Federal Reserve Bank of Boston

Communities&Banking

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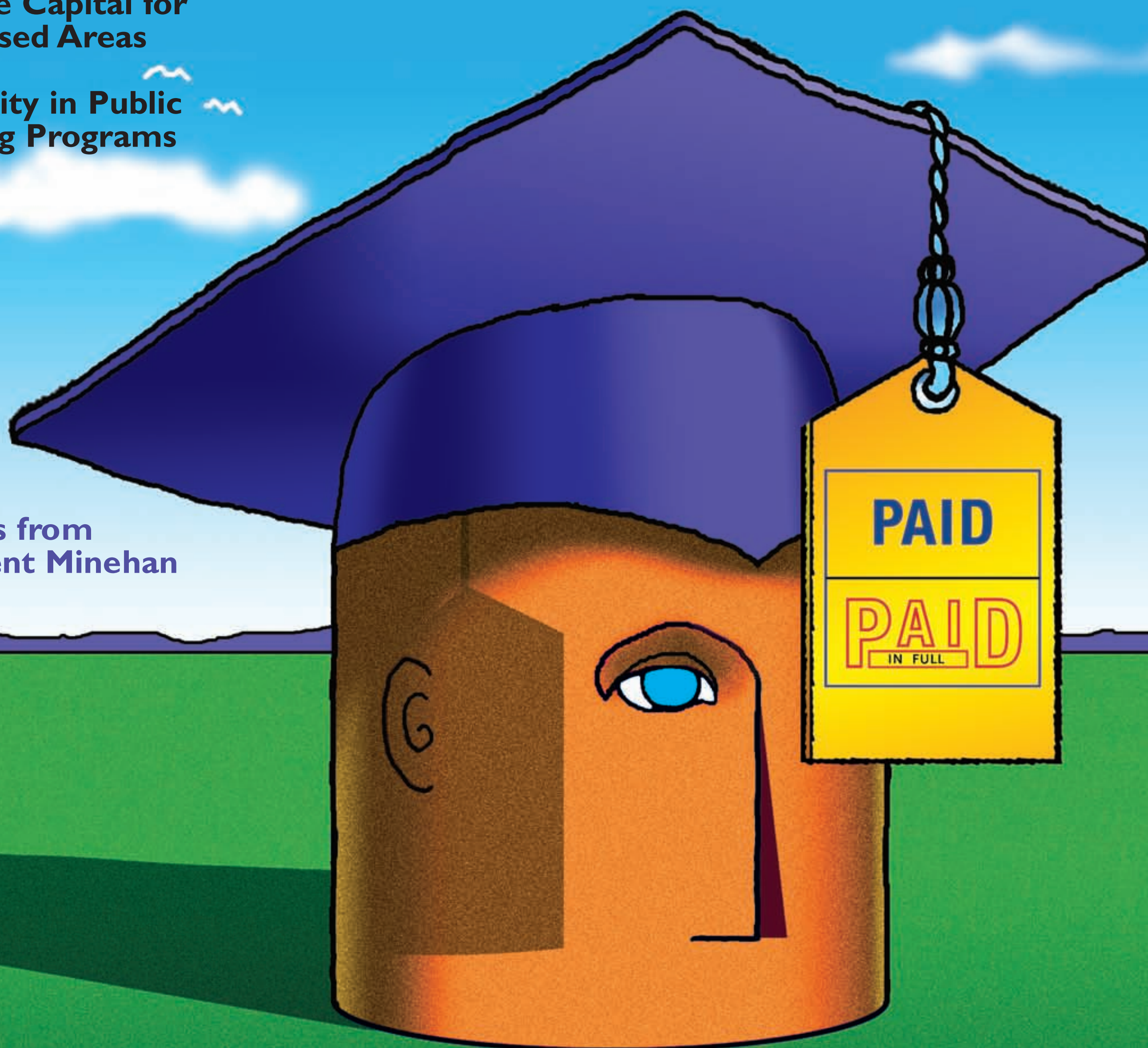
New Research on Generosity

Alice Rivlin on Cities

Venture Capital for Distressed Areas

Flexibility in Public Housing Programs

Insights from President Minehan



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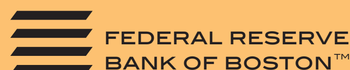

When Donors Feel Generous:

Economic Research on Prosocial Behavior

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by Stephan Meier
Federal Reserve Bank of Boston

Economists have studied selfish behavior extensively, but until now, not much economic research has been done on prosocial behavior. To some extent, that has handicapped nonprofits, which rely heavily on volunteers, donations, and the thoughtful impulses of individuals, businesses, and governments. For them, the more that is understood about prosocial behavior—why people are generous or kind, what inspires them to give more, what sorts of people give to what sorts of organizations—the better.

Recent research into the prosocial psyche highlights three basic precepts: people give at the level of their peers; people want their giving to have an impact; and people give to groups with which they identify.

Understanding the conditions under which people behave prosocially is important—not only for fund-raisers but also for policymakers.

The Role of Self-Interest

Self-interested behavior is not always undesirable. Indeed, it often benefits society. One of the most important insights in economics is that the pursuit of self-interest by both consumers and producers is consistent with broader social goals and even necessary to them.

Adam Smith famously stated the precept in his 1776 book *The Wealth of Nations*: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard of their own interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our necessities, but of their advantage." The idea is that individuals need not consciously act to optimize social welfare, because the invisible hand of the market will guide them to do good.

Adam Smith was also aware, however, that the pursuit of self-interest does not always maximize the wealth of nations. Too often, it falls short. If many people behave selfishly and take a free ride on the efforts of more civic-minded citizens, the public good is not served.

Some free-riders leave to others the job of protecting the environment, for example, or organizing a community event. Some refuse to donate blood but count on others providing blood if they need it for themselves. And there are many who refrain from enforcing a social norm like picking up litter because they think littering laws are for others to enforce.

All these individual calculations result in suboptimal outcomes: too little environmental protection, difficulty finding somebody to organize community events, too few blood donors, and too few people enforcing social norms. If everybody behaved like that, there would be insufficient donations of time and money to provide a socially optimal amount of public goods.

The Common Good

For society as a whole, it is therefore important that more individuals be prosocial and fewer be purely money maximizers. Fortunately, humans are among the most cooperative species, and people help each other even if not related by blood. In 2001, for example, Independent Sector reported that around 45 percent of American adults volunteered, and 98 percent of all private households donated on average $1,620 to charitable organizations.[1] Nonprofits of all sizes depend on prosocial behavior to accomplish their mission.

There are numerous other examples of prosocial behavior: some senior citizens vote themselves higher taxes in order to help schools from which their children have long ago graduated; and fewer people abuse welfare or bankruptcy programs than a selfish model would predict (in fact, some who are eligible for welfare programs don't even apply).

Understanding the conditions under which people behave prosocially is important—not only for fund-raisers but also for policymakers who hope to increase cooperation among individuals in a society.

What the Research Shows

Research on this topic points to three important factors influencing people's pro-social behavior:

Peers. People want to know if other people are being generous. In the area of charitable giving, for example, people look very closely at the behavior of their reference group. If others give money, they do, too. If others give a lot, they give a lot. When the envelope comes around for a colleague's gift, who does not look at what the others have given and use that to decide what amount would be appropriate?

This feature of human behavior has implications for all who want to inspire their target audiences to be cooperative and prosocial—and to keep them from underestimating how willing their peers are to promote the public good. Government agencies, for instance, should hasten to remove small signs of crime like smashed windows so that people don't overestimate the amount of criminal activity in the area, which can actually lead to more crime.

People are more likely to behave prosocially if others do, and the same holds for antisocial behavior. When the group behavior is antisocial, it is very difficult to reverse. Consider the rampant tax evasion in some parts of the world. How do you change the culture when individuals in a country can reasonably ask why they should pay taxes if nobody else does? This may explain the persistence of big differences in prosocial behavior among regions, nations, and neighborhoods.

Impact. People want to get a bang for the buck. When they buy a car or a television, it matters to them if they are getting good value. Similarly, people care about how expensive prosocial behavior is. For example, if they can deduct charitable giving from their taxes, they feel that giving is less expensive. If the individual's tax rate is 30 percent, one donated dollar will translate to only 70 cents with the deduction. Of course, if people have a lower tax burden—say, 10 percent of income—giving one dollar will be more expensive.

One way to counteract that is by matching people's donations instead of giving a tax rebate. If every 70 cents in donation is matched by someone else's 30 cents, people tend to give more. Many corporations match their employees' charitable giving, and nonprofits often find one donor to match others' gifts. Governments, too, might think of using some kind of matching to inspire prosocial behavior.

Group identification. People are favorably inclined toward members of the groups they identify with—their nation, their race, their university, their favorite baseball or soccer team, or their profession. Some of these identities are more important to them than others, but all influence their prosocial behavior. People

are more likely to cooperate and help somebody from their group. Even when people are randomly assigned to a group, such as a social class or a dormitory, they automatically become more prosocial toward members of the group. Although that fosters desirable behaviors within the group, it may present challenges when the goal is to interest people in helping outsiders from a different dormitory, race, social class, or nationality.

In sum, research shows that people behave prosocially in the absence of any clear monetary gain, even in total anonymity. The reasons are manifold, but the bottom line is that it makes them feel good.

A study done with German data showed very explicitly that helping others through volunteering makes people happy.[2] Not only did volunteers report higher life satisfaction than nonvolunteers but volunteering causally increased people's life satisfaction.

So the same Adam Smith who praised the advantages of selfishness was probably right when he stated in his 1759 book *The Theory of Moral Sentiments* that "concern for our own happiness recommends to us the virtue of prudence: concern for that of other people." He was probably right in both books. Often people who are focused on making their own fortune are simultaneously doing the socially desirable thing, but in many situations they also need to be encouraged to behave more selflessly for the greater good.

People behave prosocially in the absence of any clear monetary gain, even in total anonymity. The reasons are manifold, but the bottom line is that it makes them feel good.

Stephan Meier *is an economist in the Research Center on Behavioral Economics and Decision Making at the Federal Reserve Bank of Boston.*

Endnotes

[1] See *Giving and Volunteering in the United States* (Washington, D.C.: Independent Sector, November 2001), http://www.independentsector.org/PDFs/GV01keyfind.pdf.

[2] Stephan Meier and Alois Stutzer, "Is Volunteering Rewarding in Itself?" *Economica* (conditionally accepted for 2006). See also Stephan Meier, *The Economics of Non-selfish Behaviour: Decisions to Contribute Money to Public Goods* (Cheltenham, United Kingdom: Edward Elgar Publishing Ltd., 2006).

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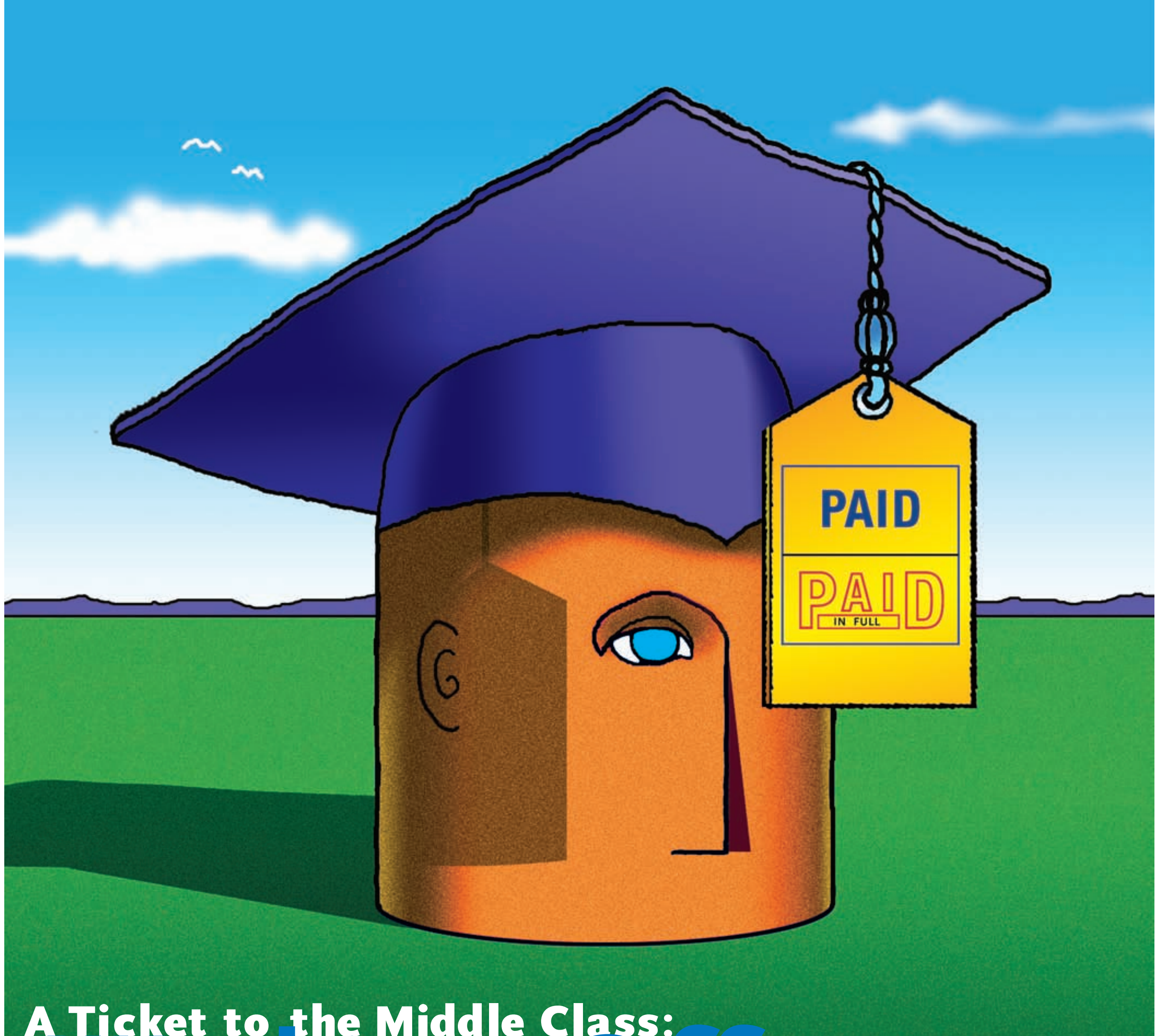

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A Ticket to the Middle Class: Working Off College Debt

by Elizabeth Warren, Sandy Baum, and Ganesh Sitaraman

Americans are a contentious lot. They express an astonishing variety of opinions about politics and religion, sports teams and movies, vitamin supplements and workplace dress codes. Differences on questions of social class, the acceptable level of economic inequality, and the importance of economic mobility are particularly sharp. But on one idea we are united: **97 percent of Americans agree that a college degree is "absolutely necessary" or "helpful" to secure a place in the middle class.**[1] In fact, Americans see a college degree as the single most important determinant of a young person's chances of success, the ticket for admission to the middle class.

But it is becoming harder than ever for families to pay for that ticket. And as students increasingly try to shoulder the burden, many are graduating deep in debt—tempering the good news of higher earning potential with the higher risks associated with debt. Many others, including almost 20 percent of low-income high school graduates with high math test scores, do not manage to enroll in college at all within two years of graduation.[2]

If college is the ticket to the middle class, then a new financing mechanism is essential, one that lets students take responsibility for the cost of their own educations without burdening their families unduly, forcing them to make career choices that push them out of public service, or mortgaging their futures. Our *Service Pays* proposal is designed to give every student who wants to work hard an option to pay for college.

Aid Rises a Little; Costs Rise a Lot

Tuition and room and board now cost more than $12,000 a year at the average public university.[3] Throw in books and a few other basics, and the bill pushes $16,000. To pay that, the average U.S. family of four not receiving grant aid would have to commit 25 percent of its total pretax income.[4]

A private education is even more expensive, averaging almost $30,000 a year for tuition, fees, and room and board. Even though grant aid is available to the majority of students, many pay a high price for the opportunity to study in these institutions, often more than $100,000 by graduation. Despite the cost, some students need the choices private colleges often offer in terms of size, admissions standards, fields of study, religious affiliations, or geography. Less expensive state schools may therefore not be an option.

The numbers keep getting worse. After adjusting for inflation, in-state tuition and fees at the average state university have doubled in 15 years.[5] In fact, the price of college has grown twice as fast as the price of health care.

Grants and scholarships once were reserved for the poorest students, but today almost two-thirds of all full-time undergraduates receive them. Even so, this aid is insufficient to close the growing gap between price and family ability to pay. As charges at the average public four-year college grew by almost $5,000 over the decade from 1994 to 2004, grant aid per student grew by only half that.[6] So students and families have increasingly turned to loans. More than 60 percent of public college graduates and nearly 75 percent of private college graduates have taken on debt to pay for college. The median debt load for public college graduates who borrow is $15,500; for students from private colleges, $19,400. Although federal education loans top $60 billion, they cannot meet demand, and students are taking private loans with less favorable terms—now about 18 percent of total education debt.

The *Service Pays* proposal is designed to give every student who wants to work hard an option to pay for college.

An estimated 20 percent to 30 percent of college students have debt burdens so large that they are difficult to manage.[7] Students who choose public service or other low-paying careers, who come from low- and moderate-income families, or whose education does not open the anticipated opportunities often begin their adult lives with debts that completely outstrip their earning potential, creating a financial hole from which they may never escape.

For years, policymakers have worried about how to make college accessible to the poor. Today the middle class is worried, too. Denise Robinson, a Texas schoolteacher, describes putting her daughter through college: "You don't make enough that you're [rich], but you don't qualify for financial aid. We were probably out at least $100,000."[8]

Making College Affordable for All

College students can shoulder educational costs if they are assured of opportunities to repay loans. A program that features four years of loans, followed by four years of public service to forgive those loans, would be such an opportunity. It would significantly diminish the burden of education debt and keep open the option of public service and other lower-paying but interesting jobs for grads.

- The federal government would increase the amount students can borrow in the unsubsidized Stafford loan program, offering money for four years of college tuition, fees, and room and board to any student who wants it, on the same terms as current student loans.[9] Under Service Pays, students who work in community service after college would be forgiven one year of college expenses for each year of public service work.

- College loan forgiveness would be available to anyone graduating from any two-year or four-year accredited school, public or private.

- The dollar amounts of the available loans would be pegged to average prices at public four-year colleges and universities. Students would have four years to work off those loans.

- Any student, regardless of family income, could borrow the money, but the debts would have to be repaid by ordinary loan repayment or through community service.

With Service Pays, typical students would begin adult life debt-free at 26 with a college diploma and four years of work experience. Students could buy their own tickets to the middle class.

Serving the Country

The community service aspect of Service Pays is as important as access to a diploma. America has critical needs in national preparedness, community infrastructure, and education. Many

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young people would like to do public service, but the low pay combined with college debts often makes it impossible. Service Pays would open new avenues.

Service at Home. Community service workers could be assigned to the states to work in public schools, run after-school tutoring programs, clean up public buildings and parks, rebuild roads and bridges, improve the environment, computerize state administrative systems, assist municipal police and firefighters in administrative functions, and organize communities to reduce crime and develop the local economy. Students who work for nonprofits such as Habitat for Humanity or Teach for America would also be eligible.[10] For each year of community service after college, one year of loans would be forgiven.

Military Service. Active-duty service would qualify for loan forgiveness. Each year of active-duty service would offset one year of loans. Eight years of reserve service plus six months of active service would translate to four years of loan forgiveness.

International Service. The U.S. Foreign Service, an expanded Peace Corps, and an international aid corps (to address emergencies such as tsunamis) would also qualify for loan forgiveness. Each year of service would result in one year of loan forgiveness.

Service Pays would reduce the impact of Baby Boomer retirements from government and could help strengthen community spirit, promote patriotism and service, and improve perceptions of America abroad.

Service-based debt-forgiveness programs that already exist are limited. At AmeriCorps, for example, loans may be forgiven only up to $4,720 per year. Service Pays can build on past successes by expanding educational benefits and directing more energy toward national challenges.[11]

Costs

What are the costs? We begin with one central idea: educating our young people will pay off. The GI Bill helped 2.2 million returning World War II soldiers become engineers, scientists, entrepreneurs, and business leaders, fueling the economy and raising the standard of living.12 It cost $7 billion (about $240 billion in today's dollars).13 For every dollar invested, however, about $5 were returned over 35 years in higher productivity and tax revenues.14

The country would derive similar returns from Service Pays—the services themselves plus increased tax revenue. The average college graduate pays over $5,000 more each year in total taxes than a high school graduate.[15] It is short-sighted to lose long-term benefits by failing to make higher education financially accessible.

In the current school year, students will receive 1.5 million bachelor's degrees and 680,000 associate degrees. Roughly two-thirds of the bachelor's students and half of the

master's students will graduate with debt. If 10 percent participated in the Service Pays program and paid off their entire student debt, the cost of forgiving their loans would be about $3 billion. This cost would be borne by taxpayers as an investment in our future.[16]

Some jobs created for the students would be compensated by the federal government; others would be paid with state or local government funds or by the nonprofit organizations that employ the students. Jobs would be entry level, with corresponding wages and benefits. Some of the federal positions would be in the military, but those costs would not be attributable to the Service Pays program. Funding for the Foreign Service and the Peace Corps would be driven by policy decisions. The possible combinations of opportunities make cost estimates difficult, but a federal investment of $500 million could support 25,000 graduates at $20,000 each.

For state and local governments there would be the cost of moving an influx of college graduates into public service jobs. Although some federal support might help create the new jobs, the principal burden should be borne by the organizations—whether states or nonprofits—that benefit from the workers. The states could consider in-kind payment as well, such as housing in unused college dormitory space, surplus housing at closed military bases—or for environmental projects, some on-site housing.

At a time when some state budgets are under sharp fiscal constraints, absorbing new, short-term workers could be difficult. But states recognize the long-term benefits to the local economy of a talented workforce. In effect, Service Pays would ask the states to decide if they wanted to recruit college graduates to put down roots in state; if some states did not participate, others might expand their job offerings. A well-educated workforce is our best hope to grow the economy, remain competitive internationally, and fund government needs for health care and retirement. We are living through a time of big challenges. And big challenges call for big solutions.

Elizabeth Warren *is the Leo Gottlieb Professor of Law at the Harvard Law School.* **Sandy Baum** *is a professor of economics at Skidmore College and a senior policy analyst for the College Board.* **Ganesh Sitaraman** *is co-author of the 2003 book* Invisible Citizens: Youth Politics after September 11.

A well-educated workforce is our best hope to grow the economy.

Endnotes

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2 David Ellwood and Thomas Kane, "Who Is Getting a College Education? Family Background and the Growing Gaps in Enrollment," in *Securing the Future*, eds. S. Danziger and J. Waldfogel (New York: Russell Sage, 2000). See also Sandy Baum and Kathleen Payea, *Education Pays: The Benefits of Higher Education for Individuals and Society, 2004* (New York: The College Board, 2004).

3 *Trends in College Pricing* (New York: The College Board, 2005).

4 Bureau of the Census, "Median Income for Four-Person Families by State," http://www.census.gov/hhes/income/4person.html.

5 U.S. Department of Education, National Center for Education Statistics, *Digest of Education Statistics, 1999*, table 312, http://nces.ed.gov/programs/digest/d05/tables/dt05_312.asp.

6 *Trends in College Pricing, 2004* and *Trends in Student Aid, 2005* (New York: The College Board).

7 Sandy Baum and Marie O'Malley, *College on Credit* (Washington, D.C.: Nellie Mae, 2003).

8 Elizabeth Warren and Amelia Tyagi, *The Two-Income Trap: Why Middle Class Mothers and Fathers Are Going Broke* (New York: Basic Books, 2003), 42.

9 Qualifying students would remain eligible for subsidized loans, which could also be paid off through the program. Loans that parents take under the PLUS program to pay for students could be paid off this way.

10 Nonprofits adopt the same standards as AmeriCorps: "direct service activities must address local environmental, educational, public safety (including disaster preparedness and response), or other human needs."

11 The National Security Education Program, for example, provides scholarships for a summer ($8,000), semester ($10,000), or year ($20,000) for students to study abroad in regions critical to U.S.national security. Award recipients must spend one year serving in a federal department or agency related to national security (State, Defense, Homeland Security, Intelligence). In 2005 to 2006, about 130 students received the scholarships.

12 Suzanne Mettler, "The Creation of the GI Bill of Rights of 1944: Melding Social and Participatory Citizenship Ideals," *The Journal of Policy History* (October 2005): 345.

13 Samuel H. Williamson, "What Is Its Relative Value? Five Ways to Compare the Worth of a United States Dollar, 1790-2005," Economic History Services, http://eh.net/hmit/compare. The value is calculated as a relative share of GDP.

14 Subcommittee on Education and Health of the Joint Economic Committee, "A Cost-Benefit Analysis of Government Investment in Post-Secondary Education under the World War II GI Bill," December 14, 1988, in *The Future of Head Start* (Washington, D.C.: Government Printing Office, 1990).

15 *Education Pays Update, 2005* (New York: The College Board, 2005).

16 Service Pays would change the incentive structure in the student loan program in a variety of ways that would require careful analysis. Some observers suggest that the increased availability of student loans fuels increases in college prices. However, most empirical analyses fail to find such an effect. See, for example, Cunningham et al, *Study of College Costs and Prices 1988-89 to 1997-98* (Washington, D.C.: National Center for Education Statistics, 2002): 157.

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25 Years of Internships

by Lillian Seay, Federal Reserve Bank of Boston

"When I came to the Bank for a summer job, I was a junior from South Boston High School. I worked through the school year and the following summer. When I graduated, I thought I would leave after the summer job had ended and never see this place again. It's been 20 years at the Bank. I am now a supervisor. I am married with two children and have a house. The Bank has been good to me."

This statement by a former high school summer intern is the reality for many Federal Reserve Bank of Boston employees who have secured permanent employment inside or outside the Bank thanks to the student work program. The program is just one example of what many organizations are now doing to contribute to their communities.

Former interns credit the Federal Reserve with critical support, such as mentoring, skills training, and job experience. A recent intern writes, for example, that working at the Bank improved his communication skills and his ability to work with others—giving him an edge in his future career.

The Boston Compact

In 1982, the City of Boston, recognizing the need for an organized effort to put young idle hands to work for the summer months, partnered with the Boston Private Industry Council (PIC) to organize Boston's summer jobs program. *The Boston Compact*, a document developed the same year, encouraged local businesses of all sizes to commit to hiring high school students for summer jobs. Many businesses established formal partnerships with schools.

The Federal Reserve was matched up with South Boston High School. When South Boston High School, like many large schools in the Boston system, was divided up in 2001 to capture the potential advantages of smaller schools, it got a new name—Excel High School—but retained the Bank's ongoing commitment.

For 25 years, hundreds of students have been employed for seven to eight weeks in the summer at the Bank. Some have used their clerical skills; others have gained additional skills by assisting with department projects. Some interns have been fortunate enough to get assigned to their special interest, such as art or media. For most, the job is their first exposure to the world of work and to people outside their communities. They quickly learn that adapting to the work culture and striving for outstanding performance could lead to an after-school job when summer is over.

Students who successfully participate in the job program, who graduate from high school, and who do not have immediate plans to attend college have the option of applying for entry-level jobs at the Bank. Tuition reimbursement and in-house training are also available and have helped many students further their education and advance on the job.

Expanding the Outreach

In 1999, a newspaper article drew public attention to the poor reading scores of Boston Public School students who took the Massachusetts Comprehensive Assessment System (MCAS). The results caused concern because the MCAS would eventually determine whether or not a student received a high school diploma. Federal Reserve Bank of Boston President and CEO Cathy Minehan rallied corporate leaders to get companies involved in finding solutions.

Workplace Education

That summer, the Bank and two other organizations provided 90 minutes of paid release time during the work day for MCAS tutoring by trained Boston school teachers. Students participated in Classroom at the Workplace on-site at the companies.

The results were impressive. Overall, students achieved a 1.5 grade level increase in reading ability that first year. In 2001, math was added to the program. Other companies joined in the effort, and Classroom at the Workplace became a staple in the Boston summer jobs program. Today it is privately funded.

The Bank has offered other educational opportunities, including summer classes in advanced English and technical writing, and workshops in personal finance and credit. Last summer, interns took part in a YMCA Training, Inc., business simulation. For this class, a section of the Bank's economic-education suite was converted into a mock business workplace. Students were assigned job responsibilities, such as purchasing or accounting, and were set the task of increasing the bottom line. After meeting that challenge, they gave a PowerPoint presentation on the work. Practicing the presentation was another learning experience. One student wrote that it

Photograph by Marie McGinley

FinTech Scholars from Excel High School hold paid internships at the Federal Reserve Bank of Boston.

improved his skills and taught him that tasks are "easier when you are prepared." The biggest success, however, was that students from culturally diverse backgrounds learned to work productively toward a common goal.

FinTech Scholars

In 2006, building on the success of Classroom at the Workplace, the Bank launched an initiative to help urban students pursue careers specifically in business and finance. The FinTech Scholars program started with 12 students. As Public and Community Affairs Assistant Vice President Marques Benton puts it, the strength of the program is that "work provides a context for learning."

First, juniors at Excel High are introduced to business through a Bank-sponsored class held at the school. The curriculum comes from the National Foundation for Teaching Entrepreneurship (http://www.nfte.com). Students from the class may apply to FinTech at the Bank. Requirements are a minimum 2.5 grade point average, teacher recommendations, and a stated interest in business. Business casual dress code is emphasized. Because some students prefer not to wear business casual to school, they change their clothes when they get to work.

Students with a GPA lower than 2.5 may be admitted to the program on a probationary basis if they are endorsed by at least three teachers as having improvement potential. After their interviews, they are given jobs around the Bank. The student who fails to increase his or her GPA, or fails to meet program standards, or does not work well in the assigned job is obliged to depart. Having high expectations works. One student who entered the program with a very low GPA is now on the honor roll. It is not uncommon for students on the cusp of success to start improving right away. In FinTech's first year, the average quarterly GPA went from 2.3 in the first marking period to 2.65 in the third. Additionally, students reported making improvements in teamwork, organizing, conflict management, ability to take orders, and presentation skills.

Intangibles

When businesses offer paid internships to urban youth, they are doing more than providing a paycheck. They are offering new role models to young people and a group of adults who are interested in their welfare. At the Federal Reserve, students learn life lessons as well as career lessons.

Each FinTech Scholar is given a mentor. The mentor is selected from a department other than the one to which the student is assigned and provides support and an objective viewpoint on work, school, career—and sometimes life direction.

As the FinTech Scholars near graduation, they are encouraged to enroll in college, and Bank departments that have interns are asked to let them work part-time while they pursue higher education. All the FinTech Scholars who graduated from Excel in 2006 are now enrolled in accredited colleges. After they graduate, the goal is to find them a job at the Bank or at a local participating financial-services company.

When organizations become active members of their communities, the benefits are widely shared.

Lillian Seay *is Education and Partnership Specialist at the Federal Reserve Bank of Boston.*

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Alice M. Rivlin
Senior Fellow
Brookings Institution

Targeting Urban Revitalization

Economist Alice M. Rivlin *has had many significant roles in Washington. She was vice chairman of the Federal Reserve Board, the director of the White House Office of Management and Budget, and the founding director of the Congressional Budget Office. Currently, she is a visiting professor at Georgetown University and a senior fellow in economic studies at the Brookings Institution, where one of her key concerns is urban revitalization.*

Rivlin was born in Philadelphia and raised in Indiana. She earned a bachelor's in economics from Bryn Mawr College and a Ph.D. from Radcliffe. A winner of a MacArthur Foundation Prize Fellowship, she has published numerous articles and books. In 2003, she wrote "Revitalizing Washington's Neighborhoods: A Vision Takes Shape" about targeting specific neighborhoods for public improvement efforts. Targeting, which is meant to make a splash that will ripple outward, is being tested in various forms around the country. In 2005, for example, the Federal Reserve Bank of Richmond measured the impact of a successful local targeting initiative called Neighborhoods in Bloom.

Because of a growing interest in this concept, *Communities & Banking* decided to ask Rivlin about the Washington experience and how it might apply to New England.

http://planning.dc.gov

How did you get involved in efforts to revitalize Washington neighborhoods?

AR: From 1998 to 2001 I chaired the financial control board that the federal government created to help the city pull out of financial crisis. That assignment got me heavily involved in Washington's financial condition and its economic development.

What challenges faced the city as it recovered?

AR: A big challenge related to the fact that the city had lost more than a third of its population and much of its middle class. Washington had lost far more people than jobs. The loss of residents was especially crucial to Washington because the city is prohibited by Congress from taxing people who work in the District but live outside it. That is a serious prohibition. All states with income taxes tax nonresident income. In Washington, two-thirds of income is earned by nonresidents. Increasing the number of resident taxpayers is essential to the city's fiscal future. Hence, we needed a focus on reviving neighborhoods and rebuilding a middle class.

You have written that improving schools is critical.

AR: It's the classic chicken and egg problem. People with children avoid the city because the schools aren't good, and the schools aren't good because the middle class population with children moved out. So the question is, How do you break this cycle? One answer is: try to do a lot of things at once in neighborhoods where the collective effort is likely to be successful. Public funds are limited, so if you can concentrate them in neighborhoods that have potential, maybe you can leverage those funds. Brookings and the D.C. planning office worked together to choose target neighborhoods that were neither the worst nor the best but had development potential.

What criteria did you use to identify suitable neighborhoods for targeting?

AR: The city identified "emerging" neighborhoods with generally positive characteristics (relatively stable population, few abandoned buildings, relatively low crime) that had not had much new investment yet and "transitional" neighborhoods that were already showing evidence of rising property values. The target neighborhoods were of both kinds, but they required different investment strategies. In retrospect, there were probably too many target neighborhoods.

How did people react to your recommendations?

AR: The first thing to recognize about targeting is that it has political risks. People who live outside the targeted neighborhood wonder why you aren't targeting them. There is pressure to broaden the area. After the planning office and Brookings selected neighborhoods, the mayor officially endorsed the policy. However, the city's implementation was uneven and not sustained. Some neighborhoods received considerable attention from city agencies. Money flowed in, and the strategy worked. Elsewhere, targeting worked less well, either because of community opposition or because the city didn't follow through.

Why would there be community opposition?

AR: Mostly because of fear of change and gentrification. Long-time low-income residents fear being pushed out by newcomers and rising housing costs. In recent years, the Washington housing market has taken off. There has been a lot of building and a disproportionate rise in both home-purchase prices and rent. The rate of growth in housing prices has tapered off in Washington's

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"The importance of educational institutions to the economy of cities cannot be overstated," says Rivlin.

The more that people looked at high-crime areas, the more they realized that the problem was not just lack of law enforcement.

more affluent sections but is still rising in the lower-priced areas. The bottom line is that although Washington has put a good deal of money into creating and preserving affordable housing, it is disappearing.

It's hard to tell how much of the recent economic growth results from targeting and other public efforts. In a strong market city, such as Washington right now, much development would have happened anyway. Possibly, targeting is more necessary for weaker market cities.

Has the economic development succeeded in adding middle-class residents?

AR: We haven't had a census since 2000, but the decline in population appears to have been arrested, and the number of households is growing. However, the decline in household size continues. That adds up to more housing units, but not necessarily more people or more children in the schools.

Did the city follow your recommendations closely?

AR: Actually, Washington shifted targeting strategies in midstream. The impetus for the original targeting strategy was to jumpstart economic development. The impetus for the current strategy is reducing crime. But the two strategies are not really far apart. The more that people looked at high-crime areas, the more they realized that the problem was not just lack of law enforcement. It was neighborhood deterioration, lack of employment opportunity, poor schools—everything that goes with really bad neighborhoods. Out of that understanding came the New Communities Program, which focuses on high-crime neighborhoods that have revitalization potential.

Are there revitalization lessons that we could apply in New England?

AR: First, a city with a strong housing market can lose a lot of affordable housing quite quickly, and only a major public effort can counteract that. For example, a Washington task force that I recently co-chaired recommended doubling current efforts on low- and moderate-income housing.

Second, a targeting strategy is complex to implement. You can't just announce the targeted neighborhoods. You need a strong hand directing public spending to those neighborhoods and working hard to form public-private partnerships. Public money can only go so far, and you need the support of neighboring institutions, such as universities. It's quite hard to pull off.

Does Washington have a strong leader for New Communities?

AR: The city administrator, Robert Bobb, pushed it very hard. The first project is a major effort in an area with a badly deteriorating public housing project, Sursum Corda. The initiative is best described as a local version of HOPE 6. HOPE 6 is a federal program that has been used successfully in Washington to transform deteriorating public housing to mixed-income communities. New Communities uses local money instead of federal to preserve subsidized housing while adding market-rate housing and big improvements in public services.

You mention partnerships. In Boston, the Federal Reserve Bank partners with a local high school to offer city youth mentoring and internships. What kinds of institutions do you think should help communities?

AR: The importance of educational institutions to the economy of cities—especially in New England—cannot be overstated. When I visited Worcester, I was impressed with Clark University's community partnering, and Trinity College has built strong partnerships in Hartford. In Washington, Howard University worked with Fannie Mae to help revitalize the neighborhood around the university and aid local home-buyers. George Washington University aided and mentored a high school. Since public dollars are usually focused on affordable housing, schools, and street improvements, other partners have to help in order to finance market-rate housing and retail.

Describe a targeted revitalization that is working.

AR: The Anacostia River waterfront in Washington is an exciting example of an major project that involves numerous public and private partners with the community itself. Federal agencies are moving their offices to the waterfront, and there will be mixed-income housing and mixed development, including a baseball stadium. Success breeds success. If a targeted area makes visible changes, the progress will spread.

Are there any downsides?

AR: First, economic development puts pressure on housing prices and rents, hurting low-income renters the most. And in Washington, which is segregated historically, the conflicts are seen as racial. As economic development moves from the west to the east, blacks fear that the city will become too white. Secondly, targeting is difficult politically. It's always easier to spread the money in a broader area, but then the impact is diluted. Right now we are pinning big hopes on the Anacostia waterfront, and it seems to be going well. As long as nothing occurs to disrupt the regional economy, Washington should continue to become a more attractive and livable city for a diverse population. An important goal is to grow, attract, and retain more middle-income families—and, with them, better schools and more prosperous neighborhoods. Attaining this goal involves both opening opportunities for low-income people to move into the middle class and stay in the city, and attracting more middle-income families with children. What we don't want to become is a city of upper-income families with few children.

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Venture Strategies *for Distressed Areas*

by Michael H. Gurau
CEI Community Ventures Fund

Workers at a CEI Community Ventures Fund investment, Look's Gourmet Food Company, prepare canned seafood. In the background, Cutler Harbor.

Look's Gourmet Food Company's plant in Whiting, Maine.

Communities have businesses and entrepreneurs capable of building the sort of value that venture capital investors require.

Venture capital is a powerful tool of economic development. This form of high-risk, high-return investment typically trades capital for minority ownership in fast-growing small businesses. Venture investors provide capital to small, often loss-making businesses with the hope and intent that the capital will accelerate business development and result in value appreciation for owners.

In urban markets, venture capital investment creates meaningful employment and resources for the community and stakeholders. It also helps foster a culture of innovation and risk-taking. However, rural and distressed communities tend not to attract this form of capital.

Of the more than $30 billion of venture capital raised over the past five years and available to support fast-growing businesses, most will go to a few cities. As much as 80 percent of venture capital in the United States is invested in just five states. Venture capital tends to be directed toward high-margin, high-growth businesses, such as information technology and life sciences. It is a tremendous catalyst for job creation in those sectors, but the jobs require skill sets one generally doesn't find in rural and distressed communities.

Nevertheless, those communities have businesses and entrepreneurs capable of building the sort of value that venture capital investors require. Opportunities in these markets may be less well developed, but with the right resources and guidance, they can deliver investment-grade returns—as well as jobs and economic development for markets that do not have the resources of their richer urban neighbors.

A Need for Capital

In 2001, the U.S. Small Business Administration launched the New Markets Venture Capital program to drive capital into distressed and underserved communities. Under this program, SBA matches capital and operational-assistance resources raised by fund managers who qualify to deploy this regionally targeted form of capital.

To date, six funds have been licensed to receive New Markets funding. As a group, they manage $10 million to $30 million in equity coupled with $3 million to $6 million in operational-assistance grant funds. One of these funds is CEI Community Ventures Fund (CCVF), a $10 million for-profit subsidiary of Coastal Enterprises, Inc. CEI is a nonprofit community development financial institution (CDFI) based in Maine.[1]

All photographs for this article are courtesy of Look's Gourmet Food Company

CCVF is in its fourth year of investing funds in its targeted areas—Maine, New Hampshire, and Vermont.

Why Communities Lack Capital

In city centers such as Boston, venture capital investors typically don't lack for investment-grade opportunities. The New Markets program, however, faces challenges in uncovering and developing growth opportunities in distressed communities, whether urban (say, Lewiston, Maine, or Manchester, New Hampshire) or rural (Downeast Maine).[2] The challenges include:

- **Less-experienced entrepreneurs.** Business owners in undeserved markets often have limited perspective on their business and market opportunities. That is frequently due to lack of capital (which necessitates modest growth ambitions) and to the inexperience of the individuals running the businesses. Moreover, the business owners often lack basic information about the nature and availability of growth or expansion capital, other than that available from friends, family, and banks.

- **Few companies seeking capital.** When companies do not know that capital for growth exists, they tend to work within their own resources to build their businesses. In many cases, companies that might be able to pursue faster growth simply are not aware that they could be a fit for growth or expansion capital. Additionally, entrepreneurs often possess an aversion to taking on outside investors. They worry that sharing ownership could cause them to lose out economically or in terms of control.

- **Sector limitations.** Distressed and underserved communities are not hotbeds for technology start-ups and thus seldom attract traditional venture capital funds. Consumer- and industrial-product companies are more common than technology companies in these regions.

CCVF'S Approach

The experience of CEI Community Ventures Fund may be instructive. CCVF focuses on community education and proactive origination. To optimize the odds for success, it elected to work its markets harder and more comprehensively than traditional funds in more developed urban markets would. The fund educates local communities using seminars and editorial contributions to business publications.

In the area of education, CCVF has partnered with regional economic development organizations and business sponsors to organize and deliver nearly 40 Financing Fast Growth seminars to more than 1,500 attendees over the past three years. Such capital clinics serve two purposes: to educate potential and existing entrepreneurs that this unique form of capital exists; and to create opportunities for CEI Community Ventures Fund.

In addition to educating through seminars, the fund contributes articles on venture capital and small business growth issues to business periodicals in the targeted states of Maine, New Hampshire, and Vermont. Topics include how to find capital, how to value your business, and how to negotiate and work effectively with investors.

CCVF also develops investment opportunities directly by identifying, researching, and contacting companies whose business and market appear suited to the fund's form of capital. To find opportunities, staff members review more than 40 local and regional business publications every day looking for stories on local companies. They scan help-wanted ads and local and regional online job listings. The belief is that if companies are hiring, they may be growing—and in need of capital.

CEI Community Ventures Fund also mines Chambers of Commerce web sites to identify potential investment opportunities in a specific region. And it uses mapping applications overlaid atop business databases to identify all companies in a target region. Then it sifts through to find businesses of interest from a venture investment perspective.

Consumer education helps owners understand how to look at their businesses through an investor's lens.

The CCVF approach appears to be working well. Consumer education helps owners understand how to look at their businesses through an investor's lens. Armed with new insight, entrepreneurs and business owners can not only make an informed decision as to whether to seek such capital, but also can prepare themselves for the difficult discussions ahead—about the company's value, how much the VC should own, and who should control what.

Companies that don't understand the risk that investors take in financing small businesses tend to let their emotions and their desire for total ownership overrule their own self-interest and their willingness to engage with risk investors.

CCVF's proactive outreach and educational efforts complement each other well. The seminars and editorial contributions encourage entrepreneurs to see the fund as a trusted partner with whom they might be willing to "do the dance" that venture capital investment involves. Reaching out proactively gives CCVF a chance to talk about the value of capital to a growing business and the value of the fund's experience and network.

CCVF, licensed by SBA in 2003, has had success in booking deals but cannot expect to see overall financial performance results until 2008 to 2011, the back half of the 10-year limited-partnership life cycle. Nevertheless, it seems clear that the fund is making a difference in communities. By partnering with economic development organizations and local and regional businesses—and by providing both education and networking opportunities—it is helping the business community. Learning and connecting can create relationships and intellectual capital that last.

Michael Gurau *is president of CEI Community Ventures Fund, a for-profit subsidiary of Coastal Enterprises, Inc. It is based in Portland, Maine.*

Endnotes

1 Coastal Enterprises, Inc., makes loans and investments in small businesses, natural resource industries, community facilities such as child care operations, and affordable housing. With $370 million in capital under management or committed, CEI operates several financing programs for microenterprises and small business, venture capital investing, and large investments under the federal New Markets Tax Credit Program. Venture capital funds represent about 10 percent of total capital managed by two separate subsidiaries, CEI Ventures, Inc., and CEI Community Ventures, Inc., which often co-invest. CCVI is a New Markets VC with certain requirements targeting deals in specific high-distress census tracks throughout northern New England.

2 For data on investing venture capital in secondary cities, see Prabal Chakrabarti and Carole Carlson, "Venture Capital Investment in 'Secondary' Cities," *New England Community Developments*, issue 4 (2006): forthcoming.

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Supplier Diversity & Economic Development

by Fred McKinney, Ph.D.
Connecticut Minority
Supplier Development Council

The supplier-diversity movement is gathering steam, and for good reason. Companies that use minority suppliers are learning that there are benefits to the bottom line, while community groups are seeing just how much the success of local businesses can help neighborhoods.

The Changing Landscape

The effort to get businesses to source supplies from minorities and minority business entrepreneurs (MBEs) grew out of the 1960s civil rights struggle. Once basic rights were secured through the passage of the 1964 Civil Rights Act and the 1965 Voting Rights Act, attention turned to economic development. The initial focus was on education, training, and jobs—factors that remain critical. But today there is increased emphasis on business development.

Minority business development, at first essentially a social program, has morphed into an economic imperative thanks to a growing awareness of the economic clout of ethnic and racial minorities. Whereas corporations once promoted supplier diversity mainly as part of their corporate citizenship goals, today they talk about the business case.

Minorities represent a consumer segment that is hard for businesses to ignore. Consider that Latinos and African Americans make up more than 25 percent of the U.S. population. The Department of Commerce projects that by 2025, California, New Mexico, and Texas will actually have "minority majority" populations—that is, populations in which traditional minorities are the majority. In New England, the Connecticut and Massachusetts populations are expected to be more than one-third minority in a few years. (See "The Growth of Minorities in America.")

Where Differing Needs Meet

The numbers of minorities are growing, and so are their economic resources. In 2007 total Latino income, for example, is expected to top $1 trillion, with African Americans and Asians close behind. In relative terms, the combined incomes of U.S. Latinos, blacks, and Asians will exceed the gross domestic product (GDP) of all but the largest eight economies in the world. Minorities will increasingly matter to businesses.

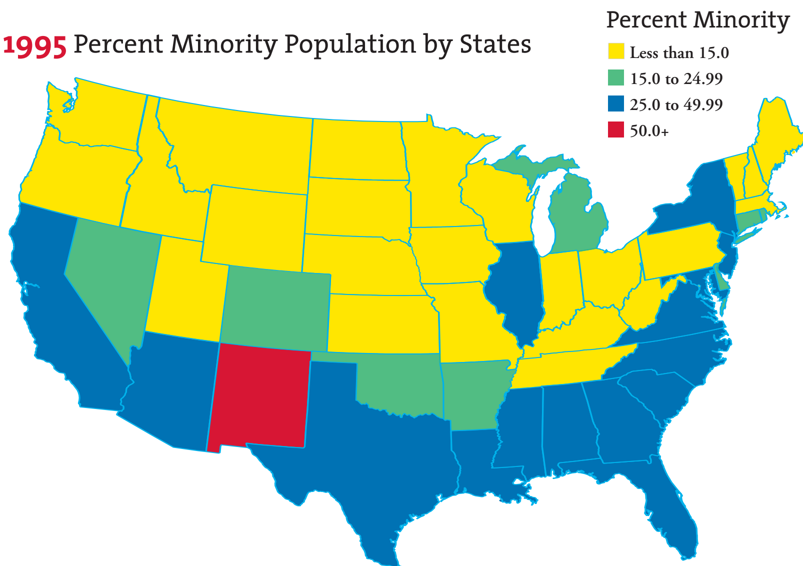
Minorities Need Assets

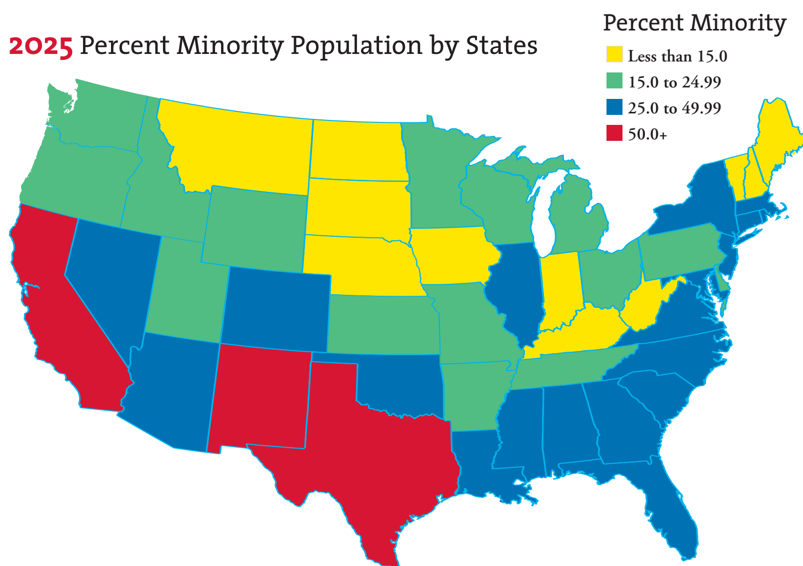
But economic resources do not necessarily translate to assets, and minorities' low level of savings has been causing concern. A Federal Reserve study on minority wealth reports that the wealth gap between minorities and whites is significant and growing. It notes the following disparities in the period 1998 to 2001:

- The gain in financial assets was $100 for families of color and $5,800 for white families.
- The net worth of typical families of color fell 4.5 percent to $17,100, while white families' net worth rose 17 percent to $120,900.
- Overall the gap between the net worth of typical white families and families of color grew by 21 percent.
- Families of color added $3,000 of installment debt, while white families added only $1,000.[1]

The conundrum of increased minority income combined with a growing wealth gap highlights the need for minority business development. There are many reason: having equity in a healthy business helps individual families retain wealth; certified minority businesses hire and promote more minorities and thus boost the community; supporting diversity among small businesses may give corporations a better pool of innovators to work with; increasing minorities' wealth may enable corporations to sell more to them; and a corporation's corporate customers may prefer working with companies that use minority suppliers.[2]

The Growth of Minorities in America





Source: U.S. Department of Commerce

Businesses Need Minorities

Meanwhile, from the corporate point of view, why *not* source from minority businesses if it will help garner minority buyers' loyalty? They do have money to spend. According to the Target Market News, a black consumer market newsletter, black households had $656 billion in earned income in 2003, an increase of 3.9 percent over the income earned in 2002.[3]

Blacks increased their purchase of big-ticket items in the same year, spending more than $32 billion on cars and trucks, for example, $23 billion on food, and $18 billion on health-care products and services.

The size of the minority consumer market is one factor underlying the business case for companies. For example, at a Johnson Controls presentation in 2004, Ford's head of supplier diversity told listeners that after a national magazine ran an ad on Ford's use of certified MBEs, a minister held the ad up before his large African American congregation and asked, "Why would you buy anything else?"

Similarly, in August 2006 at JPMorgan Chase & Company in New York, as senior executives gave their Fortune 1000 suppliers advice on submitting business proposals, they pointed out that supplier diversity contributed as much as 7 percent to JPMorgan's evaluation. The vice president for supplier diversity stated that 7 percent often made the difference between winning or losing a contract.

So companies are realizing that not only do consumers care about the role that corporations play in local communities but increasing numbers of large business customers consider minority suppliers strategically important. That is one reason the National Minority Supplier Development Council (NMSDC) was established in 1972 with the stated goal "to provide a direct link between Corporate America and the certified minority business community."

Today, the NMSDC and its 39 regional affiliates have 3,500 corporate members and 15,000 certified minority business entrepreneurs conducting more than $80 billion in business with one another. The Connecticut Minority Supplier Development Council often gets inquiries from companies whose major customers have requested information about their purchasing with certified minority suppliers (MBEs) and who want to identify MBEs.

Nevertheless, according to the most recent national Minority Business Development Agency study, "The State of Minority Business Enterprises," the 4.1 million minority businesses' combined annual receipts amounted to only 8 percent of all business receipts in 2002.[4] There is still a long way to go.

One Minority Business

The realities of today's marketplace (corporations' outsourcing, lean process management, strategic sourcing, and the like) are forcing minority business entrepreneurs to take on new roles and increase efficiency. Their success will be

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Rik Pierce

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instrumental in closing the wealth gap and improving minority communities.

The Community's Bank of Bridgeport is an example of a minority business that is improving neighborhoods both on its own and by being a supplier of services to other banks that help communities. When Fleet Bank (now Bank of America) merged with Bank of Boston in October 1999, several branches were divested, creating an opportunity for Peter Hurst, a former Federal Reserve attorney, to create a community bank. The Community's Bank, which has been certified with the Connecticut Minority Supplier Development Council, is the only minority-owned bank in Connecticut.[5]

The bank's mission is to provide consumers, nonprofits, and small businesses in Connecticut's urban markets with financial and intellectual capital. It offers both brick-and-mortar banking and online banking. It also offers commercial loans to promote entrepreneurship, residential real estate loans to promote home ownership, and a variety of deposit products to promote savings. It provides intellectual capital by sponsoring and leading seminars on financial leadership, first-time home-buying, and wealth creation.

The bank is certified by the U.S. Treasury Department as a community development financial institution (CDFI), signifying that its primary mission is community and economic development.[6] As a CDFI and a member of a nationwide network of community banks called Certificate of Deposit Account Registry Service (www.CDARS.com), it can supply many depository institutions with services.

The Community's Bank helps Bridgewater Savings in Massachusetts, for example, to make a $2 million deposit, receive a risk-free return on its investment, become eligible to apply for a Bank Enterprise Award equal to 6 percent of the deposit—and qualify for credit under the Community Reinvestment Act.

The Community's Bank itself received a Bank Enterprise Award in 2004 of more than $300,000 for its lending activities in distressed neighborhoods of Bridgeport, Hartford, and New Haven.

Fred McKinney, Ph.D., *is the president of the Connecticut Minority Supplier Development Council, based in Hamden, Connecticut (www.cmsdc.org). He serves on the Federal Reserve Bank of Boston's Community Development Advisory Council.*

Endnotes

1 See http://www.federalreserve.gov/pubs/oss/oss2/about.html for 2001 to 2004 data analysis.

2 Steven D. Jones, "Benefits of Supplier Diversity May Go Beyond 'Social Good,' " *The Wall Street Journal*, August 21, 2006, C3.

3 See http://www.targetmarketnews.com/BuyingPower04.htm.

4 U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises: An Overview of the 2002 Survey of Business Owners*, August 2006.

5 Minority businesses can become certified by completing an application with a regional NMSDC affiliate office, submitting the necessary supporting documents and agreeing to have a site visit done by NMSDC staff. The CMSDC has more than 250 certified MBEs in its council.

6 For more on CDFIs, see Brandy Curtis, "An Overview of the CDFI Industry," *New England Community Developments*, issue 2 (2006): http://www.bos.frb.org/commdev/necd/2006/q2/overview.pdf.

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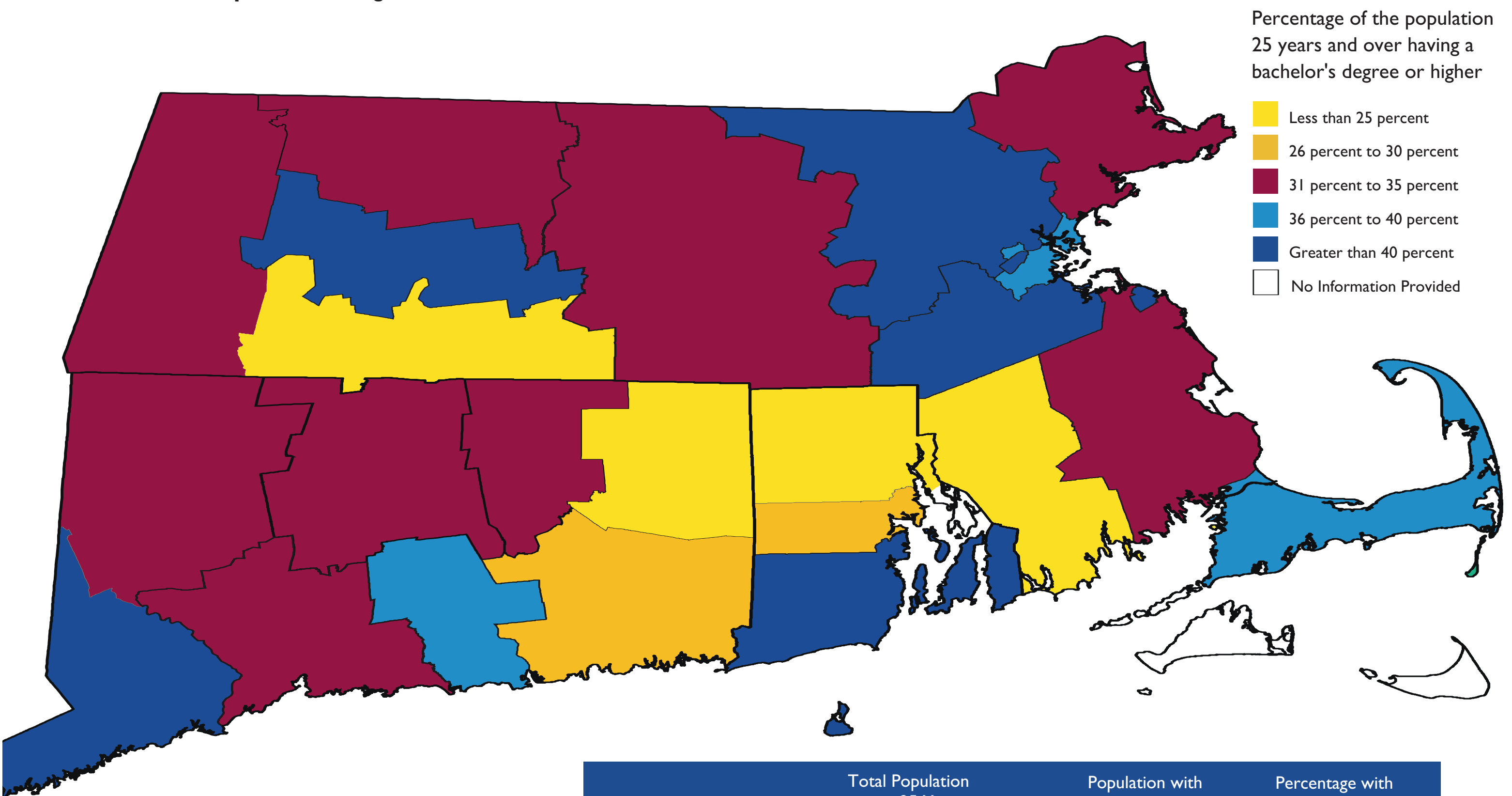
Mapping New England

College Graduates in Southern New England by County

Southern New England has a high level of college graduates. In southern New England, 35.5 percent of the population 25 years and over have a bachelor's degree or higher, compared with the national average of 27.2 percent. Massachusetts has the largest percentage of college graduates. Rhode Island has the smallest percentage but is still 2.1 percentage points higher than the national average.

Map: Ricardo Borgos, Federal Reserve Bank of Boston



	Total Population 25 Years or Over	Population with Bachelor's Degree or Higher	Percentage with Bachelor's Degree or Higher
United States	188,950,759	51,366,830	27.2%
New England	9,435,727	3,216,924	34.1%
Southern New England	7,249,251	2,574,266	35.5%
Connecticut	2,300,565	803,215	34.9%
Massachusetts	4,243,260	1,564,158	36.9%
Rhode Island	705,426	206,893	29.3%
Northern New England	2,186,476	642,658	29.4%
Maine	899,536	230,337	25.6%
New Hampshire	867,694	276,087	31.8%
Vermont	419,246	136,234	32.5%

Source: U.S. Census Bureau, 2005 American Community Survey

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A New Approach to PUBLIC Housing

by Josh Meehan and Brandy Curtis
Cambridge Housing Authority

The past six years have been difficult for public housing. The war on terror, the national debt, and the ongoing trade deficit are putting pressure on the federal government to rein in discretionary domestic spending.

Unfortunately, social programs bear the brunt. Affordable housing programs—particularly public housing's operating and capital programs—are being hit hard. Couple diminishing appropriations with a program based on costly, restrictive regulations, and you have a recipe for failure.

Within this context, a small, decade-old experiment in housing policy is taking on increasing significance.

Moving to Work

In 1996, the Moving to Work (MTW) Demonstration was born.[1] It was based on a simple premise: If a limited number of public housing agencies (PHAs) were permitted to merge funds from various programs (fungibility) and were exempted from most regulations, they might administer programs better, serve more low-income households, and reduce costs. Ten years later, many see MTW as the best hope for public housing's survival.

Congress designed Moving to Work as an experiment to see if relaxing the regulatory requirements of the 1937 Housing Act would improve public housing agencies' delivery of services to the nation's neediest. Twenty-four PHAs are currently participating. MTW public housing agencies include state, county, and city PHAs

Grand opening of a building developed in conjunction with the Cambridge Housing Authority.

Photographs courtesy of the Cambridge Housing Authority

varying in program size and services. Thanks to MTW's flexibility, they can design and test new approaches for providing and administering housing assistance. The goal is to reduce cost, increase the choices for low-income families, and boost residents' self-sufficiency.

New England Tests the Program

The four New England sites participating in the demonstration (Cambridge Housing Authority, Massachusetts Department of Housing and Community Development, Keene Housing Authority in New Hampshire, and Housing Authority of the City of New Haven) apply their MTW options in a number of ways. (See the exhibit "Moving to Work Activity.") The differences reflect each agency's response to local conditions—markets, housing needs, political cultures, and philosophies about housing assistance.

Moving to Work is allowing New England public housing agencies to innovate in four areas: merging U.S. Department of Housing and Urban Development (HUD) subsidies for increased flexibility, changing rent rules and subsidy formulas, designing administrative reforms, and increasing family self-sufficiency through social welfare programs.

Fungibility

Using Moving to Work flexibility, some agencies have merged their funding streams. Non-MTW public housing agencies have three separate streams—operating subsidies for public housing, modernization grants (Capital Funds), and tenant-based assistance (housing choice vouchers, or HCVs)—and each has a requisite use. Merged assistance enables PHAs to use funds from all three sources for any type of housing assistance or transition-to-work service.

Moving to Work Activity

	Cambridge	Keene	Mass. DHCD	New Haven
Alternative rent-subsidy formula	X	X		
Self-sufficiency program		X	X	X
Administrative reforms	X	X		X
Site-based waiting list	X	X		X
Time limits		X	X	
Change to inspection rules		X	X	
Fungibility	X	X	X	X

Lincoln Way, Cambridge, Massachusetts.

Public housing agencies argue vigorously that Moving to Work enables them to improve the quality of housing stock, enhance services to residents, and increase affordable housing opportunities.

All four New England agencies take advantage of this fungibility. Cambridge Housing Authority is able to leverage its reserves, save on energy, use operating and voucher subsidies for financing modernization projects at its public housing development, and go after acquisition and development opportunities. As a result, Cambridge has added 437 units (some affordable, some market rate) to its housing stock.

Rules and Formulas

The rules and formulas that non-MTW agencies use to calculate rent are complex and often cause residents to hide income. They require time-consuming and tedious verification and reporting. HUD's rules also increase rents each time a resident's income increases, which discourages residents from moving toward economic self-sufficiency.

Several Moving to Work sites have experimented with alternatives to the traditional percent-of-income approach for calculating tenant rent. Rent structures and optional deductions can give families incentives to work, decrease intrusion into their lives, and lessen administrative burdens. A wide range of alternative approaches exist nationwide, including some that completely detach rent determination from incomes. In New Hampshire, Keene Housing Authority has implemented a stepped-rent approach. Cambridge, too, has drastically simplified the process, listing rents by income and bedroom size on a simple one-page chart.

Under Keene's program, tenants pay an increasing share of rent over time, regardless of whether household income increases. A flat rent increases by steps after one and three years. Rental assistance is limited to five years, with a two-year extension for exceptional circumstances. In lieu of a housing-choice voucher (Section 8 voucher), participants receive a housing-assistance coupon. Unlike a housing-choice voucher, the coupon is a fixed subsidy given directly to the tenant, rather than the property owner. Property owners who rent to coupon recipients may self-certify compliance with HUD's Housing Quality Standards.

The flexibility of the MTW program has allowed Cambridge to implement comprehensive rent simplification. Rent simplification establishes an easy-to-understand rent and deduction schedule, creates biannual recertifications, and eliminates policies requiring residents to report income increases between recertifications. In its voucher program, Cambridge Housing Authority increased the amount of assets residents may possess, limited interim recertifications, restricted zero-income rents, and established new minimum rents.

Administrative Reforms

Under Moving to Work, many public housing agencies are able to alter HUD procedural and reporting requirements that they consider inappropriate and unresponsive to local housing markets. Administrative changes are producing small-scale improvements in efficiency,

Moving to Work:

What began as a small, obscure experiment in 1996 has entered the consciousness of public housing and stands a chance of creating a new vision—a dramatically altered business model that could serve communities for years to come.

cost savings, and staff time, enabling agencies to divert resources to other objectives. For instance, the Housing Authority of the City of New Haven is focusing on improving and enhancing all department services and operations to transform its management services into a cost-effective and coordinated model promoting self-sufficiency.

Self-Sufficiency

For MTW agencies, promoting work and self-sufficiency is a central goal, and many report that employment and income levels have risen substantially during the demonstration.

Massachusetts Department of Housing and Community Development's Moving to Work initiative redesigns a section of its housing-choice-voucher account to help 180 families receiving public assistance make the transition to work. Its program provides an annual stipend to participants, divided into three targeted uses: an automatic contribution to a monthly escrow account, a budget for work-related expenses, and a shallow rent subsidy. (*Shallow* means a relatively small subsidy. Participants contribute more than the typical 30 percent of income toward rent because some subsidy dollars are going toward the escrow account and the work-related expenses.)

Keene requires that participants join its self-sufficiency program, Resident Self-Reliance, which provides individualized case management, supportive services, and workshops on setting goals and developing skills.

Proponents & Opponents

Recent cuts to housing programs plus HUD's increasingly proscriptive oversight are generating calls for MTW expansion. Many industry leaders believe that tapping the program's flexibility offers the best hope for public housing agencies. Federal legislators seem to be listening. In 2006 two new bills were introduced. A bipartisan bill in the House of Representatives (H. 5443) would increase the number of MTW agencies to 40 and would make the program permanent. The Senate's far more ambitious bill (S. 3508) proposes making 250 agencies MTW agencies, establishes an accreditation board, and makes the program permanent.

As PHAs and industry groups clamor for expansion, some advocacy groups are worried that, to cut costs, public housing agencies will circumvent existing regulations requiring them to serve established percentages of extremely low-income households. Both the Center on Budget and Policy Priorities and the National Low Income Housing Coalition have advocated against expanding the MTW program.

Public housing agencies argue vigorously that Moving to Work enables them to improve the quality of housing stock, enhance services to residents, and increase affordable housing opportunities. Unfortunately, few studies evaluate the outcomes of the HUD demonstration.

Given increasing calls for expansion, MTW agencies, supportive industry groups, and low-income advocacy organizations (including opponents) are calling for further evaluation. In response, HUD and MTW authorities have begun designing outcome measurements.

What the Future Holds

As the Moving to Work debate builds in Congress and in the public arena, three things are clear. First, MTW is widely supported by those in the trenches of the public housing industry, with executive directors anxious to have its regulatory relief and financial flexibility. Second, opponents and proponents alike seek more outcome measurements. MTW agencies want to have their accomplishments measured against those of non-MTW agencies—and even against their own pre-MTW policies. Moving to Work opponents want to see whether MTW agencies are using their flexibility to shift services and funds from those who need it most to higher-income households.

Finally, what began as a small, obscure experiment in 1996 has entered the consciousness of public housing and stands a chance of creating a new vision—a dramatically altered business model that could serve communities for years to come.

Josh Meehan *is the special assistant to the Executive Director for Public Relations and Policy of the Cambridge, Massachusetts, Housing Authority, where* **Brandy Curtis** *was a research assistant until August 2006.*

Endnote

[1] See http://www.hud.gov/offices/pih/programs/ph/mtw.

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Reasons for Optimism

by Cathy E. Minehan
Federal Reserve Bank of Boston

Photograph by Frank Leone

Federal Reserve Bank of Boston President Cathy E. Minehan with Marty Meehan, U.S. Representative from the Massachusetts Fifth Congressional District, and David Hartleb, president of Northern Essex Community College, at a July 2006 conference in Haverhill, Massachusetts.

Cathy E. Minehan, *President and CEO of the Federal Reserve Bank of Boston, delivered a longer version of this speech during the July 2006 convening of the Bank's Community Development Advisory Council at Northern Essex Community College in Haverhill, Massachusetts.*

People sometimes wonder why the Federal Reserve is involved in community development. Well, one of the jobs that Congress gave us involves making sure that financial services are accessible on a broad and fair basis. To do that, we use both a stick and a carrot. Our bank examiners assess what banks and bank holding companies are doing in their communities, and if their performance is lagging, the law requires us to seriously scrutinize their requests for expansion, among other things.

Our education and convening capabilities are the carrots. To that end, we have long had a Community Development Advisory Council, or CDAC, made up of heads of development groups

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throughout the region. The CDAC members are invaluable in informing us about activities in their states and working with us to promulgate best practices.

I will present a 50,000-foot view of economic challenges facing us nationally, regionally, and in Massachusetts and the Merrimack Valley.

At the national level, the U.S. economy is in its fifth year of expansion after what was, viewed in the aggregate, a mild and short recession. People may quarrel with that assessment. Indeed, Massachusetts as a whole was harder hit than the rest of the nation and is taking longer to return to its former level of employment, largely because the industries hit hardest—high-tech in general and telecommunications in particular—were more important here than elsewhere. And while it can be said that the severity of Massachusetts job loss is a reflection of the heights to which employment reached in the late 1990s, the difficult effects of the recession and the slow growth since cannot be denied.

But for the nation as a whole, these five years have been characterized by strong growth, falling unemployment, strong productivity, rising business profits, growing world growth and demand, and low rates of core inflation. I'd like to take some credit for the latter as I believe inflation has been kept in check, in part, by the Federal Open Market Committee, which took the low interest rates needed during the recession back to levels better suited to a thriving economy.

Today rising domestic and global demand is putting pressure on capacity. Add to that a related rise in energy and other commodity prices as well as geopolitical uncertainty, and there is reason for the U.S. central bank to be cautious in addressing its dual goals of price stability and sustainable economic growth.

Over the longer term, the economy faces an even tougher challenge—how to get national savings in line with the needs of an aging society and reduce what the country owes the rest of the world. National savings is composed of the savings of business, government, and people like ourselves. Traditionally, one thinks of households as net savers, businesses as net borrowers, and governments as roughly neutral, adjusting for economic cycles.

But in the last five years, the personal savings rate has dropped steadily to below zero; the federal government has gone from surplus to deficit, and businesses have become big net savers. The nation currently does not save enough, filling the gap by borrowing from abroad, which is reflected in the huge and growing U.S. account deficit. We are currently borrowing nearly 7 percent of gross domestic product—nearly $900 billion dollars.

While households may begin to save more as rising interest rates and moderating house values make borrowing more difficult, the federal government faces a daunting task. Although the deficit as a percentage of GDP is smaller right now, reflecting, in part, outsized business profits and the earnings of high-income taxpayers, Social Security and Medicare will add significantly to the deficit by the end of the next decade. Policymakers must rein in spending, and/or raise revenues—a challenging but vital task.

The Merrimack Valley has experienced the recent economic cycle more negatively than other areas. On the hopeful side, the region is apparently not losing population like other parts of New England. Between 1990 and 2000, its population grew at twice the pace of Massachusetts, with half of the increase attributable to Latinos, largely from the Dominican Republic and Puerto Rico.

New immigrants bring vibrancy to civic life and culture, and are a needed source of labor supply. But immigration brings concerns as well. Some people believe immigrants displace native workers, but that is difficult to prove. Others say immigrants represent a new source of both supply and demand—filling jobs that are not wanted by native workers (or jobs that did not exist prior to the supply

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In the 1990s, Merrimack Valley's population grew at twice the pace of Massachusetts, with half of the increase attributable to Latinos.

of lower-cost workers) and buying goods and housing. I find the latter train of thought more persuasive, though it is not hard to understand the fears that have made immigration a hot topic.

Indeed, immigration is challenging to the immigrants themselves. Here in the Merrimack Valley, housing costs are high, as they are statewide. And the influx of new immigrants has worked to create an unusually bifurcated immigrant workforce, with highly educated technical and professional people at one end and, at the other, linguistically challenged, less educated residents.

Highly educated workers are likely to find jobs, but workers at the other end of the spectrum face more challenges. Immigrants, particularly Hispanic immigrants, are the fastest growing part of the Merrimack Valley population. Indeed, Lawrence is a predominantly Hispanic city, with a Latino population that grew 47 percent from 1990 to 2000, while the non-Latino population fell almost 30 percent. But for all the vitality of these newcomers, there are issues.

Nearly 42 percent of Lawrence residents of age 25 and above do not have high school diplomas, and a rather significant share have less than a ninth grade education. In Lawrence, better than 20 percent have poor English skills, according to the 2000 census, and roughly the same share identified themselves as "linguistically isolated"—that is, part of a household in which everyone over age 14 has poor English skills. It's hard for immigrants to participate in economic growth here without a good match to an available job.

The Merrimack Valley has a supply of workers, but what is the demand?The Lower Merrimack Valley Workforce Investment Board has analyzed labor supply and demand as part of its annual workforce development plan. The four established industries it has identified as critical are health care, construction, communication, and manufacturing. And there are three emerging industries: food products; medical instruments and supplies; and trucking and warehousing. The study highlighted the nature of the jobs involved in each industry and the human resource issues needing attention. What I found interesting was the emphasis on a high-technology and/or professional quotient in the jobs being created—making a good match for some, but not others.

So this takes me to my final point.

Many of the challenges the Merrimack Valley faces are unique to its population and to the industries that wax and wane here. But at the heart of things, the Merrimack Valley faces the same challenge New England and the nation face—how to train and educate the current population for the jobs being created. The mismatch at the lower end may be more significant here—certainly the unemployment rate in Lawrence would suggest that—but the basic issues are the same. In an ever more technologically sophisticated and globally competitive world, the need to train workers, students, and new entrants to the labor force for the highly skilled jobs being created is critical.

Indeed, as I travel the region and listen to my colleagues from the rest of the country, I am struck by the fact that although job growth has been called disappointing, many employers bemoan their inability to find the skilled labor they need. Here I should acknowledge that the Merrimack Valley is tackling the issue—with the new transportation center in Lawrence, for example, and the efforts of both Northern Essex College and Middlesex Community College to develop workforce training. But this will be a continuing challenge.

Let me end on a note of optimism. Although there is much hand-wringing in Massachusetts over slow growth in jobs and population, I believe the discussion is overly alarmist. Certainly Massachusetts has been through a difficult economic period. But it wasn't long ago that we were enjoying an economic boom. Incomes were growing rapidly, labor was scarce, and office space impossible to find. The fundamental underpinnings of that prosperity—our world-renowned research institutions, highly educated workforce, and entrepreneurial culture are all still here. The state has a history of reinventing itself, and the Merrimack Valley has illustrated that process in the past.

But one cannot simply count on history to repeat itself. So I am encouraged at how well business and public leaders are working together to address the challenges—in extending health insurance to the uninsured, for example, or in bringing Bristol Myers-Squibb to Devens. And I am encouraged by my work with John Hamill of Sovereign Bank and Paul Grogan of The Boston Foundation on the John LaWare Leadership Forum, which discusses the challenges facing Greater Boston and the state, and focuses on coordinating and channeling the energy being directed at those challenges. Civic leadership is vital to economic growth, and such leadership is alive and well in Massachusetts, in Boston, and certainly here in the Merrimack Valley.

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