BRINGING SMALL BUSINESS DEVELOPMENT TO URBAN NEIGHBORHOODS

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For African Americans to achieve economic parity in American society, black business ownership and revenues must roughly approximate the black proportion of the population. This assertion has not always been self-evident to much of the civil rights community.[1] Yet the inconvenient fact remains that in a market economy, the principal means of creating and accumulating private wealth is business ownership.[2]

This Article begins with an explanation for the anemic state of black business activity in deteriorating urban neighborhoods, and continues with a summary of local government business development policies and their shortcomings. It concludes with a policy proposal that identifies both a source for the required human and social capital investments necessary to make entrepreneurs from these neighborhoods competitive and a cost-free mechanism, Tax Increment Credits, for the transfer of this capital to the intended beneficiaries.

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[1] In black America, there is an established history of racial business chauvinism. See GUNNAR MYRDAL, AN AMERICAN DILEMMA 803–05 (20th anniv. ed. 1962). Booker T. Washington, one of the two preeminent leaders of black America at the turn of the last century (the other was W.E.B. DuBois), established the National Negro Business League in 1900 for the purpose of promoting commercial achievement that would pave the way to economic independence. *Id.* at 815. However, the leadership that won the civil rights victories of the 1960s emerged from the protest and integrationist leadership wing, descended from DuBois, which opposed the accommodationist policies of Washington. These leaders—Martin Luther King, Jr., Roy Wilkins, and Whitney Young—developed within the confines of nonprofit, self-help organizations and the black church. More fundamentally, this leadership, as epitomized by Dr. Ralph Bunche, viewed the "Negro business ideology" as futile, beneficial to only a handful of entrepreneurs, perhaps harmful to the ordinary black worker, and exploitative of an already downtrodden group. *Id.* at 804 (quoting Ralph J. Bunche, Memorandum on Conceptions and Ideologies of the Negro Problem, 122–24 (1940) (unpublished manuscript)). Bunche's criticism may have been accurate in 1940, but changed circumstances of the present era, including the potential for much more widespread entrepreneurship, suggest that it has lost its validity.

[2] *See, e.g., Household Wealth and Asset Ownership: 1984*, U.S. BUREAU OF THE CENSUS, CURRENT POPULATION REP. ser. P-70, no. 7, tbls. A, C, F, 1, 3, 4 (1986). For individuals under 55 years of age, equity in a business or profession is the largest source of wealth after home ownership. *Id.* at tbl. F. A strong linear relationship exists between high household net worth and increasing likelihood of owning equity in a business or profession. *Id.* at tbl. 3. In households with net worths of $500,000 or more, 51.9% have equity in a business or profession with a mean value of $454,446. *Id.* at tbls. 1, 3. Only 1.9% of households have a net worth of $500,000 or more. *Id.* at tbl. 4. While 2.1% of white households fall into this category, only 0.1% of black households do. *Id.*

I. The Importance of Black Business Development

In contrast with the mass campaigns to secure for blacks the right to vote and access to housing, employment, and public accommodations, little thought was given during the civil rights era to the racial barriers that stifle business activity. Due to insurmountable practical enforcement problems,[3] no federal civil rights statute that would bar racial discrimination in private business transactions has ever been seriously considered. The operating assumption presumably was that as barriers in other spheres of activity were dismantled, those constraining business activity would also erode.[4] This lack of emphasis on business activity has had serious consequences for African Americans, and it provides at least a partial explanation for the persistent inequality of black incomes as compared to those of whites.

Since the height of the civil rights movement thirty years ago, black family incomes have measured approximately 55 to 60% of white incomes.[5] Comparing wealth rather than income reveals an even greater disparity: on average, blacks own fewer than $23 of assets for every $100 owned by whites.[6] However, the greatest economic difference between blacks and whites is in business activity. Blacks constitute nearly 12% of the population, but their business activity in 1982 (when the last comprehensive survey was conducted) accounted for only 0.16%—or $12 billion—of all business receipts.[7] Unless this more than seventyfold disparity in business receipts is reduced, it is unlikely that income parity will be achieved.

For the black residents of deteriorating urban neighborhoods, education has become an avenue of escape from poverty. Yet the failure of urban public school systems denies this avenue to many talented and ambitious individuals.[8] Entrepreneurship (self-employment) offers an alternative way out that does not depend upon the acquisition of traditional educational credentials during childhood. Moreover, entrepreneurship may benefit ur-

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[3] *See generally* Robert E. Suggs, *Racial Discrimination in Business Transactions*, 42 HASTINGS L.J. 1257, 1284–1303 (1991).

[4] *See* MYRDAL, *supra* note 1, at 795.

[5] *Money Income and Poverty Status of Families and Persons in the United States: 1983*, U.S. BUREAU OF THE CENSUS, CURRENT POPULATION REP. ser. P-60, no. 145, tbl. 3 (1984).

[6] *See Household Wealth and Asset Ownership: 1984*, *supra* note 2, at tbls. 3, 5.

[7] *See* Robert E. Suggs, Recent Changes in Black-Owned Business v, 5–6 (Joint Center for Political Studies Working Paper, Sept. 1986) (on file with author). The Bureau of the Census last attempted a comprehensive survey of black-owned businesses in 1982. The most recent available census, taken in 1987, eliminated from its scope a significant group of firms. *See infra* note 25.

[8] *See, e.g.*, *Angry Chicagoans Push for Changes in Schools*, 20 NAT'L J. 410 (1988); Kimberly J. McLarin, *Poor Schools Avert Seizure by New Jersey*, N.Y. TIMES, Dec. 12, 1994, at A27.

ban neighborhoods by providing increased employment opportunities, retail services, and tax revenues.

The potential for entrepreneurship in these inner-city neighborhoods is substantial. The pervasiveness of the illegal drug trade testifies to the strength of the profit motive, especially in an environment where violence (often culminating in homicide), rather than bankruptcy, supplies the ultimate market discipline.[9] However, potential neighborhood entrepreneurs cannot compete successfully in the world's largest, most complex, and most dynamic economy unless their skills increase dramatically. More than financial capital, they need the human capital (skills, attitudes, and values) and the social capital (networks of trust relationships, family support, and mentoring) that undergird successful business activity.

The term "human capital,"[10] in the context of entrepreneurship, refers to the accumulated self-investment made by a business owner to gain the skills, knowledge, and experiences necessary to operate a successful business. "Social capital,"[11] as used in this Article, refers to the *relationships of trust* acquired and developed over time that provide access to and credibility with suppliers of credit, equipment, space, labor, and other resources. Social capital is a group phenomenon, created by the combined

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[9] *See* DRUGS AND CRIME 35–38, 56–57, 280–82 (Michael Tonry & James Q. Wilson eds., 1990). Violence is endemic to drug dealing, both as an organizational tool that maintains worker discipline and as a means of protecting lucrative selling locations. *Id.*

[10] In general terms, investments in human capital are "activities that influence future monetary and psychic income by increasing the resources in people .... The many forms of such investments include schooling, on-the-job training, medical care, migration, and searching for information about prices and incomes." GARY S. BECKER, HUMAN CAPITAL 11 (3d ed. 1993).

The exact relationship between education and the economy is unclear, and considerable controversy regarding this issue remains. *See generally* Richard Rubinson & Irene Browne, *Education and the Economy*, *in* THE HANDBOOK OF ECONOMIC SOCIOLOGY 581 (Niel J. Smelser & Richard Swedberg eds., 1994) [hereinafter THE HANDBOOK].

[11] "Social capital" was probably first used in print by the economist Glenn C. Loury to characterize the differences in community and social resources between disadvantaged inner-city black children and other children. *See* Glenn C. Loury, *A Dynamic Theory of Racial Income Differences*, *in* WOMEN, MINORITIES, AND EMPLOYMENT DISCRIMINATION 153–86 (Phyllis A. Wallace & Annette M. LaMond eds., 1977). It has been most developed by sociologists who use rational choice theory. *See, e.g.*, James S. Coleman, *A Rational Choice Perspective on Economic Sociology*, *in* THE HANDBOOK, *supra* note 10, at 166, 175–76 (defining "social capital" as a resource that: (1) facilitates production; (2) is neither consumed nor otherwise used up in production; and (3) is derived from ordinarily informal relationships established for noneconomic purposes but with economic consequences).

Scholars of immigrant entrepreneurship emphasize the bounded solidarity and enforceable trust aspects of social capital. *See* Ivan Light & Stavros Karageorgis, *The Ethnic Economy*, *in* THE HANDBOOK, *supra* note 10, at 647, 662; Alberto Martinelli, *Entrepreneurship and Management*, *in* THE HANDBOOK, *supra* note 10, at 476, 483; *see also* Frank A. Fratoe, *Social Capital of Black Business Owners*, 16 REV. BLACK POL. ECON. 33, 34 (Spring 1988) (using "social capital" to refer to the self-help support network that provides role models, training, financial support, sources of labor and clientele, attitudes, values, business contacts, and advice).

actions of several people.[12] The more that people use trust in the course of business and social interactions, the stronger such trust becomes and the more social capital is created. Nonuse, by contrast, may deplete the supply.[13] "Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time."[14] A network of trustworthy business relationships provides a quick and effective means of gaining accurate information about the competence, intentions, character, and integrity of potential business colleagues. Thus, it greatly reduces the transaction costs and risks associated with commercial transactions.

A shortage of both human and social capital seriously disadvantages aspiring inner-city entrepreneurs. This shortage undermines the economic vitality of urban neighborhoods as surely as does a lack of financial capital. While many programs have attempted to address the shortage of financial capital,[15] the shortages of human and social capital have received far less attention.

II. Civil Rights Progress and Black Business Development

Ironically, the very success of the civil rights movement has contributed to the anemic state of black business activity, at least in central city communities. Until the mid-1960s, black businesses operated in sheltered markets, spatially isolated and relegated to the black community by the white business community. Black businesses were protected in those markets by the same racial animus that excluded them from the mainstream.[16] Racial attitudes among whites prohibited white firms from providing to blacks services of the kind often performed by servants; no whites of any standing in their own communities would cook, serve, or clean for black customers. Black firms therefore served the black clientele that the then prevailing racial hierarchy inhibited white firms from fully exploiting. The typical black business owner operated a small retail or personal service firm, such as a beauty parlor or barber shop, a small eatery or grocery

[12] *See* Coleman, *supra* note 11, at 170.

[13] *See* ROBERT D. PUTNAM, MAKING DEMOCRACY WORK 169 (1993).

[14] *Id.* at 170 (quoting Kenneth J. Arrow, *Gifts and Exchanges*, 1 PHIL. & PUB. AFF. 357 (Summer 1972)).

[15] *See, e.g.*, Small Business Act §§ 7(j), 8(a), 15 U.S.C. §§ 636(j), 637(a) (1988). For implementing regulations, see 13 C.F.R. § 124.401 (1995) (advance payment of expenses); 13 C.F.R. § 124.402 (1995) (business development expenses); 13 C.F.R. § 124.403 (1995) (development assistance program); 13 C.F.R. § 124.404 (1995) (additional assistance); *see also* 13 C.F.R. § 115.30(c) (1995) (implementing 15 U.S.C. §§ 694(a)–(b) (1988) and providing for special assistance to minority firms under surety bond guarantee regulations).

[16] Andrew F. Brimmer, *Small Business and Economic Development in the Negro Community*, *in* BLACK BUSINESS ENTERPRISE 164 (Ronald W. Bailey ed., 1971).

store, a cleaning and pressing shop, a shoe shine and repair shop, or a funeral parlor.[17]

Black firms were ill-prepared to compete in the mainstream when the desegregation of public accommodations mandated by the 1964 Civil Rights Act[18] destroyed their protected markets. Suddenly, their most affluent clientele could choose from the goods and services offered by the entire economy, including powerful non-black-owned firms. Black firms found themselves forced to compete with national chains and other large firms with diverse and convenient locations, national distribution systems, lower costs, large amounts of capital, sophisticated research and development programs, and the kind of extensive marketing and advertising resources that create desirable brand names.[19] Black firms were unable to respond to this unexpected challenge, either by retaining their old customers or by entering the integrated marketplace. Further, even if some black firms were tempted by and could conceivably enter the much larger and potentially more lucrative mainstream, few white Americans were prepared to abandon their prejudices and patronize black-owned establishments. In most cases, black-owned firms were still inconveniently located, under-capitalized, and overpriced. Thus, at the high-water mark of the civil rights revolution, the small retail and personal service firms that had been the mainstay of black business activity began a sustained and inexorable decline.[20]

Two other legislative developments further undermined the economic base of black firms. First, the enactment of the Fair Housing Act of 1968[21] facilitated the dispersal of the black middle class, who left formerly segregated urban areas in pursuit of better housing, better schools, or just more conveniently located neighborhoods.[22] Second, Title VII of the 1964

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[17] *See, e.g.*, MYRDAL, *supra* note 1, at 304–18; Eugene P. Foley, *The Negro Businessman: In Search of a Tradition, in* THE NEGRO AMERICAN 555, 580 tbl. 1 (Talcott Parsons & Kenneth B. Clark eds., 1966).

[18] Pub. L. No. 88-352, 78 Stat. 243 (codified as amended at 42 U.S.C. §§ 2000a–2000h (1988)).

[19] *See* Timothy Bates, *Urban Economic Transformation and Minority Business Opportunities*, 13 REV. BLACK POL. ECON. 21, 28–32 (Winter 1984/85).

[20] *See* Suggs, *supra* note 7, at 15–24.

[21] Pub. L. No. 90-284, §§ 801–819, 82 Stat. 81 (codified as amended at 42 U.S.C. §§ 3601–3619 (1988)). The 1968 Act prohibited discrimination on the basis of race, color, religion, or national origin in the sale or rental of housing. The prohibition against sex discrimination was added in 1974. Pub. L. No. 93-383, § 808(a), 88 Stat. 633 (1974). The Act was further strengthened by the Fair Housing Act Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (1988). The amendments prohibited discrimination on the basis of family status or disability, broadened the substantive reach of the Act, and strengthened the Act's procedural aspects.

[22] *See* WILLIAM J. WILSON, THE TRULY DISADVANTAGED 50 (1987); *see also* DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID 84–88, 143–47 (1993) (arguing that increasing concentrations of poverty would have occurred even without the out-migration of middle-class blacks, and that even high-income blacks remain highly segre-

Civil Rights Act[23] barred discrimination in employment and led to a parallel dispersal of the workplaces of black Americans. These twin factors eliminated whatever advantages had accrued to black firms from their location in black neighborhoods and accelerated their decline. With this decline of black business and the dispersal of the black middle class, the black community's former central city neighborhoods deteriorated.

Despite significant growth in the overall economy, from 1972 to 1982,[24] when the last comprehensive census of black firms was attempted,[25] total receipts of black-owned businesses stagnated. This occurred despite gains achieved by African Americans in political representation, employment, housing, and educational opportunities. What this discouraging picture of business stagnation failed to reflect was the increasing diversification of black business. A closer analysis of the economic data revealed that the aggregate data obscured two important and offsetting trends. First, black personal service and consumer retail firms, which have never been very numerous, large, or strong when compared to their white counterparts, have declined significantly over the last two decades.[26] Second, black firms in nontraditional sectors—such as business services, manufacturing, and wholesale trade—were growing faster than the economy as a whole.[27] These two trends, of growth and decline, offset each other at the aggregate level.

Undoubtedly, the civil rights gains of the 1960s and 1970s were necessary preconditions for the rapid growth of black business firms in

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gated). This argument implies that an affluent and geographically segregated customer base remains for neighborhood personal service and small retail firms, but that the location of this customer base would require the relocation of firms from the central city to outlying areas.

[23] Pub. L. No. 88-352, 78 Stat. 241, 253–66 (codified as amended at 42 U.S.C. §§ 2000e–2000e(16) (1988 & Supp. V. 1993)).

[24] *See* Suggs, *supra* note 7, at 10. Between 1972 and 1982, the average receipts (in constant dollars) of black-owned retail firms declined 25.8%. These firms accounted for 43.5% of all black business receipts in 1972 but only for 33.1% of such receipts in 1982. *Id.*

[25] The more recent 1987 census of black-owned businesses is not directly comparable to prior censuses because in 1987, for technical reasons, the Bureau did not attempt to count regular C corporations—that is, non-Subchapter S corporations. C corporations probably constitute a major share of the largest and most advanced corporations because, among other restrictions, S corporations cannot have more than 35 shareholders, shareholders who are nonresident aliens, or shareholders that are corporations or other artificial entities (except estates and certain trusts). *See* 26 U.S.C. § 1361(b) (1988).

Subchapter S corporations are taxed like partnerships, and their tax returns include information sufficient to identify the race of their shareholders. The tax returns of C Corporations do not provide a basis to identify the race of shareholders. The 1986 Tax Reform Act increased the incentives for election of Subchapter S status so that even the 1982 and 1987 data for S firms are not directly comparable—since a C corporation in 1982 might have elected S status by 1987 in order to gain the benefit of lower tax rates.

[26] *See* Suggs, *supra* note 7, *passim.*

[27] *See id.* at 15, 28–29.

industries outside of those to which blacks had been historically relegated. But this fortunate development for firms in nontraditional sectors should not lead us to devalue personal service and small retail firms as merely the obsolete casualties of some Darwinian selection. The offsetting consequence of a decline in black businesses that focus on personal service and small-scale retail operation has been costly for black urban communities. At the current stage of black business development, many black urban neighborhoods are bereft of the stores that give vitality to a community by providing not only the necessities of everyday life, but also employment opportunities and role models for African American youth. Truly competitive personal service and small retail firms can add to the health of inner-city neighborhoods. Public policy must address the continuing paucity of black firms of this type which are capable of competing and prospering despite desegregated markets.

III. Local Government and Minority Business Development Policy

Local governments have responded to the underdevelopment of black business by using government procurement to bring minority firms into the larger and more sophisticated mainstream business world. Advocates for minority economic development have concentrated on examining ways that local governments can use procurement to spur such development, especially business ownership.[28] Interest in this approach derived from the example set by the Small Business Administration's (SBA) section 8(a) minority business set-aside program,[29] which since the late 1960s has enabled black firms, identified by the SBA, to participate as suppliers in federal procurement.

The first federal use of set-asides that required federal prime contractors independently to identify and subcontract with Minority Business Enterprises (MBEs) was established by the Public Works Employment Act of 1977, which attempted to insert MBEs directly into the "old boy network" of the construction industry.[30] It was premised on the theory that the experience gained in working with MBEs on federal construction projects would transfer into the private sector, so that the same federal prime contractors required to subcontract with MBEs on government construction projects would then voluntarily subcontract with MBEs on private construction. Instead, aside from a few programs initiated by major corporations, often in response to political or consumer pressure,

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[28] *See generally* Drew S. Days III, *Fullilove*, 96 YALE L.J. 453 (1987); Robert E. Suggs, *Rethinking Minority Business Strategies*, 25 HARV. C.R.-C.L. L. REV. 101 (1990).
[29] 15 U.S.C. § 637(a) (1988).
[30] Public Works Employment Act of 1977, Pub. L. No. 95-28, 91 Stat. 116 (codified in significant part at 42 U.S.C. §§ 6705(e)–6707(j) (1988)).

virtually the entire private construction market has remained closed to MBEs.

To date, the focus of MBE development policy has remained on the use of government procurement as an assured source of contracts, combined with financial, technical, and managerial assistance to encourage the formation and growth of MBEs. Unfortunately, this focus on procurement does not directly address the problems of deteriorating urban residential neighborhoods, nor should we expect it to, as a moment's consideration will make clear.

Given the industrial and commercial nature of the goods and services that governments purchase, as well as the large scale of their requirements, the types of minority individual entrepreneurs benefiting from such procurement programs are those who already possess the skills and education to place them firmly in the middle and upper-middle classes. In fact, they may already reside in the suburbs. Further, while minority firms do tend to employ minorities,[31] and while some employees of benefited firms may live in deteriorating urban neighborhoods, modern zoning ordinances usually require commercial and industrial firms to locate themselves outside of residential neighborhoods. This factor minimizes the potential benefit of these commercial and industrial firms to inner-city residential neighborhoods. As a result, public procurement programs have virtually no impact on the type of small, neighborhood, consumer-oriented personal service and retail firms that, without government assistance, have revitalized deteriorated neighborhoods such as Adams Morgan in Washington, D.C., and SoHo in Manhattan.

IV. Strengthening Black Entrepreneurship

Policy analysts have identified many problems that undermine the vitality of inner-city black neighborhoods, including outflows of financial capital and entrepreneurial talent and the weak internal market supplied by low-income residents.[32] Some observers would discourage black entrepreneurs from entering these sectors (inner-city black neighborhoods) because, given these problems, the prospects for success are poor. This advice may be appropriate for the new generation of black entrepreneurs resulting from the large increase in blacks attending college and majoring in business.[33] These entrepreneurs typically have educations, incomes, and

[31] *See* Timothy Bates, *Utilization of Minority Employees in Small Business*, 23 REV. BLACK POL. ECON. 113, 118–19 (Summer 1994). Of black firms in nonminority neighborhoods, 78.9% have 75% or more minority employees. Of black firms in minority neighborhoods, 93.1% have 75% or more minority employees. Of white firms in minority neighborhoods, 29.4% have 75% or more minority employees. But 32.9% of nonminority firms in minority neighborhoods have no minority employees. *Id.* at 118.

[32] *See* TIMOTHY BATES, BANKING ON BLACK ENTERPRISE 71 (1993).

[33] *Id.* at 21; J. BLACKS HIGHER EDUC. No. 2, at 37 (Winter 1993/94).

employment experiences that remove them from the pool of candidates likely to operate personal service or small retail establishments. Rather, they are developing larger and more sophisticated firms in nontraditional lines of business.

Many of the stores that do exist in these urban black neighborhoods are owned and operated by outsiders of different ethnicities, a factor which exacerbates tensions between blacks and these other ethnic groups. The presence of these outsiders gives rise to a question: if Jewish, Asian, and Arab Americans can operate retail and personal service stores successfully in black urban neighborhoods, then why cannot more African Americans?[34] Answering this question requires an understanding of the climate in which black business traditions have developed.

African Americans form business firms at a rate that is barely one-fourth the national average and barely one-eighth the rate for some white ethnic groups.[35] Such a low rate of self-employment reflects a lack of opportunities for success and weak traditions of entrepreneurship. While the lack of opportunities resulting from discrimination has been well documented, it is the lack of strong business traditions that may explain why the mid-1960s—with the expansion of employment, educational, and housing opportunities—produced no immediate burgeoning of black business activity. It has taken a full generation for significant activity to appear, and even then only outside of the business sectors where such black-owned firms have historically been concentrated. Over the past several decades, a dramatic shift has occurred in the sectors of black business activities.

> In 1960, owners of personal services [firms] accounted for nearly 30 percent of self-employed black entrepreneurs, while fewer than 10 percent ran skill-intensive enterprises such as those in professional services, business services, and finance, insurance, and real estate. By contrast, among . . . those [black firms] that began operations in the 1976–82 period, only 10.3 percent were in personal services, while 25 percent were in skill-intensive industries.[36]

A further sign of a weak business culture is that traditional black entrepreneurs have had income and educational levels below those of black wage and salary workers, the exact opposite of white male entrepreneurs and salary workers.

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[34] Bates argues that Asian-owned firms in this category do not prosper either, but that they do provide employment while their owners gain language fluency and an avenue of economic mobility. *See* BATES, *supra* 32, at 37.

[35] *See* Frank A. Fratoe, *A Sociological Analysis of Minority Business*, 15 REV. BLACK POL. ECON. 5, 9 (Fall 1986).

[36] BATES, *supra* note 32, at 27.

A weak indigenous business culture, handed down through family and social networks and acquired independently of formal education, should be expected given the severity of the American system of chattel slavery, which must have extinguished many African merchant traditions.[37] The post-Reconstruction era did little to encourage black business activity. Until World War I more than ninety percent of the black population lived in the South.[38] Little accumulation of the human capital represented by business knowledge and experience could occur under a system that resorted to terror to ensure that the black population remained subordinate. Furthermore, when government actively and unashamedly denied blacks basic political, civil, and human rights, market competition with whites was physically dangerous.[39]

This environment led blacks to favor self-help organizations that least threatened the white hierarchy. These were nonprofit, social welfare institutions such as churches, schools, charitable associations, and fraternal organizations. Some of the largest modern black financial organizations trace their origins to such nonprofit precursors.[40] Moreover, the current black leadership, rarely drawn from the business community, developed during the era when the overwhelmingly conservative position of the white business community and its adamant defense of segregation contributed to the alienation of black leaders from the business ethic and its values. Thus, these leaders remain uncomfortable with business, the profit motive, and market competition.

This hostile climate, persisting over several centuries, inhibited the formation and development of traditions of entrepreneurship and left a legacy of diminished black business activity. Indeed, black merchants could develop only in markets disdained by whites.[41] Thus, for African Americans, the acquisition of business experience and knowledge occurs less through informal mentoring within the extended family or from working in family businesses than for other groups.[42] Instead, business skills and experience must be gained through formal education, typically at the college level, and through employment by major corporations.[43] Nascent

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[37] Under the American system of slavery, slaves could neither own property—except with the consent or connivance of their masters—nor hire out their labor. A. LEON HIGGINBOTHAM, JR., IN THE MATTER OF COLOR 173–75 (1978). By contrast, slaves in the Portuguese and Spanish colonies had the right to purchase their freedom and acquire property. In Brazil, a slave was entitled to work for himself on all Sundays and holidays—that is, 85 days annually—and accumulate money for his purchase price. Slaves were often encouraged to hire themselves out and in rural areas could sell their garden produce and keep the proceeds. STANLEY M. ELKINS, SLAVERY 75–76 (1963). *See generally* MYRDAL, *supra* note 1, at 304–18.

[38] *See* MYRDAL, *supra* note 1, at 183.

[39] *See id.* at 558–69.

[40] *See* Fratoe, *supra* note 35, at 16.

[41] *See* MYRDAL, *supra* note 1, at 304–05, 308–10, 314–18.

[42] *See* Fratoe, *supra* note 11, at 35–39.

[43] *See* Timothy Bates, *The Changing Nature of Minority Business*, 18 REV. BLACK POL. ECON. 25, 38–39 (Fall 1989).

entrepreneurs with business degrees and Fortune 500 experience have more attractive entrepreneurial options and, often, larger ambitions, than those available in deteriorating inner cities and through personal service or retail consumer outlets.[44]

However, bright the future is for this vanguard, they will not revitalize urban neighborhoods. Revitalization will require investments in the people left behind, those who cannot take their education with them and escape to the suburbs.

To spur the number and types of consumer firms that might revitalize central cities requires a mechanism that creates incentives for the transfer of the requisite business skills, values, and networks, *from* those who have them *to* those who need them. These investments in human and social capital must be made by the established business community's most competitive firms and must target the most talented, ambitious, and motivated residents of deteriorating urban neighborhoods—individuals who nevertheless lack other viable entrepreneurial options. While other programs are needed to assure the availability of financial capital and insurance coverage, local governments should now place the primary emphasis on increasing the human and social capital of neighborhood residents. Existing programs fail to accomplish this latter objective.

V. Human and Social Capital Investment

A major component of existing MBE programs consists of managerial and technical assistance designed to upgrade the skills and expertise of black entrepreneurs.[45] These programs have provided assistance of uncertain value, typically furnished by government employees lacking successful track records in the industry about which they purport to educate black entrepreneurs. No evidence exists that recipients of this assistance would be willing to pay for it, which suggests that they do not value it highly. Even if the assistance offered were informed by experience gained from operations in the black entrepreneurs' own markets and therefore were of greater value to its recipients, the providers of such assistance would have no vested interest in the success of those recipients. While they may have a professional interest in the program's success or a political commitment to its goals, they suffer no personal loss if it fails.

To benefit the recipients of assistance, not only must the assistance be valuable, it must go beyond augmentation of skills. It must include access to the networks of lenders, suppliers, and other players in the

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[44] The black-owned firms that remain in business in the inner city are more likely to be headed by high school dropouts than by college-educated owners. *See* Timothy Bates, *Small Business Viability in the Urban Ghetto*, 29 J. REGIONAL SCI. 625–26, 640–42 (1989).

[45] *See* 15 U.S.C. §§ 637(a)–(b) (1988); 13 C.F.R. § 124.401–.404 (1995) (implementing regulations).

business world who in the past have actively excluded blacks and now are ambivalent at best about these new entrants into the mainstream business community. Black entrepreneurs must gain access to and become an integral part of the networks of successful entrepreneurs so that they benefit from the full range of skills, experiences, and relationships that sustain the mainstream.

The following proposal seeks to harness the entrepreneurial energy of residents of inner city neighborhoods. It explores the feasibility of using local government taxing powers, without incurring additional tax costs, to foster small, neighborhood-based, consumer-oriented retail firms. The proposed program adapts tax increment financing (TIF), an established policy tool for redeveloping the streets, sidewalks, street lighting, and utility service infrastructure of blighted urban areas, to foster the transmission of the skills, attitudes, and values (human capital), as well as access to the networks of business relationships (social capital), required for successful entrepreneurship. The proposal provides a mechanism to connect established and savvy business owners with aspiring minority entrepreneurs, and to create between them the economic equivalent of a familial bond. It concludes with a brief suggestion for curricular changes in high schools that is aimed at increasing the supply of potential entrepreneurs able to benefit from the business opportunities generated by this proposal.

A. *Tax Increment Credits for Human and Social Capital Transfer*

Traditional TIF uses the increase in future tax revenues generated by the redevelopment of blighted areas to finance the initial public infrastructure investment needed to spur private redevelopment.[46] In a typical example, a city issues revenue bonds[47] and uses the proceeds to pay for site clearance and new streets and lighting. To pay the principal and interest on the bonds, the city pledges all the property tax receipts attributable to the redevelopment, i.e., those receipts in excess of the amounts collected prior to redevelopment. The improvements to infrastructure cost virtually nothing[48] because the money borrowed to pay for them will be repaid with

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[46] *See, e.g.*, Richards v. City of Muscatine, 237 N.W. 2d 48 (Iowa 1975) (upholding a tax increment financing statute against state constitutional challenges based upon tax uniformity and public purpose grounds, among others).

[47] An added advantage of TIF is that since revenue bonds are not backed by the full faith and credit of the issuing local government, but only by the revenues produced by the project for which they are issued, they do not count as borrowings against the local government's debt limitation. For the same reason, they often do not require voter approval.

[48] The "no-cost" virtue of this TIF example, and of TIF programs in general, depends on several assumptions. First, it assumes that private redevelopment occurred only because of the initial public infrastructure investment, and that market forces were insufficient to

incremental funds that the city receives only because of the redevelopment. Adapted for human and social capital transfer, this proposal would similarly cost virtually nothing.[49] It would not even require the actual issuance of bonds or other indebtedness,[50] and would pay for itself from the increased revenues that the proposal would generate.

The proposal, termed Tax Increment Credits (TIC), works by granting local sales and property tax credits to established business owners who mentor minority entrepreneurs selected on the basis of their potential for success. Tax Increment Credits provides a continuing financial incentive for successful business owners to transfer their human and social capital to aspiring minority entrepreneurs as they would to a member of their own family.

Local government would provide a financial incentive—tax credits—to motivate mentoring by established business owners when, and so long as, the protégé succeeds in generating tax revenues from a new business. The tax credits for mentors would come into existence only when new tax revenues are generated by the entrepreneurs to replace the credits granted. Since mentors would only receive sales and property tax credits based upon the sales and property taxes that their protégés pay, and since the protégés would not generate business tax revenues without this program, the city would recoup in additional tax receipts what it would lose in tax credits.

Additionally, by excluding from eligibility as protégés all individuals with family or kinship ties to mentors, the mentors would only make human and social capital investments in persons otherwise unlikely to become entrepreneurs. If protégés are selected properly so that they are unlikely either to generate business tax revenues absent this program, or to generate them in such large amounts, then no real tax revenues are lost by granting the credits, even in the long term.

One potential problem for TIC is a tax uniformity requirement commonly imposed by state constitutions or statutes.[51] Where authority in the local government exists to abate taxes, use of TIC would generally be

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spur redevelopment without it. Second, it does not include a budget for administrative overhead.

[49] So long as protégés are selected who would not otherwise create tax-paying firms within the time frame of their participation in the program, the city forgoes only revenue it would never receive but for this program. This also assumes that no unassisted firm would otherwise be able to exploit the existing market opportunity and generate tax revenues. If assisted firms displace unassisted firms, then revenues are lost.

[50] This avoids the problem that such an experimental program would have in convincing the investing public of the merits of this proposal. Unless so convinced, such bonds would remain unmarketable. As structured here, only governments with the powers to grant tax credits or exemptions need be convinced of the merits of this proposal.

[51] *See, e.g.*, Richards v. City of Muscatine, 237 N.W.2d 48 (Iowa 1975); Tax Increment Fin. Comm'n v. Dunn Constr. Co., 781 S.W.2d 70 (Mo. 1989) (rejecting uniformity challenges).

authorized; where it does not, the local government would have to obtain specific authority from its state legislature. Benefiting private firms with tax credits might also prompt state constitutional challenges on public purpose grounds.[52] The risk of such a challenge succeeding is greatest when a private benefit is being bestowed using public resources and the private marketplace stands willing and able to provide the same benefit, but for a slightly higher price.[53] In the circumstances of this proposal, however, there exists no private-sector alternative that provides the mentoring and human and social capital transfer for which the tax credits offer the necessary financial incentive. Thus, the chance of invalidation on public purpose grounds would be remote.

B. Program Design

To implement this proposal, two groups of potential participants must be identified. The first group—the mentors—would be people of all ethnicities chosen from operators of local, owner-operated, predominantly consumer-oriented personal service and retail businesses of the kind selected for recognition as exemplars of quality and sophistication in city magazines such as *The Washingtonian* or *Baltimore Magazine*. These would include restaurants, clothing boutiques, bakeries, auto repair shops, and housewares and hardware stores. Such outstanding firms are unlikely to operate in distressed central city neighborhoods. The second group—the protégés—would consist of young people, predominantly minority, who are identified by community organizations and other sources as particularly motivated, disciplined, and interested in business, but not likely to continue their formal education beyond high school. This program would avoid the bias of most business development programs, which require their beneficiaries to have sufficient capital and skills already to assure themselves a place in the middle and upper-middle classes.

Mentors would do far more than train their protégés in their businesses.[54] They would also informally "sponsor" protégés with lenders and trade and equipment suppliers, impart their skills and experiences, and make their business networks available.[55] They would guide protégés in

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[52] *Compare* Hesse v. Rath, 164 N.E. 342 (N.Y. 1928); Wilson v. Connecticut Prod. Dev. Corp., 355 A.2d 72 (Conn. 1974); *and* Massachusetts Home Mortgage Fin. Agency v. New England Merchants Nat'l Bank, 382 N.E.2d 1084 (Mass. 1978) (rejecting public purpose challenges) *with* State *ex rel.* McLeod v. Riley, 278 S.E.2d 612 (S.C. 1981) (invalidating bond issuance on public purpose grounds).

[53] Municipal bond financing is cheaper than commercial financing because the interest income to the supplier of capital is exempt in certain circumstances from federal income tax.

[54] Protégés would have sufficient initiative and industry to be attractive employees. Public wage subsidies also exist under other programs to increase their attractiveness.

[55] Mentors would not be required to guarantee protégés' financial obligations or otherwise risk their own financial capital.

finding suitable business locations and advise them in lease or purchase negotiations. Since mentors would receive the tax credits only if their protégés' businesses succeeded and incurred local tax liability, mentors would have a vested interest in their protégés' continuing success. Finally, the mentor would continue to offer advice and counsel after the protégé established an independent firm.

Several ancillary benefits might flow from this proposal. For instance, it would forge ties of mutual economic interest between black entrepreneurs and those from Asian and other ethnic immigrant communities that have stronger and more successful business traditions.[56] At a neighborhood level, it would replicate the global U.S. trade policy of defusing political tensions through the development of mutually beneficial bilateral trade, as with mainland China. In effect, the tax incentive substitutes for an ethnic tie of affinity. The linked interests of mentors and protégés created by the tax incentive would counteract, in part, the mutual distrust and suspicion that currently characterize relationships between some groups.

In addition, protégés who achieve lasting success might provide a market of potential buyers to whom mentors could sell their firms when they retire. Given the smaller size of contemporary families and the occupational and geographic mobility of younger generations, the mentors' family members might not wish to follow in their footsteps. The lack of a successor can prevent mentors from profitably exiting their businesses. Mentors with a long-term perspective might consider this as an additional reason to participate in a TIC program.

One apparent risk to mentors is that their protégés might open competing firms. However, mentors will have established firms, with significantly greater equity and less debt—and thus lower interest expense—than the new firms started by their protégés. Mentors hold an additional advantage due to the local tax credits offered by TIC, which reduce the mentors' tax expenses. Even if the personal relationship between mentor and protégé were to break down, the mentors' lower expenses heavily tilt the competitive odds in their favor. Protégés would thus have little incentive to locate in sufficient proximity to their mentors to compete directly.

A second hurdle for TIC is the constitutional concern with race-conscious criteria. Earlier state and local government efforts to spur MBE development, such as minority business set-asides, used race-conscious selection criteria to determine benefit eligibility, raising serious equal protection challenges to these programs under the federal Constitution.[57]

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[56] Asian male-owned small businesses consistently outperform those of nonminority males, while businesses owned by black males are disadvantaged relative to nonminority male-owned businesses with respect to failure rates, profitability, and capital invested. *See* Bates, *supra* note 43, at 25.

[57] *See, e.g.*, City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989). In the wake of the *Croson* decision, the Minority Business Enterprise Legal Defense and Education Fund, Inc. (MBELDEF) identified at least 45 state and local governments that had

To survive the strict scrutiny imposed on such programs by the equal protection doctrine elaborated in *City of Richmond v. J.A. Croson, Co.*,[58] such programs must first be justified by a history of identified prior direct or indirect discrimination by the jurisdiction, the effects of which continue into the present.[59] If the program meets this requirement, it must also be "narrowly tailored,"[60] a requirement that necessitates adding waivers and other flexible provisions that complicate program administration by creating exceptions and exemptions for compliance with set-aside MBE participation goals.

By using race-neutral selection criteria,[61] TIC avoids such potential constitutional problems and thereby averts the distortions in program design[62] and the increased consumption of funds and energy that these constraints often create. The desired degree of minority participation as protégés could be assured by requiring residency in central city neighborhoods identified by low income or high unemployment levels, or by requiring protégés to graduate from or enroll in specified high schools that draw students from targeted zones. Given the high degree of residential segregation[63] and the resulting de facto public school segregation in our society, overwhelming minority participation would result from these racially neutral selection criteria. Even Justice Scalia would likely permit such remedial use of race-neutral criteria despite their racially disproportionate impact.[64]

Although TIC is intended to spur economic development in inner cities, eligibility for tax credits should not depend upon the protégé locating the new business in a particular neighborhood. Despite the advantages gained by access to human and social capital, protégés, like all new

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terminated or suspended set-aside programs. It also identified 65 lawsuits that had been filed attacking the legality of state and local government minority and gender-based set-asides. *See* Memorandum from Franklin M. Lee, Chief Counsel, MBELDEF (Feb. 17, 1995) (on file with author).

[58] *Croson*, 488 U.S. at 493.

[59] The use by government of racial classifications must be justified by a compelling governmental interest. The remedying of the continuing effects of identified prior discrimination is one such justification. *See Croson*, 488 U.S. at 504. The City of Atlanta's justification study cost $517,000 and comprised eight volumes and nearly 1100 pages. Andrew Brimmer & Ray Marshall, Public Policy and Promotion of Minority Economic Development (June 29, 1990) (on file with the author).

[60] *See Croson*, 488 U.S. at 507–08 (rejecting administrative convenience as a basis for avoiding the bureaucratic effort necessary to tailor remedial relief narrowly); *cf.* Fullilove v. Klutznick, 448 U.S. 448, 487 (1980) (upholding a federal set-aside incorporating a waiver provision applicable when minority firms were unavailable).

[61] Washington v. Davis, 426 U.S. 229 (1976) (establishing that equal protection violations require a showing of intentional racial discrimination and foreclosing use of disparate impact analysis alone to sustain an equal protection violation).

[62] For a generalized efficacy critique of the design of minority business set-asides, see Suggs, *supra* note 28, at 123–29.

[63] *See generally* MASSEY & DENTON, *supra* note 22.

[64] *See Croson*, 488 U.S. at 526 (Scalia, J., concurring).

entrepreneurs, will still face an uphill struggle to succeed. The conditioning of mentors' benefits upon the protégés' location in areas that more experienced and better-capitalized businesses have abandoned might program the upstart firms for failure. While not required to locate in distressed areas, a trained and experienced cadre of indigenous neighborhood entrepreneurs might recognize business opportunities that others unfamiliar with particular communities might overlook. Only the provision of additional incentives designed to compensate for the disadvantages of a particular neighborhood, perhaps in conjunction with comprehensive redevelopment efforts, would justify locational requirements.

These considerations indicate that a tension exists between the goals of assisting entrepreneurs and benefiting particular neighborhoods. Some black neighborhoods are too poor and too dangerous to support significant profitable and legitimate business activity.[65] As such, it would not contribute to the welfare of entrepreneurs or to that of their communities to spur the creation of firms at non-viable locations. If the inner-city neighborhoods that are the intended beneficiaries of this proposal contain viable locations, and if such locations are accurately discerned, growing and increasingly profitable firms would result. In these instances, the neighborhoods involved would gradually regain the retail services, jobs, and role models that they currently lack. However, if few such viable locations are discovered, then successful business activity may require that some firms founded by protégés be located on the fringes of minority neighborhoods, in mixed areas, or in nonminority areas. But even locations outside of minority neighborhoods can provide substantial employment opportunities to young black workers. Black-owned businesses employ predominantly minorities, regardless of location, while nonminority firms in minority neighborhoods often employ no minorities at all.[66] This short Article cannot resolve or even fully describe all of the policy issues raised by the tension between aiding individual entrepreneurs and improving the overall condition of black neighborhoods. At a minimum, however, spreading entrepreneurship to talented African American youths who are not college-bound increases the socioeconomic mobility of these individuals and, potentially, the human and social capital wealth of their own personal and business networks, which would likely include friends and family from their former neighborhoods.

This proposal does contain one implicit locational constraint: unless the protégé locates in the city enacting the tax credit provision and incurs local tax liability, the mentor will receive no benefit from the availability of the tax credit. TIC also ties the mentor to the city; because if she moves her firm out of the city, the mentor will incur no city taxes and therefore

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[65] *See* BATES, *supra* note 32, at 71.
[66] *See supra* note 32 and accompanying text.

will have no city tax liability to be offset by tax credits. To avoid undue interference with locational imperatives, two or more governments in the same metropolitan region might mutually recognize the credits provided by each other's programs.

C. Curriculum Changes: Preparing Protégés

The TIC proposal for human and social capital transfer provides incentives for mentors to share their business skills and make available their business networks, but protégés also need to be prepared. Currently, little if any preparation is available in public secondary school education for a career as a small business owner. Universities, at both the graduate and undergraduate levels, do not foster ownership of the type of firms targeted by this proposal, and they probably should not.[67] Yet mentoring should not be relied upon to provide all of the knowledge and experience required for successful business operation.

To address this need, clinical or experiential education could be used in secondary schools. The experiential learning suggested here is not vocational education. Experiential learning designates the method of learning and teaching employed, not the content and subject matter. Despite the fact that learning can take place in a number of different ways—seven, by the count of one leading theorist[68]—the American educational system is "heavily biased toward linguistic modes of instruction and assessment and, to a somewhat lesser degree, toward logical-quantitative modes as well."[69] As a law teacher, I frequently encounter students and practitioners who tell me that the light finally came on, or that they "got it," or that law fully engaged their interest only when they took a clinical course. If a clinical experience can so strongly affect the highly motivated and academically successful, then experiential learning might similarly affect students alienated by their years spent in the traditional classrooms of marginal or dysfunctional urban public schools.

The time may therefore be ripe to consider instructional alternatives to conventional teaching formats. Experiential learning could be used to upgrade the skills and increase the potential of entrepreneurs. In the guise of acquiring practical business skills in high school clinical programs, students could be taught substantive academic content. These programs could operate aspects of the school cafeteria or other school programs, some of which are already being contracted out to commercial firms.

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[67] Universities focus on fulfilling the needs of institutional business employers by training individuals to be marketing, financial, and management executives. Neighborhood firms, of the type targeted by this proposal, can neither meet the compensation requirements nor offer the career mobility opportunities of large corporate employers.

[68] HOWARD GARDNER, THE UNSCHOOLED MIND 11–13 (1991).

[69] *Id.* at 12.

Mathematics that could be learned in such a setting include everything from the simple arithmetic required for bookkeeping to the calculus employed by modern financial theory to establish the value of businesses under conditions of uncertainty. English composition could be taught through the preparation of marketing brochures and business correspondence, while grammar could be learned by drafting and interpreting contracts. American government or civics could be taught through the experience of complying with government regulations applicable to the clinical business operations and the lobbying or administrative efforts needed to secure waivers or exemptions from these regulations.

As in law school clinical programs, these students could be placed in selected business firms in part-time, after-school, or summer internships that would continue their training at a more intensive level. Permanent employment could follow for the best students. After several years of such seasoning, protégés would then be ready to operate their own firms under the aegis of the TIC program. Clinical education, internships, and employment would provide not only the desired training, but also the trial experience that would aid in identifying the most motivated and talented future entrepreneurs.

The proposed curriculum changes would have significant budgetary implications for the state and local governments that control educational policy for the public schools and provide the overwhelming share of their resources. Clinical education—at least as structured with full-time faculty in law schools—is expensive; with its emphasis on individual coaching, it is more labor-intensive than the traditional large classroom lecture. However, the basic TIC proposal does not depend upon curricular reform, and at least some of the suggested reforms—the internships and externships, for example—would not require significant new resources. In any event, if experiential education is effective, it would be far cheaper in the long run for society to accept the initially higher costs and reap the subsequent rewards obtained from harnessing the human potential that is currently squandered in our central cities.

VI. Conclusion

The civil rights era produced an enormous increase in the human and social capital resources of the black middle class. However, this group has largely abandoned the inner city, just as the white middle class did before it. Those minorities who have yet to see the economic benefits produced by the civil rights era now need policy tools to increase their human and social capital investments. They have suffered the adverse consequences of both the changing role of central cities and the restructuring of American industries so that these no longer provide an expanding number of high-wage, unskilled jobs with health and pension benefits as the auto and steel industries once did. This proposal cannot address these larger problems. Instead, it is offered as one way to harness the ambitions and talents of those who thus far have been left behind. It is just one arrow in the quiver of local governments that need many more. If a black entrepreneurial class can be strengthened and enlarged while simultaneously creating ties of mutual interest across the racial barriers that divide our society, we will all gain.