



The effects of location-based tax policies on the distribution of household income: Evidence from the federal Empowerment Zone program



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ABSTRACT

Location-based tax policies are redistributive as evidenced by their placement in distressed areas. However, the previous literature has focused on mean effects which can mask important effects that the program has on the distribution of households. Therefore, we extend the literature by studying changes in the entire household income distribution, in the context of the federal Empowerment Zone (EZ) program. We do not find evidence that the impoverished residents benefited from the program. Our findings are consistent with the areas becoming more attractive to high-income households. The improvements in the areas were concentrated in those portions of each zone that were relatively better-off prior to EZ designation. The results confirm the prior literature findings that the areas, on average, became more attractive but also suggest that the benefits of the program likely did not accrue to the lower-income residents of the EZ areas.

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1. Introduction

Policymakers are increasingly relying on location-based tax policies to help their constituents spurring a proliferation of studies that attempt to determine their effectiveness. However, despite the potential redistributive nature of these policies researchers have predominately studied the policy effects at the mean instead of throughout the income distribution. To investigate the importance of studying distributional changes in the context of location-based tax policies we study the federal Empowerment Zone (EZ) program, which offers a set of tax incentives to firms if they locate their business in specified distressed areas and hire workers who reside in the area. Specifically, the EZ program offers wage and capital tax incentives as well as service block grants to the community in order to induce businesses to locate in specified distressed areas. The largest and most utilized incentive (Hanson, 2011), the wage tax credit, provides employers (or employer) tax credits worth 20% of the wages of employees who live in these distressed areas, up to \$3000. Overall, this program is the largest location-based redevelopment program evident by the

Department of Housing and Urban Development (HUD) estimated annual cost of \$11 billion.¹

While the program was designed to stimulate economic activity in distressed areas, which could manifest in a variety of possible outcomes or metrics, at least part of the impetus for the program was to improve the lives of people living in the areas. In a 2002 joint letter to President George W. Bush, Senator Rick Santorum and Congressman J.C. Watts, Jr. stated that the goal of the EZ program is

“...to create an environment that enables distressed urban and rural communities to have hope for the future through economic and social renewal. Our belief is that when private industry flourishes in these communities, it directly, and positively, impacts peoples' lives.”²

Researchers interested in how the federal EZ program, or other economic development programs, impacts individuals' lives typically study socioeconomic indicators such as the poverty rate

¹ The HUD estimate does include costs pertaining to the less generous and smaller Renewal Community and Enterprise Community areas which are not included in this paper.

² See U.S. Department of Housing and Urban Development, “Questions and Answers on Renewal Community and Empowerment Zone Tax Incentives,” at <http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/index.cfm>.

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(e.g. Oakley and Tsao, 2006; Hanson, 2009; Ham et al., 2011), income (e.g. Hanson, 2009; Krupka and Noonan, 2009; Busso et al., 2013), or housing values (e.g. Hanson, 2009; Krupka and Noonan, 2009; Busso et al., 2013). To evaluate whether or not the EZ program improves the lives of people residing in these impoverished areas, we propose to investigate changes in the income distribution that would suggest that households are being moved out of poverty.

Estimated effects on mean and median income or the overall poverty rate, as have been produced in the prior literature, may provide little information about this question. In fact, evidence about the success of the federal EZ program is mixed.³ For example, Ham et al. (2011) find large increases in average income, Oakley and Tsao (2006) find no effect on average income, and Busso et al. (2013) find positive effects on weekly wages but not on average earnings per worker. Likewise, the EZ program's effect on the poverty rate has been found to be positive by Ham et al. (2011) while Krupka and Noonan (2009) found mixed results, and the U.S. General Accounting Office (2006), Hanson (2009) and Oakley and Tsao (2006) find no effect of the program. While some of the differences in estimates within the literature are due to methodological choices, a possible partial explanation is that the program has a complicated effect on the distributions of households across economic measures. These distributional effects could in turn affect mean impacts, potentially differently based on empirical methodology.

For illustration, suppose that the federal EZ program causes firms to hire some workers who are very low income and that doing so moves these households from severe to moderate poverty. This would have no effect on the estimated poverty rate, since all of the movement is below the poverty line, and could have little effect on the estimates of either median or mean household income, the latter because the distribution of incomes is highly skewed. Such estimates of the average effect could lead researchers and policymakers to conclude that the program has little overall effect on reducing poverty. However, investigation of the changes in the poverty distribution would suggest that the program was successful.

Alternatively, suppose instead that the EZ program causes an increase in the density of households at the top of the income distribution. This could result because the program attracted higher income individuals to reside in the area. This could produce a positive estimated effect of the program on mean income. If the researcher only observes the positive mean income effect, it could lead to incomplete or inaccurate policy conclusions. The result could be misconstrued as a positive because of increasing average incomes of residents of the EZ area, even though the target impoverished population has not benefited from the program. Of course, there are other possibilities for how the EZ program affects the distribution of economic outcomes but the larger point is that understanding the distributional impacts could be critical for policy analysis, and has largely not been considered previously in the literature on place-based policies.

We investigate how the federal EZ program affects the density of individuals and households across the income distribution, as well as the distributions of other previously considered outcomes such as housing costs. Our approach is similar to previous studies in other contexts, such as Neumark et al. (2005) who study how the distribution of family incomes is impacted by minimum wages and find no evidence of an increased density of households just above the poverty line. In our analysis, we use block group data from the 1980, 1990 and 2000 censuses. While the prior literature has used this data, or the more aggregated tract-level data, on

average incomes and wages, we utilize information on the counts of households and individuals within specified ranges of household income. These counts allow us to construct estimates of the density of individuals and households across the income distribution, as well as other distributions, in each year of our data. Thus, we can estimate how the densities of individuals and households changes at various points in these distributions, thereby providing a more complete picture of the effects of the program compared to average estimates.⁴

For identification, we utilize the selection process of the program that chose distressed areas from a set of qualified applicants. Specifically, we compare changes in the distribution in areas that received EZ designation with areas that qualified and applied for the EZ program but were rejected. While this control group has been utilized frequently in the previous literature, there is evidence that the EZ program selected areas with worse observable characteristics (Ham et al., 2011; Busso et al., 2013; Reynolds and Rohlin, 2014). Similar to Busso et al. (2013), we account for these differences by reweighting the control group to be more similar to the areas selected for the EZ program. For each outcome we consider, we use weights based on the propensity score to construct a set of control areas that have the same empirical distribution of households or individuals, in both 1980 and 1990, as those areas ultimately selected for the EZ program in 1994. We will demonstrate that our procedure produces a control group with nearly identical empirical distributions in both 1980 and 1990, and therefore changes in the pre-designation distributions, compared to the EZ areas.

Overall, we find that EZ designation has a polarizing effect on the distribution of households relative to the poverty line. Estimates show an increase in the density of households making twice the poverty rate as well as an increase in the density of households whose income is less than half the poverty rate. We further find that the increase in households with income more than twice the poverty rate is driven by an increase in households making more than \$100,000. This increase at the upper part of the income distribution explains at least part of the positive mean income effects of the EZ program found in the previous literature. We demonstrate that our results are robust to concerns discussed in the previous literature including the use of alternative matching methodologies, the use of imputed lagged values to avoid division bias (Borjas, 1980), and comparisons to areas bordering the Empowerment Zones.

These results provide no evidence that the existing impoverished residents experienced gains from the EZ program. First, there appears to be an increase in the severely impoverished in the EZ areas compared to the control group. Second, the increased density above \$100,000 occurs at roughly four times the pre-designation average household income in EZ areas. While there could be wage and employment gains associated with the program, either through the \$3000 wage credit or other program components described later, it seems unlikely that such gains could move the existing impoverished households so high up into the income distribution. Instead, the change in the distribution is more likely to be explained by the EZ areas becoming more attractive to higher income households. In this case, positive movements of mean income or poverty rates should not be interpreted as improvements to the targeted impoverished population.

Further evidence that the EZ areas have become more attractive to high-income households is found by looking at changes in other distributions within the EZ area. For example, we find increases in

³ This could be due to a number of potential reasons. There have been numerous methodologies employ across a variety of outcomes including business- and employment-related outcomes which are outside the focus of this paper. Additionally, there is a large literature on state placed-policies which contribute to the discussion on place-based policies.

⁴ This paper is not the first to consider the possibility that mean estimates may disguise underlying effects that are important for program evaluation. Bondonio and Greenbaum (2007) separate the mean effect of state EZ programs into gross flows of firms into and out of existence finding that mean estimates on firms counts miss important dynamics. Bitler et al. (2006) document important heterogeneous effects of welfare reform missed by more standard mean estimates.

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