those who are eligible for state benefits should be last in line, rather than first, for any additional PJP slots.

The net savings benefits of PJP programs emerge more clearly when dealing with the welfare population, since all of the savings accrue to federal or state general funds, and thus, represent a net savings to the general tax-paying public.

In terms of countercyclical strategy there are two other considerations which lend support to hiring those most in need of income rather than anyone who is unemployed. First, the net aggregate demand stimulus is higher if the net increase in the person's income is greater. For example, if a person is collecting $100 per week in UI benefits and is hired for a $200 per week PJP slot, we see a net increase in the purchasing power of $100 per week (a bit less, actually, since taxes must be paid on PJP slots while UI is tax-free). But if a person is given a job who is collecting $50 per week in welfare or has exhausted UI benefits, we see a $150 or $200 per week addition to purchasing power.[2] These arguments, of course, hold only if the increased income is financed by reducing the budget surplus (enlarging the deficit) rather than by raising taxes to pay for the program.

Another important consideration is that the impact of the recession falls disproportionately upon the lower income segments of the economy. This is well-documented in the literature of economics.[3] The implication, on equity grounds, is that a disproportionate amount of the available funds should also be targeted to the lower income groups.

[2] These arguments are more fully developed in a paper entitled "The Equity, Efficiency and Economic Stabilization Aspects of Public Employment Programs," May, 1975, available from the a[illegible]

[3] See Edwar[illegible] Gramlich, "The Distributional Effects of Higher Unemployment," *Brookings Pape[illegible] Economic Activity*, Vol. 2, 1974, p. 293 ff.

The problems discussed above are not directly addressed by the LIP program; in fact, almost the opposite is true. Those most skilled in "grantsmanship" are likely to obtain funds and these persons are usually the "most employable" and least needy of the unemployed pool. A provision for employment in LIP is that the person be registered with the employment office, even if not collecting benefits. One possible way to solve this problem is to specify that a certain portion of those to be hired in a PJP project come from the following groups:

Those who have exhausted UI benefits;

Those who are on federally funded extensions of UI benefits; and

Those who are collecting in any public assistance program.

In addition, applicants should also be screened on the basis of "family income," rather than on personal income. One could find little support or justification for the spouse of a $25,000/year executive receiving a position in a PJP.

Use of stricter criteria in hiring would not only make the program more equitable, but may aid in realizing greater net increases in purchasing power. These criteria could be incorporated in the LIP model through use of a simple formula on the percentage of persons from any of the most disadvantaged groups in terms of present and potential transfer income.

All persons hired in LIP make payments to the UI fund and are eligible to collect benefits if they cannot find a job when the project terminates. Thought should be given to including a provision for continuation of federally-funded extensions for participants in any new PP program or strategy. A variation on this theme is put forward by Michael Wiseman, who recommends a lump-sum bonus for those who find a regular job. The "bonus" would increase the incentive to find regular employment and reverse the alledged negative employment incentive of the current UI system.[4] This suggestion by Wiseman would be an excellent addition to any PJP, even one operating under the LIP model, since it is unlikely that there will be any shortage in applicants for PJP jobs in the next few years.

Even if the LIP model is incorporated into U.S. PJP programs, target group problems will prevail unless more thoughtful and restrictive regulations are included. Special attention should be given to the supplementation of the PJP funding by the federal UI fund and realignment of the priority groups. Family need and availability of alternative sources of income should be considered in assigning "significant segments."

Output of PJP Programs

Job creation in the public sector has been stigmatized by many as "make work," "leaf-raking," and so on. In some instances the criticism is are fair, and in others it is simply the result of not understanding what the persons involved are doing. This stems from "built-in" problems of the CETA program. The "loose" guidelines and Department of Labor pressures to hire quickly often lead the hiring agents, usually local or State government, to "make work" if they have nothing on the agenda prevented by budget problems. The jobs concentrate as addi

[4] Michael Wiseman, "On Giving a Job: The Implementation [illegible]deration of Public Service Employment," Joint Economic Committee, Congress of th[illegible]ted States, August 1975.

tions to the staffs of service organizations and are essentially invisible to the taxpaying public. Secondly, there have been many cases of nepotism, political rewards or the like. Thirdly, many of the workers (and their output) have not been represented as net additions to the number employed or to the community betterment.

The fact that the vast majority of PSE slots were additions to public sector service organizations is not *per se* negative since the need for public services is still far from saturated. However, the fact that no new money was provided for capital equipment and facilities often precluded the addition of previously unprovided services. The net addition of one or two staff persons to a public sector organization is unlikely to generate any enthusiasm or add to the "output of the agency." This scheme for finding jobs also renders priorities for the function and placement of new personnel to the discretion of the local politicians or bureaucrats. Again, this is not necessarily negative, but certainly not optimal.

The LIP model would take the best of this form of job creation and leave the worst behind. The community organizations and even the public bureaucracies could apply for grants in the same manner as everyone else and, if deemed worthwhile, they would be funded. The LIP model would simply inject a competitive facet into the provision of necessary but absent public services. An additional benefit would be the circumvention of the whole system of civil service, since the jobs would be of limited duration without the polemics of "transition." Much less feather-ruffling of the unions and taxpayers would be provoked.

The issues of "cronyism," "nepotism," and political wards will not be solved by the injection of a new model of PJP. These could be diminished if the projects were smaller in magnitude, if there were no guarantees for continued employment in the public sector, and if projects were subject to a set of rules as simple as those written along with any "breakfast food giveaway" (i.e., any relatives of employees of X company or its advertising agencies may not be etc.). The situation would be further improved if wages paid were less than similar jobs in the private and public sector. In addition, use of target criteria for "long term" unemployed or those under the extended UI benefits would have a minimizing impact on the whole issue.

Most important in relation to the "output" of the PSE programs is the *visibility* question. The lack of popularity of PSE programs, in the author's opinion, centers around the fact that the taxpayers do not see any net addition to the community in terms of facilities or services. The project approach of LIP virtually guarantees visibility by having signs indicating that the work is being carried out under a LIP grant, and by making sure the press is aware of projects. The press then also serves as a built-in monitoring system.

The potential "snowball" effect of visible PJP projects is very large. If one community has renovated old homes, landscaped the park or cleaned up the subway, they are certain to gain favorable publicity. At the same time, the officials in the next town or State are going to be asked what improvements are being carried out in their community. The potential is incredible. One only has to inspect (or use) accomplishments of the PJP's under the New Deal program to realize just how much [illegible] done.

Further, if the projects are planned and initiated by the community (whether by one person or a group) the need must be present. Participation in decisions on the spending of tax money has to be one of the most satisfying experiences that jobless persons can have.

The critics of PSE often argue that the bulk of the projects under any PSE program are projects that the taxpayers would not want badly enough to pay for through increased taxes. This argument is insubstantial on several levels. First, the decisions made in local and state budget committees regarding priorities are certainly not always what the "taxpayers" would choose. Secondly, the tax burden in some cities and states (New York City and Boston, for example) are already so high that even if something in great demand were not already provided, it is highly unlikely that it could be undertaken during the current recessionary period. Finally, those who make decisions concerning the allocation of public funds are not always aware of the real needs. The simple act of project proposal would bring "neighborhood" or individual desires to the attention of at least the advisory group making project decisions.

The use of the LIP model would not contribute to the swelling of public bureaucracies with additions to staffs that often have little marginal impact; it would lend itself to a decrease in the "cronyism" that pervades certain present PSE programs, and would produce visible output in areas deemed important by the general populace, rather than by the local officials or bureaucrats.

Maintenance of Effort

With a recession comes not only a drop in the employment, but also a decrease in the tax revenues of government units. Coupled with this comes an incredible increase in the need for social welfare services, crime prevention, and medical care. The devastating human problems caused by poverty and joblessness are exacerbated by the State and local financial inability to increase services to the necessary extent. In the midst of the fiscal crisis, many of the States sought budget and employment cuts along with tax increases. At the same time they were given large sums of money through the Prime Sponsors to hire persons to work in the public sector. This clearly is not the right fiscal time to inject a massive dose of money and expect strict compliance with maintenance of effort provisions.

As a result, we can easily document the fact that many of the positions created under CETA were simply replacement funding for state or local jobs. There is nothing wrong with revenue sharing, particularly countercyclical revenue sharing but not in the guise of a public jobs program.[5]

The model of adding persons to the public payroll within the confines of the civil service system can be a very effective anti-poverty effort, but it can only hope to be effective in times of expanding employment and general economic prosperity. Clearly, we are not enjoying these conditions now, nor are we likely to for several years.

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[5] Legislation to provide countercyclical grants to State and local governments was introduced in the present Congress by Senators Humphrey and Muskie [illegible] Representative William Moorhead. At the time this study went to press this legislation, which had been incorporated into H.R. 5247, was awaiting final House action on the conference report.

The LIP project approach virtually guarantees that each and every one of the jobs will be a net addition to the employment pool since none of the projects had even so much as an organizational structure prior to funding. Further, the persons hired had to be taken from the UI rolls and obviously could not be "transferred" from one job title to another in the same governmental unit.

Estimates vary widely on the use of PSE jobs to finance state and local existing positions; some go as high as 80 or 90 percent. If the states and localities are in need of special temporary loans or additional revenue sharing, this should be (and, as rated, is being) seriously considered in Congress, but not under the aegis of a public jobs program. With an explicit goal of job creation and a tacit goal of revenue sharing, any program is likely to do a poor job on both counts.

IMPLEMENTATION OF THE LIP MODEL

It must be mentioned at the outset that there are no provisions in the current CETA legislation which prevent a Prime Sponsor from taking the LIP model and incorporating it into their distribution of funds allocated under Titles II and VI (possibly even under Title I: "Work Experience"). However, present administrative arrangements, voluminous rules and regulations, planning structures and past experience make it unlikely that the LIP approach would be implemented by Prime Sponsors. In addition, the limited jurisdiction of the Prime Sponsors and the fact that the Federal government is not presently a hiring agent precludes any projects which cross Prime Sponsor or state lines. Most important of all is the simple fact that a change in structure takes an enormous amount of effort and the Prime Sponsors are unlikely to embark in a new direction unless they are legally obligated to do so.[1]

Alternatives to offering the existing Prime Sponsor network incentives to implement LIP can take several forms. The first is to draft a new piece of legislation which would incorporate the elements of the LIP program suiting the current economic situation. Secondly, revision of the rules and procedures of planning and hiring could be added to any new appropriations for public jobs programs under CETA. Thirdly, a combination of "emergency appropriations" and guidelines with an experimental flavor could be adapted while drafting and planning of new legislation is occurring. Each of these is discussed in turn.

NEW LEGISLATION

Presently there are at least two bills in committee in the U.S. House of Representatives that directly address the question of programs for the provision of additional public service employment. Rep. Daniels introduced a bill which specifically addresses the issue of enlarging and strengthening the countercyclical aspect of the CETA legislation. Rep. Esch has introduced a bill which takes an even broader approach by calling for far reaching changes in both Titles I and VI of CETA.

Under the original Daniels' proposal private non-profit organizations could apply directly to the Sec. of Labor for a grant to implement a public employment project. Under the initial Esch proposal the same agencies would have to apply through the Prime Sponsor network. The Daniels proposal also allows for the Prime Sponsors to apply to the Secretary of Labor, thereby injecting an element of competition into the process of countercyclical funding. It is obvious that the Daniels bill relies heavily on the Canadian model, although

[1] Despite these difficulties, some successful examples of the use of CETA funds for temporary work projects do exist. Some of these are described in "Creating Jobs Through the Project Approach in New England" by William Spring (Joint Econ[illegible] Committee, Congress of the United States, forthcoming).

Administration could be accomplished through the Regional Offices of the Labor Department and publicity to solicit proposals could be achieved through the media—at no real expense. The recent advertising campaign of a well-known oil company regarding ideas for mass transportation illustrate the incredible response that can be generated by using television to solicit ideas. The solicitation of project proposals might be done in the same manner.

If this emergency piece of legislation is adopted, I would recommend that the previously discussed amendments to the CETA be incorporated. In addition, the U.S. counterpart of the Constituency Advisory Groups could be formulated quickly by either using the present Manpower Services Council or by having each Representative (or Senator) immediately establish area committees to screen and finalize the proposals.

Another useful addition which could be made if a specific piece of emergency employment legislation were drafted and passed would be the inclusion of a provision to keep the funding triggered by the unemployment rate within an area, not the national rate. It is unlikely that the various states or regions will recover from this recession in the same temporal framework. The unequal dispersion of unemployment at the present time well illustrates this point. The provision could then serve as the model for a permanent countercyclical jobs program with one year project tenure.

An emergency piece of legislation would have to give consideration to the present CETA program, particularly Title VI. This could be done by simply not requesting any new Title VI appropriations and by continuing the funding levels of the remainder of CETA.

FUNDING LEVELS FOR COUNTERCYCLICAL JOBS PROGRAMS

In a sense, detailed discussion of the needed funding levels for PJP's under the present economic conditions is academic. The amount of money appropriated for these programs is dependent on the willingness of Congress and the White House to engage in deficit spending. The recent report by the Congressional Budget Committee on alternative jobs programs estimates that 80,000–125,000 jobs are initially created by each 1 billion dollar appropriation.[1] Even if the program were aimed at employing one out of every 20 workers officially counted as unemployed the appropriation would have to be in the neighborhood of 4 to 5 billion dollars for each year. There is no need to go into detail regarding the efficacy of public jobs programs in stimulating employment during a recession, since this is well-laid out in the Budget Office report. The important questions center on the model for providing the jobs and the level of funding. As is argued in this report and summarized in the next section, the Canadian LIP model of employment creation offers a means by which we can circumvent the majority of negative aspects of current CETA efforts.

The funding level needed and the level that is likely to be realized are far apart given the present "mood" of Congress and the White House. To operate a program of the same magnitude as the 1975-76 LIP program would require appropriations of about $2 billion, while a program to employ even 5 per cent of those currently unemployed would cost between $4 and $5 billion. According to the Congressional Budget Office study, a program funded at the $4 to $5 billion level would employ between 350,000 and 750,000 persons with a net outlay after 24 months of approximately 53 percent of the total appropriation. An investment of this size will certainly not eliminate the current problems of unemployment, but would represent a sound investment in the future economic and social environment of the country.

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[1] Congressional Budget Office, *op. cit.*

SUMMARY

The major criticisms of public employment programs under current legislation center on three related areas: maintenance of effort, the output of the programs, and the long-run benefits to those who participate in the programs. The chief criticism of the programs from the fiscal "conservative" viewpoint is indicated in the concluding section of a booklet published by the American Enterprise Institute:

> The effect of public employment programs on unemployment and increasing of public services turns out to depend on the extent to which federal funds displace state and local funds. A review of the evidence suggests that in the long run 60 to 90 percent of the public employment program funds would merely displace state and local funds . . . Apparently public employment programs add considerable fewer jobs than the nominal number of slots they fund. [1]

The author then goes on to "concede" that displacement is somewhat smaller in "countercyclical programs" than in long-run programs. Without conceding the conservative argument—and the concrete evidence is not yet in—the use of the LIP model would significantly decrease the possibility of substituting federal for local tax dollars.

The success of the LIP program in Canada cannot automatically be duplicated in the United States. The advantages offered by the LIP model, however, can be replicated in the United States with the likely benefits outweighing the costs of altering the current structure of our countercyclical public jobs programs.

On the administrative side of the issue, the Canadian model offers a simple and workable substitute for the cumbersome methods of administration employed under CETA. The responsibility for justification of proposals is placed with the applicants, not with already overburdened public bureaucracies. The limitation on the size of the projects would make the monitoring process less complicated and would also allow for easy cancellation of projects not operating as designed. Further, the problems of ongoing funding and administration are eliminated under the LIP model since all projects must have an automatic termination date. Application or extension are considered along with any new proposals.

The Canadian model also avoids both the problems associated with civil service regulations and the choice of swelling the permanent bureaucracy.

Another side benefit of implementation of the LIP model is that the CETA operation, as presently in place, could concentrate its efforts in the areas of training, retraining and other programs specifically related to anti-poverty efforts. New legislation funding countercyclical programs separate from anti-poverty programs automatically eliminates the "gray" area now present and assures that each "type" of program is run with clear delineation of its goals.

[1] Alan [illegible], "Public Employment Programs," American Enterprise Institute, 1975.

As mentioned above, the maintenance of effort questions are also remedied since the project approach and the application procedures, if strictly adhered to, virtually assure that the positions will be not additions to the employment pool. This development may lead indirectly to more pressure from the states and localities for the Federal government to institute counter-cyclical revenue sharing. This too is desirable and necessary in the current economic climate.

Although the possibility of nepotism and cronyism still exists under the Canadian model, it would be lessened if clear specifications on target groups and eligibility were written into any amendments or new legislation. The Wiseman study demonstrates that there are many factors which must be taken into account in the selection of participants. Even in a strictly countercyclical program, the needs of applicants and their families should be considered.

The costs of the Canadian model would not be any more and would possibly be less per person hired than the present structure. We may find a decrease in administrative costs and even a lower average salary than the $7,800 per year goal of CETA. The salary levels allowable under new legislation should be carefully considered so as to allow for incentive to return to "normal" work as soon as possible. Even if the target average wage were lowered to $7,000 per year, this would still exceed the annual earnings of 20 million full-time American workers. On the other hand, the wages must be high enough to induce people to leave the unemployment insurance roles and desire participation in the programs. A wage somewhere in between the UI benefits and that of comparable work in private industry should be the target.

Since the LIP model would allow for public agencies to apply for grants, it would facilitate the added benefit of injecting some competition into the provision of public goods and services. If a neighborhood association can plan and operate a project more efficiently than a state or local government unit, they should be given the opportunity to do so.

LIP also facilitates projects which cross city, state and Prime Sponsor lines. At present this is not possible, save the very unusual circumstances of Prime Sponsor cooperation. The opportunity for special railroad or other regional projects would be possible.

There are few who question the efficacy of public jobs programs as an effective countercyclical tool, but many who justifiably criticize its current implementation. The majority of the problems in the present system of PJP's could be virtually eliminated with the adoption of the Canadian model. Serious attention must be given to the expansion of public jobs programs in general and to the adoption of the Canadian model in particular.

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ABSTRACT AND ANALYSIS OF "AN EVALUATION OF THE MASSACHUSETTS LOCAL INITIATIVE PROGRAM (MLIP)"

In September of 1976 the Massachusetts State Manpower Services Council and Abt Associates, Inc. of Cambridge, Massachusetts entered into a contract for the purpose of evaluating the Massachusetts Local Initiative Program (MLIP). As a result of over six months work, Abt Associates, Inc. has compiled a three volume final report: Volume I, which discusses Abt's findings and recommendations for MLIP as a whole; Volume II, which documents the project-by-project basis for their findings; and an Afterword, which presents the results of a follow-up study designed to determine the effects of MLIP on its participants' subsequent employment status.

The following abstract and analysis focuses on Volume I of Abt's report. An attempt has not been made to summarize or analyze Volume II because that volume is primarily a form of documentation for the findings and recommendations contained in Volume I. The significant conclusions and recommendations of the Afterword are included verbatim.

The purpose of this abstract and analysis, prepared by Massachusetts State Manpower Services Council staff, is two-fold: (1) to summarize the key findings and recommendations contained in Abt's extensive report, and (2) to analyze the findings; with particular emphasis on the interests of CETA Prime Sponsors and Department of Labor officials, especially relating to the project approach to public service employment (which is engendered in Title VI - Part B). It is the feeling of SMSC staff that many of the findings and recommendations in the evaluation study can assist Prime Sponsors in improving the planning, program development, and operations of their Title VI-B public service employment projects; and can be of use to the Department of Labor in their work in this regard.

However, this abstract and analysis is intended to supplement the full Abt report, not to replace it. The SMSC staff strongly encourages Prime Sponsor Directors, Planning Council members, key PSE staff, and Department of Labor officials to review the entire report.

The Massachusetts Local Initiative Program

Designed and administered by the State Manpower Services Council, MLIP had three basic program objectives:

(1) To assist an individual or group to initiate a project which is meaningful to the community.

(2) To provide a community with a good or service which in some way improves the quality of life and is presently needed but unavailable.

(3) To offer productive employment to unemployed persons who are certified as eligible for participation in programs operating under the administrative framework of the Comprehensive Employment and Training Act of 1973.

MLIP planned to provide short-term jobs to approximately 279 unemployed or underemployed Massachusetts residents. "These persons were put to work on 26 projects all over the state. The projects provided a wide range of community services, including recreational activities for youth, restoration of historic buildings and community clean-up. Some projects had primarily long-term objectives, involving the establishment of cottage industries or new businesses. All but one of the projects were administered by local citizens' organizations or established community service organizations; only one project was administered by an agency of local government.

Project duration was generally six months, starting in July, 1976 and terminating by January, 1977. One project began in September and will end at the time this report is being written (end of March, 1977). The projects cost between $25,000 and $50,000 and employed an average of 11 persons each. A total of $1,000,000 was made available for MLIP." These funds were provided out of the Governor's 4% Discretionary Fund under Title I of the Comprehensive Employment and Training Act of 1973 (CETA).

Major Findings and Recommendations

Note: The style for this section of the abstract and analysis will be to quote directly from the Abt report and then further analyze the finding or recommendation cited. The latter analysis will not appear in quotations, and will thus be distinguishable as the thoughts of State Manpower Services Council staff.

- Findings

"Overall, the MLIP program has been successful in achieving a major portion of its goals. The most dramatic achievements have been in the provision of community services. MLIP projects tried hard to achieve the objectives that were specified in their work statements, and 19 of 26 projects were very successful. These projects achieved either most or all of their community service objectives. What frustrated projects most often were the State's budget limitations, requirements or regulations which were unidentified prior to project start-up, and their own overly ambitious plans. This latter characteristic of the MLIP projects distinguishes them from typical, public service employment projects. MLIP projects also distinguished themselves by providing services which did not represent the mere continuation of existing programs."

"Part and parcel of the program's community service success was the achievement of productive employment for majority of MLIP employees. Although precise figures were difficult to calculate, we estimated that the program filled over 90% of its planned 279 job slots."

"More than half of these jobs were full-time over the course of the project, although projects which involved discrete phases of activity usually staggered their MLIP enrollment...Between 90 and 98.5 full-time equivalent years of work were provided, at a cost of about $9,830 per worker-year."

Analysis

A key phrase here is "MLIP projects tried hard to achieve the objectives that were specified in their work statements..." Part of the MLIP program design was a requirement that program applicants clearly define the proposed objectives and accomplishments of their efforts, in as measurable a set of terms as possible. Having to get something done, within a fixed time frame, was an important factor in the projects' success (Abt cites this factor a number of times in the report).

As is noted above, certain requirements or regulations were unclear to, or unidentified by, project operators. Thus, it is important to have a project operator's manual (which MLIP did have) and regular communication between program administrators (probably Prime Sponsors and subgrantees) and project operators, to uncover or clarify such problems. Later in the report Abt suggests that a general orientation, problem solving, and training session be held with project operators before projects are initiated. SMSC held such a session prior to MLIP, but would probably expand such an effort - and strongly concurs with Abt's suggestion in this regard.

MLIP project directors and workers were ambitious. MLIP offered productive employment, not "make-work." Again, a good part of this can be traced to allowing local groups and individuals to initiate their own programs, in response to a community need. The MLIP Request for Proposal was quite open ended and unstructured, allowing for a variety of local ideas and programming. Working toward a set end result or the accomplishment of a discrete task also added to the productive nature of the employment. ("Undoubtedly, the existence of concrete, quantitative project objectives also facilitated increased productivity. With specific objectives and a specified time frame in which to achieve these objectives, project directors were watchful of staff productivity. One indicator of this was the percentage of terminations due to lateness, absenteeism or poor performance. According to the State's data as of October, 1976, 14 or 31% of the programs' terminees had been fired for these reasons. Projects could not afford to allow individuals who came late, didn't show up or performed poorly to remain on the job for very long.")

- Finding

"When projects encountered difficulties, the one factor which usually operated to overcome these problems was the enthusiasm of the staff. Virtually all MLIP projects achieved some of their objectives, and the one factor mentioned most often in accounting for this was "staff enthusiasm." We attribute this not so much to the careful selection of staff as to the soundness of MLIP's concepts of "local initiative" and "projects," and the basic desire for work. In many MLIP projects, particularly those involving visible products, staff worked together as a team, developing rapport and commitment to their mutual efforts. On a number of occasions, individuals from the same town were acquainted with each other prior to MLIP, and this added to the "team" spirit."

Analysis

In many cases the MLIP employees coalesced around a project and had a "vested interest" in its success. There was a real spirit and feeling of "community" in many of the projects (Hampshire Canning Center, Kangaroo's Pouch, etc.). This was due to the fact that a group of unemployed community people were able to organize a project and do something constructive for their community, their "folks." It was often important that persons from the same neighborhood or community (Crown Hill/Worcester, South Middlesex/Framingham) or of like skills (crafts people), interests (canning), and cultural backgrounds (blacks, Indians, Spanish-speaking), were drawn together.

- Finding

"The MLIP program was a good demonstration of local initiative. A quick review of the project grantees--groups like the South Middlesex Community Center, the Wampanoag Tribal Council and the Worcester Tenants' Association--reveals the 'grass roots' nature of many of these projects. Local initiative was also evidenced by the extent of linkages sought with other community groups, the business community and the press. Indeed, projects frequently cited "community support" as a key factor contributin to project success. Projects sought donations of funding, materials and administrative and technical support. Project officials occasionally expressed disappointment with the results of their efforts, but the figures tell a different story. Collectively, these projects amassed $151,886 worth of contributed time and materials."

Analysis

This finding is important for Title VI PSE projects for at least two reasons. It shows that labor intensive PSE projects (with the CETA regulation requiring at least 85% of the funds to be spent on wages and fringe benefits) can be augmented by locally donated dollars and items (equipment, supplies, etc.) if the project has "community support." Projects may also be able to locate other funding (Community Development Block Grants, Community Services Administration funds, etc.) to mix with CETA dollars, and to be used for labor or non-labor expenditures.

As well, this aspect of "community support" may bode well for the prospects of the project continuing after CETA funding, by attaining self-sufficiency or other funding. Community support would appear to be an essential ingredient for long-term existence of any local project.

Although this information indicates that many projects can locate other resources to augment their 15% of funds for non-labor expenditures, we feel that it is important to emphasize that as much of this remaining 15% as possible must be filtered to the projects. The use of this money for specially skilled non-CETA staff, equipment, supplies, etc. is often crucial to the real success of projects.

- Finding

"MLIP projects assisted the future job prospects of employees in several ways. The program increased the self-confidence of its employees, taught new skills and provided general work experience. A few projects helped their employees find jobs, and a few employees were able to make contacts during their MLIP employment which resulted in full or part-time job offers afterwards."

Analysis

Job development and placement was not an explicit goal of MLIP, and a formal job placement mechanism was not built into each project. Obviously, however, the program's designers and the project operators hoped to see as many participants as possible locate future, unsubsidized jobs. Perhaps Prime Sponsors will want to build a more formal job development and placement mechanism into their Title VI operations (a suggested approach here is to have existing Prime Sponsor staff provide such support, rather than build this capability into each individual project.

This aspect (the post-program status of MLIP participants) is summarized in a later two page attachment, direct from the Abt Afterword.

As the report states, the increased self-confidence, new skills, and general work experience gained by the employees has added to their future job prospects. The mere opportunity to work was of importance to MLIP participants. As is noted in an interim evaluation report by Abt: "Indeed, for a majority of employees the work experience itself has been one of the most valuable aspects of the job. The opportunity to work and to say that one has worked was very important to LIP employees."

In addition, many of the MLIP employees were able to work in their areas of interest and expertise (child care, theatre arts, sculpture, crafts education, canning of foods, etc.). Many of the areas cited are not traditionally areas of public service employment. These employees could point not only to the fact that they had worked, but to the fact that they had worked in an area they had been educated and/or trained for, or experienced and interested in.

• Finding

"Type of project activity, per se, did not have an overwhelming effect on project success or failure. However, certain obstacles were particularly troublesome to certain types of projects. For example, three out of the four clean-up and beautification projects had difficulty obtaining the large equipment needed for removal of debris. Commitments from city parks departments to lend trucks were not honored. Similarly, the number of homes which could be repaired by the home rehabilitation projects was constrained by CETA restrictions on the allowable income of the households. Moreover, all of the projects which involved either rehabilitation or restoration as a principal activity were constrained by their ability to hire skilled supervisors at the CETA-authorized wage levels. For example, the Worcester Tenants' Association omitted plumbing jobs from its plan when it couldn't find a master plumber who would work for $192.30 a week. The early onset of cold weather was a problem encountered by almost half the projects, affecting all those projects which had components of rehabilitation, restoration, clean-up or outdoor performances."

Analysis

These are hints that can be applied quite readily to Title VI-B projects. The obstacles cited (donation of trucks, skilled crafts supervisors, etc.) should be considered for similar Title VI-B projects proposed in a Prime Sponsor area, in order to avoid potential failures or disappointments due to these factors.

It is interesting to note that the "type of project activity, per se, did not have an overwhelming effect on project success or failure". Certain projects may have a local priority (health, housing rehabilitation, recreation, etc.), and these priorities may be built into project review criteria, but the MLIP evaluation findings indicate that there is not a strong correlation between type of project and project success or failure.

- Finding

"Naturally, it was much easier for us to evaluate projects which specified hard outputs. We could determine the number of acres cleaned or homes rehabilitated compared to plan. It was less easy to evaluate projects which hoped to enhance cultural pride or to teach something. Frequently, these projects had not specified concrete outputs. We believe that teaching, planning or research projects should be required to specify concrete outputs, such as working papers or curriculum materials, in the future."

Analysis

SMSC staff concurs with this recommendation. Teaching, planning or research projects should be given all due consideration in Title VI appropriations, but the specifying of concrete outputs should add to the success of such projects (as is indicated in earlier Abt MLIP findings).

Attached is a page from the Abt report, which although it repeats a number of the findings already noted herein; is an excellent summary of some very salient points. (Attachment 1)

- Finding

"The best projects, in terms of the achievement of planned community objectives, also evidenced better planning. The project director's experience and proclivity towards management also played a role in project success."

Analysis

This finding, along with Abt's analysis, points to two basic considerations for Title VI-B projects or similar approaches to PSE: (1) perhaps a planning period should be incorporated into projects after a project director is hired (as Abt noted, many project directors were not involved in proposal development - thus there was often a slight adjustment of plans upon their hiring and a need for orientation of staff). Such a short planning period may be a valuable investment. (2) As Abt notes, selection of project managers should include a consideration of the management experience and capability of prospective candidates, as well as their "substantive" knowledge in a particular area.

- Finding

"Only a few projects had skill training components, and these were usually of short duration or sporadic over the course of the project. Consequently, other than the apparent improvement of interpersonal skills reported by some, skill development in other areas was limited."

Analysis

Again, skill training was not an explicit objective of MLIP. The primary emphasis was on public service employment and the work experience engendered in PSE. However, Prime Sponsors may want to build a stronger skill training component into their projects, or choose PSE projects which emphasize (and measure) skill development.

- Finding

"The balance sheet on MLIP indicates that it was a reasonable investment, returning a minimum of 24 cents on every dollar expended. This means that for the $880,000 total expenditure on MLIP there were returns of almost $210,000, leaving the net cost at only $67X,000. These returns came in the form of increased tax payments and saved welfare and UI payments. Transfer savings were the greatest, accounting for 66% of total returns. Savings due to FICA and UI were preeminent within this category, with other transfer and various tax returns accounting for about equal amounts of the total returns. About 42% of total returns accrued to Massachusetts State government, with 58% going back to the Federal government."

Analysis

As one can see, expenditures in the area of public service employment can result in savings in other areas of public outlays (and such calculations do not include the "human capital" developed and personal satisfaction felt by employees).

As Abt notes elsewhere in the report, these savings can be increased by focusing client eligibility on current recipients of unemployment insurance and/or public assistance payments (as the new Title VI does).

(Note: The MLIP eligibility guidelines required that persons be unemployed for at least 30 days or underemployed, or economically disadvantaged, and a Massachusetts resident. 89% of the MLIP employees were unemployed prior to the program.)

Detailed information on the characteristics of MLIP participants and their post-program status are included in Abt's report. Of particular note are summary charts on page 15 of Volume I and page 8 of the Afterword.

- Finding

"MLIP was unique in comparison to other programs by virtue of its administrative structure. In the history of public service employment programming, no other program has relied so heavily on "grass roots" initiative. All but one of 26 MLIP projects was administered, on a day-to-day basis, by local residents. Some of these individuals had no other affiliation prior to MLIP. Some were employed by local citizens' organizations. Only one project was administered by a department of local government. We feel that much of MLIP's success can be attributed to its utilization of local input."

Analysis

The "grass roots", local nature of MLIP has been mentioned a number of times. But it was such an important part of the program's success that it should be reiterated.

An MLIP type approach (focusing on local, "grass roots" organizations) may require more administrative support at the Prime Sponsor or subgrantee level. But, SMSC staff feel this investment in additional technical support returns many dividends in terms of project success and benefits to participants.

One final note on this subject from Abt: "We believe that the characteristics of "grassroots" input and "smallness" have contributed critically to the success of MLIP, and we would be skeptical of future program efforts which sought to deny these features. On the other hand, MLIP's limitations must be realized. It cannot be expected to have a major impact upon unemployment rates. This would almost inevitably require much larger projects and a different administrative structure. This, in turn, would take us back to earlier, larger-scale experiments whose problems are now familiar to us."

It is hoped that some of the insights gained from MLIP will help us avoid such "problems."

- Finding

"A complaint vocalized by many projects was that financial reimbursement procedures were slow. This was bad for morale and posed cash flow problems for some individuals. When umbrella agencies covered the pay checks, they had cash flow problems...One recommendation might be to consider alternative reimbursement procedures."

Analysis

MLIP allowed advances for the projects. However, the system of advance payments did not run smoothly (due to reporting difficulties and slowness of payments) and there were instances where projects had to borrow money to meet their payroll.

This may appear to be simply an administrative problem, which can be corrected quite easily. However, the system of payment that a Prime Sponsor or subgrantee is able to put in place will have a substantial affect on the types of organizations that apply for PSE project (Title VI-B, etc.) monies. For example, many community agencies, with limited financial resources and cash flow problems, do not have sufficient capital of their own to operate a program for a month or more and then be reimbursed for their expenditures (and as indicated by the MLIP evaluation, these are just the type of organizations which can be very successful in operating such programs).

Advance payments, or some other mechanism which allows speedier payments to projects (for example, having the payroll handled by the Prime Sponsor or subgrantee, rather than the project operator) would appear to be imperative for such organizations. Of course, reimbursement or advance systems that are developed would have to conform to the Prime Sponsor's financial requirements. A number of cities and towns do not normally allow advance payments to contractors - thus the possibility of waivers or other alternative approaches would have to be investigated.

• Finding

"The Chester Threads of History Project ran into a similar type of regulatory problem. One of the objectives of the project was to establish a cottage industry and market the quilts and other crafts made in the classrooms. After project inception, however, it was learned that project staff could not sell these products while still sponsored under MLIP. At least one other project with cottage industry hopes reported learning about the regulation after grant award."

"Abt staff were surprised to learn that few of these projects were thinking in terms of self-sufficiency. We believe that this is an objective which is very consistent with local initiative, and should be emphasized in future program endeavors."

Analysis

The SMSC staff wholeheartedly agrees with the Abt evaluators that self-sufficiency can/should be a part of such future program endeavors. However, there are many regulatory requirements/issues to be addressed in this regard. The whole issue of "program income" and income generation must be thought through and dealt with by federal, state and local officials. Manpower officials should investigate the possibility of utilizing CETA monies for economic development and the creation of unsubsidized jobs - without displacing other jobs and businesses. This is a very complex issue, which is currently being researched by SMSC staff.

The final page and one-half of the MLIP evaluation are worth repeating verbatim (they appear here on one page). Abt suggests some valuable recommendations for those interested in replicating or expanding on an MLIP-type approach. (Attachment 2)

The key "conclusions and recommendations" from the Abt Afterword, which discusses the effects of MLIP on participants' subsequent employment status, are included verbatim as Attachment 3.

ATTACHMENT 1

Some Findings Regarding Project Characteristics

- MLIP received 487 applications from which to select between 20-40 projects.
- 27 projects were selected; only one dropped out of the program.
- MLIP sponsored eight projects in the Balance-of-State area, seven projects in Boston and 11 projects located in five of the six remaining prime sponsor areas of the state.
- MLIP projects were sponsored by a variety of organizations, including incorporated citizen's action agencies, schools, clubs, societies, professional associations, units of local government, and individuals.
- Four of the 26 projects were sponsored by units of local government. *
- In eight of the 26 projects, the sponsor had little involvement in day-to-day project administration.
- The eight projects which relinquished their administrative role included three of the four projects sponsored by units of local government.
- There was no clear relationship between the separation of sponsorship and administration and either project operations or outputs.
- It was helpful to involve proposal authors in project start-up activities, a criteria which was sometimes not met in projects whose sponsorship and administration were separate.
- Project directors were usually chosen on the basis of substantial knowledge rather than administrative or managerial experience, a feature which frequently affected the smoothness of project operations.
- Bookkeeping staff were frequently unskilled and required great support.
- Type of project activity, per se, was not a key factor in project success or failure.
- Certain obstacles, such as weather, equipment availability, CETA restrictions and salary limitations were particularly troublesome to rehabilitation, restoration, and beautification projects.
- Teaching, research, and planning projects were less likely than other types of projects to specify concrete outputs.

*SMSC Note: although four were "sponsored" in such a way, only one project was <u>administered</u> on a day-to-day basis by an agency of local government.

ATTACHMENT 2

We have tried to highlight here some of our key findings regarding the MLIP program, and to explore some of the tradeoffs which may be involved in any decision to expand MLIP. Concrete recommendations about future project and program operations appear below. These recommendations deal primarily with suggestions or modifications which could improve MLIP in the future. The list is not long because MLIP has already done many things right.

- Clarify the CETA regulations which may apply to the projects in the initial program announcement
- Consider making "prospects for self-sufficiency" a criterion for project selection
- Select projects which appear to be well-planned; look for a schedule of tasks, specified outputs, and evidence that possible problems have been anticipated
- Select projects which appear to have made an effort to gain commitments for materials; the existence of on-going relationships with agencies promising materials might be a better indicator than a mere "letter of cooperation"
- Urge the selection of participants who are currently recipients of UI or public assistance payments
- Urge that the selection of project management be based not only on "substantive" knowledge, but also on experience and interest in management
- Conduct a workshop for state personnel; familiarize staff with CETA regulations and with the appropriate state role in program administration
- Conduct a workshop for project staff at the outset; provide practice in problem-solving and planning techniques
- Select projects which will not compete with each other for limited resources in a single community
- Allow projects to start-up on a more flexible time frame, so as to better match the project's plan of activity to the appropriate season
- Consider alternative reimbursement procedures, such as utilizing the Employment Service on a contract basis for fiscal review and reimbursement
- Alter the monitoring format so as to focus more on the substantive aspects of project operations
- Encourage more inter-project exchange of ideas, problems, etc. during the course of the program
- Consider expanding MLIP to allow for projects of greater size and duration in order to have a greater local employment impact
- Consider more flexible funding arrangements in future MLIP projects, so as to enable particularly innovative or important projects to attract needed skilled personnel
- Consider making public-service oriented firms, such as large utilities companies, eligible to administer special projects

5.0 CONCLUSIONS AND RECOMMENDATIONS

This study provided us with an opportunity to determine the status of MLIP participants in the program's aftermath. Overall, our conclusions are that MLIP had a positive effect on post-employment experience. Indeed, MLIP appeared to have a direct effect for almost one-quarter of all individuals currently employed. Even unemployed people continued to be positive about their MLIP experience.

We also believe that other factors help explain the 38% rate of post-MLIP employment, as well as the continued high rate (53%) of unemployment. Most prominent among them might be local labor market conditions.

We believe that there are certain aspects of MLIP which contribute to the satisfaction expressed and the rate of people transitioning into unsubsidized, private sector employment. These features include: the program's short-term duration, its primary utilization of local organizations rather than already overburdened and possibly overemployed local governments, and its "task" orientation. These features made the experience more like a "private sector" job, without the rigid work practices and competition sometimes associated with private sector employment. In addition, the jobs provided useful services for the communities in which employees resided, and as such provided an additional source of satisfaction. If a primary goal is to maximize transition into unsubsidized, private sector employment, we believe these program aspects should be retained in future program implementation efforts.

We might also suggest that either a job development component be built into the program, or that greater linkages with the private sector be created in project planning and implementation. This might facilitate an even higher percentage of placements. If the program attempts to reach more "hard-core" disadvantaged persons in the future, these recommendations might prove especially important.

Decisions about the type of projects to be funded cannot be easily prescribed. Teaching and training type projects register high degrees of job satisfaction, but do not necessarily yield higher rates of positive transition than other project types. This seems to be more

a function of a complex of factors, including the peculiarities of a project's design, (e.g. Kangaroo's Pouch was designed to provide future employment to those trained under its auspices), local labor market conditions and individuals' skill levels.

If a program like MLIP is to demonstrate cost savings, it will be necessary to clearly ascertain its effect on the rate of unemployment compensation. In the short run, MLIP appeared to create a pool of newly eligible unemployment insurance recipients. Will these people still be collecting unemployment insurance a few months from now? A list of ways to reduce or avoid this impact should be generated and discussed.

Finally, on a more global level we would recommend that states or other units of government interested in sponsoring similar temporary job creation programs conduct evaluations. Neither of the other two states which operated LIP-like programs did this, so corroboratory information concerning costs, transition into private sector employment, etc., is not available. This information is important if the MLIP experiment is to be enlarged in the future.

INTRODUCTION

The CETA Job Creation program is designed to create permanent job opportunities for unemployed members of local communities through the creation of self-sustaining non-profit enterprises. Local CETA Prime Sponsors will allocate funds from Title VI of the Comprehensive Employment and Training Act of 1973 (CETA) to enterprises sponsored by eligible community-based organizations, community action agencies, community development corporations, or individuals. CETA funds will be used as wage subsidies to help defray the start-up costs of an enterprise; funds for capital investment must be obtained from other public and private sources. Establishing enterprises may be one way to provide long-term jobs for the community as well as training opportunities for the participants.

The passage of CETA in 1973 marked a new era in public service employment programs. CETA tried to combine the goals of reducing structural unemployment through the provision of skill training and/or subsidized, transitional employment and relying on local initiative to define spending priorities. The Department of Labor makes grants to about 400 Prime Sponsors who design and execute their own programs according to federal guidelines.

Title VI was added to CETA in 1974 in response to the recession. It was aimed at providing transitional public service employment opportunities for the disadvantaged and temporarily disadvantaged. Its underlying assumption was that the economy would improve after a year and private sector jobs would once more be available. In fact, however, unemployment rates have remained high and Title VI has been refunded annually; this temporary holding mechanism is becoming a permanent approach to the unemployment problem. The apparent ineffectiveness of this and other CETA programs in reducing the unemployment rate has been a source of dissatisfaction among Massachusetts agencies involved in em-

ployment programas. This concern has led to proposals for new uses of CETA funds to make a direct connection between public spending and permanent job opportunities. Two such proposals are the Massachusetts Local Initiative Program and the CETA Job Creation Program.

In 1976 the Massachusetts Local Initiative Program (MLIP), inspired by the Canadian attempt to solve similar problems, was sponsored by the State Manpower Service Council (SMSC). One of its objectives was similar to the traditional public service employment programs of CETA--to offer short-term productive employment to CETA-eligible persons. However, MLIP had two additional objective that carried the notion of local initiative even farther. One objective was to assist individuals or groups in initiating projects meaningful to the community. The second was to provide the community with a good or service which in some way improved the qualtiy of life and was presently needed but unavailable. Such projects as craft guilds, craft marketing, day care centers, recreational activities for youth, restoration of historic buildings, community clean-ups, tenant associations, residential improvement programs, fisheries, and food cooperative were funded on a six-month basis. The funds came from a discretionary budget allocated to state governors under Title I of CETA. Projects were chosen according to the extent to which they provided, among other things, a product, training, or a service which was lacking in the community, the extent to which they serviced disadvantage groups, and the extent to which they utilized other funding sources.

Although MLIP was short-term, the SMSC's intention was to distinguish employment provided under MLIP from the isolated, agency job slots often characteristic of other public service employment programs. Thus, productive MLIP employment was to involve work proposed and performed by individuals or

groups in the community. Such work could have future value to the individual; however, MLIP was designed as a short-term job creation program that did not necessarily have any long-run impacts.

The CETA Job Creation Program is based on a similar notion--that community-based and -created projects are more likely to be beneficial to both workers and the community than are traditional isolated job-slots. In addition, however, the Job Creation Program attempts to create permanent job oppotunities. Most other CETA programs provide only temporary employment or training with the assumption that private sector jobs will be available for CETA "graduates". Such jobs, however, often do not exist due to both cyclical downturns in the economy and structural problems (which are particularly severe in Massachusetts). Also, discrimination against women and minorities often prevents them from moving into jobs in the private sector. Although the latest CETA legislative revision has reoriented much of Title VI funds from job slots to project-oriented employment, the projects are still only short-term. It is important to note that CETA Job Creation is not a legislative change; rather it is an adminstrative attempt to more effectively use CETA funds.

By combining public and private resources, Title VI has the potential to provide self-sustaining jobs. Resources in addition to the CETA wage subsidy will be used to furnish tools and equipment useful in teaching workers new skills. The result may be higher levels of productivity than was previously feasible with MLIP projects that were funded solely with wage subsidies. Increased productivity, in turn, may lead to increased project revenues, higher wages, and self-supporting activities. Examples of MLIP projects which have potential as long-term enterprises are craft guilds, food cooperative, and canneries.

It is important to note again the conditions which the CETA Job Creation Program is trying to fulfill and which will guide the type of enterprises to be funded. First, the program is aimed at severely disadvantaged and long-term unemployed workers. (Experienced managerial personnel can be paid from the ten per cent of CETA funds not restricted to wages and from enterprise income.) Second, CETA Job Creation is aimed at creating new opportunities for the unemployed while at the same time providing a good or service meaningful to the community or to the quality of life of its members. That is, the enterprise should have a public service objective. Third, projects must not displace currently employed workers. Fourth, new enterprises must be non-profit. Fifth, CETA funds will be provided for one year only.

The next section of this Handbook (Section II) provides a more detailed description of how the CETA Job Creation Program will work, how the above conditions affect which enterprises will be the most feasible, and some of the problems that may be enountered. Part Two explains how to evaluate a project applicant: Section III explores the employment impacts of an enterprise; Section IV describes the three components used to assess the potential for self-sufficiency--management, market analysis, and financial analysis; Section V discusses how to evaluate whether a project needs the CETA subsidy. An example of the type of project that may suitable for the subsidy is presented in Appendix 1. This case study illustrates how the steps outlined in the text of the Handbook can be applied by the Prime Sponsors to evaluate project proposals. Finally, Appendix 2 lists sources of capital and technical assistance available to Program applicants.

II. How Will CETA Job Creation Work?

A. Goals

The CETA Job Creation Program has several goals, related to providing jobs for the unemployed and inducing local economic development. Because of the constraints outlined below inherent in the CETA regulations and the difficulty in starting a viable enterprise even under ideal conditions, it is unlikely that any enterprise will meet all of these goals. However, it is hoped that every CETA enterprise will be designed to achieve at least one of the purposes described in the following paragraphs.

The basic goal of the program is the creation of permanent, good jobs for the unemployed by developing self-sustaining enterprises. An example of such an enterprise is a housing rehab business which used its first (subsidized) year to accumulate equipment, train workers and build a reputation in the community, and by the second year became a viable enterprise, providing permanent jobs for its workers.

Since achievement of this goal may be extremely difficult, we present a secondary goal: the creation of enterprises which provide skill training and entrepreneurial experience for participants. Since Job Creation projects, unlike traditional CETA employment, must produce marketable goods or services, they have the potential to train participants in marketable skills; the projects can also give their workers valuable entrepreneurial experience. This training and experience is important for individual worker mobility as well as for community economic development. An example is the Hampshire Community Canning Center, a LIP project in which a few workers used the entrepreneurial experience gained by organizing and managing the cannery in developing additional projects to stimulate the local agricultural sector. If a project gives its participants

marketable skills and experience, it may be valuable even if the enterprise ultimately fails.

Another secondary goal of CETA Job Creation is the development of enterprises which will further stimulate the local economy. Small-scale projects are generally seen as having little potential for economic development. In small towns and rural areas, however, well-placed CETA Job Creation projects can have an impact by buying from and selling to established local enterprises. One example is the network of community enterprises begun as an offshoot of a Community Action Agency in northeastern Vermont; a home building project spurred the creation of a sawmill, which spawned a logging operation, and all three utilized CETA labor.[1]

B. Problems in Achieving These Goals

Three components are needed to create a viable enterprise--good management, a marketable product or service, and adequate capital. Entrepreneurial and managerial ability are crucial because enterprise creation demands creativity, dedication and the ability to inspire confidence in others (especially the enterprise's creditors.) A marketable product or service is essential for an enterprise to operate without subsidy, and capital is a prerequisite for all enterprises to get off the ground, remain solvent, and expand.

These elements are difficult for any new enterprise to obtain, but they present special problems for CETA Job Creation enterprises because of constraints inherent in Title VI regulations.[2] These constraints include the following:

[1]Boston University Institute of Employment Policy, "Locally Directed Economic Development: The Experience in Northern Vermont," December, 1976.

[2]The State Manpower Services Council of Massachusetts is currently awaiting interpretation of these regulations from the Department of Labor, and some may be waived or modified for the CETA Job Creation Program.

1. Projects must employ members of the target population (Massachusetts' residents are eligible if they have exhausted their unemployment insurance benefits but their claim has not expired, or if they are not eligible for unemployment insurance benefits for monetary or non-monetary reasons.). This poses potential problems in finding an entrepreneur and in capital acquisition. The target population may not have access to personal savings, which are an important source of equity for a new enterprise. Banks often require personal equity investment as a measure of entrepreneurial commitment to a project.

2. Projects must be non-profit and have a "public service objective". The public service objective requirement will limit the type of product or service that the enterprise can sell, and may consequently limit its viability because most goods and services with a clear public service objective are not marketable. The non-profit constraint may make it difficult to sttract a good entrepreneur to the enterprise, for it requires finding people who will commit a tremendous amount of energy with little desire for monetary reward. It will also prevent the enterprise from attracting investment capital, and force it to rely on contributions for initial equity.

3. Projects must not displace currently employed workers. This limits the type of product or service that the enterprise can offer by virtually prohibiting competition with existing local businesses. It dictates the creation of enterprises which will meet a new demand or one inadequately met by existing local business.

4. Projects must use at least 90% of their Title VI funds for wages and fringe benefits. This means that the CETA subsidy will not provide start-up capital. The types of capital which are the most crucial and the most difficult for a new enterprise to obtain are equity and long-term debt; a subsidy earmarked for wages will not help the enterprise obtain either of these.

5. Projects must be completed within one year. According to current interpretation of the regulations, this means that an enterprise can receive a CETA subsidy for one year only.[1] This creates problems for viability, since virtually all new businesses take from two to five years to reach the break-even point.

C. What Types of Enterprises Will Work?

Given the constraints outlined above, are there any types of enterprises which may be able to succeed in attaining self-sufficiency, providing good, permanent jobs, offering worthwhile training and experience, and/or stimulating the local economy? The answer is a qualified yes. Each proposed enterprise must be critically evaluated in terms of its potential to meet these goals, but some generalizations can be made about types of enterprises which will have the greatest chance of success:

1. Small-scale enterprises--Because of their size and relative non-complexity, small-scale enterprises have the best chance of succeeding without an experienced, high-powered entrepreneur. They are also more likely to have a non-hierarchical organizational form and hence a high degree of worker commitment, which can substitute for certain entrepreneurial qualities.

2. Labor-intensive enterprises--Since the CETA subsidy is primarily a wage subsidy and obtaining other capital will be a major problem for CETA Job Creation projects, labor-intensive enterprises can make the best use of the subsidy. For a manufacturing firm requiring $20,000 worth of equipment/worker, the major obstacle comes in finding start-up equipment capital; a wage subsidy will hardly make a dent in the start-up expense.

[1] If, however, "project" can be defined as the start-up of the business, then in subsequent years expansion or continued operation of the same enterprise could be defined as a separate project and re-funded. We are awaiting Department of Labor clarification of this issue.

Any such industry which could succeed with a wage subsidy could probably also succeed without one. For a weatherization business requiring much less equipment/worker, however the CETA subsidy could make the difference between successful or unsuccessful start-up.

3. Collectively-organized enterprises--As mentioned in connection with small-scale enterprises, non-hierarchical organization often means more worker commitment, which can substitute in part for the lack of an experienced entrepreneur. This is especially true for an enterprise created by a group of people with strong personal motivation to make it work--in a sense, they share the role of entrepreneur. This was the case in the Mass-Craft Marketing Project, a successful LIP project. Collectively organized enterprises can also provide broader training for participants by encouraging both rotation of responsibilities and opportunities for self-management.

4. Enterprises producing a good or service which is needed in the community or for which a public agency provides a captive market--This assures the enterprise a market in spite of the public service and nondisplacement constraints. One example is the Wind-O-Seal enterprise started by the Lynn Economic Opportunity Agency, which markets its product to Community Action winterization programs throughout the state. Another example would be a community-sponsored child-care center in an area with no existing child-care facilities.

5. Enterprises providing innovative products which are not currently available in the marketplace--This addresses similar marketing problems to those mentioned under the previous point. It also has economic development ramifications, because if a new product developed in a town catches on, it has great potential for expansion within the town. Job Creation subsidies are not geared to high technology industries, but could be used for small-scale, experimental production such as wind power equipment, innovative agriculture (e.g. hydroponics), devices

for handicapped people, etc.

6. Enterprises which train people in difficult skills--Because of the one year wage subsidy, the CETA Job Creation concept is especially well-suited to projects which require long training periods or high training costs. Although such enterprises might succeed without a subsidy, it allows them to hire and train members of the target population by providing a year-long period before workers must reach full productive capacity.

7. Enterprises linked to a community development corporation (CDC), community action program (CAO) or some other well-established organization--Such a connection provides the enterprise with technical assistance and administrative support to supplement its limited entrepreneurial experience. It can also confer legitimacy on the enterprise and help provide access to capital through non-profit, tax-exampt status in the case of a CAP, and through federal and foundation grants, etc. in the case of a CDC.

8. Enterprises which are linked to other community enterprises--As in the northern Vermont experience mentioned previously, community-based enterprises whose products are linked, e.g. they buy from and sell to one another, can reinforce each other and have a significant impace on a rural or small town economy. Economic links with other public enterprises help non-profit, community-based enterprises overcome the difficulties they encounter in an economy geared to private enterprise.

No enterprise will embody all of these characteristics. However, Prime Sonsors can seek out projects with some of these qualities by distributing information on CETA Job Creation to community groups representing segments of the target population. It is likely that substantial interest can be generated, particularly given the Success of the LIP program in which project initiative came from small community groups and individuals.

D. Pitfalls to Avoid

Title VI constraints make it difficult to design projects that will meet the goals of the CETA Job Creation program. Keeping the goals in mind, therefore, Prime Sponsors should be especially cautious of the following types of enterprises:

- -Projects which will provide "bad jobs", displace local workers, or fail to employ the target population
- -Enterprises which will take the subsidy and fail after a year
- -Enterprises which do not need the subsidy

These last two issues are closely related, because many enterprises with potential for lont-term survival will not really need the subsidy to start up, and many enterprises which need the subsidy to start up will not be viable when it is withdrawn.

The remainder of this handbook is oriented toward these three issues, and suggests how Prime Sponsors can evaluate proposed projects in terms of their employment impact (Section III), potential for viability (Section IV), and evidence of need for the subsidy (Section V). Such an evaluation is a particularly difficult task. While a project's employment impact is fairly straightforward, analyzing both viability and need for the subsidy requires some knowledge of finance and experience in business. This handbook provides a framework for such analysis and suggests questions for evaluating CETA Job Creation proposals, but it does not explain how to do a thorough analysis. It is strongly recommended that after screening projects for their employment impact, Prime Sponsors seek help from knowledgeable people in finance, business or public technical assistance services such as the Small Business Administration (SBA) or the Economic Development Administration (EDA) to evaluate viability and need for the subsidy.

It is especially important to avoid raising unrealistic

expectations for the CETA Job Creation program. Some enterprises can succeed, create permanent jobs, and possibly even stimulate the local economy. Other projects, even if they ultimately fail, will provide valuable training and experience. However, the program's constraints and the difficulty of starting new enterprises must be acknowledged and considered both by Prime Sponsors and the individuals and groups applying for a CETA subsidy.

REDLINING AND DISINVESTMENT CAUSES, CONSEQUENCES, AND PROPOSED REMEDIES*

by Frances E. Werner,** William M. Frej*** and David M. Madway****

I. INTRODUCTION

For decades, mortgage redlining has flourished unnoticed in urban America. Yet it was only five years ago that the victims themselves realized that irrational mortgage disinvestment was leading their communities inexorably into cycles of decay. And it was the victims, led by the West Side Coalition of Chicago and Gale Cincotta, who built grass roots organizations which finally focused national attention on the plight of disinvested neighborhoods and the consequences of redlining on the body politic. The process of decay continues, but the speed of governmental response has been glacial; to date, only a handful of federal, state and local legislative and regulatory schemes have been proffered in an attempt to halt redlining. The hearings for which this paper was prepared are significant because they offer an opportunity for HUD to assume a leadership role in prompting comprehensive executive branch action.

This paper describes redlining and its consequences and suggests a variety of remedial actions, all of which could be immediately implemented by the executive branch without further congressional action. The phenomenon and consequences of redlining are discussed in some detail in order to provide the federal agencies with a conceptual framework within which to fashion the most effective remedies. It is the authors' hope that the information elicited at the hearings will do more than simply add to the already well-documented concern about redlining, but instead will serve as a catalyst for change.

II. REDLINING AND ITS ROLE IN PHASES OF NEIGHBORHOOD DETERIORATION

The social and economic well-being of any community is dependent upon the availability of credit to finance the purchase, construction and rehabilitation of homes. The problems encountered in urban areas of obtaining affordable institutional mortgages and other loans for these activities have been an increasing concern for those cities suffering from neighborhood decay and housing abandonment. This process of decay is most apparent in an urban neighborhood's pattern of decline, which begins in an all-white residential community and proceeds through progressive stages of racial change and property exploitation until it resegregates as an all black or Latin community and dies as an abandoned wasteland.

Although many factors contribute to neighborhood deterioration, the decision by an area's lending institutions to extricate themselves from neighborhoods they predict will deteriorate is critical in this process of decay. This disinvestment decision reflects a loss of confidence in the community as a viable economic investment and has grave consequences for the neighborhood as well as for the city as a whole.

The principal tactic used in the disinvestment process is "redlining," a term used to describe the practice of refusing to loan money or invest in selected geographic areas. In addition to an outright refusal to invest in a neighborhood, redlining tactics may include a number of subtler actions.[1]

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1. These points are summarized in Agelasto and Listokin, *The Urban Financing Dilemma: Disinvestment-Redlining*, 890 EXCHANGE BIBLIOGRAPHY, 1-2 (1975).

— requiring down payments of a higher amount than that usually required for financing properties in other neighborhoods;

— fixing loan interest rates in amounts higher than for mortgages in other neighborhoods;

— fixing loan closing costs in amounts higher than for mortgages in other neighborhoods;

— fixing loan maturities below the number of years for mortgages in other neighborhoods;

— refusing to make loans below a minimum value (thus excluding many of the lower-priced properties found in redlined neighborhoods);

— refusing to make loans on properties below a minimum size;

— refusing to make loans on the basis of presumed economic obsolescence without regard to a property's actual condition;

— stalling on appraisals to discourage potential borrowers;

— appraising property below the actual market value (thus making purchase transactions more difficult to accomplish);

— applying structural appraisal standards of a much more rigid nature than used on comparable properties in other neighborhoods; and

— charging discount "points" as a way of discouraging financing.

Whether redlining occurs as a blatant refusal to extend credit or assumes a subtler form, the end result is the same: the deterioration and abandonment of neighborhood housing. For property owners, the inability to obtain financing has serious implications. First, the lack of new funds to finance the remodeling or rehabilitation of property accelerates the decline of an area. Second, since property owners (or potential owners) can secure mortgage money only by payment of a substantial premium, additional financial pressure is placed on them. This in turn impels them to increase the cash flow from the property by further subdividing or overcrowding it.

As a policy, redlining is defended on the grounds that investment in high risk areas is an unsound business practice equivalent to mismanagement of depositors' funds and is "ultimately counterproductive, both for the depositor and for the lending institution."[2] In practice, however, redlining is less of a protection against unnecessary financial risk than it is a selffulfilling prophecy of decline for the targeted neighborhoods. The decision to redline is based on a subjective assessment of the likely effects of such arbitrary criteria as the age of the housing stock, the racial and ethnic composition of the neighborhood, and the income levels of the residents. This assessment of a community as an economic risk is often made prior to any evidence of actual decline, and without reference to such factors as the residents' credit ratings, the actual condition of the housing stock and the viability of the community as a whole.[3]

2. NAPARSTEK and CINCOTTA, URBAN DISINVESTMENT: NEW IMPLICATIONS FOR COMMUNITY ORGANIZATION, RESEARCH AND PUBLIC POLICY, 8 (1975) [Hereinafter cited as NAPARSTEK and CINCOTTA.]
3. *Id.*, p. 9.

As a consequence of the decision to redline, the funds required to maintain a neighborhood's health are withdrawn. The spectrum of this withdrawal ranges from the redirection of savings to the actual relocation of the depository institution from the inner city to the suburban ring. Take, for example, this situation in Chicago.

The following chart shows the net changes in Savings and Loan Association Home Offices for Chicago and Suburbs from 1960 through September 1974:

Location	Number of Associations 1960	September 1974
Chicago	158	89
Suburbs	131	145
Total	289	234

Chicago had a net loss of 69 associations' home offices during this 14-year period, while the suburbs had a net gain of 14 home offices.[4]

Disinvestment insures that decline will occur. Local depositors living in redlined areas find that their savings are directed to other areas of investment — often new suburbs — instead of being used for mortgage and home improvement loans for local use.[5] One study of redlining practices in Chicago has shown that bank mortgages in many neighborhoods amounted in dollars to less than 1 percent of the savings the residents had deposited in the banks.[6] Another study undertaken in Washington, D.C., found that almost 90 percent of the mortgage loans made by the city's savings and loan associations went to nearby Maryland and Virginia suburbs, even though an estimated 40 to 60 percent of their savings deposits had been collected in the District of Columbia.[7] Thus, the residents of redlined neighborhoods are doubly victimized: not only do the banks insure their neighborhoods' gradual decline, but they also deprive the residents of the rightful use of their own savings.[8]

III. PHASES OF NEIGHBORHOOD DETERIORATION

Several studies of neighborhood decline have outlined six phases of deterioration which are initiated by the disinvestment decision:[9]

4. THE ROLE OF MORTGAGE LENDING PRACTICES IN OLDER URBAN NEIGHBORHOODS: INSTITUTIONAL LENDERS REGULATORY AGENCIES AND THEIR COMMUNITY IMPACTS, 338 (1974). [Hereinafter cited as MORTGAGE LENDING PRACTICES.]
5. NAPARSTEK and CINCOTTA, *supra*, note 2.
6. *Hearings on S. 1281 Before the Sen. Comm. on Banking, Housing and Urban Affairs, To Improve Public Understanding of the Role of Depository Institutions in Home Financing*, 94th Cong., 1st Sess., 191 (1975). [Hereinafter cited as *S. 1281 Hearings*.]
7. *Neighborhood Decay: Is Redlining a Factor?*, CONG. QUARTERLY, 1040 (May 17, 1975).
8. NAPARSTEK and CINCOTTA, *supra*, note 2 at 9.
9. *Id.* at 9-10; *see also* Frej, William M., *The Home Mortgage Disclosure Act of 1975: Combating Redlining for Neighborhood Reinvestment*, 1 ECONOMIC DEV. L. PROJ. REP. 6, 11-13 (January February 1976); *S.1281 Hearings*, *supra*, note 6 at 562.

Phase I: The Healthy Community. The neighborhood is characterized by housing stock in excellent condition, thriving local businesses, good urban services, and ready access to conventional mortgages and home improvement loans from a multiplicity of lending institutions. Property values are stable or rising, and there is a strong demand for housing in the area.

Phase II: The Decision to Disinvest. Perceiving some "risk" of deterioration, pace-setting city-wide depository institutions and some local savings and loan associations set stringent loan requirements for the neighborhood and indicate a preference for granting loans in outer-ring suburbs and relatively new innerring communities. Although mortgages are still made available, their terms are generally harsh: high interest rates, excessive down payments (sometimes as high as 40 percent) and short loan life.

Phase III: Redlining. The neighborhood is explicitly selected for disinvestment. Lending institutions act more aggressively to channel money to other areas and refuse to make conventional loans on the basis that the risk of property devaluation is too high. Real estate appraisers employed by the financial institutions confirm the risk on the basis of subjective criteria. Residents of the neighborhood are unable to obtain home improvement loans, thus guaranteeing that the process of decline will occur as home repairs and improvements are left unattended. Potential buyers are told that loans are unavailable and are steered to other neighborhoods. As confidence in the neighborhood is undermined, businesses and financially mobile homeowners begin to relocate in other parts of the city.

Phase IV: The Rise of FHA Insured Mortgages. The financial institutions concur in the decision to redline the neighborhood, and FHA 100 percent insured loans become the only ones available. FHA mortgages hold virtually no risk for the investor and can be pooled and bought and sold through the Government National Mortgage Association and the Federal National Mortgage Association. Substantial "front-end" profits are made in commissions, brokers' fees, "points," and servicing fees. By levying a front end finance charge on loans, early foreclosure on a mortgage becomes profitable. In such cases, unsound loans and early foreclosures make money. Thus, it is to the profitable advantage of realtors, savings and loan associations, and mortgage bankers to turn over the neighborhood since once a house is sold, the profit is secured whether or not the buyers default or simply abandon their homes.[10] Stuck with deteriorated housing at inflated prices and unable to finance both mortgage payments and needed repairs, homeowner defaults and abandonment proliferate.

Phase V: Neighborhood Decline. Insured FHA mortgages and absentee landlordism compound the loss of incentive for property maintenance. Unable to refinance and improve their properties, landlords resort to overcrowding and higher rents to maximize their profits in the short run. Eventually, real estate can no longer be sold or refinanced, and deterioration spirals as maintenance declines. Businesses and property owners leave the neighborhood, trapping only the very poor in what has become a "blighted" area. City services decline, housing code enforcement collapses and building abandonment and crime accelerate. Home and property insurance become a memory.

Phase VI: Urban Renewal. Neighborhood deterioration has become cumulative, blighted areas are torn down, and residents are "relocated." The same financial institutions which denied loans in the redlined neighborhood now stand to profit from financing housing projects for higher income families and new commercial ventures. Where the redlined neighborhood borders on a still viable business district, it is to the latter's advantage to sponsor urban renewal as a means of creating spatial externalities through which new commercial development enhances the value of the old. With this end in mind, it is possible that the initial decision to redline a neighborhood is a conscious choice aimed at bringing about urban renewal and commercial expansion.

IV. FAILURE OF THE "FILTER DOWN" THEORY

Through those disinvestment practices in which local financial institutions invest their savings in other communities, the urban poor end up subsidizing suburban development where most new housing and employment opportunities are to be found. In turn, the residents of the disinvested neighborhoods are expected to benefit from the "filter down" process whereby the poor are expected to move into the housing vacated by the more economically and socially mobile. The filtering process is based on the assumption that housing naturally deteriorates and becomes less valuable with age, eventually filtering through the social structure until it becomes available to the poor.[11]

In practice, this filtering process has never worked adequately.[12] In part, this has been due to the inability of the housing delivery systems in the U.S. to build adequate new housing to meet demand. Without a sufficient amount of new housing fed into the system from the top, the entire process collapses. Moreover, since blacks and other minorities tend to be concentrated in the lower income levels, they have difficulty in obtaining loans for other than relatively low cost housing; thus, even when housing is available, lower income urban residents find it difficult to obtain financing. These factors have a discriminatory effect on the city's residents, explaining why a disproportionate amount of minority housing is located in run-down and declining neighborhoods.

Of even greater significance is the fact that the filter down theory is based on the assumption of upward income mobility for the entire population. The poor, however, have

10. For a description of the ravages wrought by this process in Chicago, see Brown v. Lynn, 385 F.Supp. 986 (1974) and 392 F.Supp. 559 (N.D. Ill. 1975). See also, Hood and Kushner, *Real Estate Finance: The Discount Point System and Its Effect on Federally Insured Home Loans*, 4 [illegible] L.REV. 1 (1971); Madway, *A Mortgage Foreclosure Primer*, 8 CLEARINGHOUSE REV. 168-169, 251-257, 479-480 (1974).

11. Duncan, Hood, and Neet, *Redlining Practices, Racial Desegregation, and Urban Decay: Neighborhood Housing Services as a Viable Alternative*, 7 URBAN LAWYER 515 (1975) [Hereinafter cited as Duncan, Hood and Neet.]

12. For two excellent discussions of the filtering process, see HARVEY, SOCIAL JUSTICE AND THE CITY, 172-3 (1973), and Myers, *Housing Allowances, Submarket Relationships and the Filtering Process*, 2 URBAN AFFAIRS QUAR. 11, 218-225 (December 1975).

4. Housing abandonment is occurring (or has occurred) exclusively in racial transition areas, or in areas that have undergone transition from white to nonwhite sometime in the past.[23]

5. Lower homeownership rates and fewer conventional mortgages in black neighborhoods imply a pattern of neglect for the black segment of the housing market.[24]

6. Holding income constant, whites have a significantly higher level of homeownership than blacks, and as the percentage of blacks increases in an area, the level of homeownership decreases.[25]

These phenomena indicate that disinvestment has a discriminatory effect on low income groups which, in turn, has a disproportionate impact on American minorities. Ultimately, redlining can result in a neighborhood's resegregation.[26]

It is difficult to substantiate allegations that disinvestment is motivated by racial discrimination rather than economic forces due to the overlapping of these factors. Nevertheless, there is "ample evidence on the public record of discrimination in mortgage lending"[27] indicating an "immediate correlation between minority areas and redlining."[28]

The results of a 1972 HUD survey reported that nearly 1,000 lending institutions (out of 15,000 respondents) admitted that the racial and ethnic composition of a neighborhood was a consideration in assessing loan applications.[29] Ninety-nine flatly admitted that they considered the race of the borrower and 415 confessed that they did not make loans in areas of minority concentration.[30]

In 1974, the regulatory agencies conducted fair housing information surveys covering lending institutions in 18 Standard Metropolitan Statistical Areas (SMSAs) in order to determine whether the supervised lending institutions were practicing discrimination in mortgage lending.[31] These surveys collected information concerning approximately 105,000 mortgage applications. The results indicate sharp disparities in the rejection rates of white and nonwhite applicants, substantiating allegations that lending institutions have practiced widespread discrimination.

In the survey conducted by the Federal Home Loan Bank Board (FHLBB), 53,705 applications were analyzed from Atlanta, Buffalo, Chicago, San Antonio, San Diego and Washington, D.C.[32] White applicants had an eight percent rejection rate compared to 18 percent for black applicants. This disparity existed in each of the six SMSAs:[33]

SMSA	White Rejection Rate (percent)	Black Rejection Rate (percent)
Atlanta	7.1	12.4
Buffalo	15.4	28.8
Chicago	7.0	18.4
San Antonio	8.8	23.3
San Diego	5.4	18.2
Washington, D.C.	5.8	15.1

Similarly, disparities appeared in the rejection of white and Spanish applicants in San Antonio (8.8 percent for whites and 18.0 percent for Spanish) and in San Diego (5.4 percent for whites and 8.7 percent for Spanish):[34]

In a second survey devised by the Federal Reserve Board and the Federal Deposit Insurance Corporation ("FDIC") in which more than 20,000 applications were analyzed for six SMSAs, whites experienced a rejection rate of approximately 12 percent compared to a minority rejection rate of approximately 22 percent:[35]

SMSA	White Rejection Rate (percent)	Minority Rejection Rate (percent)
Baltimore	12	24
Jersey City	12	22
Tampa-St. Petersburg	11	18
Galveston-Texas City	7	18
Jackson	14	17
Vallejo-Fairfield-Napa	24	10

Finally, in a third survey devised by the Comptroller of the Currency, 12,707 applications were analyzed,[36] and the disparity in rejection rates for loan applications was 14.8 percent for whites compared to 24.8 percent for nonwhites:[37]

SMSA	White Rejection Rate (percent)	Nonwhite Rejection Rate (percent
Bridgeport	11.1	15.8
Cleveland	16.2	26.5
Memphis	13.1	23.0
Montgomery	15.6	48.5
Topeka	11.5	33.5
Tucson	9.3	22.0

23. *S.1281 Hearings*, *supra* note at 1328.
24. *Id.* at 1549.
25. *Id.*
26. Duncan, Hood and Neet, *supra* note 11 at 521.
27. SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, REPORT ON FAIR LENDING EN-FORCEMENT BY THE FOUR FEDERAL FINANCIAL REGULATORY AGENCIES, 94th Cong., 2d Sess., 6 (1976) [Hereinafter cited as FAIR LENDING REPORT.]
28. *S.1281 Hearings*, *supra* note 6 at 1072, reported by Center for New Corporate Priorities, *Where the Money Is: Mortgage Lending, Los Angeles County*.
29. FAIR LENDING REPORT, *supra* note 27 at 6.
30. *Id.*
31. The results of these surveys are reported in FEDERAL HOME LOAN BOARD NEWS (August 19, 1975).
32. 66,320 applications were collected, of which 18 percent were not analyzed because they did not include race or other personal data. The furnishings of this data by the applicant was optional.
33. The following statistics are compiled from Tables 2.1 through 2.6, FEDERAL HOME LOAN BANK BOARD NEWS (August 19, 1975).
34. *Id.* at Tables 2.4 and 2.5.
35. This data is cited in the complaint filed in National Urban League v. Comptroller of Currency, C.A. No. 76-0718 (D.D.C., filed April 26, 1976).
36. Of 18,372 forms collected from 152 institutions, 5,665 were not analyzed because they were incomplete or appeared to contain substantial errors.
37. National Urban League v. Comptroller of Currency, C.A. No. 76-0718 (D.D.C., filed April 26, 1976).

In this last survey, credit-worthiness data was included, making it possible to analyze rejection rates while holding certain factors constant. In every case, minority rejection rates are considerably higher than for whites among persons having the same gross annual income, the same gross assets, the same outstanding indebtedness, the same monthly debt burden, and the same number of years in their present occupations. Specifically:[38]

1. Among those persons whose annual earnings fall between $15,001 and $25,000, the white rejection rate is 13.9 percent compared to 20.9 percent for nonwhites. Among those persons earning over $25,000, the white rejection rate is 12.1 percent compared to 22.6 percent for nonwhites.

2. Among those persons whith assets valued between $60,001 and $100,000, the white rejection rate is 14.0 percent compared to 18.8 percent for nonwhites. Among those persons with assets of more than $100,000, the white rejection rate is 13.8 percent compared to 18.8 for nonwhites.

3. Among those persons with outstanding indebtedness of less than $5,000, the white rejection rate is 14.0 percent compared to 22.2 percent for nonwhites.

4. Among those persons with monthly debt payments of less than $100, the white rejection rate is 12.9 percent compared to 20.0 percent for nonwhites.

5. Among persons with more than five years in a current occupation, the white rejection rate is 14.1 percent and the nonwhite is 23.2 percent.

The fact that the lending institutions tend to devalue both the minority neighborhood and the minority background of the applicant doubly victimizes minorities seeking mortgage loans. A black loan applicant is likely "to encounter discrimination both because he is black and because he proposes to obtain a mortgage on property in a predominantely black neighborhood."[39]

In addition, sexual discrimination in lending practices which has been documented by the FHLBB results in a disproportionate impact on minority families. Since a higher proportion of wives work in black families than in white families, discounting all or a substantial part of a wife's income discriminates against black families. Similarly, refusing to make loans to female headed families or imposing more stringent terms and conditions on loans to female headed families tends to discriminate against minority families who are more commonly headed by women than white families. In five of the six SMSAs surveyed by the FHLBB in 1974, the rejection rate for female loan applicants was consistently higher than for males:[40]

SMSA	Female Rejection Rate (percent)	Male Rejection Rate (percent)
Atlanta	5.7	7.6
Buffalo	18.3	16.3
Chicago	10.4	7.6
San Antonio	16.8	12.5
San Diego	9.3	6.1
Washington, D.C.	12.6	9.7

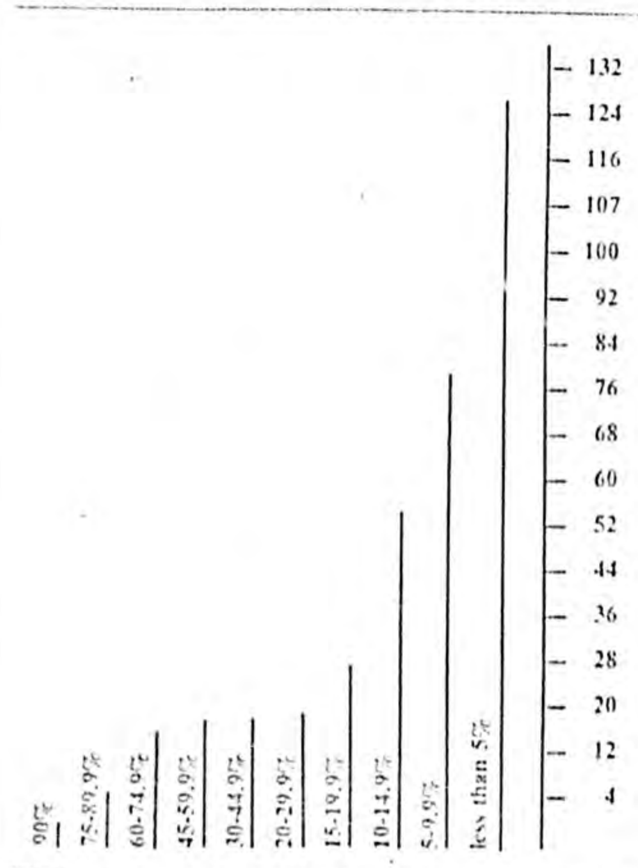
38. *Id.*
39. FAIR LENDING REPORT, *supra* note 27 at 7.
40. The following statistics are compiled from Tables 1 through 36, FEDERAL HOME LOAN BANK BOARD NEWS (August 19, 1975).

A direct correlation between redlining and areas of minority concentration has been well documented in a study of mortgage lending in Los Angeles County.[41] Using five months' lending statistics from all state licensed savings and loan associations (amounting to $671 million in mortgage loans between January and May, 1974), the study concluded that "over a million people live in neighborhoods where there is no prospect of lending at all."[42] A seventh of the population of Los Angeles County lives in neighborhoods which received less than 1 percent of the single family loan dollars, yet two higher income communities with just over 1 percent of the population — Beverly Hills and Palos Verdes — received one seventh of the loan dollars.[43]

Disinvestment was directly correlated with higher percentages of minority population and lower median incomes. The all white areas of Los Angeles received about twice as much per capita loan dollars as any integrated area.[44] Lending ranged from one dollar per capita in all Hispanic[45]

Table I

Lending to Hispanic Population (Mortgage Dollars per Capita



Source: S. 1281, U.S. Senate Banking Committee, *Hearings*, II, 1073.

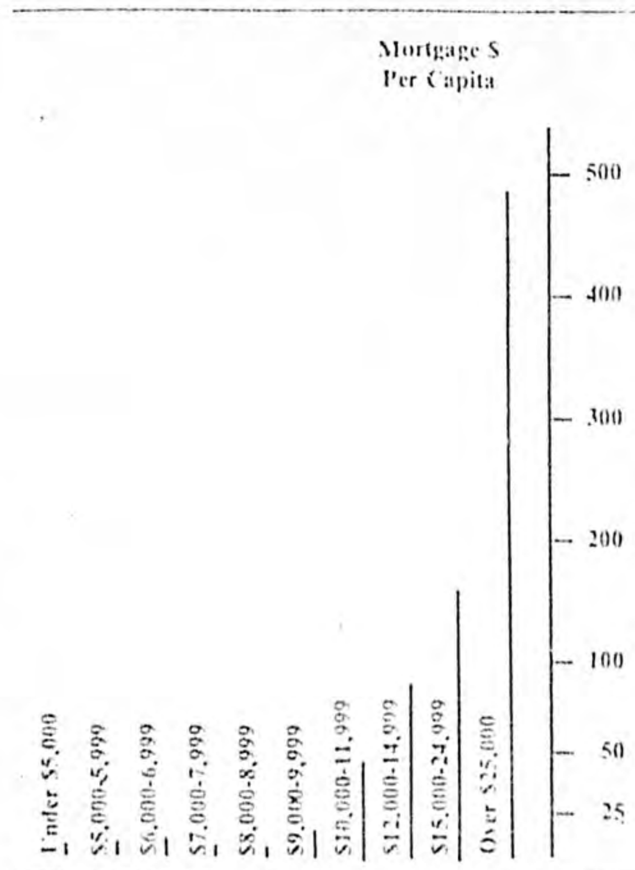
41. CENTER FOR NEW CORPORATE PRIORITIES, WHERE THE MONEY IS, 1063-1120.
42. *Id.* at 1065.
43. *Id.*
44. *Id.* at 1072.
45. "Hispanic" includes Spanish-surnamed and Spanish-speaking individuals, as recorded in the 1970 U.S. census.

neighborhoods to $125 per capita for areas with fewer than five percent Hispanic (see Table I). Similar patterns were observed for areas of black population.[46]

An even sharper disparity was observed for income levels in Los Angeles. Areas with a median family income of over $25,000 (1970 census) had four times the per capita loan dollars than the next highest income category, and 900 times the loan dollars of the lowest income areas[47] (see Table II).

Table II

Mortgage Lending Versus Median Family Income
Los Angeles, California
1970 Census



Source: S. 1281, U.S. Senate Banking Committee, *Hearings*, II, 1073.

Twelve major Los Angeles County "loan starved" or redlined communities were identified as: Compton, Covina, East Los Angeles-Boyle Heights-Echo Park, Highland Park, Long Beach, Pacoima-San Fernando, Pomona, Pasadena, San Pedro, South Central Los Angeles, Venice-Santa Monica, and West Covina.[48] Lending patterns for these areas were compared to lending patterns in San Fernando Valley (which are close to the average figures for all Los Angeles County) and to those of Beverly Hills and Palos Verdes. The following is a compilation of the study's findings:[49]

Area	Percent Minority	Average Number of Loans per 10,000 Population (Single Family)	Mortgage Dollars Per Capita
San Fernando Valley	10.7	18.1	$55.47
Compton	86.8	1.7*	2.41
Covina-Azusa	21.6	1.4*	2.78
East L.A.-Boyle Heights-Echo Park	85.0	0.7*	1.01
Highland Park	34.9	1.8*	4.27
Long Beach	40.1	0.2*	.27
Pacoima-San Fernando	61.9	1.6*	3.53
Pasadena	50.5	1.6*	2.22
Pomona	31.8	1.5*	2.94
San Pedro	53.3	1.7*	3.75
South Central L.A.	90.1	1.6*	2.30
Venice-Santa Monica	30.6	2.5*	6.59
West Covina	44.1	0.8*	1.55
Beverly Hills-Bel-Air	9.1	73.5	617.03
Palos Verdes	7.0	77.8	454.99

*Redlined Communities

VI. PAST DISCRIMINATORY ACTIONS AND THEIR LEGAL IMPLICATIONS

On the basis of the data presented above, it is evident that the mortgage lending institutions' practices disproportionately affect racial minorities on a nationwide level. However, few lenders today would admit to a discriminatory intent and, indeed, it would be difficult to prove in a court of law that many of the practices which are neutral on their face yet have discriminatory effects were introduced for that purpose. In addition, the economic rationales put forward to justify the more subtle practices which have the effect of redlining have tended to remain immune from public scrutiny because they are generally accompanied by dire warnings of bank collapses when policy changes or even modifications are suggested.

However, when current lending practices are viewed against the backdrop of the overt discriminatory behavior of the lending institutions during the past four decades, they are easily seen as a mechanism for carrying forward and

46 CENTER FOR NEW CORPORATE PRIORITIES, WHERE THE MONEY IS, at 1072, 1074.

47 *Id.* at 1072.

48 *Id.* at 1066.

49 *Id.* at 1085-1113.

rigidifying the effects of the prior discrimination. Thus, this brief history of racial discrimination in housing is presented not only for its independent utility as an historical reminder but also because it has direct bearing on the validity, legal and ethical, of the reasons given by lenders for their continued use of criteria which have discriminatory effects.

Redlining as we know it today is directly traceable to more traditional and overt forms of discrimination which created segregated housing patterns in our urban areas. After World War I, when blacks began moving out of the South, unequal lending opportunities resulted in immediate ghettoization, and by 1933, when the federal government began its major involvement in the delivery of housing, racial discrimination was a standard operating procedure.[50] Regardless of whether the private housing industry simply reflects private prejudice, or whether it acts on its own prejudices, "it is the real estate brokers, builders, and mortgage finance institutions which translate prejudice into discriminatory action;"[51] and it is conduct, not attitude, that is the subject of civil rights laws.

Realizing the jeopardy to their own economic self interest, lenders did not absolutely refuse to deal with blacks in all areas of financing, but the dealings were on a separate and unequal basis. For example, new construction loans were impossible to obtain and blacks were restricted to existing housing stock.[52] The housing stock available to them, due to the failure of the "filter down" theory explained earlier, was in most cases in the oldest and most deteriorated neighborhoods which were considered economic risks requiring more stringent loan terms.

While it is impossible to separate the lending institutions from the various actors such as realtors and builders necessary to consummate a mortgage transaction, there is ample evidence of the lending institutions' independent discrimination. They did more than simply react to the discriminatory appraisal practices which are described later in this paper. One savings and loan official said in the 1950s: "We make loans to colored in established areas only. If they were introduced into new areas property values would fall 50 percent."[53] In 1958, one report notes that the property values theory had been properly exploded and was losing strength in most lending institutions; it was, however, being replaced by a "public relations" theory which was founded on the belief that it is sound business policy to cater to the prejudices of potential white customers by not introducing blacks into white areas.[54]

When the federal regulatory agencies stepped into the picture, they adopted wholesale the discriminatory practices of the institutions they were created to regulate. Two theories have been advanced to explain this phenomenon: the first is that they perceived their mission solely as one of alleviating financial distress in the housing finance industry, and racial segregation seemed unrelated to that goal; the second is that, typical of many federal agencies and their special interest groups, there was a free interchange of personnel between the regulators and the regulatees and the already existing prejudices of the lending institutions easily became the policy of their regulators.[55] For whatever reason, by 1940 the FHLBB's Division of Research and Statistics had published articles on the desirability of rating neighborhoods according to their racial composition.[56]

This brief history of the blatant discrimination of lending institutions and their regulators has significant legal implications. In a general equitable sense, they are unable to come to the defense of their current lending practices with "clean hands." The change from an outright refusal to lend in racially mixed areas, or from the imposition of stricter standards of credit-worthiness for blacks, to a policy which is racially neutral on its face — such as denying loans on buildings over a certain age — but which has a racial effect, has the effect of perpetuating the former policies.

As discussed below in the section on fair housing responsibilities of the federal agencies and lending institutions, it is not necessary to find personal culpability in the creation of a dual housing market — it is enough if the insti[illegible]ns' policies perpetuate it. But here there is direct responsibility.

A. FHA and Private Financing

Regardless of whether or not the initial decision to redline a neighborhood was intended to discriminate along racial lines, the result is to make the goal of owning one's home unattainable for a large number of America's low and moderate income minority families. Unable to obtain conventional mortgage loans, these families must seek other sources of home financing.

Revisions of the National Housing Act in the late 1960's liberalized the standards of the federally insured mortgage programs, making FHA insured loans available virtually in all neighborhoods. Even these loans, however, are out of reach for many residents living in deteriorated, racially transitional areas.[57] Moreover, the FHA program itself has been accused of redlining,[58] maladministration,[59] and spurring the flight of homeowners from redlined neighborhoods.[60] In its report on housing conditions and programs in the United States, the Douglas Commission in 1969 flatly accused the FHA of entering into an unwritten agreement with lending institutions to redline inner city neighborhoods:

> This tendency to neglect the poor has been reinforced and partially extended by the FHA tendency to shun the central cities and concentrate on the suburbs. The experience of members of the Commission and others con-

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50. U.S. COMMISSION ON CIVIL RIGHTS, HOUSING (1961), at 16.
51. COMMISSION ON RACE AND HOUSING, WHERE SHALL WE LIVE? (1958), at 22.
52. R.C. WEAVER, THE NEGRO GHETTO (1948), at 222-227.
53. U.S. COMMISSION ON CIVIL RIGHTS, UNDERSTANDING FAIR HOUSING (1974), at 11.
54. WHERE SHALL WE LIVE? at 29.
55. HOUSING, *supra* note 50, at 159.
56. *Id.* at 17.
57. Duncan, Hood and Neet, *supra* note 11 at 518.
58. *Id.*
59. MORTGAGE LENDING PRACTICES, *supra* note 4 at 346.
60. *Id.*

> vinced us that up until the summer of 1967, FHA almost never insured mortgages on homes in slum districts, and did so very seldom in the "gray areas" which surrounded them. Even middle class residential districts in the central cities were suspect, since there was always the prospect that they, too, might turn as Negroes and poor whites continued to pour into the cities, and as middle and upper middle income whites continued to move out.
>
> The result was a general, even if unwritten, agreement between lending institutions and FHA that most of the areas inside the central cities did not have a favorable economic future, and that their property values were likely to decline. . . .
>
> There was evidence of a tacit agreement among all groups — lending institutions, fire insurance companies, and FHA — to block off certain areas of cities within "red lines," and not to loan or insure within them. The net result, of course, was that the slums and the areas surrounding them went downhill farther and faster than before.[61]

Community leaders have accused the FHA of indiscriminately insuring loan applicants "regardless of how poor they may have been as credit risks or how dilapidated the purchased homes may have been."[62] In turn, relatively high rates of foreclosure and abandonment have been observed in neighborhoods with heavy concentrations of FHA mortgages.[63] Homeowners therefore associate the advent of FHA mortgages in their communities with redlining by conventional lenders and the beginning of deterioration. They begin to relocate elsewhere even though they may have had no intention of moving prior to the flight of conventional capital. According to Gale Cincotta, "Redlining and reform of FHA practices go hand-in-hand. I've never seen a city where the two problems weren't intertwined."[64]

In addition to the fears associated with federally insured mortgages, the effects of FHA loans are felt through their higher direct costs in comparison to conventional loans. These costs include the FHA mortgage insurance premium and the additional time required to process loan applications. To the extent that they are borne by the applicants, they reduce the funds available for home maintenance, further contributing "to the self fulfilling prophecy that FHA mortgages presage neighborhood decline."[65] To the extent that they are borne by the sellers who reduce the price of their homes as an inducement to buyers, they represent a loss of equity to those sellers, "contributing to the fears of homeowners in other neighborhoods where FHA mortgages may begin to appear."[66]

The dearth of conventional mortgage financing has resulted in the predominance of private "contract" financing in disinvested neighborhoods. Usually these private contracts are detrimental to the buyer and the community. Non-institutional mortgage capital is generally more expensive than capital from institutional sources because interest and amortization rates are charged and rather steep discounts are levied.[67] This imposes a severe strain on the mortgagor since debt service is typically a large component of monthly installment payments. In addition, the length of maturity of a private loan is sometimes briefer than for institutional financing, causing further debt service pressures. As one study of disinvestment in Bronx County has noted:

> Not unexpectedly, owners in many areas find it most difficult to increase rental receipts to the extent they will cover higher debt service costs. Under such conditions, the "rational" strategy would be to maximize revenues by any means possible. Such a strategy leads to solicitation of welfare tenants, overcrowding, illegal subdividing, maintenance skimping, and tax delinquency. Once this has commenced, abandonment is not far behind.[68]

The fact that private financing is used most often by those who have been denied regular bank credit enhances the prospects of exploitation by speculators. In order to increase their number of sales, speculators. In order to increase their number of sales, speculators frequently play on racial fears by engaging in blockbusting and forcing panic sales.[69] Moreover, speculators have taken advantage of the fact that private financing is a quasi-private transaction unlike institutional financing which is quasi-public. Lower income families who are seeking home financing and are often unfamiliar with the home purchasing process are sometimes forced to agree to clauses and conditions that are inequitable if not illegal.[70]

The socioeconomic realities of the U.S. cities are such that minorities are more often dependent upon private financing and subject to its abuses. More susceptible to fluctuations in the economy, they may miss a month's service debt which can lead to immediate eviction and a total loss of all equity.[71] Even if they can meet all of their payments, the higher

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61 U.S. NATIONAL COMMISSION ON URBAN PROBLEMS, BUILDING THE AMERICAN CITY (1969) at 100-101.
It has been alleged by community groups in Oakland that HUD is presently practicing redlining. Threee cases are cited. In April of this year, FHA refused to send an appraiser for property on the basis that it was located in a neighborhood of encroaching industrial and commercial concerns. In March, a HUD appraiser simply drove by and rejected a house on the basis of its location. Finally, in mid-1975, a HUD appraiser refused to look at a property below East 14th Street.

62 *Supra* note 4 at 346.

63 *Id.*

64 Zigas and Barry, *Special Report: Neighborhood Preservation: FHA: Neighborhood Friend or Foe*, HOUSING AND COMMUNITY DEVELOPMENT REP. 3 No. 9 (September 22, 1975) at 394-396.

65 *Supra* note 4 at 347.

66 *Id.* at 348.

67 Devine, *S 1281 Hearings*, *supra* note 6 at 1343.

68 *Id.*

69 Sternlieb, *S 1281 Hearings*, *supra* note 6 at 562.

70 *Id.* at 564.

71 *Id.*

cost of private mortgages resulting from higher interest rates and shorter terms makes it difficult to maintain their properties. One study of mortgage availability in Chicago's racially transitional neighborhoods summarized the dilemma of the black family:

> For the black contract buyer, the present state of affairs spells hardship, suffering, exhaustion, and despair. It means that husbands must work two and sometimes three jobs in order to make ends meet. It means that wives must work, that wives must work, that family life is all but destroyed, and that children must be left unsupervised, and then people ask why there is a high crime rate in black areas. It means that widows beyond retirement age must scrub floors. Contract buying also means for many that they have chosen the lesser of two evils. Couples were faced with the choice of continuing to pay exorbitant rents comparable to their current monthly installments or buying on contract with the hope that someday they might own their own homes. It also means that they must stand under the criticism of the white munity for not maintaining their buildings and living in squalor. And it hurts all the more because they are only too well aware that they cannot do much in the line of repairs after having put all their money into the pockets of speculators through their outrageous monthly installments. It means too, that they must face embarrassment in admitting that they entered into bad deals, especially when many of them sought out the advice of attorneys when they made their purchases. Contract buying means only one thing: frustration or the impossibility of escaping from living in a slum.[72]

1. The Problems of Refinancing

The refusal of financial institutions to refinance paid down mortgages is perhaps even more devastating than increases in debt service costs.[73] Refinancing is critically important not only for rehabilitation funds, but also for capital accumulation, and in some cases, for cash flow. The main attraction of refinancing is that borrowed money is not subject to federal taxes. Without this supply of capital, there "appears to be a paucity of incentive for owner activity which adds to the viability of a particular improvement."[74] A landlord's behavior is determined as much by present yield as by expectations of future yield. Thus, an institution's unwillingness to extend refinancing not only indicates institutional disinvestment but signals owners to disinvest as well. When the prospects of selling or refinancing become increasingly remote, property owners tend to milk a property in order to accumulate as much capital as quickly as possible. Capital improvements or new investments are viewed as adding little of ultimate value to their properties. The almost inevitable result is neighborhood deterioration and abandonment.

As soon as it becomes apparent to homeowners that capital for refinancing is not being made available, their alternative and reaction is to put their properties up for sale. As greater numbers of homeowners flee an area, a large supply of housing is placed on the market at one time. If only blacks and other lower income families are moving into an area, the supply of housing is likely to exceed demand, thus lowering property values. In turn, other homeowners feel compelled to leave the area before their properties depreciate still further. Without institutional capital to finance a sale, or if institutions are only willing to lend amounts less than the asking price, the original owner will have to:[75]

reduce the sum of the sale price so that it matches the amount of financing being offered; or,

assume a second mortgage amounting to the difference between the sale price and available financing; or,

in the absence of capital, take back a first mortgage on the property.

In any case, the owner will realize a cash return that is less than if the market had not been constrained by a lack of institutional financing. Moreover, the owner is forced to remain attached to the property if it is necessary to take back a first or second mortgage which means that the primary objective of the transaction has not been realized.

In summary, it should be apparent that the presence of institutional lenders in the housing market is vital to the social and economic health and viability of a community. Without institutional capital, the supply of funds for the purchase, construction, rehabilitation, and refinancing of homes is extremely limited and costly. Moreover, institutional lenders contribute to overall economic stability from the neighborhood to the metropolitan level.

VII. THE ROLE OF THE FEDERAL FINANCIAL REGULATORY AGENCIES

The focus of the preceding discussion has been on the pathology of redlining. This section describes the federal agencies that regulate most of the lenders accused of the practice and suggests the ways in which their acts and omissions may have contributed to mortgage disinvestment.

For virtually every institution that originates home mortgage loans, federal examination, supervision and regulation (and protection) are facts of life. National banks are chartered by the Comptroller of the Currency ("COC"), they automatically become members of the Federal Reserve System ("FRS") (which is controlled by the Federal Reserve Board ("FRB")), and their deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). State chartered commercial banks may be admitted to membership in the FRS, in which event their deposits are also insured by FDIC. State charted, non FRS-member commercial banks and state chartered mutual savings banks may have their deposits insured by FDIC. Federal savings and loan associations are chartered by the Federal Home Loan Bank Board ("FHLBB")

72. *Id.*
73. Devine, *S.1281 Hearings, supra* note 6 at 1341.
74. *Id.* at 1346.

75. *Id.* at 1345.

and are members of the Federal Home Loan Bank System ("FHLBS"). All federal savings and loan associations' deposits are insured by the Federal Savings and Loan Insurance Corporation ("FSLIC"), which is controlled by the FHLBB. State chartered savings and loan associations may also be admitted to the FHLBS and have their deposits insured by FSLIC.

As of 1974, 75 percent of outstanding non-farm, one to four family residential mortgages were held by lenders subject to the regulatory authority of at least one of these agencies.[76] Since approximately 15 percent of the mortgages originated by regulated lenders are sold to and held by permanent investors not regulated by these agencies,[77] it is safe to say that something considerably in excess of 75 percent of the mortgage loans *originated* each year are made by regulated lenders. The only significant element in the mortgage origination business that has not fallen into this alphabet soup is the mortgage banking industry, and it has to contend with HUD.

A. Federal Home Loan Bank Board

The FHLBB was created in 1932 to supervise the FHLBS. In 1933 its authority was expanded to include the chartering and supervision of a new kind of association, the federal savings and loan association. The following year, the National Housing Act of 1934 expanded the FHLBB's authority to include the direction and management of the newly created FSLIC. In 1970 the Federal Home Loan Mortgage Corporation was set up to buy conventional mortgages and to thus provide additional liquidity for mortgage originators. The FHLBB directs and controls the FHLMC.

The FHLBS was created to provide a central credit system to supplement the resources of private mortgage lending institutions. Its function is to smooth out seasonal differences between savings flows and loan closings and to supplement institutions in capital-deficient areas.

For a lending institution, the principal benefit of membership in the FHLBS is assured access to "advances" of funds, in plain language, loans, from regional Federal Home Loan Banks at low interest rates. For the economy as a whole, one of the major benefits of the system is the ability of the regional banks to transfer funds among themselves to relieve intermittent regional credit shortages. In this way, the FHLBS makes mortgage funds available in capital-deficient areas. Considerable autonomy is given to the regional banks in allocating advances, but the allocations are reviewed by the FHLBB.

The ability to obtain additional capital through this federally operated credit system is indispensable to most savings and loan associations. Eighty-four percent of all savings and loan associations, holding 98% of all resources of savings and loan associations, are members of the FHLBS.[78] Since the bulk of mortgage debt financing is held by savings and loans, regulation and supervision of the FHLBS has an overwhelming impact on home financing.

No institution is permitted to join the FHLBS unless the FHLBB approves of its home financing policy, and the FHLBB may remove institutions from membership, or deny advances to institutions whose home financing policy fails to meet the objectives of "sound and economical home financing."[79]

Another aspect of the FHLBB's supervisory authority over the FHLBS which affects the availability of home mortgage funds is its regulation of the liquidity of member institutions. This means that the FHLBB requires member institutions to hold a specific portion of their total outstanding loans in short term investments, as a first line of defense against unusual withdrawal demand.

The FHLBB has encouraged the disinvestment of certain urban neighborhoods by requiring higher reserves for loans made there, a policy which has had the effect of directly decreasing the money available for loans in those areas.

> The [FHLBB] examiners who come in to examine the savings and loan associations look at the high risk loans on their portfolio. They can spot appraise and if in fact in their appraisal the properties do not equal the value for which they are on the books or for which the loan was made, they are required to write those loans down . . . required to place specific loss reserves against those balances. So the best way for the institutions to avoid the restraints of the regulatory bodies is to make the majority of loans in housing areas where the property values are not going down.[80]

The FHLBB's authority over members of the FHLBS is extensive; its authority over federally chartered savings and loan associations is plenary. Their very existence depends on the FHLBB, since Congress authorized it to charter, examine and regulate them to assure that they serve the dual purposes of meeting *local* thrift and home financing needs.[81] The benefits of a federal charter for these institutions are significant. They have the exclusive privilege within the savings and loan community of using the word "Federal" in their titles, and enjoy, at least in the minds of many people, direct association with the federal government. Indeed, the FHLBB itself has taken the position that federally chartered savings and loan associations are "federal instrumentalities."[82] More tangibly, they enjoy certain tax exemptions and automatic membership in the FHLBS.

The application procedures for obtaining a federal charter emphasize the Board's concern with establishing locally-focused associations. Applicants for a federal charter must submit detailed information about the savings and lending needs of the area to be served. They must designate

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76. FEDERAL HOME LOAN BANK BOARD, SAVINGS AND LOAN FINANCING SERVICE BOOK (1975) at 45.
77. *See*, U.S. LEAGUE OF SAVINGS AND LOAN ASSOCIATIONS, SAVINGS AND LOAN FACT BOOK '75, at 29.
78. *Id.* at 95, 97.
79. *See* 12 U.S.C. §§1424(a), 1426(i), 1429.
80. Testimony of W. Dean Cannon, Jr., Executive Vice President, California Savings and Loan League, Special Hearing on Redlining (Calif. 1975).
81. 12 U.S.C. §1464.
82. *See*, Advisory Opinion of FHLBB, In the Matter of Schott v. Mission Federal Savings and Loan Ass'n (July 30, 1975), at 6-10.

local service areas from which they expect to draw their savings and make their loans,[83] and such designation then becomes part of the "terms and conditions" of the charter and can be viewed as obligating the association to provide lending and thrift services to the area specified in the application.[84] They must demonstrate that thrift and home financing needs exist in the designated area. Because people will travel further to obtain a loan than to deposit savings, the lending service area will likely be larger than the savings area. But applicants must show some level of local mortgage demand.[85]

Another indication of the FHLBB's concern with providing local service it its requirement that some of the applicants seeking a federal charter reside in the community to be served by the proposed association.[86]

The FHLBB's failure to establish standards for adequate service to the designated areas or to develop examination procedures to evaluate the performance of the associations in those areas at least arguably amounts to tacit approval of redlining. The Governor's Commission on Mortgage Practices in Illinois stated in its report:

> This commission feels strongly that were the FHLBB to begin to regulate the attention of Federal savings and loans to their local primary service areas, redlining would cease its deleterious impact on older neighborhoods (communities) of major metropolitan areas in Illinois.[87]

Instead, the FHLBB has chosen to focus its examinations on the solvency of member institutions. This emphasis on loan quality and net worth ratios tends to discourage investment in conventional mortgages in certain inner-city neighborhoods.[88]

> The agencies which supervise mortgage lending institutions traditionally have shied away from substituting their judgment for that of the lending institutions for purposes of criticizing them for loans they have chosen not to make. Rather, the agencies have confined themselves to criticizing lending institutions for loans they have made which, for credit reasons or otherwise, should not have been made.[89]

The FHLBB conducts fair housing examinations of its members through questionnaires completed by examiners. The questionnaire asks whether the institution engages in various racially discriminatory practices. However, because of the way in which it is administered and because of the absence of hard data on the racial or ethnic origin of loan applicants and loan recipients, the U.S. Commission on Civil Rights has concluded that the questionnaire has been of little value in uncovering discriminatory mortgage lending practices.[90] In fact, the FHLBB itself has never viewed the questionnaire as revealing discriminatory practices on the part of any member institution.

When the redlining of a community reaches advanced stages, local savings and loans which have previously stopped lending in the community tend to flee and relocate elsewhere. The FHLBB must approve applications by federal savings and loans on branching, merging and relocating. However, the current regulations and administrative procedures of the Board totally ignore the impact on older urban neighborhoods of the flight of savings and loans. They fail to provide any procedural safeguards to permit residents of a community about to be deserted by a savings and loan association to show adverse impact, and they fail to require a showing that the area will continue be be adequately served.

An additional function of the FHLBB is to direct the activities of FSLIC which was created in 1934 by the National Housing Act ("NHA") to insure the deposits of all federally chartered savings and loans and qualified state chartered savings and loans. As of 1974, savings and loan members of FSLIC held 97 percent of the residential mortgages held by all savings and loan associations.[91]

FSLIC is authorized to refuse to insure any savings and loan association which has violated its charter or has violated an applicable law, rule or regulation of FSLIC. The NHA contains a broad grant of authority for the FHLBB, as head of FSLIC, to adopt such regulations as in its judgment are appropriate to carry out the purpose of NHA. To date, the FHLBB has not used its power of terminating FSLIC coverage to discourage redlining practices of savings and loan associations.

B. Comptroller of the Currency

The COC charters and supervises national banks.[92]

> As with Federal savings and loan associations, national banks are a federal creation . . . . Their status carries with it many substantial benefits: they hold the exclusive privilege within the banking community of using the word "National" in their titles; they automatically receive the benefit of FDIC deposit insurance; they are members of the Federal Reserve System; and they are protected by federal statute from certain forms of state taxation. . . . [T]hey have been treated with great solicitude

83. Checklist of Supporting Documents for Permission to Organize, FHLBB Form 756.
84. Mortgage Lending Practices, *supra* note 4 at 65-71.
85. *Id.*
86. 12 C.F.R. §543.2(b).
87. GOVERNOR'S COMMISSION ON MORTGAGE PRACTICES, HOME OWNERSHIP IN ILLINOIS, THE ELUSIVE DREAM, at 18.
88. See discussion of the testimony of Nelson Brown, Ass't Counsel, Illinois Federal Savings and Loan, in HOME OWNERSHIP IN ILLINOIS, *supra* note 87 at 24.
89. U.S. COMMISSION ON CIVIL RIGHTS, FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1970) at 513.
90. U.S. COMMISSION ON CIVIL RIGHTS, FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1974) Volume II, at 178.
91. FEDERAL HOME LOAN BANK BOARD, COMBINED FINANCIAL STATEMENTS, FSLIC INSURED SAVINGS AND LOAN ASSOCIATIONS (1974) at 128.
92. 12 U.S.C. §26.

by the courts, which have noted a quasi-governmental character about them.[93]

National banks are generally regarded as the leaders of the financial community and enjoy the highest prestige. As of 1974, they held $43 billion (10 percent) of the outstanding residential mortgages.[94]

As administrator of national banks, COC is authorized to issue federal charters, to specify the terms and conditions of their charters, and to promulgate rules and regulations relating to these banks,[95] and to conduct examinations of them.[96]

While the statutes which govern the chartering of national banks do not define or even mention the concept of local service areas, the application for a charter does require applicants to designate the geographic area where they expect to generate 75 percent of their deposits and loans. Furthermore, when investigating an application for charter, COC may look into the "convenience and needs of the community to be served by the proposed bank."[97] But COC has apparently not used this authority to require national banks to serve the communities where they are located. The COC is also charged with authority to approve the relocating, branching and merging of national banks.

C. The Federal Reserve Board

The FRB is authorized to regulate the member banks of the Federal Reserve System.[98] The FRB determines the general monetary, credit and operating policies for the FRS. It also sets the requirements for reserves to be maintained by member banks and limits interest rates paid on savings deposits. Benefits of membership in the FRS include access to its discount facilities, loans, and various financial publications which allow each bank to evaluate its financial status.[99]

All national banks are members of the FRS. The Board has authority to admit state chartered banks who apply for membership, and to set the terms and conditions of membership. As of 1974, state chartered member banks held $11 billion (4 percent) of residential mortgages.[100]

Among the criteria used by the Board in reviewing a membership application from a state chartered bank, special consideration is supposed to be given to "the convenience and needs of the community to be served by the bank."[101] Even though the president of the Board, Arthur Burns, has said the first obligation of bankers is to the credit requirements of their service areas,[102] there is no indication that the Board has attempted to enforce this obligation. In fact, the Board has said its authority over state member banks is limited because the primary regulatory control rests with the state chartering agencies.[103]

D. The Federal Deposit Insurance Corporation

The FDIC automatically insures the deposits of member banks of the FRS. It also insures state chartered, non-Federal Reserve member commercial banks and mutual savings banks which apply for and are granted the benefits of FDIC insurance.[104] As of 1974, commercial and mutual savings banks insured by FDIC held $115 billion (27 percent) of the non-farm, one to four family residential mortgages.[105]

The statutes creating FDIC express the concern of Congress that FDIC should determine that a financial institution applying for insurance will serve the community where it is located.[106] The FDIC does require institutions to describe in their applications for insurance the area where its customers reside. But this information has apparently not been used by FDIC to require its insured banks to serve the credit needs of a particular area or community. The FDIC also has authority to approve branching, merger and relocation by insured institutions. But none of its regulation of these activities takes into account the impact of such moves on the service needs of the community where the institution was originally located.

E. Efforts to Prod the Federal Regulatory Agencies Into Promulgating Regulations to Enforce Fair Lending Requirements

It cannot be said that the failure of the federal agencies with regulatory authority over the home financing industry to enforce fair lending practices is due to lack of advice about how to get the job done. The Oversight Hearings Report documents the Job-like patience and repeated attempts of HUD, the Justice Department, the U.S. Commission on Civil Rights, and private civil rights and civic organizations to move the FHLBB, COC, FDIC and FRB to act.

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93. U.S. COMMISSION ON CIVIL RIGHTS, HOUSING (1961) at 40.
94. FEDERAL DEPOSIT INSURANCE CORPORATION, ASSETS AND LIABILITIES: COMMERCIAL AND MUTUAL SAVINGS BANKS (1974), at 2.
95. 12 U.S.C. §26(e).
96. 12 U.S.C. §161.
97. 12 C.F.R. §42.
98. 12 U.S.C. §221 *et seq.* (1970). The FRS was created, over the initial opposition of the banking industry, for the purpose of establishing a central banking system and enhancing the safety of deposits through regulation of banking practices. L.M. KOHLMEIER, JR., THE REGULATORS (1969) at 231.
99. U.S. COMMISSION ON CIVIL RIGHTS, FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1974) at 136, fn. 376.
100. FEDERAL DEPOSIT INSURANCE CORPORATION, ASSETS AND LIABILITIES: COMMERCIAL AND MUTUAL SAVINGS BANKS (1974) at 2.
101. 12 C.F.R. §208.5.
102. Letter from Arthur Burns to the Federal Reserve Banks of Chicago, Dallas and Kansas City.
103. Letter from Robert C. Holland to Theodore M. Hesburg, Chairman of the U.S. Civil Rights Commission, with appended Federal Reserve Board Memorandum, March 12, 1971.
104. As of December 1972, 98.4 percent of all commercial banks in the United States, and over two-thirds of all mutual savings banks, participated in federal deposit insurance. FEDERAL DEPOSIT INSURANCE CORPORATION, ANNUAL REPORT, 1972 at XII.
105. FEDERAL DEPOSIT INSURANCE CORPORATION, ASSETS AND LIABILITIES: COMMERCIAL AND MUTUAL BANKS (1974) at 2.
106. 12 U.S.C. §1816.

Fifteen years ago, the U.S. Commission on Civil Rights inquired of the three banking supervisory agencies and the FHLBB whether they were engaged in any activities to eliminate the racially discriminatory practices of their member institutions. Only the FHLBB had taken any action — a resolution expressing opposition to discrimination — and none of the other three were even in the planning state. In fact, the FRB and FDIC excused their inaction on the now familiar grounds that the introduction of blacks into a neighborhood adversely affects property values.[107]

In 1968, with the passage of the Fair Housing Act and its statutory mandate to all federal agencies to act affirmatively to promote fair housing, the U.S. Civil Rights Commission again contacted the four agencies to point out their legal duties and to inquire about the steps taken in satisfaction of them. The sole response of the agencies was to correspond with their regulatees informing them of the requirements of the new act and vaguely indicating that sanctions could be imposed on violators.[108]

In 1968 HUD, pursuant to its role as primary enforcer of Title VIII of the 1968 Fair Housing Act, initiated a series of meetings, which continue to this day, to assist the agencies in the formulation of enforcement procedures. Most of the elementary aspects of the enforcement program suggested by HUD in 1969 are still being sought today:

> HUD officials proposed an eight point affirmative action program for the bank regulatory agencies, including issuance of regulations, racial data collection and record-keeping to monitor actual lending patterns by institutions, training of examiners in civil rights compliance, maintenance of applications by race; development of civil rights compliance review procedures in examinations, referral of fair lending complaints by the bank regulatory agencies to HUD and the Justice Department; posting of a fair lending poster; development and use of sanctions against discriminating lenders.[109]

In 1971, the four agencies heard from thirteen civil rights and civic organizations, many of whom represented potential victims of the industry's discriminatory actions, in the form of a petition seeking the promulgation of regulations along the lines proposed two years earlier by HUD. The reaction of the agencies was barely civil and certainly not responsive.[110]

The Justice Department was not idle during these years either. The record of the Oversight Hearings includes a long exchange of correspondence between the present Assistant Attorney General in charge of the Civil Rights Division, and his predecessor, and the legal advisors of the four agencies, and their predecessors. In those letters, dating from 1972 to the present, the Justice Department provided legal advice on the authority and the duty of the agencies to enforce Titles VI of the 1964 Civil Rights Act and VIII of the Fair Housing Act to keep racial records, to investigate charges of discrimination, and to do all those things that HUD proposed back in 1969.[111]

With respect to the banking supervisory agencies, the only success HUD, Justice, and the interested organizations met with was the issuance of the requirement that an equal housing lending poster be displayed and included in media advertisements.[112] The FHLBB was more responsive, and its actions are dealt with separately in this paper. In addition, in 1974 the four agencies cooperated with HUD, on a pilot basis only, in collecting lending information, including racial data in eighteen metropolitan areas. Despite the disparate treatment of black and white applicants revealed in the statistics, the agencies have not yet instituted a permanent data collection system; moreover, they are not investigating the institutions involved in the survey on the remarkable theory that to do so would discourage similar voluntary efforts in the future.[113] This attitude is a fairly clear indication that the agencies are not seriously contemplating a data collection system on an ongoing basis.

In April 1976, the thirteen organizations which had been rebuffed in their petition of the four regulatory agencies to issue effective enforcement regulations filed suit in federal district court to compel their issuance.[114] Their request for relief reads much the same as HUD's original suggestions to the agencies in 1969.

Finally, while HUD has not been remiss in its obligation to prod the four financial regulatory agencies into action, it has not fully exercised its own power over that segment of the mortgage lending industry over which it has regulatory authority. The U.S. Civil Rights Commission recently criticized HUD for failing to issue regulations requiring racial data collection and affirmative action by institutions making federally insured loans, including FHA, VA and Farmers Home Administration loans.[115] HUD alone has the authority to monitor the mortgage banking companies which are playing an increasingly larger role in the origination and servicing of loans in the inner city as the other federally regulated institutions turn to suburban investments. Also, HUD has not flexed its regulatory muscle over FNMA and GNMA, that portion of the secondary mortgage market which it may directly regulate.

VIII. APPRAISAL AND UNDERWRITING PRACTICES

Appraisal and underwriting standards play a major role in determining whether and on what terms a lending insitution will extend credit to an individual to purchase, refinance, or rehabilitate a home. In fact, it could be said that appraisal and underwriting practices are the primary devices by which redlining is accomplished.

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107. U.S. COMMISSION ON CIVIL RIGHTS, THE FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1974) at 515.
108. U.S. COMMISSION ON CIVIL RIGHTS, FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1970) at 514-515.
109. OVERSIGHT HEARINGS REPORT, *supra* note 27 at 5.
110. *Id.* at 190.
111. *Id.* at 79-125.
112. THE FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1974) at 147-148.
113. FAIR LENDING REPORT, *supra* note 27 at 6.
114. National Urban League v. Comptroller of the Currency, No. 76-0718 (D.D.C., filed April 26, 1976).
115. THE FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT (1974) at 131.

The appraiser and underwriter perform two distinct functions. The appraiser estimates the "market value" of the property which is to be the subject of the transaction, a value which has been defined as "the price at which the property would sell when both the *buyer* and *seller* are *willing* and when *neither* is under any *abnormal pressure*."[116] The appraiser of residential property typically uses the "market data" appraisal approach which compares the condition of the property and its location with similar properties in similar neighborhoods.[117]

The underwriter estimates the overall risks involved in making loans. One inherent risk of loaning money is that the borrower will not repay the loan. To minimize this risk the underwriter examines the applicant's "credit-worthiness," including past credit record, current debts and income, and future income prospects. To protect the lender against the risk of a defaulting borrower, the underwriter also must evaluate whether the security property will be sufficient collateral during the entire life of the loan so that a foreclosure sale of the property will yield a price equal to the unpaid balance of the loan. In making this estimate the underwriter relies on the appraiser's estimate of market value, which, in turn, was based on both the condition of the property and its location. The underwriter then uses his evaluation of the totality of the risks in determining whether to approve a loan and as a basis for setting the terms of an approved loan, *i.e.*, amount of down payment (loan to value ratio), interest rate and repayment period (term of maturity).[118]

The appraisal and underwriting process as thus far described, insofar as it appears to be objective, involves legitimate criteria reasonably calculated to ensure a sound portfolio. Superimposed on it, however, and acting as the guiding force in the appraisal and underwriting profession is the overwhelming emphasis on the characteristics of the neighborhood in which the property is located. There is an old real estate axiom that there are three important facts relative to the value of a piece of property — location, location and location."[119]

The reference to location in fixing property value and determining risks manifests itself in two related assumptions on which appraisers and underwriters have unquestioningly relied for years. The first assumption is that racial integration has an adverse effect on property values in the integrated and surrounding areas. This assumption has been consistently reflected in major texts widely read by the profession. In fact, prior to 1950, the Code of Ethics of the National Association of Real Estate Boards, whose violation subjected realtors to disciplinary action, explicitly prohibited the introduction into any neighborhoods of "members of any race or nationality or any individuals whose presence will clearly be detrimental to property values in that neighborhood."[120] Even after the words "race or nationality" were removed, the Code was construed the same way: blacks and other minorities were thought to have an adverse effect on land value.[121]

McMichaels' *Appraising Manual*, a textbook for real estate agents, ranks races and nationalities according to their beneficial or detrimental effect on property values. This textbook, referred to by its publisher as "the bible of the real estate man," with its 15th printing (4th edition) released in 1970, appears to be religiously followed. One realtor testified in 1967 that many real estate manuals have been "quite emphatic on the dire results to be expected when minorities were brought into white neighborhoods" and "this axiom is still regarded as 'gospel truth'... by most realtors...."[122]

The second assumption underlying current appraisal and underwriting decisions is the belief that all neighborhoods have a built-in obsolescence factor. This theory of the inevitable deterioration of neighborhoods, described in some detail earlier in this paper, regards as one of the signals of decay the introduction into the neighborhood of nonconforming uses and users. Thus, appraisers are taught the "principle of conformity" which "holds that maximum value is realized when a reasonable degree of sociological and economic homogeneity is present."[123] The 1975 training manual of the Society of Real Estate Appraisers presents eight aspects of the neighborhood conformity principle:

1) Similar styles of houses
2) Houses of similar utility
3) Similar age of houses
4) Similar quality of houses
5) Similar price range of houses
6) Residents' income in the same general bracket
7) Residents of similar cultural, educational, ethnic and social backgrounds
8) Similar land uses[124]

It is here that the two assumptions overlap: to the extent that the existence of different racial groups in the same neighborhood is considered a "nonconformity," the neighborhood is viewed as already on the road to decline.

The problem posed by discriminatory appraisal and underwriting policies is most visible in the practices of local savings and loans. But appraisers and underwriters influence the availability of credit at the local level in more indirect ways. For example, the federal agencies which insure or guarantee mortgages and the private mortgage insurance companies use standard appraisal and underwriting criteria to evaluate the risks prior to approving mortgage insurance applications. The criteria used by these insurers natually influence the lending policies of local lenders who are anxious to approve loans which satisfy the requirements of the mortgage insurers.

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116. MORTGAGE LENDING PRACTICES, *supra* note 4 at 110.
117. *Id.* at 114.
118. Discussion paper, *Appraisal and Underwriting Practices of Residential Loans in Seattle Neighborhoods*, OVERSIGHT HEARINGS at 212-213.
119. MORTGAGE LENDING PRACTICES, *supra* note 4 at 110
120. Zuch v. Hussey, P.H.F.O.P. Rptr ¶13,708 at 14, 511-14, 512, n.12, (E.D. Mich. 1975).
121. R. HELPER, RACIAL POLICIES AND PRACTICES OF REAL ESTATE BROKERS, 23 *et seq.* (1969).
122. *Hearings on S.1358, S.2114 and S.2880 (Fair Housing Act of 1967) before the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency*, at 407.
123. AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE, 40 (6th ed. 1964).
124. AN INTRODUCTION TO APPRAISING REAL PROPERTY, at 6-11.

For example, HUD Handbook instructions to FHA appraisers adopt the principle of conformity: "To obtain its maximum value, the property must conform to its existing surroundings in size, age, condition and style, and should attract an occupant of similar economic status."[125] The Handbook also adopts the "life cycle" concept of a neighborhood, the inevitability of neighborhood deterioration, and the idea of the adverse effect of neighborhood conditions on the particular property.[126] The Handbook contains no cautions limiting consideration of such factors to the immediately surrounding block or blocks, or warnings about the subjective nature of such evaluations. Finally, the appraisers are instructed to consider the general income level of the neighborhood when estimating the value of the property, indicating that marketability (and hence value) increase with the conformity of the subject property to the neighborhood.[127]

Many mortgage loans made by local lenders are sold to other private lenders across the nation and to the federal government in what is called the secondary mortgage market. The federal markets, the Federal Home Loan Mortgage Corporation ("FHLMC"), the Federal National Mortgage Association ("FNMA"), and the Government National Mortgage Association ("GNMA"), are described in greater detail in another section of this paper. These secondary markets use appraisal and underwriting standards to determine which mortgage loans they will buy. Since a majority of local residential loans are sold in the secondary mortgage market, local lenders are induced to make loans which satisfy those secondary market appraisal and underwriting criteria.

The FHLMC on their Residential Appraisal Report,[128] under the general heading of "Neighborhood," contains boxes to check off whether the property values in the neighborhood are increasing, stable or declining. In addition, under the same general heading, the form calls for a ranking as good, average, fair, or poor of the following neighborhood characteristics:

1. Employment stability
2. Adequacy of shopping
3. Convenience to schools
4. Quality of schools
5. Recreational facilities
6. Level of taxes
7. Adequacy of utilities
8. Neighborhood compatibility
9. Protection from adverse influence
10. Police and fire protection
11. General appearance of properties
12. Appeal to market

The form contains no cautions concerning the subjective evaluations inherent in some of these evaluations — for example, the assessment of "neighborhood compatibility" or "protection from adverse influences"; nor does it specify the meaning of an "increasing, stable or declining neighborhood."

One study of the federal secondary mortgage market notes that GNMA and FNMA (when it purchases insured or guaranteed mortgages) do not do their own underwriting, but rely instead on FHA's or VA's and the private seller's underwriting judgments.[129] As has been shown above, they are, in effect, relying on the judgments of mortgage insurers and lenders who, in turn, have relied on appraisal techniques which redline.

In the context of these interrelated influences affecting the availability of credit at the local level, reform should not be limited to changing only the appraisal and underwriting practices of local lenders. The local lenders do not operate in a vacuum. Without a uniform reform of appraisal and underwriting standards, local lenders' ability to make credit available on a nondiscriminatory basis would be restricted because they would have difficulty insuring or reselling those mortgages.

IX. DATA GATHERING AND ANALYSIS TO DETECT REDLINING

As residents of neighborhoods across the country became aware of the fact that they were victims of redlining, they soon realized that basic lending information concerning deposit and loan patterns was not available to assist them in documenting the practice. Efforts to induce the institutions to disclose such data voluntarily usually met with the response that it was either impossible to collect or that it was confidential. Lobbying federal, state and local governments proved more successful, and the spate of ordinances, regulations and statutes dealing with "the public's right to know," and which were all recently issued or enacted, is described in this section. Unfortunately, the requirements of the various disclosure rules and legislation fail in many respects to arm the public with complete enough information to detect and act on redlining practices. The model proposed in this section for pinpointing redlining underscores these inadequacies and provides guidelines for future disclosure requirements and analysis.

A. Provisions and Limitations of Federal, State and Local Legislation and Regulation

1. The Federal Home Mortgage Disclosure Act of 1975

The Federal Disclosure Act[130] applies to depository institutions which are federally insured or regulated, or which originate loans insured or guaranteed by HUD or intended to be sold to the federal secondary mortgage market.

The number of loans and the principal amount of the following categories of loans must be itemized: total mortgage loans; home improvement loans; FHA or VA loans (except on

125. HUD HANDBOOK, 4150 1, VALUATION ANALYSIS FOR HOME MORTGAGE INSURANCE, ¶1-13(d).
126. *Id.* at ¶1-13(b) and 1-17.
127. *Id.* at ¶1-36(d).
128. FHLMC, *Single Family Underwriting Computer Matrix* reprinted in BNA, HOUSING AND COMMUNITY DEVELOP. REP., 70:0703.

129. K.Kenny, *The Secondary Mortgage Market: FNMA and GNMA and FHA-Insured Single-Family Homes*, in THE ROLE OF MORTGAGE LENDING PRACTICES IN OLDER URBAN NEIGHBORHOODS, 230-231, 252.
130. 12 U.S.C. §2803 *et. seq.*

multifamily dwellings); other mortgage loans (except multifamily dwellings); loans on multifamily dwellings; and nonoccupant loans (except on multifamily dwellings). The information is compiled for each census tract (zip codes may be used only under certain circumstances) and must be supplied for all loans purchased and originated by the institution.

The Board of Governors of the Federal Reserve System is instructed to issue regulations implementing the Act,[131] although all agencies with regulatory authority over depository institutions are empowered to enforce the Act. In addition, the Federal Reserve Board may by regulation exempt from the Act's requirements any state chartered depository institution if it determines that the institution is subject to requirements substantially similar to those imposed under the Act.

The deficiencies of the federal law are obvious: For example, it does not require disclosure of the origin of the institution's deposits on a geographical basis, there is no data relating to rejected applicants; also missing is information such as the race, age, sex and income level of all applicants; and no information on deposit patterns is required. A further defect is that the institution is not required to take any affirmative steps towards informing the public of this information, and is only required to make the disclosure statement available to the public upon request.

2. Illinois

The state of Illinois has enacted a disclosure law[132] requiring lending institutions (banks, credit unions, savings and loan associations, insurance companies and mortgage banking companies) to disclose semiannually the number of loan applications and the total dollar amount of loans granted within each census tract or zip code area which lies within a county having a population of more than 100,000 persons. The Director of the Illinois Department of Financial Institutions is required to make copies of the data available for public inspection, and each financial institution is required to have the data available for public inspection in each of its offices during regular business hours. Institutions that fail to file promptly are fined, and an intentionally false filing is a felony.

The city of Chicago has approached disclosure differently by requiring it of all lenders who bid annually on the approximately $2 billion in city and school funds available for deposit.[133]

The information required includes the number and total amount of loans made within the six county Chicago SMSA; the average interest rate for all loans; and the down payment as a percentage of all amounts. In addition, for the city of Chicago, the lender must provide information on the number, total amount, and terms and conditions of FHA-VA loans made within each census tract. The lender is also required to submit the number and total amount of all construction and home improvement or rehabilitation loans made within each census tract in the city of Chicago. Finally, the lender must indicate separately the number of savings accounts and checking accounts and the total dollar balances of those accounts for each census tract within the city of Chicago.

3. Massachusetts

On August 1, 1975, the Massachusetts Commissioner of Banks issued directives requiring disclosure of mortgage lending practices. The information required includes the number of mortgages, average interest rates, outstanding balances, and the number of foreclosures, itemized according to geographical location. The banks must also indicate the geographical distribution of deposits. For a specified number of areas the information is to be collated by census tract with the remaining areas (including all cities and towns within the Boston SMSA) by zip code. The disclosure requirement applies to all state chartered banks and credit unions having $20 million in deposits and with main offices located within the Boston SMSA. The requirements will also be imposed upon any institution, provided twenty-five or more of its depositors having an average of $50 or more in their savings account for a period of at least six months, petition the Commissioner of Banks requesting such information. The information is to be available to the public at the offices of the bank and at the office of the Commissioner of Banks. The disclosure requirements are implemented by incorporation into the Annual Report of Examination for state chartered banks and credit unions.

4. New York

The New York State Banking Department has issued a regulation[134] requiring all state chartered financial institutions to submit annual reports to the Banking Department indicating the number and dollar amount of loans made and rejected for each census tract or zip code area in the state. The disclosure statement must also indicate the geographical origin of the institution's deposits. Records maintained must also indicate the race, sex, marital status, age, income level, and the years spent in present employment for each application. Finally, the reasons for rejected applications must be noted on the record. The disclosure statements will be made available to the public in an annual report issued by the Banking Department.

5. California

The California Commissioner of Savings and Loans has imposed the most detailed disclosure requirements thus far required by any federal, state or local government. While they will not reveal patterns of deposits, they will provide excellent information on the characteristics of successful and rejected loan applicants and the real estate in question. Also, since they were developed in the context of a comprehensive enforcement scheme designed to eliminate redlining, they go beyond mere disclosure for the sake of public information. The patterns of redlining revealed in the statistics are to be used by the state in

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131. These regulations were issued and became effective June 11, 1976. *See* 41 Fed. Reg. 2391 (June 14, 1976).

132. Financial Institutions Disclosure Act, H.B No. 1103.

133. MUNICIPAL CODE OF CHICAGO, MUNICIPAL DEPOSITORIES, Ca. 7, §§7-30 - 7-41 (June 10, 1974).

134. Supervisory Procedure 6-107, N.Y. State Banking Department, effective May 1, 1976-1980.

proceedings by the savings and loan commissioner against associations found to be guilty of the practice, in acting on charter, merger, or branching applications of savings and loans, or by the rejected applicant who files a complaint of redlining.

All state licensed savings and loan associations will be required to report comprehensive information on each real estate loan and home improvement loan made and denied, and also certain information on loans purchased and sold. The information to be reported relates to the character of the neighborhood, the loan, the borrow/applicant, and the property, as follows:

1. *Neighborhood:* census tract

2. *Loan:* purpose; type (e.g., FHA, VA, conventional); loan amount (including amount requested when different from amount granted); amount going toward improvements in the property and old balance (in cases of refinancing); interest rate; term to maturity; fees; points; whether or not variable rate.

3. *Borrower/Applicant:* race or ethnic descent; total family income; the sex, age, and income of the borrower/applicant. The sex, age, and income of the co-borrower/applicant (if there is one); and whether or not the borrower intends to reside in the property.

4. *Property:* type of property; number of units; appraised value; selling price; age of house; square footage of improved living area.

The regulations also require disclosure of marketing policies and programs. Each association is required to furnish every applicant (and to make available to the public) a pamphlet explaining the association's criteria for deciding whether and under what terms and conditions to approve a mortgage loan application. If the loan is denied, or terms are imposed which are more onerous than usual, the applicant must be provided with a clear statement of the reasons for denial or variation in terms, and given notice of the right to file a complaint with the Savings and Loan Commissioner.

B. A Model for Pinpointing Redlining

The problems of both pinpointing redlining practices and formulating programs which might aid in its amelioration are compounded by the absence of extensive empirical data on urban lending patterns. The passage of the Home Mortgage Disclosure Act of 1975 which took effect June 28, 1976, and terminates four years thereafter, is an initial, but inadequate, step in determining where redlining is occurring.

Though the Federal Home Mortgage Disclosure Act will make public what has previously been confidential information, it does not require mandatory analysis and public dissemination of the information. Given the fact that those persons most directly concerned with redlining are the lower income groups concentrated in disinvested neighborhoods, it is an unfair burden on their resources to require citizen initiation in the analysis and dissemination of loan data. It would seem appropriate, therefore, that regulations modeled after the previously discussed California Reporting and Disclosure Requirements be issued at the federal level in order to have the necessary information available to adequately investigate mortgage practices. In addition, it should be required that:

— lenders document and identify the reasons for all loan refusals, including those made by telephone; and,

— lenders provide regular periodic analysis of the loan data to determine whether certain areas are being excluded from receiving loans and whether racial and/or ethnic minorities are being restricted in loan activities.

An aggregation of this type of information compiled by individual financial institutions could prove to be extremely useful in analyzing socioeconomic and demographic trends as they relate to lending practices at both the metropolitan and national levels. At the same time, since redlining is a practice which most immediately affects Americans at the neighborhood level, a model to determine if redlining is occurring in selected neighborhoods needs to be developed.[135] Essentially, such a model requires the comparison and analysis of lending behavior in two or more neighborhoods. Redlining should be suspected in at least one of the neighborhoods and not suspected in at least one other.

Since the model will concentrate on data aggregation and analysis at the neighborhood level, the first priority is a clear and concise identification of the physical boundaries of the neighborhoods. Generally, this identification process will involve isolating areas with common socioeconomic, racial and/or ethnic and housing stock characteristics. Community groups should be consulted in this process to insure the boundaries' validity and reliability. Once the neighborhoods to be investigated have been defined, the census tracts therein will be used for statistical comparison. In the event that two or more neighborhoods jointly share census tracts, these tracts can be allocated to the neighborhoods according to the following scheme:

1. Where a neighborhood contains more than 50% of a census tract's area, it can be allocated to that neighborhood.

2. Where multiple sharing of a census tract occurs, the tract can be allocated to the neighborhood containing the largest portion of it.

Naturally, a valid study of redlining requires comparison between different yet internally homogeneous areas. In some cases, a census tract may encompass both a declining, redlined area and a thriving, higher-income area. These factors must be kept in mind when choosing neighborhoods for investigation.

Neighborhood demographic profiles should be developed as a framework to infer levels of mortgage demand and to distinguish the neighborhoods' relative socioeconomic characteristics. Since redlined neighborhoods share some characteristics, certain measurements or proxies can be used to determine which neighborhoods are likely prospects for institutional disinvestment as well as to infer what factors may have provided the impetus for redlining. Multiple regression analysis can be used to determine which variables are significant in explaining mortgage lending activity in a city. These variables or proxies fall into four general categories:[136]

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135. *S 1281 Hearings, Supra* note 6 at 493-495, report by Frey, William M., *Discriminatory Lending Practices in Oakland*, where most of the following points are discussed.

136. The following variables and their significance are discussed in Ahlbrandt, Mortgage Lending in Pittsburgh, Public Policy Series No. 6, 9-10 (1975), (mimeographed).

1. *Economic Variables. Median family income* is used to describe the economic level of the neighborhood. The *amount of time properties stay on the market* indicates the economic viability of the neighborhood.

2. *Neighborhood Variables. The percentage of vacant units* is used to measure one aspect of the neighborhood: living environment; as the vacancy rate rises, it is assumed that the quality of the neighborhood deterioriates. The *homeownership rate* is used as a proxy for the relative stability of the neighborhood; higher rates are assumed to indicate a more stable neighborhood. The *crime rate* is used to measure one aspect of the quality of life; a higher incidence of crime is assumed to indicate a less desirable environment and a greater risk for potential investors. *The age of the housing stock* is used to measure a neighborhood's relative desirability for investment, and *the number of abandoned houses* is used to indicate relative disinvestment and deterioration.

3. *Racial Variables. Nonwhite population as a percentage of total population* and the *percentage change in nonwhite population 1960-1970* are used to measure the significance of race to mortgage lending practices.

4. *Demand for Mortgage Financing.* The *number of real estate transactions* is used to account for the differences in mortgage demand between neighborhoods.

Once this data has been collected, it can be used in the following sequence of steps to pinpoint redlining and to infer what criteria has been the basis for the disinvestment decision:

Step I. Comparison of the proxy measurements for all neighborhoods to be investigated and identification of the suspected redlined neighborhoods which are generally defined as encompassing a low median income, a high percentage of minorities, a high percentage of vacant units, older housing stock, low rate of homeownership, and long periods of time that properties spend on the market.

Step II. Analysis to determine whether there is any basis for the suspicion of redlining based on the data provided by the lending institutions. If substantial differences exist between neighborhoods in the number of conventional loans granted or denied, the terms of the loans, and/or the number if FHA mortgages, further analysis is warranted.

Step III. Correlation of the proxy measurements with the data on loan transactions. If neighborhoods which are characterized by equal credit-worthiness (as indicated by sharing comparable economic profiles) experience substantial differences in lending practices, then the allegation that redlining is occurring cannot be ignored and further analysis is warranted.

Step IV. Examination of the possible criteria influencing the disinvestment decision (racial distribution, age of housing stock, etc.) and analysis of the possible impact redlining has had on a neighborhood (using data on the number of abandoned houses).

Whenever possible, this model should incorporate comparative data over a period of time. This time element becomes extremely important in determining the actual role disinvestment plays in neighborhood decline for, on one hand, victims allege that redlining is both a *cause* of and *catalyst* for neighborhood decline. On the other hand, financial institutions justify disinvestment as a *response* to deterioration. If it can be shown statistically that a neighborhood's decline commenced or substantially quickened after disinvestment, the victims will have justification for their claim that redlining has not only fostered but actually caused central city deterioration.

X. REMEDIAL ANTI-REDLINING EFFORTS BY FEDERAL AND STATE GOVERNMENTS

Only one federal agency and two state governments have gone beyond the mere disclosure of lending patterns and have taken steps to provide remedies for residents of redlined neighborhoods. They are the FHLBB, the Illinois legislature and the California Commissioner of Savings and Loans. Each government's actions are described below.

A. The Anti-Redlining Efforts of the Federal Home Loan Bank Board

Because the FHLBB is the only one of the four financial regulatory agencies to have acknowledged and acted upon the adverse effects of redlining, it is worth taking a closer look at their policies and implementing regulations. There is some danger that the other three regulatory agencies — because they have shown a decided lack of imagination in the area thus far — may regard the FHLBB's efforts as a model and duplicate them. While certain aspects of the FHLBB's activities are commendable, others are gravely deficient and should be modified.

Briefly, as of March 1, 1976, the FHLBB had taken the following steps which bear on redlining:

1. It had published regulations requiring nondiscrimination in federally-assisted programs and providing for a complaint procedure.[137]
2. It had published regulations requiring nondiscrimination in lending.[138]
3. It had published guidelines interpreting its nondiscrimination requirements.[139]
4. Its general counsel had written two opinions further expanding on the nature of discriminatory lending practices.[140]
5. It had instituted equal opportunity review procedures as part of its regualr examination of member institutions.[141]

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137. 12 C.F.R. §529.
138. 12 C.F.R. §528.
139. 12 C.F.R. §531.8.
140. Opinion letter dated from FHLBB General Counsel to FHLBB Office of Housing and Urban Affairs March 21, 1974; and EOP Memorandum, from William Sprague to OES Professional Staff, May 23, 1975, concerning nondiscrimination.
141. *Hearings Before the Senate Committee on Banking, Housing and Urban Affairs, Oversight on Equal Opportunity in Lending Enforcement by the Bank Regulatory Agencies,* 94th Cong. 2d Sess. 45-53 (1976). [Hereinafter cited as OVERSIGHT HEARINGS.]

MEMORANDUM ONE

ISSUES AND RESPONSES

NEED FOR A PUBLIC BANK

Q: What are the concerns and problems that led to the conceptualization of the public bank?

A: 1. Redlining -- Redlining is a policy of banks in New York and across the country to avoid investing for new home construction and mortgages in "undesirable" communities. The observable phenomenon that many sections of the State of New York, particularly our cities and low income communities, are unable to obtain financing for new home construction and that existing property renovation and rehabilitation are virtually impossible is the result of this bank policy. The pervasive effects of redlining undermine the very financial structure of our cities and low-income communities.

2. Municipal Bond Market -- The erosion of the municipal bond market is the result of another bank policy. The repeal of the Port Authority covenants and the UDC crisis have shaken the confidence of the banks in the municipal bond market. The recent suspension by Standard and Poor's of New York City's "A" rating has further eroded this confidence. As a result, the financing of municipalities has become an increasingly costly burden.

3. Community Development -- The perception by the banking community that community development is not profitable has led to an almost total lack of long-term capital for community development. As a result, neighborhoods have nowhere to turn for funds making community decay all but inevitable. Lack of this kind of funding by the banks represents a severe disservice to the people of the communities from which the banks draw their funds.
4. Venture Capital -- Venture capital is high risk capital for new industrial and commercial enterprises. This flow of money to innovative businesses is essential to keep the state's economy healthy and to provide a base for future job creation. Being basically risk averse, the banking community has shunned these investments resulting in an almost total absence of risk capital in the state.
5. "Strip mining" of Capital -- The disintermediation of monies has resulted in the flow of money from rural areas to small villages, from towns into cities of increasing size, and finally into the major money centers. Ultimately, this money is exported to other states and countries where it

can earn the higher rates of return than are currently available in the state. Increasingly, monies deposited in New York State are being used to finance development elsewhere in this country and abroad. Doubtless, this process will be accelerated by the statewide Branch Banking Law, and in that context, the following direct quote as reported in the Rochester Democrat and Chronicle, April 10, 1975, from Arthur M. Richardson, President and Chief Executive Officer of Security, New York State Corp., an upstate regional bank holding company, is of relevance:

> "To the internation giants like Citibank, Chase Manhattan and others, their upstate banks are like strip mining operations. The raw material, money, is extracted from our local communities to be used anywhere in the world where they can get the best terms regardless of local consequences."

MORE GOVERNMENTAL BUREAUCRACY

Q: Are there alternatives to a state bank in order to accomplish the same purposes? In other words, do we need a new institution and a new governmental bureaucracy?

A. Yes, we do. For perfectly sound reasons having to do with maximizing earnings per share in the case of commercial banks, and the less clear purpose of increasing capital surpluses in the case of savings banks and Savings and Loans, the banking institutions have historically been unable and continue to be unable to deal adequately with the collection of problems referred to previously. It is pointless to berate the FHA for its historic reluctance to insure in urban areas, (leading to the self-fulfilling prophetic results of disinvestment) and it is equally unproductive to criticize banks

for preferring to loan under insured and reduced risk circumstances. However, the socially undesirable results of these policies are observed in the geographical distribution of the New York State savings banks' mortgage portfolio as of December 31, 1974. At that time 44.21 percent or $19,115,000,000 of mortgages were in insured VA or FHA mortgages. Conventional one and two family mortgages were only 18.3 percent of the portfolio or $7,797,000,000 worth. Of the total mortgage portfolio of the savings banks, 51.8 percent or $22,396,000,000 worth was in New York State and the balance or 48.2 percent being $20,840,000,000 was in mortgages outside of New York State.

Clearly, the private sector is not serving the needs of the state. A new governmental agency is needed in order to stimulate the private sector to better serve public needs.

YARDSTICK COMPETITION

Q: How will the state bank effect the performance of existing banking institutions?

A: There is at present no adequate yardstick by which the performance of conventional banking institutions can be measured relative to their performance as underwriters and market creators of governmental financing. Experience in North Dakota with the State Bank of North Dakota established in 1919 is valid historic precedent for seeking to establish this yardstick.

A multiplicity of incentive and guarantee insurance programs would not be sufficient to produce an efficient, coordinated system of public purpose federal and state programs. However, through direct

competition and indirect support, the state bank can act as a positive influence on the existing banking structure and thereby achieve a healthy level of "yardstick" competition.

MANAGERIAL COMPETENCE

Q: Where would the managerial competence come from to run this large scale enterprise?

A: National examples abound of special purpose financial institutions such as farmers credit programs and other public purpose banking efforts which have been run competently and profitably so that capital structure is owned by the client population although policy continues to be set by the executive and by Congress. Even private lending institutions will privately admit that there is no reason to suppose the state cannot run this effort in a profitable manner. Attracting competent management is not an insurmountable obstacle.

UNIVERSAL PANACEA?

Q: Are you seriously trying to tell us that this bank is going to solve New York State's financial problems and the financial problems of the cities?

A: Of course not. Opponents of the bill will seek to destroy this valuable institution by imputing to it such vast goals and objectives that it must necessarily fall of its own weight. It will of necessity have relatively modest resources with which to operate.

ANOTHER UDC?

Q: Why isn't this just another UDC?

A: 1. Profitability -- The whole operational premise of UDC was that it was a developer and builder of last resort. The public bank would not be exclusively a lender of last resort. The public bank is charged with the responsibility of being profitable.

2. Flexibility -- UDC is entirely limited to the most difficult form of long term financing whereas the public bank has unlimited flexibility to lend both long and short.

3. Cash Flow -- It was never contemplated that the cash flow from UDC projects would be adequate to pay debt service until the projects were, in fact, complete. It should also be remembered that the banks refused to loan to UDC prior to the completion of the projects.

4. Regulation -- The public bank would be subject to the regulation of the banking department whereas UDC was essentially unregulated.

5. Intent -- There is little relationship between a development organization such as UDC and a bank. These organizations were designed for different purposes and there is no reason to suspect that they will be subject to the same pitfalls.

SOURCES OF FUNDS

Q: Where will the money come from?

A: The money will come from a variety of sources including:

1. Capitalization of $50 million of first instance funds;

2. Municipal deposits and state deposits which at year end

1974 totalled $3.4 billion on hand in state chartered commercial banks;

3. It is contemplated that local assistance funds projected to be $6.2 billion for 1975 will be transferred through the state bank producing an average daily deposit in excess of $11.5 million a day;
4. The state bank will solicit time deposits of all varieties including day of deposit to day of withdrawal, time deposits, certificates of deposits and other like debt instruments. Under consideration is the possible exemption from federal, state and local taxation of interest earned on time deposits in the state bank;
5. The state bank will solicit demand deposits;
6. It is contemplated that the state bank will be an eligible recipient of grants both federal and state and other forms of public assistance to pursue its objectives.

UNSOUND AND DESTRUCTIVE COMPETITION

Q: Won't the state bank destroy other commercial and thrift institutions?

A: Not at all. The state bank will work closely with such institutions and will function in some respects like the import-export bank. It could participate in loans with other banks and could administer loan insurance and guaranty programs. It should be remembered that banking as a regulated industry is a protected industry and it is not the purpose of the public bank to limit competition but to increase competition. The combined effect of the bank holding law and the statewide banks

banking law are far more significant events relative to decrease of competition than the state bank could ever be.

INSURANCE

Q: What security will the depositors have that their money will be there when they want it?

A: In addition to the moral authority of the State of New York we are exploring whether it is more appropriate to obtain Federal Deposit Insurance or create a State Deposit Insurance as the State Bank of North Dakota did. Either of these alternatives should provide depositors with firm safeguards that their deposits are secure.

MEMORANDUM TWO

"HISTORICAL PRECEDENT -- THE BANK OF NORTH DAKOTA"

HISTORY

-- The Bank of North Dakota opened in 1919.

-- It is owned by the state government, not private stockholders.

-- It sought to save farmers from ruinous falling agricultural prices following World War I. At that time, private bankers were quick to foreclose on property and slow to grant loans. As a result, the state successfully stepped in and saved many farmers from financial ruin.

OPERATIONS

-- It is run like any other bank and as such, seeks sound, profitable investments.

-- Its assets are four times greater than any other bank in the state.

-- According to Forbes magazine (1/15/75), its rate of return on assets is almost twice as great as any of the 100 largest banks in the United States.

-- It does little direct lending and soliciting of deposits. Rather it seeks large corporate and state accounts and acts to participate in loans initiated by other banks.

-- One of its most valuable functions is to act as a primary market for small municipal bond issues.

MODEL FOR NEW YORK STATE

-- New York has parallel problems to those for which the North Dakota Bank was established. For example, the issue of redlining and the lack of capital flowing to low income communities is analogous to the problem faced by farmers in North Dakota.

-- In addition, many New York municipalities and state authorities would benefit from the role the North Dakota Bank plays in bolstering the market for municipal and state bond issues.

SUMMARY

-- The Bank of North Dakota proves that a state government can be successful in the banking business.

-- The Bank of North Dakota also proves that social, public interest needs can be met while profits are simultaneously pursued.

-- The Bank of North Dakota provides a positive competitive influence on the banking system to act in the public interest as well as aid to the existing private banking structure by participating in loans by banks.

MEMORANDUM THREE

"BANKING HISTORY"

INTRODUCTION

-- Banking in New York is a complex scheme of commercial banks and trust companies, savings banks, savings and loans, credit unions, state and federal regulatory agencies.

-- This is the result of an historically decentralized banking system with over 13,700 separately incorporated commercial banks.

-- This is an unusual system. Most other nations have a powerful central bank which does not exist in the United States.

EARLY BANKING

-- In 1791, the First Bank of the United States was established. It was jointly owned by the federal government and private investors. Political division in Congress prevented renewal of its charter in 1811 but it did act to establish banking as an industry in the United States.

-- From 1811-1816, private banks proliferated. With little control and regulation, these banks irresponsibly issued notes causing inflation and widespread monetary disorder.

-- In 1816, Congress created the Second Bank of the United States. This bank ran into political trouble with President Andrew Jackson and in 1836, its charter was not renewed.

MODERN BANKING

-- In 1864, Congress approved the National Bank Act which provided for a national currency and federal chartering of banks. It provided the first real regulation and supervision of the banking

system. This Act brought order and stability to banking for a while.

-- Despite the stability achieved under the banking act, true banking reform and the beginnings of modern banking began with the Federal Reserve System, established in 1914.

-- In 1935, after the wave of banking failures during the depression, the Federal Deposit Insurance Corporation was established. The FDIC has brought stability and confidence to the banking system.

BANKING REGULATION

-- Banks can either be chartered federally by the U.S. Comptroller of the Currency or by the state through the State Banking Department. Federally chartered banks are regulated by the Comptroller of the Currency and must become members of the Federal Reserve System. State chartered banks are regulated by the State Banking Department and by the Federal Reserve Board if they choose to join the Federal Reserve System.

-- Membership in the Federal Reserve System imposes certain restrictions on banks but also grants them borrowing privileges. State chartered banks that don't join the Federal Reserve System are supervised by FDIC.

-- State chartered savings and loan associations and credit unions are regulated by the State Banking Department. Federally chartered savings and loan associations fall under the supervision of the Federal Home Loan Bank Board.

TYPES OF BANKS

Commercial Banks

-- They are corporations owned by shareholders.

-- They may be federally or state chartered.

-- They may provide the following services:

-- time deposits,

-- checking accounts,

-- bank credit cards,

-- consumer and business loans, and

-- home and corporate mortgages.

Savings Banks

-- In theory they are owned by their depositors. However, actually there are no owners. Operating capital comes from depositors rather than shareholders.

-- Savings banks are permitted by Federal Reserve Board and the FDIC to pay higher interest rates on deposits than commercial banks.

-- Savings bank services include:

-- savings accounts,

-- home mortgages and general real estate financing, and

-- passbook loans and savings banks life insurance.

-- Savings banks cannot offer checking accounts, personal loan services, or bank credit cards.

Savings and Loan Associations

-- They are similar to savings banks and subject to many of the same limitations.

-- Savings and loan associations are owned by depositors similarly to savings banks.

There is limitation on savings and loans for investing their assets in home mortgages. Otherwise, they operate the same as savings banks.

Credit Unions

-- These are organized around existing institutions or organizations and are not generally open to the public.

-- Credit union members own the organization and get paid dividends in lieu of interest.

-- Credit unions engage mostly in consumer loans for the benefit of their members.

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Linked Deposit

January, 1973

THE ILLINOIS PLAN
BY ALAN J. DIXON, STATE TREASURER

For some years now, the office of the State Treasurer in Illinois has aided taxpayers by investing public funds putting their money to work, to generate revenue for the State and accomplishing other goals as well.

The investment programs of the Treasurer's office in Illinois have been developed to accomplish four goals:

a. Maximum earnings

b. Stimulate economy of the State

c. Provide an even geographic spread of State funds

d. Benefit deprived and needy citizens

We believe that the combination of these programs, developed and modified during the past six years has been highly successful in meeting these goals.

In addition, interest returned to the State's General Revenue Fund constitutes one of the chief sources of major revenue, amounting to more than $63 million last year, thanks to day-to-day attention to investment at optimum interest rates.

Two of the investment programs employ the linked-deposit concept. That is, time deposits are made with banks on condition that a specific lending action be taken by each bank at our request.

(1) Our Specific Opportunity [Program] uses the "linked-deposit" concept to encourage banks to participate in the financing of a particular project or projects. For example, when our state was in danger of losing $95 million of federal subsidized housing because interim financing couldn't be found, we persuaded a group of banks to supply the necessary funds. In turn, we agreed to allot funds to interest bearing time deposits. I would like to point out that not all projects have

to be of this magnitude. As an example, a time deposit was made with a small downstate bank to encourage purchase of bonds to effect modernization of a sewage treatment plant. When the corn blight disaster hit Illinois, we made available interest bearing time deposits to rural banks to encourage them to extend agricultural loans. This same program has promoted Small Business Administration and student loans. It is clear to us that the program has alerted the banking community to the desirability of becoming involved in public programs. Time deposits are allocated under this program when funds are available. We do not attempt in any way to ease or alter the credit requirements of the financial institution.

A study for the Ford Foundation of the "Illinois Plan" was completed in October, 1968. It researched at great length the economic impact of our investment program using the "linked-deposit" concept. One section of the report concluded, "As indicated by our economic flow model (Part 111-A) such shifts would generate income multiplier effects within the state several times larger than the state deposits themselves -- assuming the banks lend all they can based on such deposits. This would, in turn, create sales tax receipts providing an annual rate of return to the state almost as large as, or perhaps larger than, the interest earned on the deposits themselves." It should be noted that this report was made before Illinois had an income tax. The multiplier effect creating additional income taxes was not considered.

(2) Our Community Services Program also utilizes the "linked-deposit" concept but after, rather than before the fact. In effect, it rewards banks for their past history of involvement in community service oriented loans. The types of bank activity recognized include such areas a bank purchases of local tax anticipation

warrants, student loans, Small Business Administration loans, pollution abatement loans and so forth.

Under this program, proposals are taken each year from banks wishing to participate. This year 874 of the 1160 Illinois banks applied for and received deposits. We determine a minimum rate and banks must bid at or above that rate. Banks are requested to report their outstanding loans in 13 categories listed on the proposal form.

We determined the categories on the basis of responses to a questionnaire we sent to all of the Illinois banks. They were asked to list the types of loans which they felt should be recognized as community service oriented.

In order to eliminate subjectivity from our allocation, we use a computerized system based on a mathematic proration formula. Each bank's outstanding loan record by category is input to the computer, the formula applied, and each bank's time deposit is calculated. The term of the deposit is one year.

(3) Our third program, the Basic Deposit Program, acknowledges the right of all Illinois communities to share in the use of public funds, as long as they can demonstrate a need for deposits. The emphasis is on interest rate bid. The major Chicago banks are not eligible for participation in this program.

[six big Chicago banks held 52% of Illinois deposits in 1970]

Proposals are taken each year. The bid form submitted reports the bank's total outstanding loans, the amount of the time deposit requested and interest rate they are willing to pay. A minimum rate is established and those banks applying above this minimum are awarded larger deposits. The term of the deposit is one year.

Again this is a computerized allocation. Awards are made through a mathematic proration between the funds available for deposit, and the relationship of a bank's weighted outstanding total loans to the total outstanding loan of all

qualified banks applying for State funds. It is a proration of what one bank's weighted outstanding loans bear to the total of all applying banks weighted outstanding loans. Weights are injected for rate bid and size of the bank.

In order to maintain necessary liquidity, short term investments are also made. Again we attempt not only to obtain high yield but to the extent possible obtain a return from the multiplier effect. We therefore shy away from sterile investments such as government securities and place short term time deposits: 30, 60 and 90 day. To obtain a good geographic spread, these funds are placed with banks around the State who are willing to pay the prevailing Chicago rate.

The Ford Foundation study referred to above, concluded, "With certain modifications, the acceptance and use of the linked-deposit concept by more State Treasurers and other controllers of funds would further the welfare of the states concerned and the nation as a whole."

It is my own belief that Treasurers of all public funds ought to put to work, at interest, the funds in their custody, treating the interest returned as a source of revenue and thus helping to avert new or higher taxes.