

1981

New Business Development

Hugh L. Carey

Follow this and additional works at: <https://ir.lawnet.fordham.edu/ulj>



Part of the [Administrative Law Commons](#)

Recommended Citation

Hugh L. Carey, *New Business Development*, 9 Fordham Urb. L.J. 785 (1981).

Available at: <https://ir.lawnet.fordham.edu/ulj/vol9/iss4/1>

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Urban Law Journal by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

New Business Development

Cover Page Footnote

Governor of the State of New York. B.A., J.D., St. John's University.

NEW BUSINESS DEVELOPMENT

Hugh L. Carey*

I. Introduction

The key to sustained economic progress is the continued development of new businesses. The range of new businesses is as broad and diverse as the economy itself. It includes the small, young firms that pioneer in areas of high technology as well as established corporate giants that invest hundreds of millions of dollars in the development of new products. It includes the banks, insurance companies and other financial service institutions that have undertaken the challenge of serving an expanding world economy — and in doing so have vastly increased the strength and stability of the nation's economy.¹ And it includes the local merchant who moves to fill an unmet need for services in his community.

What all of these businesses have in common is a willingness to invest, to innovate, to take risks.² A state cannot by itself create

* Governor of the State of New York. B.A., J.D., St. John's University.

1. Recognizing the diversity within our economy, it has been argued that what is necessary is a national industrial policy which is developed on a sector-by-sector basis, that is, a comprehensive policy tailored to the needs of a particular industry. See PRESIDENT'S COMMISSION FOR A NATIONAL AGENDA FOR THE EIGHTIES, REPORT 35-36 (1980) [hereinafter cited as REPORT FOR THE EIGHTIES]; 126 CONG. REC. H8636 (daily ed. Sept. 9, 1980); Hirschhorn, *Reindustrializing America: Toward a Federal Policy*, Balt. Sun., Aug. 21, 1980, reprinted in 126 CONG. REC. H8636 (daily ed. Sept. 9, 1980). The federal government's bail-out of the Chrysler Corporation, see Chrysler Loan Guarantee Board, 15 U.S.C. §§ 1861-1875 (Supp. 1980), and the loan guarantee program to the steel industry undertaken by the Economic Development Administration, Salpukas, *Reassessing Loan Aid for Steel*, N.Y. Times, Jan. 2, 1981, at D1, col. 3, may be an indication of such a policy. However, this Article is based on the premise that a comprehensive federal and state development program is necessary to lay a foundation for revitalization initiatives on a sector-by-sector basis.

2. While all firms must and do take risks, all are in competition for a limited amount of funds to finance innovation and expansion. See B. DANIELS & L. LITVAK, *INNOVATIONS IN DEVELOPMENT FINANCE* (1979) [hereinafter cited as *INNOVATIONS IN DEVELOPMENT FINANCE*].

For an enterprise to get a good place in the queue, it must convince these savers or their intermediaries, that its use of funds will offer them the most return on their money. Enterprises 'bid' against one another for a priority position by attempting to convince capital suppliers that the investment projects for which they seek funds will provide superior, or at least sufficient, return.

Savers and their intermediaries are not only interested in the probable return that an enterprise can offer. They are also concerned about risk. Risk arises because of uncertainty about the rate of return on an investment project. A venture whose rate of return is more variable will be more 'risky'; that is, returns may be lower than

this entrepreneurial spirit, but it can help create the conditions that allow it to flourish.³ It can do this by removing the barriers that currently inhibit growth and development. These barriers may be shortages of crucial factors: capital,⁴ energy,⁵ skilled labor,⁶ or more subtle barriers: the disincentives to investment or risk-taking that are inherent in state and federal tax codes and regulatory structures.⁷ Small and new businesses face unique problems in

expected. Suppliers of capital view this risk negatively, and either demand a higher rate of return, or avoid the risk altogether.

Id. at 18. Unfortunately, our capital markets have handicapped the ability of new and small businesses to obtain needed capital. The transaction and information costs associated with the acquisition of capital are greater for small firms. See B. DANIELS & M. KIESCHNICK, *THEORY AND PRACTICE IN THE DESIGN OF DEVELOPMENT FINANCE INNOVATIONS* 47-56 (1978) (working papers drafted for the Council of State Planning Agencies) [hereinafter cited as *1978 Working Papers*]. The cost of capital is "inversely related to the market power (that is, its size) of a firm." G. MEADOWS & J. MITRISIN, *CONG. RESEARCH SERV., A NATIONAL DEVELOPMENT BANK: SURVEY AND DISCUSSION OF THE LITERATURE ON CAPITAL SHORTAGES AND EMPLOYMENT CHANGES IN DISTRESSED AREAS* 31 (Apr. 1979) [hereinafter cited as *CAPITAL SHORTAGES AND EMPLOYMENT CHANGES*].

3. See *State and Local Industrial Location Incentives—A Well-Stocked Candy Store*, 5 J. CORP. L. 517, 522 (1980) [hereinafter cited as *Industrial Location Incentives*].

State and local governments offer incentives in order to influence corporations' location decisions. . . . Industrial location economists have developed two basic theories to explain the location decision-making process; revenue maximization and cost minimization. The revenue maximization theory suggests that firms locate in areas with the maximum demand for their product. The cost minimization theory proposes that firms build facilities where their costs are lowest. The synthesis of these two theories suggests that companies build new facilities at the location where the difference between expected revenue and costs is greatest in order to maximize profits.

Id. (footnote omitted).

4. See M. KIESCHNICK, *VENTURE CAPITAL AND URBAN DEVELOPMENT* 24-25 (1979) [hereinafter cited as *VENTURE CAPITAL*].

5. See Henderson, *Energy Policy and Urban Fiscal Management*, 41 PUB. ADMIN. REV. 158, 160 (1981) [hereinafter cited as *Energy Policy*] ("industrial, and commercial locational decisions in urban areas are becoming increasingly influenced by rising energy costs").

6. *VENTURE CAPITAL*, *supra* note 4, at 24-25; *Industrial Location Incentives*, *supra* note 3, at 610.

7. Many have argued that current federal tax, expenditure and regulatory policies have contributed to the depressed states of many of our nation's cities, see *Hearings before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 47 (1979) (statement of Belden H. Daniels) [hereinafter cited as *Economic Development Legislation*]; M. C. McFARLAND, *FEDERAL GOVERNMENT AND URBAN PROBLEMS* (1978), in addition to stifling the growth of small firms. See U.S. SMALL BUSINESS ADMINISTRATION, *REPORT OF THE SBA TASK FORCE ON VENTURE AND EQUITY CAPITAL FOR SMALL BUSINESS 1* (1977) [hereinafter cited as *VENTURE AND EQUITY CAPITAL*] ("in the face of emerging needs and the clearly documented benefits to the United States economy, a set of impediments have developed that are preventing smaller businesses from

these areas.⁸ They must shoulder disproportionate burdens of high tax rates, inadequate access to capital,⁹ onerous regulations,¹⁰ and

attracting the capital without which they cannot perform their traditional function of infusing innovation and new competition into the economy.”)

Congress has recently taken steps to rectify some of the regulatory problems facing small businesses with the enactment of the Small Business Investment Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 (1980) (to be codified at 15 U.S.C. §§ 80a-1-80a-64). The purpose of this legislation is to facilitate the activities of business development companies by streamlining compliance requirements for these firms with federal securities laws, thereby, encouraging the mobilization of capital for new, small business. See S. REP. No. 958, 96th Cong., 2d Sess. 1 (1980). For a detailed discussion of this legislation see Comment, *The Small Business Investment Incentive Act of 1980 and Venture Capital Financing*, 9 FORDHAM URB. L.J. 865 (1981). Congress has also enacted the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 96th Cong., 2d Sess. (1980) (to be codified at 5 U.S.C. §§ 601-612). This legislation is intended to “fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation.” *Id.* § 2(b). See generally *Proposed Amendments to the Small Business Investment Act of 1958: Hearings on H.R. 12666 Before the Subcomm. on Capital Investment and Business Opportunities*, 95th Cong., 2d Sess. 1 (1978) [hereinafter cited as H.R. 12666].

8. See H.R. REP. No. 1341, 96th Cong., 2d Sess. 20, reprinted in [1980] U.S. CODE CONG. & AD. NEWS 8444, 8446 [hereinafter cited as H.R. 1341] (“No system of regulation is without cost. . . . [It has been recognized that there has been a] slowing of the flow of capital to American enterprise, particularly to smaller, growing businesses, that has occurred in recent years. The importance of these businesses to the American economic system in terms of innovation, productivity, increased competition and the jobs they create is, of course, critical. Hence, the need to reverse this downward trend is of compelling public concern. Without doubt, the slowdown that has occurred is the product of many economic forces quite apart from the costs of securities regulation, taxes and inflation principal among them. . . .”).

9. See *Hearings before the Subcommittee on Capital Investment and Business Opportunities of the House Committee on Small Business*, 95th Cong., 2d Sess. 43 (1978) [hereinafter cited as H.R. 9549].

We know, based on our experience, that there is little incentive for these large financial institutions to make direct equity investments in small business. In addition to the comparatively higher risk and restricted liquidity attributes of such investments, the underlying costs involved in establishing a significant small business equities portfolio would make such an undertaking cost-inefficient for these institutions. Development of such a portfolio would involve additional professional expertise, specialized research and analysis, establishment of unique financial strategies and techniques applicable to small firms, and unusual servicing and monitoring responsibilities.

Id. (statement of Patricia M. Cloherty, Deputy Administrator, United States Small Business Administration). See also Kieschnick, *Policies to Support New Businesses: Implications for Urban Development*, COMMENTARY, July, 1980, at 21 [hereinafter cited as *Policies to Support New Businesses*].

10. VENTURE AND EQUITY CAPITAL, *supra* note 7, at 4. (“Compliance with Government regulations — tax returns, registration statements, ERISA reporting requirements, and a variety of reports and surveys — constitute a heavy burden for the small businessman. . . . [T]he small business today is in grave danger of smothering under the weight — the cost —

difficulty in recruiting and training their labor forces.¹¹ Their resources are often painfully strained. Yet each state's and the nation's economic futures depend heavily on the ability of these businesses to withstand the process of rapid economic change.

This Article will address a number of alternatives which the states and the federal government could undertake to improve and facilitate the development of new businesses. In section II, areas where the states must take steps to improve the business climate and provide the resources necessary for future development will be discussed. Three reforms will be specifically discussed: 1) tax reform to stimulate the availability of capital for the development of new products and businesses, and to reward productive and innovative employment; 2) development finance initiatives to ensure adequate funds for small and new enterprises and for research and development; and 3) regulatory reform to ensure that regulations do not impede the development of our growth industries.

In section III, the role and initiatives available to the federal government to encourage new business development will be analyzed. The initiatives developed on both the federal and state levels to meet each of these objectives form part of a coherent strategy. They should not be viewed separately, because they act symbiotically. Each must be actively encouraged in order to promote business development.

II. State Initiatives

A. Taxes

Present taxing policies discourage development in many ways.¹²

of repetitive paperwork."). See also *Joint Hearings before the Subcommittee on Private Pension Plans and the Subcommittee on Financial Matters of the Senate Committee on Finance and the Senate Select Committee on Small Business*, 94th Cong., 2d Sess. 11 (1974) ("[ERISA] imposes a tremendous burden on the small employers by requiring reports which are costly and time consuming to prepare and plans which are costly and impractical to administer.") (statement of Bruce G. Fielding). Because the costs of compliance with regulations is proportionately higher for new and small firms, this type of regulation is clearly regressive. 1978 *Working Papers*, *supra* note 2, at 79. It remains to be seen what effect the Regulatory Flexibility Act will have on alleviating this problem. See note 7 *supra*.

11. See *Industrial Location Incentives*, *supra* note 3, at 702; *Policies to Support New Businesses*, *supra* note 9, at 21.

12. See generally Pomp, Kantor, Simonson & Vaughan, *Can Tax Policy Be Used to Stimulate Economic Development*, 29 AM. UNIV. L. REV. 207 (1980); Solomon, *New Urban Economic Development Initiatives: History, Problems and Potential*, 16 HARV. J. LEGIS.

Not only do they erode the comparative advantage of a particular state as a place to live and to conduct business, but they discourage investment in modernizing plant and equipment,¹³ deter entrepreneurs from risk taking and innovative behavior,¹⁴ and inhibit investors from providing the capital resources needed by the business community.¹⁵ Any tax cut intended to alleviate the bias against new businesses should aim to stimulate the flow of funds available for capital investment, and improve the cash-flow position of small and new businesses.¹⁶

To stimulate the supply of investment funds, investments made during the first five years of a firm's existence could be exempted from a state's capital gains tax.¹⁷ Furthermore, state investment

811 (1979) [hereinafter cited as *New Urban Initiatives*].

13. B. DANIELS & M. KIESCHNICK, *DEVELOPMENT FINANCE A PRIMER FOR POLICYMAKERS, Part I* (1979) [hereinafter cited as *DEVELOPMENT FINANCE PRIMER*]. An investment tax credit because it favors the purchase of new equipment, see note 77 *infra*, may only hasten the migration of industry from the Northeast and Midwest to the Sunbelt.

14. See *Foreword: Small Business and the 'Welfare' Problem*, 11 *ANTITRUST L. & ECON. REV.* 1, 5 (1979).

The need for capital is determined primarily by business *growth* rates and, because small companies account for most of the nation's expansion of productive facilities, its capital needs tend to be disproportionately high. Lacking the size and market power of the larger business organizations, it similarly lacks the ability to internally generate the funds needed for this high rate of growth and expansion. Small business pays, moreover, a significantly higher rate of interest on borrowed capital and, when such funds are in relatively short supply — as they tend to be as a matter of national policy in periods of recession — it is the larger firms that are served first.

Id.

15. The failure of the capital markets to service the needs of the small business community is, to an extent, a function of inflation. See Mendenhall, *Tax Indexation for Business*, 33 *NAT'L TAX J.* 257 (1980) ("In a period of high inflation, businesses are paying taxes on capital and not on real income, since inflation tends to cause the overstatement of profits. These illusory profits and higher replacement costs for capital goods sharply reduce the capacity of companies to generate internally the funds needed for capital outlays and replacement of inventories.").

16. In order to adequately address the needs of small businesses in the formation of capital, a graduated business tax system should be established. See *Hearings before the Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance*, 95th Cong., 2d Sess. 276-77 (1977) [hereinafter cited as *Capital Gains Tax Bill*] ("Given the difficulty small businesses face in raising capital for investment, as compared to the ready access to capital markets enjoyed by the larger companies, there must be lower taxes for all small businesses. This would allow smaller companies to plow back more of their earnings for necessary expansion and improvement.") See also *VENTURE AND EQUITY CAPITAL*, *supra* note 7, at 9.

17. An exemption of this nature would be especially important to many small businesses. It has been estimated that 90% of all businesses fail within their first five years. See *Hear-*

tax credits could be extended and increased to conform with the eligibility requirements for federal tax credits. Investment tax credit and accelerated depreciation could also be extended to investment in research and development.¹⁸

In order to help new and small businesses, provision should be made for the refunding of investment tax credits.¹⁹ This will provide new enterprises with increased cash flow during their crucial early years when income is too low for the firms to take significant advantage of tax credits which would normally be carried forward or back to other tax years.

In the treatment of Subchapter S corporations, conformity on the state level with the federal tax code would eliminate the double taxation of earnings at both the corporate and the individual levels.²⁰ This reform should be aimed at corporations providing goods and services and venture capital corporations providing risk capital and management assistance to new businesses, rather than those firms having substantial passive investment income.

In addition, increasing the amounts and variety of items excluded from state corporate franchise taxes²¹ and broadening state sales tax exemptions for certain types of equipment and supplies²²

ings Before the Select Committee on Small Business, 95th Cong., 1st Sess. 374 (1977).

18. See, e.g., CAL. REV. & TAX CODE § 17223 (West 1976) (research and experiment expenditures treated as deductions); N.Y. TAX LAW § 210(3)(D)(d)(2) (McKinney Supp. 1980) (deduction allowed for certain research and development programs). See also *Hearings before the Subcommittee on Financial Matters of the Senate Committee on Finance, 94th Cong., 2d Sess. 98 (1975)* (statement of John W. Kendrick) (proposing a 10% tax credit for research and development costs).

19. Making an investment credit refundable could substantially enhance the ability of the credit to have a positive impact on investment. There is no reason for making the availability of the credit dependent on whether or not a firm has a tax liability in a given year. See *Refundable Investment Credits—Better Luck This Time?*, 11 TAX NOTES 524 (1980) ("Many 'cyclically sensitive' and 'structurally maladjusted' industries are being denied a needed investment incentive just because of transient economic conditions. . . . [It is] logically inconsistent to deny investment subsidies to those who need them the most, in particular new firms and firms that are undertaking substantial investment programs.").

20. See generally *Report for the Eighties, supra* note 1, at 30; Chang, *Recommendations for Restructuring of Tax Rules Relating to Subchapter S Corporations: A Comparative Summary*, 34 TAX LAW 403 (1980).

21. See, e.g., FLA. STAT. ANN. §§ 191.371-376 (West 1971) (encourage financial institutions to locate within state through the use of franchise tax election).

22. See, e.g., FLA. STAT. ANN. § 212.08(5)(b) (West Supp. 1981) (partial exemption for machinery and equipment used to increase productive output); N.Y. TAX LAW §§ 115-118 (McKinney 1972) (existing exemptions). See also Due & Mikesell, *State Sales Tax Struc-*

will also aid in stimulating the flow of funds.

B. Development Finance Initiatives

New enterprise and new products require capital. Yet there is increasing evidence that necessary capital for certain types of projects is not readily available through private financial institutions.²³ New small firms and older firms in need of funds for restructuring and modernization often face great difficulty.²⁴ At a time when interest rates are at record levels, the debt to equity ratio for small firms has climbed dangerously. The research and development process for new and small firms can be painfully long, and high interest payments can stifle promising new initiatives.²⁵ Cumbersome federal regulations of financial institutions coupled with the high transaction costs associated with processing and servicing small projects²⁶ have discouraged banks, savings and loan institutions and other sources of investment funds from participating aggressively in small business deals.²⁷

When private financial institutions cannot offer financial resources on appropriate terms to viable projects,²⁸ a state should be prepared to use the policies at its disposal to encourage new busi-

ture and Operation in the Last Decade—A Sample Study, 33 NAT'L TAX J. 21 (1980) (survey of sales tax structures in 13 states revealed no substantial change in past 10 years).

23. See DEVELOPMENT FINANCE PRIMER, *supra* note 13, PART I at 20 ("new and small enterprises generally face enormous barriers in acquiring funds in the long-term debt and equity markets — a difficulty that appears remarkably unjustified by differences in the rate of return and risk.").

24. See notes 3-11 *supra* and accompanying text.

25. See generally H. HOVEY, DEVELOPMENT FINANCING FOR DISTRESSED AREAS 9 (North-east-Midwest Inst. 1979) [hereinafter cited as DEVELOPMENT FINANCING].

26. See 1978 Working Papers, *supra* note 2, at 48-56; VENTURE AND EQUITY CAPITAL, *supra* note 7, at 4 ("One of the more serious problems is the skyrocketing cost of entering the public market to seek new sources of financing. An analysis of six of the smaller offerings made in 1976 by companies having assets of less than \$5 million shows the average cost of registration is \$122,350 an automatic and, in some cases, insurmountable roadblock for companies interested in entering the public market."). See generally Taylor, *Equity Financing for the Small Business: A Layman's Guide*, 20 S. TEX. L.J. 253 (1980).

27. See VENTURE AND EQUITY CAPITAL, *supra* note 7, at 3. "Recent economic trends have caused all investors — institutional, large nonfinancial companies, venture capitalists, individuals and local bankers — to become more conservative in their investment policy. . . . Savings and other financial resources, so desperately needed by small companies to finance their growth, have become concentrated in larger financial institutions."

28. The development prospects of an area can be determined by examining its current economic structure, labor market characteristics and expense of local transportation.

ness initiatives. The state, however, should not be expected to replace the activities of banks, insurance companies and investment houses²⁹ because state governments usually have neither the expertise nor the resources to finance private capital accumulation prudently.³⁰ Rather, a state can accomplish this either by using incentives to correct shortcomings in the private sector or a state can directly intervene through a public instrumentality to correct the failings of the private market.

The Stevenson-Wydler Technology Innovation Act of 1980,³¹ recently enacted by Congress, is a good example of a government-sponsored program which will channel resources to firms to promote technological innovation during the difficult stage of product development before traditional sources of funds are available.³² Working within the university system where many new ideas and innovations will originate³³ and drawing upon the expertise of the

29. See R. NATHAN, COUNCIL FOR INTERNATIONAL URBAN LIAISON, LESSONS FROM EUROPEAN EXPERIENCE FOR A U.S. NATIONAL DEVELOPMENT BANK 18 (1979) [hereinafter cited as EUROPEAN ECONOMIC EXPERIENCE] ("In many distressed areas in the U.S., commercial banks (particularly in large cities) have considerable expertise about public and industrial facilities and economic and labor market conditions, as well as being a source of loanable funds."); *The Northeast—The Role of Banking in Local Economic Development*, BANKER'S MAG. Nov.-Dec. 1979, at 74 ("the banker is a valuable resource to both the public and private sectors because of his knowledge of the local economic environment, ability to evaluate investment alternatives, and . . . unique position to facilitate the identification and financing of local investment opportunities.").

30. See DEVELOPMENT FINANCE PRIMER, *supra* note 13, Part I, at 39-50; ECONOMIC CAPITAL CORP. OF NEW YORK CITY, NEWSLETTER 2 (1980) (corporation acts as a facilitator between major commercial banks and small and medium sized firms within the city). See also *Fish Concern Loans the First by City's New Agency*, N.Y. Times, Feb. 6, 1980, at B1, col. 2 ("One of the keys to making economic development work is the involvement of the financial community.").

31. Pub. L. No. 96-480, 94 Stat. 2311, 96th Cong., 2d Sess. (1980).

32. See H.R. REP. NO. 1199, 96th Cong., 2d Sess. 6, reprinted in [1980] U.S. CODE CONG. & AD. NEWS, 8536, 8540.

Innovation in new products and services is central to the process by which an economy grows and renews itself. . . . Innovation and productivity are closely linked because cost reductions and efficiency gains arise mainly through innovations in methods for production and distribution. . . . The health of our economy and all of the attendant consequences of increased employment and improved standard of living and progress in social areas unquestionably depends upon this innovation.

Id.

33. *Id.* at 8, [1980] U.S. CODE CONG. & AD. NEWS at 8542 ("[A] definite innovation problem existed in the United States, especially in the context of the world marketplace, and that improved university-industry relations would enhance innovation. . . . In the innovation process, universities generally provide the basic research component while the role of

private sector, the Stevenson-Wydler Act links the generators of knowledge, that is, universities and federal laboratories, with the users of knowledge, industry and local government.³⁴ The Act, therefore, will foster economic revitalization based upon a forward-looking strategy.

States could improve the operation of the private capital market by exempting high risk investments in new and small businesses from state usury law limitations.³⁵ Banks and other financial institutions must be encouraged to take greater risks in the provision of loans to these enterprises.³⁶ Such risks will necessarily entail higher returns from successful ventures to compensate for losses on unsuccessful ones. At present, the criminal usury law discourages banks from developing innovative financing techniques—such as risk pooling³⁷ and royalty repayment loans³⁸—that would increase

the industrial sector is generally in the development, commercialization and marketing of new goods and services.”)

34. *Id.* at 3, [1980] U.S. CODE CONG. & AD. NEWS at 8537.

35. See Crafton, *An Empirical Test of the Effect of Usury Laws*, 23 J. LAW & ECON. 135, 142-44 (1980) (usury laws given inflation's high interest rates have an adverse effect on economic development). See also *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978) (allowing a Nebraska bank to charge interest rate on consumer credit in excess of Minnesota usury law pursuant to 12 U.S.C. § 85 (1976)).

36. See DEVELOPMENT FINANCING, *supra* note 25, at 13-15. A major factor contributing to the capital investment shortage is the dominance of institutional investors in capital markets. Virtually all of the capital generated by individuals' savings is controlled by institutions which conduct their investment activities differently from the way individuals would. This difference may be attributed to 1) fiduciary responsibilities imposed upon institutions, subjecting them to the “prudent man rule” and tending to discourage high-risk investments; 2) state and federal regulations which limit investment choices to insure liquidity and solvency also tending to discourage high-risk investments; 3) preferences created by federal tax laws for certain types of investments by certain institutional investors; and 4) the substantial cost of information-gathering and administration expenses associated with any investment.

37. Risk-pooling combines the risks inherent in a number of investments and combines them in a single pool. Risk-pooling, in effect, spreads the risk of a single investment among a number of investors. See *1978 Working Papers*, *supra* note 2, at 147; INNOVATIONS IN DEVELOPMENT FINANCING, *supra* note 2, at 20. Investments can be pooled by industrial sector, by location and by risk. *1978 Working Papers*, *supra* note 2, at 147-48. For a discussion of the use of risk-pooling as a means of facilitating investment by pension funds in small businesses, see *Id.* at 72. See also notes 40-44 *infra* and accompanying text.

38. Royalty financing, in effect, entitles the financier to a commission or royalty on every item sold which was produced through the financed production process. This financing system was first developed in Great Britain and is currently being employed by the Connecticut Product Development Corporation. For a discussion of both the British and American experiences with royalty financing, see Note, *Royalty Financing as a Tool for Economic*

the flow of funds to these enterprises.

States could also improve the operation of private capital markets by encouraging the better utilization of the vast potential of public pension funds.³⁹ These funds could provide invaluable capital for state development programs. State laws, however, limit the types of permissible private sector investments for these funds⁴⁰ and are far more restrictive than the guidelines for private sector pension funds laid out by the Employees Retirement Income Security Administration ("ERISA").⁴¹ Particularly troubling are

Development, 9 FORDHAM URB. L.J. 979 (1981).

39. See H.R. 12666, *supra* note 7, at 61; VENTURE AND EQUITY CAPITAL, *supra* note 7, at 14.

40. It has been argued that the resources of the various institutional funds should be used to further socially relevant goals. When a trustee invests pension funds, however, he may run afoul of the prudent man standard if he invests in nontraditional investments like a venture capital company. The parameters of permissible nontraditional investments, in spite of direct benefits claimed by the trustees are set forth in *Withers v. Teachers' Retirement System*, 447 F. Supp. 1248 (S.D.N.Y. 1978), *aff'd*, 595 F.2d 1210 (2d Cir. 1979); *Blankenship v. Boyle*, 329 F. Supp. 1089 (D.D.C. 1971). See generally Hutchinson & Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 U. PA. L. REV. 1340 (1980) [hereinafter cited as *Investment of Pension Assets*]; Ravikoff & Curzan, *Social Responsibility in Investment Policy and the Prudent Man Rule*, 68 CALIF. L. REV. 518 (1980).

Plan officials may wish to act on the basis of the perceived social benefit features of investments. This will be possible under ERISA provided they have examined a broad range of investments and have found selections having those socially desirable features among a broad class of otherwise suitable and equally durable investment opportunities meeting the economic objectives of the plan.

Lanoff, *The Social Investment of Private Pension Plan Assets: May it be Done Lawfully Under ERISA?*, 31 LAB. L.J. 387, 392 (1980).

41. 29 U.S.C. §§ 1001-1381 (1976). ERISA does not apply to state governmental retirement plans. Consequently, each state applies its own standards to determine permissible investments. Generally, these investments include the acquisition of bonds or other indebtedness of the United States, other states, territories, cities, counties, municipalities and towns. Most permit investment in corporate bonds with varying restrictions. For example, Pennsylvania permits investment in corporate bonds subject to the prudent man rule, providing that the corporation has a history of profitability and has not defaulted on interest or principal payments within the last 10 years. The Pennsylvania statute does not authorize investment in stock although the retirement board may purchase corporate bonds that are convertible into common stock but may not exercise the conversion option. PA. STAT. ANN. tit. 72 § 3603 (Purdon 1975); 1957 OP. ATTY. GEN. No. 29, *reprinted in* PA. STAT. ANN. tit. 72 § 3603 (Purdon Supp. 1980-1981).

Many states permit investment in preferred or common stock but these investments are limited to corporations that have paid dividends for a certain number of years and that have had aggregate net corporate earnings available for dividends during that period which have been at least equal to the amount of such dividend. In addition states often require a corporation to be registered on a national security exchange. These kinds of restrictions preclude

those provisions which effectively prohibit investment of pension funds in new businesses with significant growth potential.⁴²

State governments should broaden the range of enterprises in which public employee pension funds can invest. This will permit the pension funds to increase simultaneously their rates of return and their investments in growing businesses.⁴³ Pension funds would not only be able to invest in individual new businesses, but also in locally based, locally oriented venture capital companies.⁴⁴ In recent years, these companies have been a major source of financing for new businesses, and many of them have consistently

new businesses from being a qualified investment. ARIZ. REV. STAT. § 38-757 (Supp. 1980-1981); CAL. GOV'T CODE § 20205.2 (West Supp. 1980); N.Y. RETIRE. & Soc. SEC. LAW § 177 (McKinney Supp. 1980-1981); TEX. REV. CIV. STAT. ANN. art. 6228a sec. 7 (Vernon Supp. 1980-1981); WASH. REV. CODE ANN. § 41.40.071 (1972).

The possibility for small business development, however, does exist under statutes with greater flexibility. For example, the statute governing the Kansas' Public Employees' Retirement System provides:

In investing and reinvesting moneys in the fund and in acquiring, retaining, managing and disposing of investment of the fund there shall be exercised the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital. Within the limitation of the foregoing standard and subject to clause (b) of this subsection, there may be acquired, retained, managed and disposed of an investment of the fund every kind of investment which men of prudence, discretion and intelligence acquire, retain, manage and dispose of for their own account.

(b) Notwithstanding clause (a) of this subsection total investments in common stock may be made in the amount of up to fifty percent (50%) of the total book value of the fund.

KAN. STAT. ANN. § 74-4921 (Supp. 1979).

42. See *New Urban Initiatives*, *supra* note 12, at 842 ("Unavailability of capital, rather than limited expected profitability, appears to impede risky but viable investments of some businesses.").

43. The Department of Labor regulations concerning the capital collected in private retirement-plan trusts, 29 C.F.R. § 2550.404a-1 (1979), require a fiduciary to analyze the relative riskiness of an investment, not by itself, but in conjunction with the entire portfolio. *Id.* It has been stated that the Department's regulations "provide some flexibility to the administration of the nation's pension plans so that investment of appropriate amounts in smaller business and venture capital pools will not be precluded as a legal and practical matter as they now are." H.R. 12666, *supra* note 7, at 61. See also *Investment of Pension Assets*, *supra* note 40, at 1357.

44. See H.R. 12666, *supra* note 7, at 43-45. In conjunction with a freeing of pension funds for investment in small firms and local venture capital companies each state could establish a special commission on Pension Fund Investments to assist the trustees of these funds in identifying opportunities for more productive investment in the state.

outperformed the market as a whole.⁴⁵

C. Regulatory Reform

When the marketplace fails to operate properly or if it produces side effects which threaten the health or safety of our citizens, the federal and state governments have intervened through various regulatory initiatives.⁴⁶ There is also, as a corollary to this intervention posture, a commitment on the part of federal and state governments to eliminate regulatory programs which no longer serve a public purpose and to modify those programs which are not fully effective.⁴⁷ Regulatory reform must address several problems: first, substantive regulation should be modified where the marketplace is capable of producing a satisfactory equilibrium; second, unnecessary duplication within a state and among state, local and federal governments should be eliminated; third, procedural regulation should be carefully tailored to provide for the expeditious administration of regulatory programs and fourth, reporting and other requirements should be no more burdensome than necessary. Two areas where the states should pay particular attention are communications and transportation deregulation because these areas can have an important impact on the development and growth of new business.

New developments in telecommunications technology, the convergence of innovative communications and information services, and regulatory change at the federal level⁴⁸ have made it necessary

45. See *INNOVATIONS IN DEVELOPMENT FINANCE*, *supra* note 2, at 82-87; *VENTURE CAPITAL AND URBAN DEVELOPMENT*, *supra* note 4, at 21-23, 48-49; H.R. 12666, *supra* note 7, at 43-44 (statement of Patricia M. Cloherly).

46. See, e.g., Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, § 302, 89 Stat. 1125 (codified at 12 U.S.C. §§ 2801-2809 (1976)); Community Reinvestment Act of 1977, Pub. L. No. 95-128, § 802, 91 Stat. 1147 (codified at 12 U.S.C. §§ 2901-2905 (Supp. II 1978)). See also Wisniewski, *Mortgage Redlining (Disinvestment): The Parameters of Federal, State and Municipal Regulation*, 54 J. URB. L. 367 (1977).

47. See Regulatory Flexibility Act, Pub. L. No. 96-354, § 2 (4)-(7), 94 Stat. 1164 (federal regulations which become a burden on economic development must be reformulated or revised to reflect economic realities).

48. The movement toward deregulation of the communications industry reflects the federal policy which supports access and dissemination of information. See *Federal Communications Comm'n v. Midwest Video Corp.*, 440 U.S. 689, 699 (1979) ("[FCC access and capacity rules intended to] promote the long-established regulatory goals of maximization of outlets for local expression and diversification of programming. . . ."); *WNCN Listeners Guild v. Federal Communications Comm'n*, 610 F.2d 838, 842 (D.C. Cir. 1979). This move-

for states to examine their approach to regulating communications.⁴⁹ New telecommunications technologies can greatly enhance the productivity of financial and other service industries on which many states will depend for much of their future growth.⁵⁰ The cable television industry is rapidly evolving from a simple system for retransmitting traditional television programming into a multifaceted information and communications system.⁵¹ If a state is to take full advantage of developments such as these, it must assure that its regulatory system does not inhibit innovation, or the application of new technologies.

The trucking industry transports a large percentage of all goods shipped in this country.⁵² To attract and hold industry in a given state, especially small firms⁵³ that particularly depend upon common carriers,⁵⁴ and to ensure energy efficiency in transportation,

ment also supports the improvements and innovations in this area. Deregulation of the communications industry is necessary both to support the growth of the industry, and to encourage economic revitalization in general. However, the public's right to and need to receive information and the individual's right to self-expression grounded in the first amendment must be recognized. See Note, *Broadcast Deregulation and the First Amendment: Restraints on Private Control of the Publicly Owned Forum*, 55 N.Y.U. L. REV. 517, 520 (1980); Comment, *FCC Regulation of Cable Television*, 54 N.Y.U. L. REV. 204 (1979).

49. See CONSTRAINTS ON THE REGULATORY PROCESS: A CASE STUDY OF REGULATION OF CABLE TELEVISION (R. Berner ed. 1976); DEREGULATION OF CABLE TELEVISION (P. MacAvoy ed. 1977).

50. See *United States v. Midwest Video Corp.*, 406 U.S. 649, 651 (1972) (Cable systems can be employed to bring a number of new communication services to homes and industry, that is, "facsimile reproduction of documents, electronic mail delivery and information retrieval either locally or nationally." *Id.* at 651).

51. *Id.* at 651-56; *United States v. Southwestern Cable Co.*, 392 U.S. 157, 163 (1968) ("whatever the estimate, CATV growth is clearly explosive in nature." (citing Second Report and Order, 2 F.C.C.2d 725, 738 n.15)).

52. 1976 STATISTICAL ABSTRACT OF THE UNITED STATES 583. The percentage of total ton miles (the movement of one ton of freight one mile) has been calculated at over 20% for the years 1959-1974. See generally *Hearings before the Subcommittee on Surface Transportation of the House Committee on Public Works and Transportation*, 96th Cong., 1st Sess. (1979).

53. See Steinfeld, *Regulation Versus Free Competition—The Current Battle over Deregulation of Entry into the Motor Carrier Industry*, 45 I.C.C. PRACTITIONER'S J. 590, 599 (1978). Here, the author noted that "[N]ew industries and rapidly expanding established industries needed ever more transportation services to meet their increasingly particular customer demands in a timely and expeditious manner. The increase in competition in the general business community meant a greater need for reliable, efficient, and responsive transportation." *Id.*

54. A common carrier has been statutorily defined as "any person which holds itself out to the general public to engage in the transportation by motor vehicle in the interstate or

the trucking industry must be freed from unnecessary and inefficient regulation.⁵⁵ Recent federal legislation has taken a step in this direction.⁵⁶ State legislation is necessary first, to reduce the role which states play in regulating local transportation services and second, to adopt the more competitive, market-oriented approach that now characterizes federal regulation on the state level.

foreign commerce of passengers or property . . . for compensation. . . ." 49 U.S.C. § 303(a)(14) (1976). A common carrier, however, must be authorized by the Interstate Commerce Commission ("ICC") to operate in interstate transportation. *Id.* §§ 306, 307. To receive such authorization the applicant must make a showing of "public convenience and necessity." *Id.* § 307. This requires that the applicant "identify clearly the commodities they ship or receive, the points to or from which their traffic moves, the volume of freight they would tender to applicant, the transportation services now used for moving their traffic, and any deficiencies in existing services." Novak Contract Carrier Application, 103 M.C.C. 555, 557 (1967) (quoting the papers which accompany a notice of processing). See also Pan American Bus Lines Operations, 1 M.C.C. 190 (1936); Note, *The Interstate Commerce Commission and The Motor Carrier Industry—Examining the Trend Toward Deregulation*, 1975 UTAH L. REV. 709 [hereinafter cited as *The ICC and the Motor Carrier Industry*].

55. The regulations of the ICC have resulted in inefficiencies. "Often, carriers are forced to circuitous routes in performing their operations when a straight line shipment of commodities would result in much shorter travel distances . . . [and] a concomitant reduction in gasoline usage. Carriers whose authority is not territorially nor commodity balanced may . . . [be] forced to . . . simply move their equipment without a load to another area, commonly referred to as 'deadheading.'" *The ICC and the Motor Carrier Industry*, *supra* note 54, at 720-21. Authorities have estimated that as much as 50% of trucking capacity is unused. R. FELLMETH, *THE INTERSTATE COMMERCE COMMISSION* (1970). See generally Kahn, *Abolition of the Trucking Exemption: Pros and Cons*, 48 ANTITRUST L.J. 555 (1980) ("[T]he process of obtaining ICC authority is often long and costly. . . . 'The applicant thus faces the possibility of a lengthy hearing and a long and costly appeals process. . . .'" (quoting Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures 203 (1979))).

56. Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (1980) (codified at 49 U.S.C. §§ 10101-10344 (Supp. 1980)). Specifically, Congress noted:

that a safe, sound, competitive, and fuel efficient motor carrier system is vital to the maintenance of a strong national economy and a strong national defense; that the statutes governing Federal regulation of the motor carrier industry are out dated and must be revised to reflect the transportation needs and realities of the 1980's; that historically the existing regulatory structure has tended in certain circumstances to inhibit market entry carrier growth, maximum utilization of equipment and energy resources, and opportunities for minorities and others to enter the trucking industry; that protective regulation has resulted in some operating inefficiencies and some anticompetitive pricing; that in order to reduce the uncertainty felt by the Nation's transportation industry, the Interstate Commerce Commission should be given explicit direction for regulation of the motor carrier industry and well-defined parameters within which it may act. . . .

Id. Pub. L. No. 96-296, § 3(a), 94 Stat. 793.

D. Infrastructure

Physical infrastructure may dictate limitations upon the development of certain new businesses.⁵⁷ The financing of new infrastructure presents a serious obstacle to urban areas due to the increased demands placed on municipal budgets. Many cities are hard-pressed to provide services, much less finance capital improvements.⁵⁸ It has, therefore, been suggested that municipalities develop a system of user charges of fees, for those businesses and individuals which utilize and benefit from the improvement or creation of physical infrastructure.⁵⁹ The condition of the facilities which provide transportation, supply water, control pollution and dispose waste will affect the quality of services within the state.⁶⁰

57. The decline of our Northeastern cities and the rise of the Sunbelt may be credited in part, to the construction of an infrastructure conducive to an exchange economy. Although the desire to create this growth has been essentially local, the dramatic development of both the necessary infrastructure and new industry has resulted primarily from federal policies. See A. WATKINS, *THE PRACTICE OF URBAN ECONOMICS* 221-33 (1980). See also REPORT FOR THE EIGHTIES, *supra* note 1, at 17-20.

58. See D. GROSSMAN, *THE FUTURE OF NEW YORK CITY'S CAPITAL PLANT* xi (Urban Inst. 1980) ("It is now becoming appreciated that preservation of [our older cities] capital network in good working order requires more vigilance. . . . Many of our cities are growing old. Although key elements in the capital system have service lives of 50 years, 100 years, or even longer, many are now reaching the end of their intended use and need to be replaced. The deterioration of the capital plant of older cities is one significant factor in their loss of appeal both for economic enterprises and for more affluent populations."); N. HUMPHREY, G. PETERSON & P. WILSON, *THE FUTURE OF CLEVELAND'S CAPITAL PLANT* xi (Urban Inst. 1980) ("In its effort to limit tax burdens and user prices, [Cleveland] has skimmed on the maintenance and orderly renewal of its public capital facilities. These deferred costs now pose a large investment and financing dilemma for the city."). See also W. LIFFORD, *CONG. RESEARCH SERV., THE NATION'S BRIDGES: PROBLEMS AND PROGRESS* (1978).

59. One example of such a program is tax incremental financing. See Davidson, *Tax Incremental Financing as a Tool for Community Development*, 56 U. DET. J. URB. L. 405 (1979).

As an element of a local urban renewal program, tax increment financing is a means for economic implementation of the redevelopment plan. The expected revenue increases from land development in the project area are allocated to a special fund of the redevelopment authority. The funds are then channeled to effectuate the overriding public purpose of the urban renewal statute: to address conditions of blight. The TIF fund may either pay directly for improvements in the redevelopments in the redevelopment district or be pledged to the retirement of bonds issued by the redevelopment authority or the municipality, so long as the scheme is rational and avoids constitutional infirmities.

Id. at 408 (footnote omitted).

60. Congress, recognizing this problem has recently enacted the Solid Waste Disposal Amendments of 1980, Pub. L. No. 96-482, 94 Stat. 2334. See S. REP. NO. 172, 96th Cong., 2d

Business choices will be determined or at least influenced, by the availability, or non-availability, of adequate service facilities.⁶¹

A program financing the maintenance and improvement of existing transportation systems and developing new accessible transportation will not succeed unless there is considerable project expediting.⁶² Delays in construction not only increase the capital expenditure but also discourage the creation of new enterprises. Moreover, uncertainty as to the time of completion of a project may make an otherwise attractive business location undesirable.

The continuing debate over hazardous wastes generates demands for new kinds of infrastructure. A comprehensive regulatory program is necessary to ensure that future disposal of hazardous wastes is consistent with the protection of health and safety.⁶³ It will also be necessary, however, to provide a consistent technical,

Sess. 1 (1980), reprinted in [1980] U.S. CODE CONG. & AD. NEWS 8665 ("The disposal of wastes, especially hazardous wastes, is a worsening national problem . . . [the Act] requires the Environmental Protection Agency to issue and enforce regulations governing the disposal of various solid wastes and hazardous wastes. In addition, the Act provides assistance to States, municipalities, and regional authorities to aid them in planning and managing disposal facilities. . . ." The Act also makes provisions for the disposal of hazardous materials, *id.* § 8, and for the establishment of a National Advisory Commission on Resource Recovery, *id.* § 33. See also 49 U.S.C. §§ 1801-1812 (1976 & Supp. III 1979) (federal hazardous material transportation regulations); FLA. STAT. ANN. § 208.001 (West Supp. 1981) (tax imposed for the generation of hazardous wastes); N.H. REV. STAT. ANN. §§ 149-H: 1 to 4 (Supp. 1979) (hazardous material transportation advisory board established to oversee the movement of hazardous materials within the state); UTAH CODE ANN. §§ 26-37.1 to -.15 (Supp. 1979) (comprehensive state regulations concerning hazardous wastes).

61. See 1978 Working Papers, *supra* note 2, at 29, in which it was noted:

Taxes affect the cost of doing business directly, through taxes on business property, inventory, and income, and indirectly, through increased wage and salary demands due to personal income taxes. . . . In a fashion parallel to wages . . . what is important is the quality and level of services provided to businesses and workers relative to the tax burden.

Id. See also Innman & Rubinfeld, *The Judicial Pursuit of Local Fiscal Equity*, 92 HARV. L. REV. 1662, 1669 (1979) (individual locational decisions are a function of taxes and the services provided in that community).

62. See notes 69-70 *infra* and accompanying text for a discussion of the use of such an expediting process in the siting of coal-fired electric utilities. See also 42 U.S.C. § 6905 (b) (1976) (expediting applications for solid waste disposal facilities).

63. See H.R. 1016, 96th Cong., 2d Sess. 18, reprinted in [1980] U.S. CODE CONG. & AD. NEWS 10249, 10250 [hereinafter cited as H.R. 1016] ("The United States Environmental Protection Agency has conducted a study to determine the number of inactive and uncontrolled hazardous waste sites in existence. In 1979 the EPA estimated that as many as 30,000 to 50,000 sites existed, of which between 1,200-2,000 present a serious risk to public health."). See also Booth, *On Hazardous Wastes*, N.Y. Times, Apr. 3, 1981, at A27, col. 3.

financial and legal framework within which the private sector can cope with the problems of managing hazardous wastes.⁶⁴

E. Energy

Economic growth requires readily available and reasonably priced energy. States must pursue policies which reduce dependence upon imported petroleum as a primary energy source.⁶⁵ An effective energy policy should stress: 1) conservation in all sectors — residential, commercial, industrial, and transportation, 2) reduction in oil usage and its replacement by coal and natural gas and 3) development of indigenous renewable energy resources — including small hydroelectric power projects, solar energy, resource recovery, biomass use,⁶⁶ and expansion of cogeneration.⁶⁷

64. See, e.g., 42 U.S.C. §§ 6921-6931 (1976 & Supp. III 1979) (providing a regulatory framework for the development of federal regulations and guidelines for state supervision of hazardous waste management); Comprehensive Environment Response, Compensation and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767, 96th Cong., 2d Sess. (1980) (creating a Hazardous Waste Response fund to be funded through a "system of fees, to establish prohibitions and requirements concerning inactive hazardous waste sites, to provide for liability of persons responsible for releases of hazardous waste at such sites. . . ." H.R. 1016, *supra* note 63, at 1, [1980] U.S. CODE CONG. & AD. NEWS at 10249. See generally Ruda & Hoffman, *Overview of Hazardous Waste Regulation Under RCRA*, 10 COLO. LAW 235 (1981).

65. See R. STOBAUGH & D. YERGIN, *ENERGY FUTURE: REPORT OF THE ENERGY PROJECT AT THE HARVARD BUSINESS SCHOOL* 15 (Ball. ed. 1979) [hereinafter cited as *ENERGY FUTURE*]

The current patterns of production and consumption, and the political alignments that accompany them, have led the United States—and the world—into a future laden with uncertainty and danger. Although the nation has had a domestic oil industry for about 120 years, the United States has, in just a few short years become heavily dependent on imported oil. This dependence means ever greater reliance on an unstable part of the world—the Middle East, and especially Saudi Arabia. It would therefore be very much in the nation's interest to stabilize, and then to reduce, oil imports.

Id. at 15. See also Nye, *Energy Nightmares*, FOREIGN POLICY 132 ("Today, nearly two-fifths of the total oil consumed in the free world economy comes from the Persian Gulf, one of the world's most politically unstable areas. The oil supply is vulnerable to terrorism, accident, warfare, and extortion. The sudden loss of Persian oil for a year could stagger the world's economy like no event since the Depression of the 1930's. The Congressional Budget Office estimates that the loss of Saudi oil for a year in 1984 would cost the United States \$272 billion.").

66. Biomass for the purposes of the Federal Energy Regulatory Commission is defined as "any organic material not derived from fossil fuels," 18 C.F.R. § 292.202(a) (1980), used in the production of energy.

67. See Public Utilities Regulatory Policies Act, Pub. L. No. 95-617, § 210, 92 Stat. 3144 (1978) (codified at 16 U.S.C. § 82a-3 (Supp. III 1979)). PURPA was enacted in conjunction with a number of other statutes commonly referred to as the National Energy Act of 1978.

Energy conservation is the most economical, effective and environmentally sound way to reduce dependence on oil. Conservation could be stimulated by economic incentives to improve or convert already existing energy systems.⁶⁸ Low-interest loans or tax credits could be provided to encourage the installation of energy-saving equipment and alternate energy production facilities.⁶⁹

Efforts to expedite conversion from oil to coal could be aided by an integrated "one-stop" process for approving the conversion of utility power plants.⁷⁰ This single review would consolidate all agency permit procedures. Although a state's one-stop review process would provide adequate opportunity for local concerns to be

Congress in enacting PURPA intended to increase and foster the conservation of electric energy, improve the distribution of electricity, encourage the development of small hydro-electric facilities, conserve existing supplies of natural gas while insuring an equitable rate structure and to foster the development of crude oil transportation systems. 16 U.S.C. § 2601 (Supp. III 1979). In Title II of PURPA, Congress intended to encourage the refinement and expansion of cogeneration and small power production facilities. 16 U.S.C. § 824a-3 (Supp. III 1979). See generally Pratt, *Cogeneration: A Successful Response to the Energy Crisis?*, 9 FORDHAM URB. L.J. 484 (1981).

68. See ENERGY FUTURE, *supra* note 65, at 167.

If the United States were to make a serious commitment to conservation, it might well consume 30 to 40 percent less energy than it now does, and still enjoy the same or an even higher standard of living. That saving would not hinge on a major technological breakthrough, and it would require only modest adjustments in the way people live. Moreover, the cost of conservation energy is very competitive with other energy sources. The possible savings would be the equivalent of the elimination of all imported oil—and then some.

Id.

69. See, e.g., I.R.C. § 48(l) (credit for investment in alternative energy sources); CAL. REV. & TAX CODE §§ 23601.5 (West Supp. 1981) (energy conservation credits); 23607 (credit for solar equipment); FLA. STAT. ANN. § 220.18 (West Supp. 1981) (gasohol development incentive credit); ORE. REV. STAT. §§ 469.160-180 (1979) (credit for investment in alternative energy sources). See also *Industrial Location Incentives*, *supra* note 3, at 572 for a discussion of the states which provide tax credits in alternative energy sources such as solar, hydro, wind and water.

70. See, e.g., ORE. REV. STAT. §§ 469.010-745 (1979); WASH. REV. CODE ANN. §§ 80.50.010-110 (Supp. 1981). The Oregon system is part of a larger statutory framework which not only seeks to facilitate the siting process, see ORE. REV. STAT. § 469.310 (1979) ("establish in cooperation with the federal government a comprehensive system for the siting, monitoring and regulating of the location, construction and operation of all energy facilities in this state"), the Oregon System also seeks to promote the development of alternate sources of energy and conservation. See also WASH. REV. CODE ANN. § 80.50.075 (Supp. 1981) (expedited application process); Christian & Koval, *Simplifying the Federal Permitting Process: The Proposed Energy Mobilization Board Legislation*, 12 NAT. RESOURCE LAW. 721 (1979).

heard and assessed,⁷¹ municipalities should not be permitted to impose conditions on, or require local approval of, conversions approved by the state.

Natural gas is another alternative to oil usage.⁷² It has become clear in recent years that the United States has enormous untapped gas reserves, even in "energy-poor" states.⁷³ The establishment of a comprehensive, consistent framework for state regulation of natural gas production which simplifies and streamlines existing permitting procedures, will help encourage new production while ensuring that all future oil and gas developments are compatible with the highest environmental standards.

Small hydroelectric projects, wind, wood, solar power, resource recovery and cogeneration can in the aggregate replace significant amounts of imported oil.⁷⁴ For this type of development the state must ensure that its tax structure and regulatory requirements are conducive to, rather than obstacles to private sector development.⁷⁵

III. The Federal Government's Role

An effective economic development strategy should lay the foundation for sustained and balanced growth in the next decade. It is therefore necessary for the federal government to press forward with two major strategies: first, there must be a carefully-crafted set of tax cuts that encourage capital formation and continued growth and second, the Gordian knot of fiscal federalism that cur-

71. The State of Washington will only permit a utility to avail itself of the accelerated permitting process if the utility can establish that the area potentially affected and the environmental impact of the plant are not significant, thereby protecting the safety and well-being of the communities surrounding the proposed plant. WASH. REV. CODE ANN. § 80.50.075(1) (Supp. 1981).

72. Congress has recognized not only the importance of natural gas to the nation's economy, but has realized that the efficient distribution of this resource requires careful attention. See Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (Supp. III 1979). See also MacAvoy, *The Natural Gas Policy Act of 1978*, 19 NAT. RESOURCES J. 811 (1979).

73. See ENERGY FUTURE, *supra* note 65, at 65-68.

74. See Federal Energy Regulatory Commission Statement of Considerations, 45 Fed. Reg. 12,214, 12,215 (1980) ("Cogeneration facilities can make a significant contribution to the Nation's effort to conserve its energy resources. Small power production facilities use biomass, waste, or renewable resources, including wind, solar and water to produce electric power. Reliance on these sources of energy can reduce the need to consume traditional fossil fuels to generate electric power.").

75. See notes 17-30 *supra*.

rently impairs intergovernmental cooperation must be cut.

A. Tax Reduction

First, priority should be given to strengthening the federal investment tax credit program.⁷⁶ In keeping with an increase in the state tax credit, Congress should enact a substantial investment credit of twenty-five percent for investment in existing industrial structures.⁷⁷ This would encourage modernization of aging capital plant and redevelopment of depressed communities.⁷⁸ Redeveloping existing communities provides an energy saving alternative to continued sprawl.⁷⁹

Second, capital gains tax rates should be further reduced for investments in productive assets in order to stimulate new and innovative businesses.⁸⁰ The nation must do this to develop the new

76. I.R.C. §§ 46-50. See also Prop. Treas. Reg. § 1.48-11(c); Investment Credit for Qualified Rehabilitated Buildings, 45 Fed. Reg. 71,367 (1980) (proposed changes in what constitutes qualified rehabilitation expenditure and allowing pass-through of credit from a developer who rehabilitates a structure to the purchaser).

77. A criticism of existing federal investment credits is that they are geared toward investments in new rather than existing equipment. It has been argued that "this makes investments in new equipment less expensive after taxes than an equivalent expenditure on renovation. This leads to bias against existing industrial centers." 1978 Working Papers, *supra* note 2, at 77. See also Cowan, *Depreciation Tax Plan Draws Some Opposition*, N.Y. Times, Mar. 25, 1981, at D1, col. 1. A limited exemption exists under the Code for buildings which are more than 20 years old and have undergone extensive repairs. I.R.C. § 48(g). Florida, on the other hand, provides a credit for the revitalization of an existing business, its structures, machinery, fixtures, or equipment, as long as the revitalization created at least five new jobs for residents of distressed areas. FLA. STAT. ANN. § 220.182 (West Supp. 1981). Because the investment tax credit is a credit against income, it is of limited utility to new businesses who often times require a number of years before they can show a profit and not-for-profit corporations, such as community development corporations. 1978 Working Papers, *supra* note 2, at 78.

78. See EUROPEAN ECONOMIC EXPERIENCE, *supra* note 29, at 21. (An incentive program could be established to help retain existing industries in distressed areas through either modernization or expansion).

79. See ENERGY POLICY, *supra* note 5, at 158-59.

80. See H.R. 9549, *supra* note 9, at 235. (statement of David T. Morgenthaler) ("We propose that a provision be added . . . that capital gains be taxed at one-half the rate of ordinary income if sold within the first five years of the investment. After a holding period of five years, we recommend that the capital gains be taxed at 33% of the rate of ordinary income."). See also *Capital Gains Tax Bills*, *supra* note 16, at 396. ("It is ironic that reductions in the capital gains incentive has coincided with startling growth in capital investment needs. Without sufficient capital, we have been unable to keep pace with a growing labor supply, and as a consequence, our economy suffers in many ways — through the burden of excessive unemployment benefits and through the social problems that arise from youth

products and equipment to help sustain economic growth. Capital gains tax reforms will also stimulate the growth of the financial services industry.⁸¹ The decline in federal revenues because of this tax change during the initial years would be negligible, yet the stimulative impact would be substantial.⁸²

Third, there should be movement toward an integration of the corporate and personal income tax to remove the present double taxation of distributed corporate earnings.⁸³ This would increase the flow of equity investment that is necessary for the sustained growth of small, new businesses.

Fourth, depreciation allowances should be administratively simplified and indexed to the rate of inflation.⁸⁴ Indexing depreciation

idleness.”).

81. A number of European countries have devised development incentive programs to aid service industries. See *EUROPEAN ECONOMIC EXPERIENCE*, *supra* note 29, at 22. Service industries, because they are labor-intensive, could be an important addition to areas with either high unemployment or underemployment. See (IV) *Is There Hope for the American City?*, Wash. Post, Feb. 24, 1980, at 15, col. 4 (“New York has concentrated on changing the support for its tax base from manufacturing to service industries like insurance, real estate and advertising. Service industries may be where the future of American cities is to be found.”).

82. A recent study reached the conclusion that reducing the capital gains tax rate should actually increase rather than decrease federal tax revenues. This conclusion which was based on a survey of a number of American companies “documents the remarkable capacity of relatively modest investments to generate large federal tax revenues year after year.” *Capital Gains Tax Bills*, *supra* note 16, at 281 (statement of Dr. Edwin V. W. Zschau).

The data in the survey comes from 325 companies which accounted for more than \$45 billion in revenue in 1976. More than one third—\$16.4 billion—of this came from exports and overseas operations. These companies employed nearly 750,000 people in the United States in 1976, spent \$2.2 billion on R & D, and paid \$1.8 billion in federal corporate income taxes and nearly \$700 million in state and local taxes. Most of the companies in the survey are young companies — 85 percent were founded in the past 22 years — and about 60 percent are still privately held.

Id.

83. See Warren, *The Relation and Integration of Individual and Corporate Income Taxes*, 94 HARV. L. REV. 717, 798 (1980) (“whether viewed from the perspective of individual investment decisions, corporate financial policy, or corporate investment decisions, the defects in current law follow from the double taxation of distributions with respect to equity, from differences in the corporate, personal and capital gains tax rates, and from the deferral of tax on capital gains.”). See also Katsoris, *The Double Jeopardy of Corporate Profits*, 29 BUFFALO L. REV. 1, 5 (1980) (“In contrast to the tax treatment of all other entities, the income of a regular corporation is taxed twice. It is taxed to the corporation as it is earned and is taxed again when distributed to the shareholders. . . .”).

84. Indexing capital depreciation rates to the consumer price index or some other indicia of inflation is necessary to allow businesses to replace or modernize aging plant and equipment. See Javits, *New Directions for Savings & Investment in 1980*, 4 J. INST. SOCIO. ECON.

allowances would assure businesses that changes in the rate of inflation would not be reflected in changes in their effective tax rate, without creating an immediate and traumatic revenue loss. The temptation to accelerate the time period over which investments may be written off, should be resisted. The accelerated depreciation proposals presently before Congress,⁸⁵ do not address one of the most basic problems faced by business — the high degree of uncertainty engendered by fluctuating rates of inflation.

Finally, saving must be encouraged.⁸⁶ Increased investment by business must be matched by increased saving by households. Yet households cannot be expected to save when they face discriminatory taxes on inflation-swollen interest rates.⁸⁷

B. Federalism

The proliferation of federal programs in past years has all too

STUDIES 1, 2 (No. 4 1980) ("To the extent that our tax system does not permit depreciation allowances to cover the actual cost of replacing capital equipment at current inflated prices, inflation overstates profits and reduces the rate of return on investment. As a result, businesses will end up paying an effective Federal income tax rate of over 66 percent on actual profits."); Mendenhall, *Tax Indexation for Business*, 33 NAT'L TAX J. 257, 260 (1980) (arguing that even if an indexing system is adopted there is still a need for additional incentives to aid capital formation such as lower rates for capital gains).

85. See H.R. 4646, S. 1435 96th Cong., 2d Sess. (1980). See also *Report of the Joint Economic Committee 1980*, 96th Cong., 2d Sess. 77 (1980) "[T]ax reduction . . . designed to provide greater incentives for capital investment . . . should be accomplished primarily by increasing allowances for business depreciation." Supporters of the accelerated depreciation proposal commonly referred to as the 10-5-3 plan, argue that the reliance on historic cost as the "predicate for traditional depreciation deductions during inflationary periods tends to overstate income. Under such a system, an investor is not allowed to recover out of pretax income the true cost of replacement and is discouraged from making investments." Rothenberg, *Proposed Depreciation Reform 10-5-3*, 4 REV. TAX. INDIVS. 332 (1980).

86. In order to stimulate capital formation, both the total amount of and percentage of the gross national product devoted to personal saving must increase. See REPORT FOR THE EIGHTIES, *supra* note 1, at 147 ("A broad but controversial incentive to save would be to deduct savings from taxable income when the savings are made. . ."). See also Javits, *supra* note 84, at 3.

87. Under present laws, individuals' savings income is taxed, I.R.C. § 61, while consumption expenditures, that is, interest on charge or credit accounts are deductible, I.R.C. § 163(a). Consumers are therefore, "discouraged from savings for future purchases when their deposit earnings are taxed; conversely they are encouraged to 'but [sic] now, pay later,' utilizing installment credit plans, when they know that the interest will be deductible and that the debt will be repaid in cheapened dollars." *Hearings before the Subcommittee on Financial Matters of the Senate Committee on Finance*, 94th Cong., 2d Sess. 226 (1976) (statement of Arthur M. Weiner). See also Becker & Fullerton, *Income Tax Incentives to Promote Savings*, 33 NAT'L TAX J. 331, 332 (1980).

often, bypassed state governments.⁸⁸ Rational and effective state programs cannot be conducted when federal programs shift with each change in the economic winds.⁸⁹ During the next few years, the fiscal and administrative responsibilities for domestic programs should be reallocated among the three levels of government in a manner that reflects administrative ability and fiscal capacity.⁹⁰

88. The federal government since World War II through the use of categorical programs has attempted to "provide [needed resources to cities] in exchange for acceptance of certain national minimum standards for a specific purpose." K. BEA, CONG. RESEARCH SERV., *THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM: QUESTIONS AND ANSWERS 2* (1980). Programs of this nature have forced states and localities to conform to federal dictates. See notes 99-101 *infra*. The pervasive influence of the federal government in urban decision-making, however, is a recent phenomena. See *THE URBAN PREDICAMENT 2* (W. Gorham & N. Glazer eds. 1976)

Twenty years ago, individual cities for the most part were left to cope with their own problems. Apart from mortgage insurance and implicit subsidies . . . involvement in urban development was modest. There was a federally subsidized public housing program dating from the 1930's, but it was small, and there was a more substantial federally subsidized program for urban renewal. The problems of the poor were addressed by what were then modest programs of federally assisted welfare and local public assistance. Since then we have lived through an explosion of federal programs, followed by an effort to retrench, reorganize and consolidate.

Id.

89. Federal grant-in-aid and revenue-sharing programs force states and localities to alter and shift their spending programs to conform with narrowly defined activities which the federal government deems meritorious. See Newman & Lewis, *Regional Resource Allocation*, 39 PUB. ADMIN. REV. 355, 356 (1979). State and local governments channel their tax revenues into activities which will produce the largest inflow of federal funds, thereby, directing local activities into projects with the highest priority from the national viewpoint. *Id.* See also Smith, *The Response of State and Local Governments to Federal Grants*, 21 NAT'L TAX J. 349 (1968) ("matching requirements of conditional grants to state and local governments often induce lower-level governments to neglect activities that do not receive Federal funds in favor of those that are Federally supported. Thus, Federal grants are said to 'distort' the budgets of state and local government by inducing changes in the expenditure patterns of the recipients.").

90. It has been suggested that development financing in this country should be modeled after the experience of the Europeans. On one level, the federal government would administer major, large-scale projects. On a second level, state development authorities in conjunction with local agencies (where they exist) would administer and direct these programs, which would be funded through the federal government. See *EUROPEAN ECONOMIC EXPERIENCE*, *supra* note 29, at 16-17; *Economic Development Legislation*, *supra* note 7, at 42 (statement of Dr. Richard Nathan). Decentralizing the decision process to allow state and local development authorities to receive and pass upon applications for development assistance will permit the more efficient distribution of limited funds. See generally *1978 Working Papers*, *supra* note 2, at 185-94. See also Van Horn, *Evaluating the New Federalism: National Goals and Local Implementors*, 39 PUB. ADMIN. REV. 17 (1979) ("power should be shifted away from the unwieldy, unresponsive, and fragmented Washington bureaucracy to state and local elected officials because they can be held politically accountable and are

This is not asking for a federal hand-out, but for consistency and efficiency in federal policies.

For example, the Highway Trust Fund,⁹¹ and the taxing power that underwrites it should be returned to the states. The interstate highway system is substantially complete and the issue now is one of maintenance and repair.⁹² Decentralization would ensure that transportation policies reflect local needs.⁹³ Each state should be free to impose the taxes it feels are appropriate and to spend the receipts on any transportation capital projects it deems necessary. The federal government should also return to the states the taxing power and the administrative responsibility for the Airport Development Assistance Program.⁹⁴

At the same time, those programs that meet broad national goals should not be eliminated in a flurry of short-sighted budget cutting. There is no real saving if federal assistance for mass transportation is cut.⁹⁵ In the long run, this type of cost-cutting will only increase our dependence on foreign oil, lead to expensive sprawl and deny job opportunities to residents of central cities.⁹⁶

'closer to the people.' Decentralization . . . would substantially improve the match of local programs with local needs and priorities.").

91. Federal-Aid Highway Act of 1973, Highway Trust Fund, 23 U.S.C. § 120 Historical Notes (1976).

92. Congress, with the creation of the Energy Conservation and Conversion Trust Fund (ECCTF), has implicitly recognized that the Highway Trust and Airway Trust funds may have outlived their usefulness. The ECCTF is funded through the motor fuel tax enacted by Congress. See [1978] U.S. CODE CONG. & AD. NEWS 7717, 7719. The ECCTF has three separate accounts: 1) an Energy Program Account which maintains the Strategic Petroleum Reserve and supports research and development of new energy technology; 2) a Mass Transportation Account which maintains and supports projects which encourage increased and more efficient use of mass transit; and 3) a States Account, established as part of the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117, which attempts to ameliorate the adverse affect the motor fuels tax will have on the states. Monies are distributed from this fund in accordance with the fuel consumption in the states. There are two restrictions placed on funds from the States Account, "[f]irst, the payments are to be used by the States only in transportation programs, including the maintenance and rebuilding of highways. Second, the States may not use the moneys from the account either directly or indirectly for the purpose of obtaining Federal matching funds." 6 U.S. CODE CONG. & AD. NEWS at 7721.

93. See notes 52-56 *supra* and accompanying text.

94. Airport and Airway Trust Fund Act, 49 U.S.C. § 1742 (1976). See note 92 *supra*.

95. It appears that the current administration is undertaking a policy which is opposed to the aid and development of mass transportation. See *The Reagan Budget, Programs, Aims and Points of Debate*, N.Y. Times, Feb. 19, 1981, at B7.

96. See *Panel Discussion on the Energy Crisis and Proposed Solutions before the*

State governments must play a much larger role in helping to target federal resources to those areas that need special assistance.⁹⁷ All too often, Congressional debates on allocation formulas lead to a loss of focus that undermines the intent of the program.⁹⁸ State targeting of federal monies will assist the federal government to achieve the most effective programs possible because the states are acutely and immediately aware of where help is needed.

C. Other Areas

The federal agenda must include other areas for action, in addition to tax reform and reform of intergovernmental financial relationships. As suggested at the state level, there must be major reforms in federal regulatory systems, including telecommunications, banking, and environmental regulation.⁹⁹ There is also an urgent need for a consistent, coherent national energy policy—emphasizing conservation, substitution of coal and gas for oil, and development of alternative energy resources.¹⁰⁰

1. Aid To Distressed Areas

Economic strategy must include policies that ensure that the economic development resources of government at all levels are di-

House Committee on Ways and Means, 94th Cong., 1st Sess. 1816 (1975) (statement of David M. Brown) ("Group transit tends to discourage urban sprawl which increases energy utilization by increasing reliance upon the automobile and also necessitates incremental costs of community support facilities. . . .")

97. In return for increased state responsibility for the financing and management of infrastructure programs, the federal government should assume increased fiscal responsibility for programs that provide economic support and social services for the poor. The federal government does not have the capacity to determine regional and local development patterns effectively. See generally Howell, *The Evolving National Urban Policy: The Role of the Private Sector—Moneychangers of the Northeast*, 11 URBAN LAW. 270 (1980); Kain, *Failure in Diagnosis: A Critique of the National Urban Policy*, 11 URBAN LAW. 247 (1980). Yet state and local governments that house and assist a disproportionate share of the economically disadvantaged do not enjoy the fiscal capacity to sustain these services.

98. This phenomenon is best illustrated by the history of the National Development Bank legislation proposed by the Carter administration. The legislation in its final form, National Development Bank Act, H.R. 7902, 96th Cong., 2d Sess. (1980), would have made assistance available to approximately 65% of the nation's population. The original version limited its coverage to 42% of the population, an intermediate proposal would have covered 59%. See *Economic Development Legislation*, *supra* note 7, at 233. See also *New Urban Initiatives*, *supra* note 12, at 823.

99. See notes 48-56 *supra*.

100. See notes 65-75 *supra*.

rected toward the most severely distressed communities and aimed at providing employment for low-income people.¹⁰¹ A major goal is to guarantee that government-assisted economic development projects result in the creation of new job opportunities.¹⁰²

There are often serious obstacles to attracting private investment to distressed areas.¹⁰³ The cost of security is often quite high

101. An effort should be made to redirect our CETA programs, Comprehensive Employment and Training Act of 1978, tit. II, 29 U.S.C. § 801 (Supp. III 1979), so that they are used effectively and aggressively to create private sector job opportunities for the structurally unemployed, especially for low-income young people. CETA alone, however, cannot meet all the needs of the structurally unemployed. The tax system must be used to encourage new investment and access to employment for those who need it most. A state targeted jobs tax credit, giving employers a tangible incentive for hiring those who are traditionally viewed as hard to employ should be enacted. See I.R.C. §§ 44B, 51-53 (New employees jobs credit); § 50A (Work Incentive program credit). Economic development agencies could also begin to direct work with state and federal labor agencies to assure that wherever possible specific agreements for the structurally unemployed, including welfare recipients, are built into major economic development projects. See *Work-sharing Initiatives at Home and Abroad*, 100 MONTHLY LAB. REV. 16, 19 (Sept. 1977) ("[T]he key to any public policy [toward work-sharing] that would not involve any additional resources appears to be the role of the federal-state unemployment system. Since under present arrangements work-sharing would mean a reduced volume of unemployment insurance claimants . . . these savings in benefits might be available to help implement a work-sharing system.").

102. See DEVELOPMENT FINANCING, *supra* note 25, at 25-27. In designing a development finance system a choice must be made between people-oriented programs and place-oriented programs. Because the individual targets of people-oriented programs are not evenly distributed geographically they are suitable targets for federal programs such as assistance to designated "distressed areas." Place-oriented programs accept diffusion of jobs to targeted individuals without requiring that the newly created position be filled by someone in the specific client population. This follows the theory that a worker leaving one job for a newly created position will create a vacancy for someone in the target population.

Along these lines, private-sector job creation is more effective in raising incomes in local economies than people-oriented programs such as public service jobs, housing assistance and welfare. This is because federal programs bring only the amount of government assistance into the local economy but do not necessarily attract outside private funds. On the other hand, the private-sector jobs will create income and increase a tax base giving rise to resources for public facilities.

103. A government strategy which seeks to bring new jobs into an area must be aware of two distinct incentive programs. One type of incentive seeks to compensate for the added cost of doing business in a particular area. A second incentive system seeks to stimulate, in effect reward, a firm for locating and operating in a particular area. See EUROPEAN ECONOMIC EXPERIENCE, *supra* note 29, at 24. To generate jobs in distressed areas two problems must be kept in mind; first, there must be available long-term credit to "help struggling firms overcome temporary reversals or to help growing firms expand." *Economic Development Legislation*, *supra* note 7, at 207 (statement of Robert. T. Hall). Second, locational incentives must be created to help offset some of the costs to firms which locate in distressed areas. *Id.* at 208.

in distressed urban neighborhoods.¹⁰⁴ Assembling land for development and securing local approvals may be difficult in these neighborhoods.¹⁰⁵ Private employers often encounter difficulty finding skilled labor in or attracting skilled labor to distressed areas, both urban and rural.¹⁰⁶ Amenities and supporting facilities that many businesses will look for, such as viable nearby commercial centers, may be absent from these areas. Many private lenders are, therefore, unwilling to finance development in distressed areas.¹⁰⁷

At the same time, these areas often have significant assets that the states could help communities use more effectively.¹⁰⁸ In dis-

104. See *Economic Development Legislation*, *supra* note 7, at 208 (statement of Robert T. Hall) ("The capital gap in the inner city . . . is aggravated by a high incidence of crime against business and the availability of crime insurance at several multitudes of standard rates, if at all."); *CAPITAL SHORTAGES AND EMPLOYMENT CHANGES*, *supra* note 2, at 23.

105. The federal government, through its open land policy for distressed areas has recognized the importance of open space for recreational, conservation and historical purposes. See 24 C.F.R. § 540.1 (1980). This program, however, does not make available funds for major construction projects in conjunction with the acquisition of the open space land, *id.* § 540.5(f), and places restrictions on land acquisitions which may inhibit urban growth patterns, *id.* § 541.10(5)(c). Such restrictions may discourage the orderly economic development of such areas. While land-use patterns in our inner-cities must reflect a balancing of environmental and development interests, policies must be created which address and foster economic revitalization and not economic stagnation within these areas.

106. See *Industrial Location Incentives*, *supra* note 3, at 460.

107. See *DEVELOPMENT FINANCING*, *supra* note 25, at 29.

Equity financing also is indirectly available on a small scale through some federal agencies. For example, government agencies currently fund State/Local Development Corporations, Small Business Investment Corporations, Minority Enterprise Small Business Investment Corporations, and Community Development Corporations. These in turn must have the ability to invest through equity participation in the growth of smaller firms. But funds available for these equity financing programs are so limited that the programs themselves cannot be considered effective in aiding the growth and expansion of small businesses. None of these, for example, has focused on the critical element of targeting equity to distressed areas.

Id.

108. A number of existing federal programs have recognized the importance which existing structures can play in the redevelopment of a distressed area. The federal urban homestead program for example, makes available to qualified individuals one-to-four-family residences for nominal amounts of money. In return, the new homeowner agrees to occupy the property as his principal place of residence for at least three years, 24 C.F.R. § 590.7(3)(iii) (1980), and to take necessary steps to bring the building into compliance with required energy conservation standards. *Id.* § 590.7(3)(ii). The urban homesteading program by providing for relocation into existing structures seeks to "utilize existing housing stock to provide homeownership, thereby encouraging public and private investment in selected neighborhoods. . . ." *Id.* § 590.3 (1980). The Community Development Block Grant ("CDBG") program has also sought to improve the quality of distressed urban communities

tressed urban areas, the basic infrastructure is already in place and transportation is available for both workers and goods. There are vacant but still usable industrial plants, which many firms will find an attractive alternative to costly new construction. Existing vacant land and housing may be attractive because of its proximity to concentrated markets. Policies must therefore be directed at highlighting the benefits of distressed areas while offering incentives which minimize the costs of locating in such areas.¹⁰⁹

The opportunities in distressed communities are enhanced by more than their physical assets. Some distressed areas have highly effective community-based economic development organizations, with a proven capacity to encourage and guide the development of new local enterprises.¹¹⁰ Deteriorating housing and inadequate services present entrepreneurial possibilities. New enterprises can use the creative energies of local residents both to provide jobs and to meet neighborhood needs. These businesses, however, require capital which is usually available only on unfavorable terms. In order to ensure that the resources of both new programs and existing ones are effectively concentrated in the areas of greatest need, cer-

through the preservation and revitalization of existing structures within these communities. 42 U.S.C. § 5301 (1976).

109. The existence of basic infrastructure and usable industrial plant makes such areas appealing to firms whether they are profit-maximizers or cost-minimizers. See *Industrial Location Incentives*, *supra* note 3. Locating in urban areas is advantageous to the profit-maximizer because of the proximity of these areas to ready markets. A cost-minimizing firm will find locating in an area with existing infrastructure and industrial plant advantageous because of the cost savings inherent in such an arrangement. The existence of infrastructure and physical plant in and of itself may not be sufficient inducement to locate in distressed areas however; therefore, incentive programs must be devised to compensate those firms which do locate in these areas. See, e.g., 24 C.F.R. § 4101.4(8)(9) (1980) (Neighborhood Reinvestment Corporation assistance to improve personal and property security and energy conservation in distressed areas).

110. See 42 U.S.C. §§ 2981-2984a (Supp. III 1979) (establishing and supporting federal community development programs). The federal program is intended to "encourage the development of special programs by which residents of urban and rural low-income areas may, through self-help and mobilization of the community at large, with appropriate federal assistance . . . contribute to the elimination of poverty and the establishment of permanent economic and social benefits." *Id.* § 2981. See *Corrugated Container Corp. v. Community Servs. Admin.*, 429 F. Supp. 142 (W.D. Va. 1977) (Congress imposed restrictions upon the use of monies awarded as part of the community development program to prevent competition with existing businesses. *Id.* at 152. If grant money designed to "promote self-help [is] diverted to instigate government-sponsored competition with existing enterprises . . . the self-sufficiency of the gainfully employed [will be jeopardized]." *Id.* at 153.).

tain chronically distressed communities must be designated as job development areas. Federal and local development resources should be focused on these areas.

In conjunction with an area designation plan, a targeted job development program should be established.¹¹¹ This program would provide flexible financing for new business enterprises in areas where commercial banks are traditionally reluctant to do business. The program should provide working capital as well as plant and equipment loans. Payback schedules should be kept flexible. This program will prove particularly beneficial in assisting new industrial and commercial business start-ups in severely distressed areas.¹¹²

IV. Conclusion

Federal and state economic programs have traditionally ignored new enterprise development as a source of economic growth. This Article has outlined some of the components of a new business-oriented development strategy. However, the mere establishment of federal and state programs to provide incentives and financing to new businesses would not in itself necessarily encourage new business development in such a way that would benefit the overall economy. The programs providing such funding would have to be aggressively "marketed" so that small and new businesses are aware of their existence. Careful targeting would be necessary to place businesses in areas where there is growth potential, to create jobs in distressed areas and to avoid unnecessary regulation. Success of such programs will depend upon a combined effort at all levels of government to provide tax incentives and reform, regula-

111. See, e.g., I.R.C. §§ 50a, 51; CAL. CORP. CODE § 14045 (West Supp. 1981) (employment incentive loan program); FLA. STAT. ANN. § 220.181 (West Supp. 1981) (job creation incentive credit); N.Y. COM. LAW § 118 (McKinney Supp. 1980) (tax credits and exemptions for job creation); PA. STAT. ANN. tit. 62 § 2084 (Purdon Supp. 1980) (tax credit). See also Forrest & Mohr, *Targeted Jobs Credit Contained in Revenue Act*, N.Y.L.J., Jan. 7, 1980, at 3, col. 8.

112. Funding should be made available to promote re-use of vacant industrial buildings. See, e.g., 24 C.F.R. § 4101.14(5)(6)(9) (1980) (federal aid for neighborhood revitalization). With the continuing inflation of both construction costs and interest rates, these structures are an increasingly valuable resource for distressed areas. A state program could assist in acquiring, refurbishing, and marketing buildings that might otherwise be abandoned. In addition, legislation authorizing reduced utility rates for new industrial and commercial customers in designated job development areas should be encouraged.

tory reform, infrastructure revitalization and compatible energy programs.