

What Makes for a Smart Community or Economic Development Subsidy? A Program Evaluation Perspective

Martin D. Abravanel, Nancy M. Pindus, and Brett Theodos

Many public dollars and numerous federal government programs support community and economic development activities in the United States. One report put federal community development spending at over \$45 billion in 2004 (Gerenrot, Cashin, and Paulson 2006), and another identified 14 federal agencies that spent a total of \$76.7 billion on 250 separate programs involving activities “useful to regional economic development” in FY 2006 (Mills, Reynolds, and Reamer 2008). While these expenditures constituted only a small fraction (roughly 2-3 percent) of federal spending in those years, the amounts are nonetheless substantial.

Given the multiplicity of federal community and economic development programs, obvious questions include whether they represent a smart use of public subsidy and if so, which approaches are the smartest. Much of the conversation involving smart subsidies either follows logically from economic theory or is based on real-world practitioner experience with initiating and financing community or economic development projects. These perspectives are compelling, but there is another way to consider whether a subsidy is smart: empiric evaluation of actual projects undertaken in conjunction with federal programs. As distinct from rules-compliance reviews or routine program monitoring, formal program evaluations tend to be done only occasionally to learn whether programs are on target to achieve, or are actually achieving, intended objectives. We turn to the program evaluation literature as an alternative perspective on whether federal community and economic development subsidies are smart.¹

History, Scale, and Trends in Federal Community and Economic Development Programs

A case can be made that the Public Housing program, initially authorized in 1937, was the first major federal government initiative to attempt to improve the economic viability and development of low-income communities. The Housing Act of 1937 was intended to provide not only affordable housing resources but also employment opportunities, economic stimulation, and slum removal. Prior to that, public responsibility for such activities tended to reside with state or local governments. It was not until Title 1 of the Housing Act of 1949, however, that the Urban Renewal program, which was originally designed to eliminate slums, evolved to emphasize economic development in lower-income urban areas. Similarly, several programs to develop rural areas were created in the 1930s and 1940s—including those administered by the Rural Resettlement Administration and, later, the U.S. Department of Agriculture’s Rural Electrification Administration, Rural Development Assistance program, and Farmers Home Administration.

In recent decades there has been a succession of federal government programs or regulations designed to improve the economic viability and development of communities. Some of these have already expired but many continue to operate. These programs include: the Small Business Loan Guaranty (1953–) and Venture Capital (1958–) programs, which in 1964 incorporated an explicit emphasis on economically distressed communities; the Economic Development Administration (EDA) grant programs (1965–); the Model Cities program (1966–1974); the New Communities program (1968–

¹ For a more extensive review of the literature, see Martin D. Abravanel, Nancy M. Pindus and Brett Theodos, *Evaluating Community and Economic Development Programs: A Literature Review to Inform Evaluation of the New Markets Tax Credit Program*: Washington, DC: The Urban Institute, September 2010. That review, which serves as a basis for this chapter, was supported by the CDFI Fund of the U.S. Department of the Treasury as part of a program evaluation of the New Markets Tax Credit program.

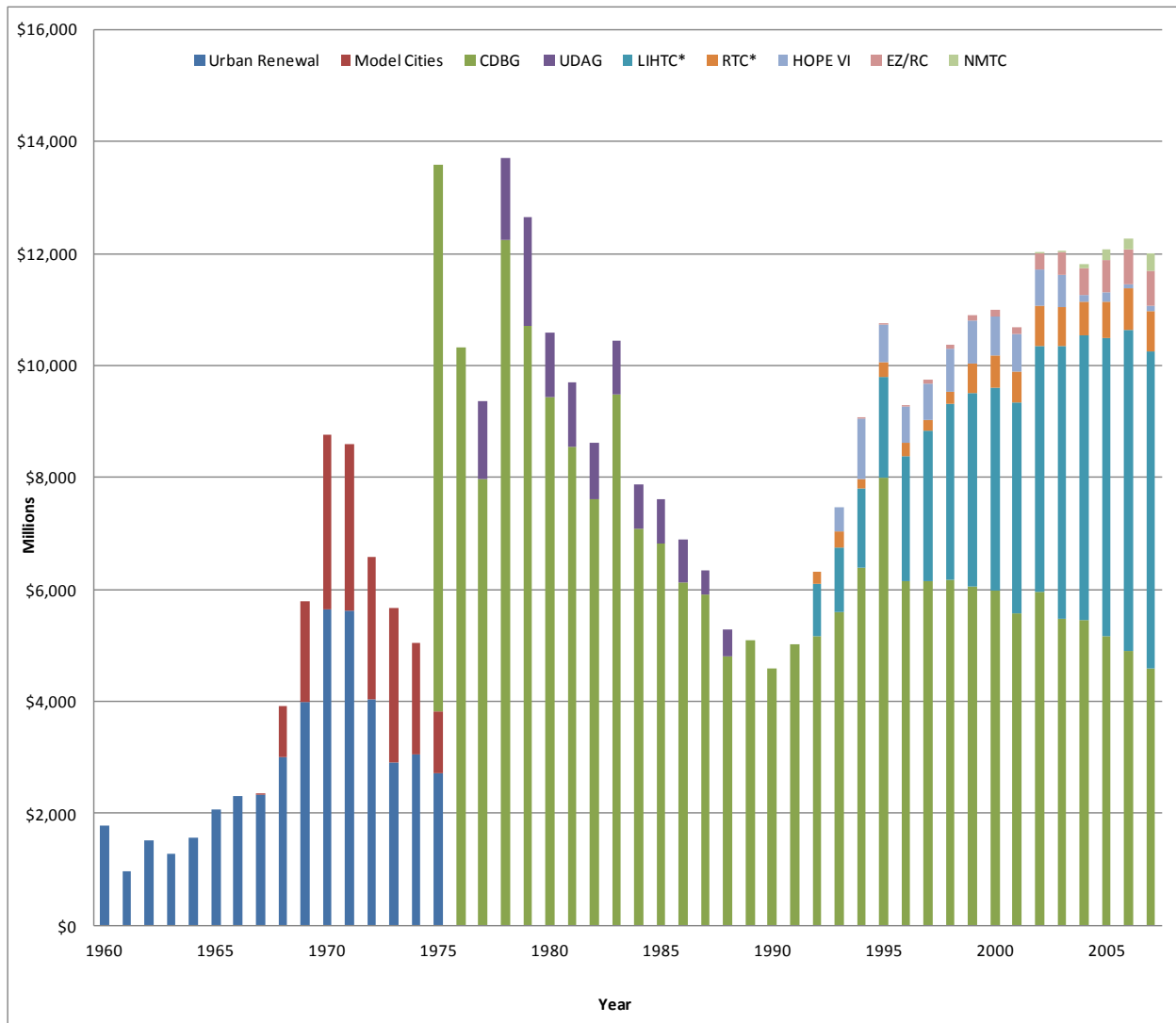
1983); various National Park Service grant programs (1968–); the Community Development Block Grant (CDBG) program together with the Section 108 Loan Guarantee program, the Economic Development Initiative (EDI) and the Brownfields Economic Development Initiative (BEDI) (1974–); the EDA Revolving Loan Fund (1974–); the Urban Development Action Grant (UDAG) program (1977–1986); Rehabilitation Tax Credits (RTC) (1977–); the Community Reinvestment Act (CRA) (1977–); the Low Income Housing Tax Credit (LIHTC) program (1986–); the HOME Investments Partnership program (1990–); the HOPE VI program (1993–); the Renewal Community/Empowerment Zone/Enterprise Community (RC/EZ/EC) initiative—along with Neighborhood Revitalization Zones, HUB zones, and the Gulf Opportunity Zone (1993–); USDA Rural Development loan and grant programs relating to business development, housing, community facilities, electricity, telecommunications, and water (some of which date back to the 1930s and 1940s and were reorganized in 1994-); and the Community Development Financial Institutions (CDFI) Fund’s New Markets Tax Credit (NMTC) program (2000–).²

To provide a basic sense of the scale and trends in federal community and economic development funding, figure 1 displays the pattern of appropriations (expenditures) and foregone taxes associated with nine prominent federal community and economic development programs, by year, beginning in 1960. The data are adjusted to reflect constant 2007 dollars. During the earlier portion of the period, the Urban Renewal program and, later, the Model Cities program accounted for between \$2 and \$9 billion annually, peaking in the early 1970s. With the advent of the CDBG program in the mid-1970s and the addition of the UDAG program, total appropriations (and foregone taxes) reached their high-water mark, varying from more than \$9 billion to about \$14 billion annually through the early 1980s. Economic development funding declined through the rest of the 1980s before climbing again in the early 1990s. For most of the 2000s, the programs that continued have accounted for about \$12 billion annually.³

² In addition to federal programs, many states and localities have their own community and economic development programs, ordinances, and tools—some of which may work in conjunction with federal programs. These include state tax credits for business, tax increment financing (TIF), industrial revenue bonds (IRBs), industrial development bonds (IDBs), state enterprise zones (EZs), tax abatements, inclusionary zoning ordinances, and community benefits agreements (CBAs).

³ Annual expenditure variations for some programs (such as CDBG) depend on Congressional appropriations whereas the amount of foregone taxes associated with the RTC program depends on taxpayer claims, which are not capped on a yearly basis. Note that program spending does not necessarily occur in the same years in which funds are appropriated or credits are allocated; hence, investments made from such appropriations or allocations may lag.

Figure 1
Expenditures and Foregone Taxes for Nine Community and Economic Development Programs, in 2007 Dollars



* RTC and LIHTC data are not available prior to 1992.

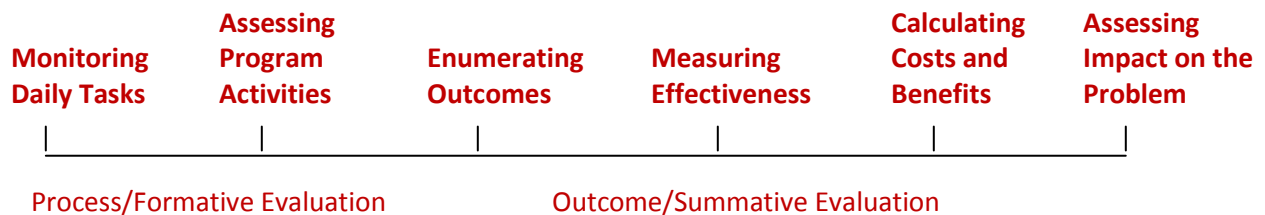
Learning what Community and Economic Development Programs Achieve

To objectively assess whether programs accomplish their goals generally requires conducting formal program evaluations. These can range from relatively simple and straightforward efforts to studies that are extremely involved and demanding. Several prominent governmental and academic observers have recently argued that evaluations of community and economic development programs, in particular, tend to fall at the challenging end of the range. This is often because of the variety and complexity of the interventions (projects) undertaken, the dynamic contexts in which they occur, and the special difficulties of measuring results and attributing them to the interventions.

Communities are multifaceted systems consisting of interrelated structures and activities that, along with external factors, influence the very conditions any community and economic development program seeks to alter. Also, it is often the case that community and economic development program

investments are small relative to the neighborhoods or communities in which they are made. This means that such investments are unlikely to have large impacts, and that any impact may not be easily detected with respect to the problems they aim to ameliorate—such as high levels of poverty or lack of community economic vitality (GAO 2009; Hollister 2007). Identifying outcomes, determining whether benefits flow to those with greater needs, and sorting out both short-term and long-term causes and effects are challenging undertakings.

There are various types of program evaluations. Bartik and Bingham (1997) provide a useful framework in the form of a continuum roughly corresponding to a program’s life cycle. It has six different “levels,” each of which builds on the previous, as follows:



The initial levels involve formative or process evaluation, focusing on how a program is delivered. Level one consists of monitoring the internal workings of a program to assess, for example, what tasks are taking place, whether they are being carried out efficiently, or whether contractual obligations are being met. Level two involves assessing program activities to determine such things as how simple or complicated procedures are or how well the program is being implemented. The third level entails determining whether a program’s objectives are being achieved; it is the initial stage of an outcome or summative evaluation. Further along the continuum is effectiveness measurement, which considers whether a program is working and whether its goals have been accomplished. The final two levels include cost-benefit analyses and impact assessments, the latter seeking proof that a program is in fact having a measurable impact on the problem(s) to which it was designed to respond.

Each successive level of program evaluation presents increasingly difficult challenges. The ultimate challenge, at the impact-assessment level, is to establish what would have happened in the absence of a program (i.e., the counterfactual) to ensure that the intervention and not other factors brought about particular outcomes.

Outcomes are events and conditions that follow from an intervention, whereas impacts are events and conditions that are directly caused by it. Experimental methods—where treatment and control groups are randomly selected and outcomes are tracked and compared between the two—are preferred for impact assessment. Whether conducted at the project, neighborhood, or community level, however, there are both substantial issues (as mentioned above) as well as non-trivial costs associated with implementing such designs in evaluating community and economic development program interventions (GAO 2002, 2009). Because rigorous efforts to prove cause and effect might be feasible in very few circumstances, researchers often use quasi-experimental methods—including econometric simulation, propensity-score matching, geographically based adjusted time series analyses, or financial or social accounting standards—to assess program outcomes (Immergluck 2008; Hollister 2007). Even then, quasi-experimental designs are not always feasible or practical for evaluating programs that operate in complex and dynamic contexts (Margolis et al. 2009).

As applied to many federal programs, community and economic development evaluations have been inconsistent with respect to methods, evidence, and rigor, and also uneven with respect to coverage. Diverse topics have been addressed: the extent and nature of targeting; program design and operations; management and financial performance; capital flows; stimulation of enhanced local or institutional capacity; the nature or extent of public participation; the extent of leveraging of program

dollars for other dollars; the pricing efficiency of credits (for tax credit programs); direct, indirect (also called contingent), or community-scale outcomes; the extent of substitution of federal investment for private or other public investment; and the sustainability (growth or decay) of program outcomes. These topics extend across the full evaluation continuum, yet it is not until the middle of the continuum that emphasis turns to results—i.e., what outcomes follow a community or economic development program intervention.

Criteria for a Smart Subsidy, Following from Outcome-focused Program Evaluations

A review of the community and economic development program evaluation literature that emphasizes results highlights two criteria that together can be said to distinguish a smart subsidy: (a) whether *beneficial* outcomes follow from project investments; and (b) whether *public subsidies are needed* to make those project investments happen.⁴ Each criterion is necessary but not sufficient for a subsidy to be smart; together, the two are sufficient. The policy rationale for this definition is that scarce public resources are wasted either when beneficial outcomes do not result from program investments or when projects would have happened even in the absence of public subsidies. Below is a brief review of the literature dealing with evaluation of community and economic development project outcomes and need for subsidies—in the latter instance, from federal programs.

Project Outcomes

The literature provides no uniform definition of, or approach to measuring, community and economic development program outcomes. However, evaluations have distinguished between direct and indirect outcomes, short-term and long-term outcomes, and outcomes associated with the supported projects as distinct from outcomes associated with neighborhoods or communities. Because of the challenges and high costs of measuring indirect outcomes, long-term outcomes, and outcomes involving neighborhoods or communities, evaluations have most often concentrated on direct, short-term project outcomes.

The outcomes expected from community and economic development programs have varied according to each program's objectives. A complication is that some programs are single-purpose while others are multi-purpose. A single-purpose program, such as one that solely provides venture capital for small businesses, would be expected to produce business development outcomes, while those like the CDFI Fund's NMTC program and the Section 108 program of the U.S. Department of Housing and Urban Development (HUD) would be expected to produce a range of outcomes. The latter may include employment, physical development, housing opportunities, public or community facilities, business development, industrial or commercial or mixed-use enterprises, or enhanced institutional capacity. Clearly, no single metric applies across all community and economic development programs or even across all projects undertaken in conjunction with multi-purpose programs. Likewise, outcome measurement will draw on different data sources (including secondary as well as primary) and involve different data analytic methods (including quantitative as well as qualitative).

Discussed below are a variety of outcomes and measures that have been associated with various community or economic development program evaluations.

⁴ While, according to this definition, beneficial outcomes are an attribute of a smart subsidy, the program evaluation literature has not established empirically the relative value of one type of outcome over another with respect to ameliorating community and economic development problems. Which outcomes are more desirable than others tends to be a policy consideration more so than a program evaluation matter.

1. Employment

A common measure of the success of community and economic development programs is the extent to which they create new jobs or retain existing jobs. Related to this is the efficiency of job creation/retention under one program versus another, the quality of the jobs created or retained, and who benefits from such jobs.

Job creation and retention. A fundamental question asked about many community and economic development programs is how many jobs they produce. Studies of the UDAG program, CDFIs, EC/EZs, and many others, offer examples of how jobs outcomes have been measured.

The UDAG program was intended to stimulate private investment, jobs, and tax revenues in distressed cities and urban counties. Since employment impacts were critical to its success, HUD attempted to evaluate its jobs outcomes after four years of UDAG implementation (HUD 1982). The focus was the number of jobs created or retained, the costs per job, and the extent to which jobs could be attributed to the program. Jobs were measured in terms of full-time equivalent positions (some jobs were full-time and some were part-time). Construction employment was separated from other jobs because these were primarily short-term. New permanent jobs were distinguished from retained jobs, and jobs for low- and moderate-income persons were distinguished from those for others. With respect to new permanent employment, the evaluators concluded that 77 percent of the jobs anticipated in initial grant agreements were actually being produced.

Several studies of CDFIs have also assessed employment outcomes. Rubin (2006) describes two studies conducted by LaPlante in 1996 and 2004 that examined the impact of the Maine-based CDFI, Coastal Enterprises Incorporated. In the first study, LaPlante estimated initial employment levels and job growth. LaPlante also surveyed firms about job quality and asked them to assess the impact of Coastal Enterprises funding on job creation. However, Hollister (2007) notes that many analysts are extremely skeptical about the value of responses to such survey questions. LaPlante's 2004 evaluation used state unemployment insurance records to measure wage growth.

An assessment of the first round of EZ/ECs used establishment-level data to measure changes in economic activity in EZ areas before and after initiation of the zone programs. It compared employment growth in an EZ area to a designated comparison area within the same city during the same period of time to determine development impacts (Hebert et al. 2001). The study found that job growth occurred in five of the six EZs and that, in four of the six, it outpaced job growth in contiguous areas. In a later study of EZ/ECs, the GAO also compared designated EZ and EC program areas with comparison areas over time (GAO 2006), calculating changes in unemployment rates from 1990 to 2000 and the total number of jobs from 1995 to 2004. GAO observed that improvements in poverty, employment, and economic growth had occurred in the ECs and EZs but that econometric analysis could not definitively tie changes to EC/EZ designation.

The CDFI Fund collects data related to the NMTC program, including job creation. The measure used is the number of jobs created, as reported on transaction-level reports that Community Development Entities (CDEs) submit to the Fund. CDEs can report on three types of jobs: those associated with the construction of a NMTC-financed real estate project; permanent jobs associated with a business receiving NMTC-financed investment; and permanent jobs associated with businesses that are tenants of a NMTC-financed real estate project (Bershadker et al. 2008). These data cover some but not all possible measures of job growth and do not address job benefits.

Job quality. Some researchers have noted that smart subsidies should create not just jobs but *quality* jobs (Felsenstein and Persky 1999). Indicators of job quality include wage levels, opportunities for advancement, job skills or training provided, and benefits. Benefits can be measured by the percentage of employees offered health insurance, a pension plan, a savings plan, sick leave, tuition assistance, or vacation time.

With respect to job quality, Seidman (2007) proposes that recipients of NMTC funds should also consider how to improve traditionally low-wage jobs that often accompany the introduction of community services to neighborhoods, such as grocery stores and credit unions. In a commentary on federal economic development programs, Markusen and Glasmeier (2008) point out that the current stress on short-term job creation in many programs comes at the expense of investment in human capital such as opportunities for continuing education and the skill-building that is needed for long-term productivity and growth. Reese and Fasenfast (1997) also call for evaluations that incorporate broader social values using measures that go beyond employment and economic growth to include such concepts as economic empowerment and sustainable improvement in income levels.

Jobs beneficiaries. Programs vary with respect to their focus on outcomes in a particular location and outcomes benefitting the *residents* of such a location. Immergluck (2008) notes that distinguishing among such strategic approaches is critical to developing outcome measures. For example, a place-based strategy aimed at improving the physical and economic vitality of a neighborhood may not differentiate between improved jobs and income for current residents and economic improvement via in-migration or out-migration. In addition, it is difficult to target employment at the neighborhood level due to the larger geographic scale of labor markets.

Depending on program goals, a number of evaluations have considered the proportion of jobs created that are filled by local residents rather than outsiders, and by targeted groups such as low-income or minority residents. Other factors to consider when evaluating employment benefits include commuting patterns, opportunity for career advancement, and multiplier effects.

The availability of employee-level data permits more detailed analyses. For example, in a case study of the impacts of chain supermarket development in the Philadelphia area, researchers measured the extent to which urban supermarket employees lived in socioeconomically distressed communities and their proximity to their place of work (Goldstein et al. 2008). Using data provided by a supermarket chain, they were able to identify the census tract of residence for employees and found that those at three store locations lived in tracts with very low household incomes, high poverty rates, or high unemployment rates. They concluded that urban supermarkets bring new job opportunities to residents in distressed communities but cautioned that, from a regional perspective, a new store does not necessarily create a net increase in the number of jobs.

2. Real Estate Construction and Rehabilitation

Real estate construction and rehabilitation (both commercial and residential) are major components of many community and economic development programs. The extent to which programs produce construction and rehabilitation outcomes has been assessed in various ways, often beginning with a basic accounting of outputs—i.e., the number of square feet developed or rehabilitated by a project. As with measurement of employment outputs and outcomes, some evaluators probe beyond these measures (depending on program goals) to consider types or uses of the real estate projects, their locations, and who benefits (or suffers) from them. With respect to adverse effects, real estate construction and rehabilitation projects have the potential for displacing existing residents and businesses. Finally, a longer-term measure included in some evaluations is the effect of real estate projects on adjoining property values.

Amount of construction and rehabilitation. A simple measure of change with respect to nonresidential real estate involves commercial property square footage. Voluntary reporting to the CDFI Fund on NMTC project outcomes includes the square footage of real estate developed or rehabilitated (Bershadker et al. 2008). More detailed measures that describe the type or purpose of the building constructed have been used in some studies, including the percentage of nonresidential versus residential construction and the percentage of new construction versus rehabilitation of existing stock.

For example, given that the RTC has been available for both housing and nonresidential projects, Listokin, Listokin, and Lahr (1998) tracked the types of projects using RTC and found that about half of them were exclusively housing and another 20 to 30 percent were in the mixed-use/other category. The remainder consisted of commercial/office renovations.

Uses of construction and rehabilitation. In addition to enumerating the number of units of housing or square feet of space constructed or rehabilitated, evaluations of community and economic development programs consider the benefits they bring to a distressed community. HUD's UDAG evaluation (HUD 1982) considered who benefits from two perspectives—whether the housing was located in deteriorated or transitional neighborhoods and whether the housing was targeted (or priced) for low- or moderate-income households. Rubin (2006) reports that some CDFIs report on the number of units designated as affordable to low-income households. Relatively few CDFIs track the income or other characteristics of ultimate tenants. A useful measure of a program's ability to address community need is the percentage of low- and moderate-income units developed as a fraction of the total units developed (Listokin et al. 1998).

The effects of construction and rehabilitation on property values. Property values are often used as a proxy for the neighborhood effects of community and economic development investments. As quality of life improves in neighborhoods (e.g., lower crime rates and better access to amenities), these improvements are capitalized in the prices of residential properties such that property values are expected to rise (Immergluck 2008; Galster, Tatian, and Accordino 2006). It should be noted that while property values are one of the most commonly used measures, they do have limitations. Immergluck (2008) cautions that property values may not incorporate the value of other neighborhood qualities such as social capital. Especially during speculative bubbles, property values may overestimate the value of the neighborhood.

A number of studies illustrate that housing investment can have a significant positive impact on neighboring property values. However most such studies are not limited to property values but consider them only one indicator of the neighborhood effects of community and economic development (Ding and Knapp 2003; Schill et al. 2002; Ellen and Voicu 2006).

Galster, Tatian, and Accordino (2006) point out that indicators of neighborhood inputs and outcomes should ideally be measured frequently, over an extended time, both before and after the intervention, and on a small geographic scale. In their analysis of the impact of a localized economic development initiative, the Neighborhoods in Bloom program (1998–2004), they compared differences in: (a) home prices between the target and comparison neighborhoods before and after the intervention and (b) the levels and trends in home prices between the target and comparison neighborhoods while controlling for coincident citywide trends.

3. Business Development

Many community and economic development programs strive to increase business development. This may involve business start-ups or expansion of existing establishments. In addition to jobs created and retained, measures of business activity include the number of establishments, the ratio of businesses to population, average receipts of businesses, and percent of businesses with paid employees. These numbers can be tracked over time for a particular program and for populations of interest and compared to a period prior to program implementation, to other similar communities, or to national or regional benchmarks. One limitation that has been noted is the lack of data on business establishments by census tract; U.S. Census data show business establishments only at the state, county, metropolitan area, and city levels (Gittell and Thompson 1999).

4. Services and Amenities

Services and amenities play a central role in many community and economic development programs. Some initiatives promote investment in amenities in order to stimulate growth and to attract new businesses and increased investment. Others, particularly the comprehensive community initiatives that emerged during the late 1980s and early 1990s, take a broader approach. Funded by national or community foundations, they sought to promote positive change in disadvantaged neighborhoods through holistic approaches that addressed physical, social, and economic conditions (Fulbright-Anderson 2006). The provision of services and amenities involved a variety of establishments, both nonprofit and for-profit. Potential outcomes included: access to quality public facilities (schools, health care, training centers, child care centers, etc.), access to grocery, banking, and other commercial/retail services, access to education (financial literacy, consumer education, entrepreneurial education), and access to financial products (bank accounts, payday loan alternatives, consumer loans, car loans, mortgages, equity financing). Currently, the CDFI Fund asks NMTC allocatees to report on the capacity of community facilities (arts centers, child care facilities, educational facilities—usually charter schools, health care facilities, and other facilities). Capacity is reported as number of slots, student-seats, or patient capacity (Bershadker et al. 2008).

Researchers have also developed composite indicators of service availability. For example, Florida, Mellander, and Stolarick (2007) use the diversity of consumer service firms as a proxy for regional amenities. Other recent efforts have measured amenities such as arts and culture and access to parks and outdoor recreation. Jackson et al. (2006) define cultural vitality as evidence of creating, disseminating, validating, and supporting arts and culture as a dimension of everyday life. Their measurement framework considers: the presence of opportunities for cultural participation, cultural participation in its multiple dimensions, and support systems for cultural participation. Other studies have assessed the community impacts of supermarket development (Goldstein et al. 2008), access to bank accounts and other banking services, as well as financial education (Kolodinsky et al. (2002).

5. Infrastructure Development

Public investments in infrastructure—such as roads, streets, bridges, water treatment and distribution systems, waterways, airports, and mass transit—can enhance community and economic development by offering a locational advantage to businesses, either by increasing productivity or reducing factor costs (Eberts 1990). Deborah Carroll (2008), in her general discussion of Tax Increment Financing (TIF), makes the same point—i.e., that TIF policy is based on the premise that public infrastructure promotes private investment by reducing the cost of business relocation and expansion. This is not a universally held belief among researchers, however, as it has been theorized that infrastructure is not a cause, but a result of economic growth (Norcross 2007). Nevertheless, if infrastructure investment is a program objective, it is necessary to consider appropriate outcome measures.

Infrastructure can be measured using a monetary approach (measuring physical capital in monetary terms by adding up past investment) or an inventory approach (assessing the quantity and quality of all pertinent structures and facilities). No single consistent measurement standard is used by researchers. Based on a review of the research on the relationship between public infrastructure investment and economic development, Eberts (1990) reports that studies show that public infrastructure investment significantly affects economic activity, but the magnitude of the effect is much smaller for public investment than for private investment (in most cases public and private capital are complements, not substitutes).

6. Beautification

Visual improvements to a neighborhood (e.g., improving street fronts and removing graffiti, litter, trash) can be seen as a physical marker of three historic ideals of spatially targeted community and economic development efforts (Thomson 2008): preservation; redevelopment; and revitalization. Preservation

seeks to curb the decline of an area by retaining and strengthening physical structures (along with existing residents and businesses). Redevelopment is the effort to transform a distressed area into a newer, more economically vibrant region and often requires demolition and construction of new physical structures (along with the displacement of residents). Finally, revitalization endeavors to reverse an area's decline and employs both preservationist and redevelopment approaches.

Examples of economic development programs that implement these strategies—transforming the physical appearance of a community to assist in transforming its economic vitality—include the RTC, LIHTC, Urban Renewal, and HOPE VI programs. Studies by Thomson (2008), Listokin et al. (1998), and Whalley (1988) suggest that the process of beautification may have a positive multiplier effect on the community by stimulating repairs and renovations of surrounding properties. Measures of the effects of beautification strategies include participation rates, additional private investment, and lower displacement rates. The literature also supports the notion that physical appearance affects homeowners' perceptions of neighborhood conditions. Residents' perceptions with regard to their neighborhood have been used in numerous studies as a qualitative component of the overall evaluation of the impact of neighborhood development programs (see, for example, HUD 2003 and GAO 2006).

7. Tax Revenue Generation

Tax revenues generated by community and economic development programs can include sales taxes, payroll taxes, and income taxes paid by individuals employed as a result of a project, as well as corporate and property taxes paid by businesses supported by the project. Tax revenues have been used in cost-benefit analyses and estimates of taxpayers' return on investment. However, in a critique of such an approach used by Thomas Miller in an evaluation of the Kentucky Highland Investment Corporation (KHIC), Hollister (2007) expresses the opinion that increased tax revenues should not count as benefits at all, since they were not one of the goals of the initiative: "If this were the government's goal, it might find that investing in a golf course in a large urban area offers far better returns." The government, he asserts, invests in a CDFI such as KHIC because it believes it to be an effective tool for creating new employment opportunities in a low-income region, and that the new jobs will benefit low- and moderate-income households in the area. Under this scenario, the relevant measure is the dollar benefit to lower-income households in the region as a result of KHIC's intervention. On the other hand, HUD's evaluation of UDAG (1982) did not discredit tax revenue as a measure of economic development performance; they argued that increasing the local tax base helps alleviate a community's distress, which was one of the objectives of the program.

Need for Federal Program Subsidies

Legislators, budget and management analysts, and evaluators often want to know whether federal program funds are the primary impetus for achieving program objectives or merely substitute for other funding available for the same purpose. This interest is premised on the notion that the effectiveness of federal programs is lessened either when resources are used for projects that could or would have proceeded as a result of other investments or when programs provide more subsidy than is necessary to accomplish their objectives. According to Redburn et al. (1984), "When public funds are merely substituted for private funds in this fashion, no real public benefits have been created and public resources have been wasted."

Substitution occurs in federal community or economic development programs when federal funds are used to pay for some portion of a project that either the private sector or state or local governments would have paid for in the absence of the federal program. If the project would not have occurred "but for" the federal program, there is no substitution. Recognizing that community and economic development projects are often location- and scope-sensitive, this test needs to take into account not

only whether a similar project would have occurred at about the same time, but also in about the same place, and at about the same scale were it not for the program investment.

A more nuanced approach involves not only whether, but also to what degree, there is substitution. Some basic distinctions involve full versus partial substitution and whether there is duplication or excessive use of subsidies. For federal government programs, full substitution occurs when a federal program investment substitutes completely for private or nonfederal public investment possibilities that could or would have been used in the absence of the federal subsidy. Partial substitution takes place when a federal program investment substitutes for only a portion of other investment possibilities. Finally, duplication or excessive subsidy occurs when more federal program investment is provided (either from a single program or in combination with other federal programs) than is needed to accomplish an objective.

Federal community and economic development programs vary with respect to their legislative or regulatory provisions pertaining to substitution, and methods for implementing such requirements are determined by each administering agency. Formal non-substitution requirements are central to some programs but not to others. For example, HUD's CDBG program generally does not require that state or local government grantees consider whether uses of CDBG funds substitute for other public or private dollars. However, there are two cases in which a formal substitution determination is required. For public services programs, CDBG funds cannot supplant state or local government funds that have been previously used to pay for the same activity within the last 12 months.⁵ In addition, the public benefit standards for economic development programs require that CDBG funds cannot be used to reduce the amount of nonfederal funds for an activity.⁶

The authorizing legislation for HUD's UDAG program contains a requirement that UDAG funds not substitute for or replace other nonfederal funds, and that a formal determination be made that a project would not occur but for a UDAG award.⁷ In essence, the program was intended to be used only when it could be demonstrated that it was a necessary catalyst or inducement for economic development.

SBA's business loan programs are required by law to serve only borrowers who otherwise could not secure loans from another source.⁸ This means that no financial assistance is to be extended if an applicant can obtain credit from nonfederal sources on reasonable terms and conditions (SBA 2000).

LIHTC administrative guidelines issued by HUD require that the U.S. Department of the Treasury's credit allocating agencies—generally state housing finance agencies—adhere to a set of rules when allocating tax credits to LIHTC projects that will also receive additional subsidies from HUD. Known as the "subsidy layering rule," a minimum contribution to the development is mandated from each credit recipient to ensure that no more tax credits are awarded to any project than are necessary to fully finance it (McClure 2000).

The NMTC program has no legislative or regulatory requirements related to substitution of a federal subsidy for other available investment resources. Program rules provide considerable flexibility as to what kinds of investments are made and their scope, purposes, and desired impacts. Although the CDFI Fund formally certifies CDEs and competitively awards NMTC allocations to a portion of them, it does not review individual projects or become involved in underwriting decisions. Those responsibilities reside with individual CDEs and their investors, who consider which investments are made, the need for NMTCs in these projects, and prospective project impacts. This flexibility means that, except for compliance with core CDFI Fund and Internal Revenue Service regulations, there is no single standard

⁵ Rule 570.201.

⁶ Rule 570.209 and Appendix A.

⁷ Wyder Amendment, P.L. 96-153, Section 104, Housing and Community Development Act of 1974.

⁸ 15 U.S.C. §636(a).

that determines whether a project is the best choice for the use of tax credits or whether the credits were essential to the project's initiation.

While substitution is a valid concern for government subsidies, agencies must balance the risk of excessive subsidy against the risk of hampering investment with overly rigid rules. Assessing whether (or the extent to which) a federal community or economic development program substitutes for other sources of funds is the equivalent of performing an impact evaluation—i.e., one that focuses on whether a particular program caused certain outcomes (Armistead 2005; Rubin 2006). In this instance, however, the focus is not outcomes such as job creation, business development, etc., but whether a project that might produce those types of outcomes would have occurred in the absence of a community or economic development program. Further, inasmuch as any rigorous effort to evaluate impacts ideally requires some type of experimental or quasi-experimental design that incorporates pre- and post-measurement and comparison of “treatment” and “control” groups, a thorough substitution evaluation would require a comparable effort. Thus, it is widely recognized among community and economic development practitioners and researchers that evaluation of substitution is extremely difficult.

Given that experimental or random assignment studies of substitution are generally impractical for community and economic development programs, an alternative approach involves “naturally occurring” experiments. This consists of comparing pairs of projects similar in all respects (such as their type, attributes, location, timing, and scale) except for receipt or non-receipt of program subsidies. The presumption is that if comparable projects not receiving a subsidy are initiated and completed, the subsidies that were provided were unnecessary.

However, several issues arise with respect to studying substitution using matched pairs of comparable projects. First, for many types of community and economic development projects, it is not always possible to identify appropriate comparables. In addition, it may be impossible or impractical to obtain the necessary information about comparable projects that are not recipients of a program subsidy, since such information is often proprietary. In addition, knowing whether a project would have proceeded without a subsidy is not simply a post-hoc program evaluation challenge; it may also be a practical challenge to those involved in attempting to initiate a project. For example, when financing packages are being assembled for some community and economic ventures, even the principals may not know with any certainty what is likely to happen if a particular subsidy were not available. In some instances, the timing and circumstances associated with such projects make it infeasible to explore alternate sources of financing, especially in complex transactions involving multiple investments, each contingent upon the others. Post-hoc determination of substitution, therefore, can be especially problematic.

Among the community and economic development programs discussed above, UDAG had the most explicit statutory mandate not to substitute for private or other public funds. When HUD conducted a 1982 evaluation of the program, therefore, considerable effort was expended to find a sensible way to assess the extent of substitution—in light of the methodological challenges identified above (HUD 1982). The approach consisted of a combination of extensive fieldwork on, and independent expert analysis of, a sample of projects selected to be representative of the program as a whole.

The fieldwork for the UDAG evaluation involved conducting detailed, on-site discussions with those directly involved in putting together each of the sampled projects (including private developers, lenders, and city officials), reviewing site histories and market conditions, examining other economic development activities in the surrounding area, and considering the intentions and long-term economic interests of the primary project actors. A triangulation process in which the answers of various parties were compared provided an opportunity to discover discrepancies and probe for differences of opinion. The expert analysis portion consisted of convening an independent panel of finance, accounting, legal, and development practitioners who were not associated with any of the projects or communities involved, and seeking their considered judgment as to whether substitution occurred based on the

information collected. Examples of issues considered were: the length of time sites had been available; the market value of the land; surrounding land uses; the value of possible alternative sites for a project; previous investor interest; the availability of alternate financing or alternate sites; and the prospective profitability of an investment compared to similar investments.

The evaluators concluded that UDAG funds were definitely needed to stimulate the private investment and benefits that resulted in 64 percent of the projects. In contrast, UDAG was needed for stimulating only a portion of the private investment in 13 percent of the projects and totally unnecessary for stimulating any of the private investment in eight percent.⁹ Based on these findings, the evaluators estimated that the amount of unnecessary UDAG funds awarded to projects, program-wide, was one dollar for every six expended, and used these findings to adjust or “discount” the value of the outcomes attributed to the program—such as the amount of private investment leveraged, number of new permanent and temporary jobs created and retained, amount of tax revenues generated, and number of rehabilitated housing units produced.

Joining Two Criteria to Define a Smart Subsidy

Worthy objectives of community and economic development program evaluations include a demonstration, or at least consideration with as much evidence as possible, of how frequently (a) program subsidies are needed for projects to come to fruition and (b) projects have beneficial outcomes. This approach is depicted in the following two-by-two table, which shows the need for program subsidies and beneficial project outcomes as conceptually distinct variables that can interact to form four possible situations (cells).

		Is a community or economic development program subsidy needed for a project to come to fruition?	
		Yes	No
Are a project's outcomes positive?	Yes	1	2
	No	3	4

Cell 1 constitutes the optimal situation and best exemplifies a smart subsidy. The worst situation is when a program's projects neither require program subsidies to come to fruition nor have beneficial outcomes (cell 4). Between a smart subsidy and the worst case are programs whose projects result in beneficial outcomes but do not require a subsidy for that to happen (cell 2), and those that need a subsidy but otherwise do not produce beneficial outcomes (cell 3).

While the table is a useful illustration, the reality is certainly not as clear-cut. This is because, as discussed above, outcome and need assessments can take various forms. For example, a community or economic development project may not require a subsidy in order to happen, but the subsidy may

⁹ The evidence was inconclusive for the remaining 15 percent.

permit desired enhancements or enable the project to be completed sooner rather than later. Likewise, a project that does not produce beneficial outcomes in the short term may simply require more time.

Conclusion

Many federal community and economic development programs provide resources for low-income people and communities, and there is the reasonable expectation that a public subsidy involved in such programs is needed to accomplish beneficial objectives. Yet the uneven patchwork of evaluation evidence across programs makes it difficult to know whether this is the case—i.e., how well each program works or which of them work better than others. Evaluation issues have not been consistent among programs or over time with respect to comprehensiveness, metrics, approaches, or methodologies. This is due in part to methodological challenges, but another strong factor may be a basic disinterest in, or distrust of, evaluation on the part of some policy makers, program administrators, or the community. Regardless, the result is that economic theorists and program practitioners more often speak with the air of authority on this issue than do empirical evaluators.

A hopeful sign with respect to program evaluation is the federal Office of Management and Budget's (OMB's) current effort to encourage all executive agencies to undertake rigorous, independent evaluations to determine whether programs are efficiently achieving their intended outcomes. This involves initiation of several government-wide efforts to help develop better systems for conducting evaluations that can "determine the causal effects of programs" (Orszag, 2010). However, whether program evaluation will improve has to take into account at least two observations from past experience. The first is that some community and economic development programs are innately difficult to evaluate using methods like random assignment experiments. Such programs may have multiple types of outcomes that are not easy to specify or measure. Indeed, the U. S. Government Accountability Office (GAO, 2002) went so far as to observe, with respect to the NMTC program:

Because each method for assessing effectiveness has significant disadvantages, definitive conclusions about the effectiveness of the NMTC program may not be possible. The methods may not establish that the NMTC causes new investment or economic development (p. 27).

The second observation is that some program stakeholders and advocates fear evaluations, believing that only bad can come from them; in some instances evaluations are performed only in reaction to negative program reviews by OMB. When evaluations are undertaken reluctantly, they can be underfunded and focus excessively on short-term outputs—intended mainly to support (or oppose) program reauthorization or re-appropriation.

Given current fiscal circumstances, evaluation funding may be at risk even though the need for it may be greater than ever. As such, there is reason to engage anew a constructive conversation among policy makers, program administrators, and other interested parties to consider the desirability and possibility of:

- Prioritizing the issues that are worth addressing through program evaluation and the kinds of methods, evidence, and standards that are practical and realistic to apply;
- Developing comprehensive evaluation agendas across agencies and programs that allow for some standardization and comparison;
- Building incentives into programs at the demonstration stage or beyond, such that evaluation is also valued for improvement purposes;

- Ensuring that formal program evaluation is properly and adequately integrated into major new federal government programs such as: HUD’s Choice Neighborhoods Initiative;¹⁰ HUD’s, the Department of Transportation’s and the Environmental Protection Agency’s Sustainable Communities Planning Grants;¹¹ the Corporation for National and Community Service’s (CNCS’s) Social Innovation Fund;¹² and the Department of Education’s Promise Neighborhoods initiative;¹³ and,
- Funding evaluation at a level that is appropriate to the challenges and issues involved.

A robust program evaluation agenda should encourage smarter subsidies, helping to ensure that current and future community and economic development programs are focused on worthwhile objectives and are instrumental in bringing them about.

The authors appreciate the assistance and advice provided by the following people in the preparation of this chapter and the literature review on which it was based: David J. Erickson of the Federal Reserve Bank of San Francisco; Greg Bischak and Jim Greer of the CDFI Fund, U.S. Department of the Treasury; John P. Caskey and Robinsin G. Hollister, Jr. of Swarthmore College; Michael J. Rich of Emory University; Julia Sass Rubin of Rutgers University; Kenneth Temkin of Temkin Associates; Sean Zielenbach of SZ Consulting; and Betsy Chang, Kassie Dumlao, Adam Greenberg, Randy Rosso, and Ashley Williams of the Urban Institute.

Martin Abravanel is a Senior Research Associate in the Metropolitan Housing and Communities policy center at the Urban Institute. He studies affordable housing and community and economic development programs, specializing in program evaluations and performance measurement. Dr. Abravanel is currently co-directing an evaluation of the New Markets Tax Credit program for the Community Development Financial Institutions Fund as well as an assessment of the Section 108 Loan Guarantee program for the U.S. Department of Housing and Urban Development (HUD). From 1979 to 1997, he directed the Division of Policy Studies in the Office of the Assistant Secretary for Policy Development and Research at HUD. Dr. Abravanel earned a Ph.D. in Political Science from the University of Wisconsin-Madison.

Nancy Pindus, MBA, CPA, is a Senior Fellow in the Metropolitan Housing and Communities policy center at the Urban Institute. She is an experienced policy researcher and project manager, specializing in program evaluation, organizational behavior, cost analysis, and service delivery. Ms. Pindus co-directs a four-year evaluation of the New Markets Tax Credit (NMTC) Program that includes administrative data analysis, surveys, and in-depth telephone interviews. Her current work also addresses the use of alternative financial services and financial literacy. Ms. Pindus received her MBA from the Wharton School, University of Pennsylvania and is a CPA, licensed in Maryland.

¹⁰ This initiative intends to make transformative investments in high-poverty neighborhoods where public and publicly assisted housing for low-income households is concentrated.

¹¹ This initiative intends to catalyze the next generation of integrated metropolitan, transportation, housing, land use and energy planning using the most sophisticated data, analytics and geographic information systems.

¹² This initiative intends to target millions of dollars of public-private funds to support grantees (intermediaries) that will work with community-based nonprofit organizations to address urgent needs in three key issue areas—economic opportunity, healthy futures, and youth development and school support.

¹³ This initiative intends to significantly improve the educational and developmental outcomes of children in the nation’s most distressed communities.

Brett Theodos is a Research Associate with the Metropolitan Housing and Communities Policy Center at the Urban Institute. His expertise is in economic and community development, access to capital for low-income individuals and businesses, geographic mobility, and affordable housing. Examples of his recent research include a study of seven models of “shared equity” homeownership, an evaluation of business and community outcomes under the New Markets Tax Credit program, and an outcome and performance evaluation of four Small Business Administration programs. He received his Master of Public Policy from Georgetown University.

References

- Armistead, P. Jefferson. 2005. *New Markets Tax Credits: Issues and Opportunities*. Brooklyn, NY: Pratt Center. http://www.picced.org/sites/default/files/publications/PrattCenter_nmrtc-report.pdf.
- Bartik, Timothy and Richard Bingham. 1997. “Can Economic Development Programs Be Evaluated?” In *Dilemmas of Urban Economic Development: Issues in Theory and Practice*, edited by Richard Bingham and Robert Mier. California (246-277). Thousand Oaks, CA: Sage Publications.
- Bershadker, Andrew, James Greer, Supapol Siris, and Michael Bzdil. 2008. *Promoting Investment in Distressed Communities: The New Markets Tax Credit Program*. Washington, DC: CDFI Fund, U.S. Department of the Treasury.
- Carroll, Deborah A. 2008. “Tax Increment Financing and Property Value: An Examination of Business Property Using Panel Data.” *Urban Affairs Review* 43(4): 520-552.
- Ding, Chengri and Gerrit-Jan Knaap. 2003. “Property Values in Inner-City Neighborhoods: The Effects of Homeownership, Housing Investment, and Economic Development.” *Housing Policy Debate* 13(4): 701-728.
- Eberts, Randall W. 1990. “Public Infrastructure and Regional Economic Development.” *Cleveland Organizational Review*. (1).
- Ellen, Ingrid Gould and Ioan Voicu. 2006. “Nonprofit Housing and Neighborhood Spillovers.” *Journal of Policy Analysis and Management* 25(1): 35-52.
- Felsenstein, Daniel and Joseph Persky. 1999. “When is a Cost Really a Benefit? Local Welfare Effects and Employment Creation in the Evaluation of Economic Development Programs.” *Economic Development Quarterly* 13(1):46-54.
- Florida, Richard, Charlotta Mellander, and Kevin Stolarick. 2007. “Inside the Black Box of Regional Development: Human Capital, the Creative Class and Tolerance.” http://www.creativeclass.org/rfcgdb/articles/Inside_the_Black_Box_of_Regional_Development.pdf.
- Fulbright-Anderson. 2006. “Community Change: Implications for Complex Community Initiatives.” In *Community Change: Theories, Practice, and Evidence*, edited by Karen Fulbright-Anderson and Patricia Auspos (9-17). Washington, DC: The Aspen Institute.
- Galster, George, Peter Tatian, and John Accordino. 2006. “Targeting Investments for Neighborhood Revitalization.” *Journal of the American Planning Association* 72(4): 457-474.

- Gerenrot Julie, David B. Cashin and Anna L. Paulson. 2006. "Community Development Spending, 1981-2004." *The Federal Reserve Bank of Chicago* 232: 1-4.
- Gittel, Ross and J.Philip Thompson. 1999. "Inner City Development and Entrepreneurship." In *Urban Problems and Community Development*, edited by Ronald F. Ferguson and William T. Dickens (473-520). Washington, DC: Brookings Institution Press.
- Goldstein, Ira, Lance Loethen, Edward Kako, and Cathy Califano. 2008. "CDFI Financing of Supermarkets in Underserved Communities: A Case Study." The Reinvestment Fund.
- Hebert, Scott, Avis Vidal, Greg Mills, Franklin James, and Debbie Gruenstein. 2001. *Interim Assessment of the Empowerment Zones and Enterprise Communities Program: A Progress Report*. Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research.
- Hollister, Robinson G. 2007. "Measuring the Impact of Community Development Financial Institutions' Activities." In *Financing Low-Income Communities: Models, Obstacles, and Future Directions*, edited by Julia Sass Rubin (265–310). New York, NY: Russell Sage Foundation.
- Immergluck, Daniel. 2008. "Research Design Issues for Measuring CDFI Performance and Impact." In *Reengineering Community Development for the 21st Century*, edited by Donna Fabiani and Terry Buss (76–93). Armonk, NY: M.E. Sharpe, Inc.
- Jackson, Maria-Rosario, Florence Kabwasa-Green, and Joaquin Herranz. 2006. *Cultural Vitality in Communities: Interpretation and Indicators*. Washington, DC: The Urban Institute.
- Kolodinsky, Jane, Caryl Stewart, Antonia Bullard. 2002. "Measuring Impact of Community Development Programs: The Vermont Development Credit Union." *Consumer Interests Annual* 47(1): 1–7.
- Listokin, David, Barbara Listokin, and Michael Lahr. 1998. "Contributions of Historic Preservation to Housing and Economic Development." *Housing Policy Debate* 9(3): 431–478.
- Margoluis, Richard, Caroline Stem, Nick Salafsky, & Marcia Brown. 2009. "Design Alternatives for Evaluating the Impact of Conservation Projects." In M. Birnbaum & P. Mickwitz (Eds.), *Environmental Program and Policy Evaluation: Addressing Methodological Challenges. New Directions for Evaluation*, 122, 85–96.
- Markusen, Ann and Amy Glasmeier. 2008. Overhauling and Revitalizing Federal Economic Development Programs. *Economic Development Quarterly* 22(2):83–91.
- McClure, Kirk. 2000. "The Low-Income housing Tax Credit as an Aid to Housing Finance: How Well Has It Worked?" *Housing Policy Debate* 11(1).
- Mills, Karen G., Elisabeth Reynolds, and Andrew Reamer. 2008. *Clusters and Competitiveness: A New Federal Role for Stimulating Regional Economies*. Washington, DC: Brookings.
- Norcross, Eileen. 2007. "The Community Development Block Grant: Does It Work?." *Mercatus Policy Series* (5).

Orszag, Peter R., *Memorandum for the Heads of Executive Departments and Agencies* (M-10-32), "Evaluating Programs for Efficacy and Cost-Efficiency," Office of Management and Budget, Executive Office of the President, July 29, 2010.

Redburn, F. Stevens, Steve Godwin, Kathleen Peroff and David Sears. 1984. "Federal Economic Development Investments." In *Productivity and Public Policy*, edited by Mark Holzer and Stuart Nagel. Beverly Hills, CA: Sage.

Reese, Laura A. and David Fasenfest. 1997. "What Works Best?: Values and the Evaluation of the Local Economic Development Policy." *Economic Development Quarterly* 11: 195–207.

Rubin, Julia Sass. 2006. "What Do We Know? Research on Outcomes and Impacts in the CDFI Field." White paper prepared for the John D. and Catherine T. MacArthur Foundation.

Schill, Michael, Ingrid Gould Ellen, Amy Ellen Schwartz, and Ioan Voicu. 2002. "Revitalizing Inner-City Neighborhoods: New York City's Ten Year Plan." *Housing Policy Debate* 13(3): 529–566.

Seidman, Ellen. 2007. "The New Markets Tax Credit: A Valuable Tool for Economic Development." New York, NY: Living Cities.

Small Business Administration (SBA). 2000. *SOP 50-10(4)(E), Subpart "A," SBA's Credit Elsewhere Criteria*. Washington, DC: Small Business Administration.

Thomson, Dale E. 2008. "Strategic, Geographic targeting of Housing and Community Development Resources." *Urban Affairs Review* 43(5):629–662.

U.S. Department of Housing and Urban Development, Division of Policy Studies. 1982. *An Impact Evaluation of the Urban Development Action Grant Program*. Washington, DC: Government Printing Office.

———. 2003. *Moving to Opportunity for Fair Housing Demonstration Program: Interim Impacts Evaluation*. <http://www.huduser.org/publications/hsgfin.html>.

U.S. Government Accountability Office. 2002. *New Markets Tax Credit: Status of Implementation and Issues Related to GAO's Mandated Reports*. GAO-03-223R. Washington, DC: General Accounting Office, December.

———. 2006. *Empowerment Zone and Enterprise Community Program: Improvements Occurred in Communities, but the Effect of the Program Is Unclear*. No. 06-727. Washington, DC: General Accountability Office.

———. 2009. *Program Evaluation: A Variety of Rigorous Methods Can Help Identify Effective Interventions*. GAO-10-30. Washington, DC: General Accountability Office.

Whalley, Diane. 1988. "Neighborhood Variations in Moderate Housing Rehabilitation Program Impacts: An Accounting Model of Housing Quality Change." *Economic Geography* 64(1): 45–61.