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Initials: RDS Date: 10/18/05

March 30, 1995

MEMORANDUM FOR THE PRESIDENT
THE VICE PRESIDENT

FROM: JACK QUINN
CAROL RASCO
LAURA TYSON

SUBJECT: Round Two of Empowerment Zones Initiative

Attached is the options memorandum you requested on a round two of the Empowerment Zone initiative. This memorandum, drafted by OMB and HUD in conjunction with our offices, includes for your review three options for pursuing a second round. The memorandum has been shared with those NEC/DPC principals integrally involved in the Empowerment Zone initiative and includes the views of OMB, HUD, USDA, Treasury, HHS, Commerce, CEA, the NEC, the DPC, and the Office of the Vice President.

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March 30, 1995

MEMORANDUM FOR THE PRESIDENT
THE VICE PRESIDENT

FROM: NEC/DPC PRINCIPALS

SUBJECT: **Round Two of Empowerment Zones Initiative**

Pursuant to your request, this memorandum addresses the issue of pursuing a second round of the Empowerment Zone (EZ) initiative.

I. Background on Current Empowerment Zone Program

More than 500 communities applied for urban and rural EZ and Enterprise Community (EC) designations in 1994. Taken together, these applications represent an extraordinary level of bottom-up neighborhood planning, significant innovation in the coordination and delivery of government services, and thoughtful changes in the relationship between the Federal government and local communities. In December, 1994, New York, Chicago, Detroit, Atlanta, Baltimore, and Philadelphia-Camden were designated as urban EZs and the Kentucky Highlands, Mid-Delta, Mississippi, and Rio Grande Valley, Texas were designated as rural EZs.

As you know, the great number of high-quality applications for the six urban EZs prevented us from designating many worthy cities. This large group of outstanding applications motivated Secretary Cisneros to secure $300 million in Economic Development Initiative (EDI) funding for additional awards. This EDI funding was used to create two Supplemental Zones (Los Angeles and Cleveland) and four Enhanced ECs (Boston, Houston, Kansas City MO-Kansas City KS, and Oakland). Despite our efforts to expand the Empowerment Zones initiative with EDI funds, though, many worthy cities were not designated EZs and no additional rural areas were designated. Your FY 1996 budget did, however, include a proposal to give the EZ tax incentives to two additional urban communities -- a commitment intended for the two Supplemental Zones.

As Chair of the Community Empowerment Board (CEB), the Vice President has committed to helping all Round I applicants, particularly the 105 EZ/ECs, successfully implement their strategic plans. For example, as part of the National Performance Review, we intend to work with Congress on broad waiver authority that would enable the CEB to grant waiver requests of all EZ/EC applicants -- many of which we are now forced to decline because of statutory constraints. Last year, we pursued such legislation, which passed in the Senate. Senator Hatfield has introduced broader waiver legislation this year. We will also consider additional reinvention strategies -- such as further consolidation, deregulation, and performance partnerships -- that could have a significant impact for all EZ/EC applicants while requiring no or modest additional budgetary resources. These reinvention measures do not preclude a second round of EZs, however you should be aware that we are pursuing them as they could have broad positive impacts for all EZ/EC applicants.

II. Discussion of EZ Round II

On March 20, 1994, we convened a meeting with the heads of the departments and agencies most involved in the EZ program to discuss a second round of the EZ initiative. In that meeting, almost everyone agreed that there are sound reasons for pursuing a second round. The group also agreed, however, that financing such an effort would be difficult, if not impossible.

A. Advantages of Pursuing Round II

As you know, there are cogent arguments for pursuing a second round of Empowerment Zones:

- Expanding the program would allow you to help several additional needy communities that worked hard to pull disparate partners together and that were disappointed and disheartened by not being designated EZs in the first round.
- The unprecedented level of community organizing and strategic planning completed by Round One applicants creates great possibilities for more success. The strong positive reports about the EZ application process suggest that the program is working and will have a significant impact in communities that move forward to implement their strategic plans.
- Many excellent applications did not receive designations in Round One. The ability of top applicants to leverage significant private resources (for-profit and non-profit) makes the EZ initiative the most cost-effective community development program now available to you.
- If a proposed Round Two fails to gain passage, it would demonstrate your continuing strong commitment to empowering poor urban and rural communities. If it passes, it would demonstrate your Administration's ability to work with the Republican Congress to develop innovative ways to address this nation's socio-economic problems.
- It would be wise to have a well-developed proposal for a Round Two ready in case a significant opportunity for negotiation with Congress arises this year.

B. Disadvantages of Pursuing Round II

There are, however, downsides to proposing a second round of EZs:

- Chances for passage appear slim, particularly because we are having difficulties opposing efforts to rescind funding for existing (budgeted) community development efforts.
- Choosing the proper vehicle for introducing a proposed second round of EZs will be tricky. Any attempt to amend your already-submitted budget would subject the proposal to heightened political scrutiny.
- It will be expensive, difficult to pay for, and will benefit only a few places. Because of budget constraints, Congress may pay for a Round II by further cutting other priority investments within the HUD/VA allocation, such as CD Banks and National Service. Through the reinvention strategies discussed above, there may be ways to benefit many more EZ/EC applicants at lower costs.

- The FY 1996 budget does not mention a Round Two but does mention the proposed expansion intended for the Supplemental Zones. If we now broaden our request to reach additional communities, this could be perceived with disfavor by the Supplemental Zones. And, the four Enhanced ECs have made it clear that they view themselves as first in line for any additional tax incentives.

- Proposing a second round before we have accurate evidence of the results of Round One may not be prudent and will add to the considerable administrative challenge of successfully implementing the existing program.

- Failure to pass such legislation could dishearten the top applicants, who may end up feeling like two-time losers.

- A proposed second round could subject Round One to more scrutiny and invite attempts to repeal the original program.

Perhaps the most difficult issue is the problem of identifying offsets. The options presented below are expected to cost at least $695 million over five years in budget offsets. Offsets will be hard to find. On the discretionary side, they could come from reducing spending for other HUD programs or from other departments, which unfortunately are already being hit hard in the rescission process. On the mandatory side, offsets could come from a possible restructuring of the $3 billion per year Low Income Housing Tax Credit (for potential savings of $600 million) and/or limiting or eliminating either of the following: the $900 million/year income exclusion for interest on Industrial Development Bond (IDB) debt; or the $400 million/year exclusion for pollution and sewerage IDB debt. Each of these proposed offsets is debatable on the merits.

More importantly, we foresee a difficult political problem with identifying publicly <u>any</u> offset to pay for EZ Round II. Any offset we identify is likely to be seized by Republican Members of Congress to pay for their budget priorities. For example, to pay for deficit reduction, the Administration recently proposed to deny the EITC to persons who receive more than $2500 in interest and dividends. The tax committees have used this proposal, in addition to an outright repeal of the FCC Tax Certificate program, to help pay for an extension and increase of the health care deduction for the self-employed. This experience makes Treasury especially wary of offering up other potential revenue raising items in this legislative environment.

III. <u>Options to Consider</u>

Outlined below are three options for a second round -- if you decide to pursue such an effort. (The advantages and disadvantages discussed below are <u>in addition</u> to those generally discussed in Section II.)

<u>Option A: Use existing authority to offer direct grants</u>

HUD and USDA propose creating six new Empowerment Zones (4 urban and 2 rural) and twenty-five new Enterprise Communities (distribution between urban and rural would have to be determined). No new EZ competition would be held: selections would be made from among the most highly-ranked applicants who did not receive first-round EZ designations. (Each applicant could be asked for a quick update of the information in their application, but not for a new plan.)

Each urban EZ recipient would receive $25 million in FY 1996 for flexible grants and $20 million each year for five years to provide the cash equivalent of a Federal tax credit program. For example, localities could use the monies to fund local versions of the employee-based tax credit and other tax credit ideas, such as a capital gains rollover or a portable tax credit.

Each rural EZ would receive a total of $10 million in FY 1996 in flexible grants and $10 million each year for five years to provide the cash equivalent of federal tax credits.

As in round one, each EC would receive approximately $3 million in flexible grant assistance.

The total cost over five years would be $695 million. All funding would be directed to an existing HUD and USDA program, such as the Economic Development Initiative (EDI) program at HUD and an existing, but unfunded, rural development demonstration program included in the 1990 farm bill. We would not request new authorizing legislation.

Advantages:

-- No new authorizing legislation required (though appropriations would be required).

-- Builds on the EDI supplemental program we developed in the first Round, which was garnered with some Republican support.

Disadvantages:

-- Current authorized activities under EDI are too narrow to include all desired EZ activities, such as social services.

-- Adds complexity; creates a new category of communities with richer benefits than those awarded to the enhanced ECs, who believe they are first in line for additional benefits.

-- It is unclear whether the "local-cash-equivalent-of-tax-incentives" would have the impact of federal tax incentives.

Option B: Seek new authorizing legislation for tax incentives and flexible grants.

Select, from the top applicants of Round I, six new Empowerment Zones (4 urban, 2 rural) and twenty-five new Enterprise Communities (distribution between urban and rural to be determined) for the same packages of tax incentives and flexible social service funding offered under Round I, but on a smaller scale. In the alternative, we could propose new federal investment tax credits or capital gains exclusions limited to certain cities, partly as a test of the effectiveness of federal capital tax incentives in revitalizing distressed areas. We could fashion this package of incentives so that the cost is limited to approximately $700 million over five years, the approximate cost of Option A.

Advantages:

-- Capital gains reductions could make this version more attractive to Hill Republicans.

Disadvantages:

-- Designing smaller tax benefits for some EZs adds unnecessary complexity to the Tax Code.

-- Adds complexity; creates a new category of communities with richer benefits than that awarded the enhanced ECs, who believe they are first in line for additional tax incentives.

-- It will be very difficult to fashion tax incentives that are powerful enough to influence behavior while keeping the cost at $700 million. The cost of 4 new urban and 2 new rural zones that have the same package of benefits as Round One would be about $1.3 billion over five years.

-- Although some Republicans might be interested in a Round II that includes tax reductions for capital gains, we did not propose such an incentive in the original EZ legislation because of the inordinate cost, the risk of sheltering activity and because Democrats preferred the wage credit, which can be tied directly to job creation.

Option C: Wait to include proposal in the FY 1997 Budget

Some agencies, particularly HHS, recommend that you wait until the next budget cycle to offer any proposed EZ Round II.

Advantages:
-- Avoids problems with finding an appropriate legislative vehicle after the FY 1996 budget has been submitted.
-- Builds a stronger case because we will have a year of evidence to justify our request for Round II.
-- Avoids the problem of proposing a new budget item (EZ Round II) while simultaneously fighting to maintain FY 1995 funding (e.g. for CD Banks, National Service, etc.)
-- Provides an election year issue if Congress does not enact the proposal.

Disadvantages:
-- Passage of new legislation is highly unlikely in a Presidential election year and measure may be viewed as largely symbolic.

IV. Recommendation

A second round of EZs would build on the success of this "signature" Administration initiative, but it would require Congressional support for additional spending. While the planning process has proven to be successful, it is still too early to have evidence on the success of the December, 1994 designations (Round One). Moreover, Round Two would reach only a few of the many cities and rural areas that were not designated in December 1994.

To us, all of the choices appear problematic. Because of the difficulty in finding suitable offsets to pay for a second round, a majority of your advisers recommend Option C. (We could begin a process to develop Round II options that you would consider for inclusion in your FY 1997 budget.) However, others believe we should proceed now with a second round in order to capture the momentum behind this program.

V. Decision

____ Option A

____ Option B

____ Option C

____ Discuss Further

Empowerment Zones - Round Two

cc: Sheryl
Cashin -
let's discuss.
Kumiki
2/22/95

February 9, 1995

TO: Leon Panetta
Chief of Staff to the President

FROM: Henry Cisneros
Secretary, Department of Housing and Urban Development

RE: THE PRESIDENT'S EMPOWERMENT INITIATIVE -- ROUND TWO

The Justifications for the Second Round

More than 500 cities and towns applied for Empowerment Zone (EZ) and Enterprise Community (EC) designation. Taken together, these applications signify an unprecedented level of bottom up neighborhood planning, significant innovation and creativity in the coordination and delivery of government services, and thoughtful but potentially revolutionary changes in the relationship between the federal government and local communities.

The great number of high-quality applications for the six urban and three rural Empowerment Zones precluded many worthy cities from winning designation. As you know, this large group of outstanding applications motivated us to work hard to secure another $300 million in Economic Development Initiative (EDI) funding. This funding was used to create two Supplemental Ezs (Los Angeles and Cleveland) and four Enhanced Ecs (Boston, Houston, Kansas City MO-Kansas City KS, and Oakland). Despite our efforts to expand the Empowerment Initiative with EDI funds, though, many cities that have experienced tremendous levels of community involvement and offer outstanding opportunities for success were not designated EZs.

In addition, the initial round of the Empowerment Initiative competition has taught important lessons to governments at all levels. Most crucially, we now know that the fundamental principle of comprehensive strategic planning at the grass roots, neighborhood level can create enormous potential for urban revitalization. We have also learned that some aspects of the Empowerment Initiative can be modified to both enhance the chances for success and conserve resources.

In short, a second round of designations could offer worthy communities the opportunity to demonstrate what can be achieved by bottom up, coordinated strategic planning. At the same time, the second round could offer the opportunity to incorporate the lessons that have been learned, thereby creating the most efficient possible urban revitalization strategy.

<u>The Elements of the Second Round</u>

The second round of the Empowerment competition should include the following features:

- **<u>Limited Competition Format</u>**

The round two competition for Empowerment Zones should be limited to those first round applicant cities not designated as EZs. We would rely on the applications already submitted by these cities; no new competition would be necessary. This approach will offer success opportunities as quickly as possible.

Based on the quality of the applications already submitted, a second round of Empowerment Zones could result in designations for cities such as Miami, New Orleans, Louisville, Newark, St. Louis, Dallas, Phoenix, Portland and San Diego.

- **<u>Smaller Individual Awards</u>**

This next tier of EZ candidates generally contains smaller cities than the cities designated during Round One. Consequently, it might be possible to reduce the size of the individual EZ awards in round two. As you know, the six urban EZ designees in round one were each awarded $100 million in Title XX funds and employee tax credits scored at $250 million over six years. Because of the smaller cities involved, round two awards could be reduced to $20 million in flexible grant assistance and $100 million in tax credits over six years.

- **<u>Tax Incentives</u>**

The use of tax incentives in the second round deserves a fresh examination. Our goal should be to place the greatest emphasis on the most cost-effective tax incentives, including those that target economic development most directly at EZ residents. Alternatives that deserve consideration include a *capital gains rollover* (allowing EZ businesses to defer capital gains taxes if the gains are re-invested in an EZ business asset); a *portable tax credit* (allowing businesses outside the EZ credit for hiring EZ residents); and a *welfare-to-work tax credit* (providing targeted incentives to business who hire EZ residents currently on welfare.)

- **<u>Federal Interagency Cooperation</u>**

Legislation authorizing the second round could institutionalize the basic principle of federal interagency cooperation. The legislation could formalize the role of the Community Empowerment Board and the EZ Task Force, thereby helping guarantee the continued cooperation of all relevant federal agencies.

- **<u>Other Federal Programs</u>**

Legislation authorizing the second round could institutionalize the principle that EZ cities receive preferential treatment in competitions for other federal resources.

- **<u>Increased Federal Waiver Authority</u>**

Legislation authorizing the second round could give the Community Empowerment Board or individual federal agencies both statutory and regulatory waiver authority for federal programs in EZs.

February 10, 1995

MEMORANDUM FOR: Leon Panetta
Chief of Staff to the President

FROM: Henry G. Cisneros

RE: <u>*OPTIONS FOR CREATING ROUND TWO OF THE PRESIDENT'S EMPOWERMENT INITIATIVE*</u>

There are two primary options for creating round two of the President's Empowerment Initiative. Under both of these options, no new competition would be held; we would rely instead on Empowerment Zone (EZ) applications already submitted. As you recall, during round one we awarded six EZs, two Supplemental EZs, and four Enhanced Enterprise Communities. <u>See</u> attached list.

<u>*OPTION ONE*</u>

Option One would require new Congressional legislation. The elements of Option One could include:

- *Creating Five New Empowerment Zones*: The new legislation would create five new EZs. Because the next tier of top EZ candidates generally contains smaller cities than the cities designated during round one, it should be possible to reduce the size of round two's individual EZ awards. Round two EZ awards could be reduced to $25 million in flexible grant assistance and $20 million in tax credits each year for five years. Total one year cost: $225 million. Total five year cost: $625 million.

- *Creating Twenty-Five New Enterprise Communities*: The new legislation would create 25 new ECs. As in round one, each new EC would receive $3 million in flexible grant assistance. Total one year cost: $75 million.

<u>*OPTION TWO*</u>

Option Two would not require new authorizing legislation. It would require additional appropriations to an existing HUD program, such as the Economic Development Initiative (EDI). This approach was used last year to create round one's two

Supplemental EZs and four Enhanced ECs.)

Under Option Two, all funds would be distributed directly to local communities. As a condition of this federal grant, the local communities would be required to use a portion of the grant to create the equivalent of a federal tax credit program.

For example, localities could create cash grants that are the equivalent of the employee-based tax credit used under round one of the President's Empowerment Initiative. Localities could also fashion cash grants to replicate other tax credit ideas that deserve consideration. These include: a *capital gains rollover* (allowing EZ businesses to defer capital gains taxes if the gains are re-invested in an EZ business asset); a *portable tax credit* (allowing businesses outside the EZ credit for hiring EZ residents); and a *welfare-to-work tax credit* (providing targeted incentives to business who hire EZ residents currently on welfare.)

Option Two funding would be distributed to new EZ designees in the same proportions identified under Option One, above.

COMPARISON OF OPTIONS

Option One's clear advantage is the provision of a definite, easily administered tax credit -- a key part of the vision for EZs. Option One's clear disadvantage is the need for new legislation.

The advantage of Option Two is that no authorizing legislation is necessary. The disadvantage is that the tax credits would need to be creatively fashioned from the cash awards, creating a potentially unorthodox program.

Of course, these two options are in addition to the current proposal to create tax credits for the two existing Supplemental EZs, Los Angeles and Cleveland. The tax credits would be valued at approximately $50 million per year for five years for each city. (As you know, the six urban EZ designees in round one were each awarded $100 million in Title XX funds and employee tax credits scored at $250 million over five years.) Total yearly cost: $100 million. Total five year cost: $500 million.

Attachment

EZs, SUPPLEMENTAL EZs AND ENHANCED ECs

Atlanta GA
Baltimore MD
Boston MA (EEC - $25M)
Chicago IL
Cleveland OH (SEZ - $90M)
Detroit MI
Houston TX (EEC - $25M)
Kansas City KS & Kansas City MO (EEC - $25M) (EEC)
Los Angeles CA (SEZ - $100M)
New York NY
Oakland CA (EEC - $25M)
Philadelphia PA & Camden NJ

OTHER TOP EZ APPLICATIONS

St Louis MO.
Newark NJ
Dallas TX
Miami FL
Ouachita Parish LA
Louisville KY
New Orleans LA
Pittsburgh PA
Portland OR
Phoenix AZ
San Diego CA
Sacramento CA