Bruce: For Monday's Meeting – Wendell Primus on the war path. TQW

ECONOMIC DEVELOPMENT

The welfare reform plan needs to include strategies that test the notion that one way out of welfare for some people is through empowering them to start their own businesses and encouraging them to save the money they earn to build for the future. During the campaign, the President endorsed the idea of helping welfare recipients help themselves by proposing to radically increase the number of microenterprises and establish Individual Development Accounts (IDAs).

> *"IDAs encourage welfare recipients to save for a first–home purchase, post–secondary education, business development (microenterprises), or retirement. They also encourage the values of thrift and hard–work which the welfare system has too long undermined."*
>
> *Bill Clinton*
> *September 16, 1992*
> *Los Angeles, CA*

We propose including large scale demonstrations of these two concepts, microenterprise and IDAs, to provide welfare recipients with the opportunity to be entrepreneurs in the private sectors. The overall cost of this program would be $100 million annually for four years. $75 million for IDAs and $25 million for the targeted microloan demonstration.

DRAFT INDIVIDUAL DEVELOPMENT ACCOUNT (IDA) PROGRAM

We believe an IDA demonstration program must be an integral part of any economic development component of the welfare reform initiative. The Federal Government spends more than $100 billion per year to provide middle– and upper–income persons with incentives to accumulate savings and assets. We believe that incentives should also be made available to low–income persons in order to promote economic self–sufficiency and to provide stakeholding opportunities.

Very few people manage to spend or consume their way out of poverty or off of welfare. Economic well–being does not come through spending or consumption, but through savings, investment and the accumulation of assets.

The IDA, like other economic development proposals, would promote entrepreneurship, economic stakeholding, skill building, and the creation of private sector jobs for individuals moving off welfare. IDA savings can be used only for education or training, microenterprise, or purchasing a first home. IDA investments can help decrease the need for public service jobs for former welfare recipients by increasing their likelihood of long–term success in the private sector. In addition, the promotion of savings for education or microenterprise may actually prevent other working poor families with children from ending on welfare in the first place.

In the context of the welfare reform effort, we propose an approach which builds on the basic demonstration framework in the Hall–Bradley (H.R. 456) bills. However, our proposal would cost less than the Hall–Bradley bills over the next four years ($400 million per year versus $300 million), and would cost considerably less to expand to the national level after the demonstration period has been completed. **We have discussed some of the details of this approach with the staffs of Rep. Hall and Sen. Bradley and the reaction thus far has been positive.** The following new concepts could be introduced in an IDA proposal incorporated in the welfare reform effort:

Eligibility

We propose using the same eligibility requirements as the Earned Income Tax Credit (EITC), although we would cap the level of income at which one could recieve the Federal government match at $18,000. We believe using the same EITC eligibility requirements has a number of advantages.

- *Reinventing government:* avoids the creation of new eligibility categories. Saves red tape. Makes it easier to get to scale.
- *Rewards work:* the EITC is limited to people who work.
- *Targets* low–income workers with families.

Targeted Population

Where should the bulk of the benefits be targeted and where should the income phaseout occur? What is the appropriate upper limit on the income level for participating families?

Option A) Target families between $6,000 and $15,000 with a phaseout up to $18,000. This favors full-time, low wage workers without penalizing part-timers. While the work incentive curve is not ideal, the cap on total federal dollars provides an implicit phaseout that mitigates the disincentive effects. This option is likely to cost a bit more than option B. It is also likely to be more successful since includes more workers who are already meeting the basic needs of their family; workers who can focus on saving and entrepreneurship. **Our working group recommends this option.**

Option B) Target primarily on very low income families in the range of $4,000 to $9,000 per year. Phase out the benefits at $11,000. This permits a sensible work incentive curve to be designed and provides an extra boost to families making the transition from no work to some work. Targeting to very low-income is likely to make the program very inexpensive. However, it leaves us open to the charge that we are subsidizing part-time work more favorably than full-time work. This option is not recommended.

Option C) Target the families between $6,000 and $15,000 with an immediate cut-off at $15,000. This causes a sharp discontinuity as individual incomes rise. There would be a big incentive to work less (or earn less) for a little while and reap big returns in the IDA program. This option is not recommended.

Capped Federal Match

We also propose limiting the total, cumulative match which any individual could receive to $3,000. Of course, individuals can continue to save after the cap is reached, but no more matching dollars would be paid. This has the following advantages:

- *Controls cost:* One of the chief complaints about IDAs is that their cost would make the program too expensive to replicate on a national level.

- *Reduces work disincentive:* phasing out the match rate as income rises distorts the carefully thought out EITC phase-out. By making the IDA match a temporary program, much of the negative impact on work incentives is mitigated.

- *Limits fraud and abuse:* If the maximum benefit from the program is capped, the potential for individual fraud or abuse is also limited.

- *Adds progressiveness to system:* $3,000 means more to a minimum wage earner than it does to a family at the high end of the eligibility range.

Various Match Ratios

We are concerned that the Hall bill may provide too great a match and the Bradley bill not enough of an incentive. In fact, no one really knows which match rate provides the most cost-effective incentive to save. We would encourage testing a matching range from 4:1 to 1:1 to determine the impact on savings behavior and family self-sufficiency.

Savings amount: Do people end up with enough money at the end to do anything reasonable? With a $3000 cap on the federal contribution, participants could end up with $6,000 in a 1:1 match program or $3,750 in a 4:1 match program. Either of these amounts would be enough to use in combination with loans and grants for college, training, microenterprise or home purchase. For actual estimates of the amounts of money people are likely to save at various income levels please contact Connie Dunham.

<u>Program Responsibility</u>

We recommend placing implementation responsibility with the Community Development Bank and Financial Institutions (CDBFI) Fund. The Fund would be responsible for contracting out local demonstration management to State, local, and private organizations on a challenge grant basis. The CDBFI Fund would decide what an appropriate grant would be depending on the size of the proposal and its merits. The CDBFI Fund would have the authority to require a matching contribution (private sector, non-profit, State, local government funds could be used to match) from the applicant if the Fund determines that a match would assist in meeting the goals of the program. The Fund would set forth in regulation selection criteria for participating entities. The selection criteria would include: targeted population requirements, matching limits, an outreach program, and an oversight plan. The Fund would set forth and publish any other regulations necessary for implementation of this program. Oversight responsibility would exist with the Fund, however, HHS and the CDBFI Fund would have joint responsibility for choosing a contractor to evaluate all the local programs. We believe placing this program with Fund makes sense for several reasons:

- *Understanding of Banking:* It is important that the agency that administers this program has a knowledge of the banking industry, since IDAs will be held in commercial banks, credit unions, and thrifts.

- *Knowledge of the Credit Needs of Low-Income Individuals:* The CDBFI Fund will be working closely with CDBFIs in creating a network of community-based institutions that will serve the credit and basic banking service needs of low-income individuals, the same population to whom our IDA proposal is targeted.

- *Reinventing Government:* Insured CDBFIs such as community development banks and credit unions are one of the most likely institutions to offer IDAs to their customers.

- *Experience In Economic Development:* One of the Fund's missions is to promote economic development and entrepreneurship in low-income communities. IDAs are an economic development and entrepreneurship tool.

Our working group has not yet reached a consensus on this issue. The Treasury Department is concerned it may be too much to ask the CDBFI Fund to run both the community development bank program and the IDA program in its first year of existence. In addition, Treasury argues that since our IDA initiative is linked to the EITC and involves the banking industry, the program should be run out of their agency. However, others in the group are concerned by the lack of expertise Treasury has in running economic development programs. One possible compromise would be for Treasury and CDBFI Fund to administer the program jointly during the demonstration period. Another option is to place the program at SBA, where the complementary micro-loan program would be housed.

Authorization

We recommend an authorization level of $75 million per year, for four years. This would fund in excess of 80,000 families.

DRAFT MICROENTERPRISE LOAN PROGRAM

INSERT

Overview of Welfare Reform/Microloan Demonstration Proposal

I. Purpose: To provide funding and technical assistance for self-employment for welfare recipients in the context of a two-year, time-limited welfare reform effort. To legitimize the pursuit of microenterprise in a reformed welfare system and lift barriers to such self-employment within the system. To enhance the current Microloan Demonstration Program so that the welfare population is adequately served.

II. Legislative Considerations to Remove Federal Deterrents: Amend HHS, HUD and DOL rules as follows:

Income Rules: treat only net income from self-employment as earned income for benefit calculation purposes;
Asset Rules: apply zero net worth to business assets acquired with SBA microloans during the period of receiving AFDC transfer payments;
Healthcare: protect against loss of health care coverage during two year time-limit;
Childcare: maintain child care options during two year time-limit;
JOBS Participation: allow microenterprise training and/or start-up as eligible activity under the JOBS, WORK, and self-initiated community service (SICS) programs;
Time Extensions: allow time limit and reasonable progress extensions for self-employment as under JOBS, WORK, and SICS;
Business in Public Housing: encourage home based self-employment in public housing;
Benefit Options: allow receipt of unemployment benefits during period of business training and start-up (DOL currently moving in this direction based on earlier testing);
Program Enhancements: CDBG use-of-funds guidelines to encourage SBA intermediary participation.

III. Program Options

(1) Increase number of SBA Microloan intermediaries by thirty (30).

Design: Utilize new intermediaries to target welfare population through lending incentives and other means. Target technical assistance to indicated population through increased grant funding for interagency outreach, improved and expanded training curriculum, client identification initiatives, and intensified follow-up services.

Costs:
Loans/Subsidy: Authorization levels for lending will require additional increases of \$38,750,000 over three years and direct subsidy by \$7,750,000 over the same period. Yearly increases in authorization levels are suggested as:
FY95 increase Loan Authority by \$11,000,000 and Subsidy by \$2,200,000.
FY96 increase Loan Authority by \$12,750,000 and Subsidy by \$2,550,000.
FY97 increase Loan Authority by \$15,000,000 and Subsidy by \$3,000,000.

Technical Assistance: Authorization levels for technical assistance will require additional funding of $3,080,000 in FY95, $3,570,000 in FY96, and $4,200,000 in FY97. (current 25% grant level plus additional 15% for assumed target participation of 20%)

Staff/Travel: Authorization levels for staff and travel/oversight will require an additional four persons to effectively increase program delivery to a level of 30 additional intermediary lenders. Staffing authorizations will require an additional four persons at an additional cost of $228,000 in salary and $57,000 in benefits. Travel costs, based on average cost of $800 per trip will require $132,000 (one trip per year to each of a total of 165 providers).

3-Year Total: Loan/Subsidy ($46,500,000) + Technical Assistance ($9,855,000) + Staff/Travel ($417,000) = $ 56,772,000

(2) Increase number of intermediaries by sixty (60) with program design as (1)

Design: Same as (1)

Costs: Loans/Subsidy and Technical Assistance costs are same as (1).
Staff/Travel: Increase staffing authorizations by an additional seven persons at an additional cost of $399,000 in salary and $99,750 in benefits.

3-Year Total: $56,990,750 (same as (1) except add salary and benefits)

(3) Increase number of intermediaries to thirty (30), increase number of Technical Assistance Grantee sites by 30.

Design: This structure will allow for one technical assistance grantee per state and territory (two sites in USVI). Increased intensity of business readiness training, loan packaging and follow-up costs for target populations will require that the current level of $125,000 per year per grantee be increased to $175,000 per year per grantee.

Costs: This will require additional grant funding of $6,500,000 during the first year of expansion. Subsequent years would follow at $9,625,000 per year. Loan, grant, travel and staffing authorizations as in Option Two.

IV. Outreach:

Joint Outreach by SBA/HHS: Office of Economic & Community Development at HHS coordinate efforts to disseminate information re: laws covering welfare recipients as entrepreneurs to intermediaries and potential borrowers.
Other Efforts at Coordination: legislation should encourage or mandate the sharing of information between intermediaries and JOBS caseworkers
State Participation: encourage state run programs to work in conjunction with enhanced microloan program

V. **Targeting (OPEN ISSUE)**

How can expansion of the Microloan Demonstration Program be targeted to assure that the welfare population is served? Should the expansion be limited to the low income or welfare-eligible population?

Should any increase in appropriations be used for technical assistance/outreach purposes or be earmarked for greater loan capacity?

VI. **Proposed Legislation/Regulatory Changes for SBA Microloan Program**

- lift cap on allowable number of intermediaries
- move SBA Program from a direct loan program to a guaranteed loan program to aid in better use of authorized funding
- authorize a creation of a secondary market for loans made to intermediary lenders
  authorize interest rate buy-down incentives for intermediaries making microloans to the target population
- alter matching fund restrictions to include some client by client matches from public sources (some funding could be federal)
- allow for expenditures of funds for interagency training costs
- authorize staffing and funding increases

Microloan Demonstration Program
Welfare Reform Specifications

I. **Purpose**-- To incorporate the SBA Microloan Demonstration Program as a tool in the Welfare Reform Package by providing additional lending and technical assistance resources which, through inter-agency cooperation, incentive based provider participation and client oriented goals will allow for Self-employment as an option for movement out of the Welfare Cycle.

II. **Legislative Design Considerations**-- Legislation must be designed to encourage integrated programming on the Agency Level.

A. Interagency coordination to fulfill goals of Welfare Reform should include language protecting programs from contra-indication in regulations. Self employment as an option for AFDC recipients must be protected under HHS, HUD, and DOL via language within their respective regulations allowing for:

- o elimination of penalties for increases in business revenue during first two years of self-employment
- o applying zero net worth to business assets acquired with SBA microloans during the period of receiving AFDC transfer payments and easing into actual net worth calculations over the next two years
- o protection against loss of health care coverage during first two years of self-employment
- o maintenance of child care (Headstart) options during first two years of self-employment
- o encouragement of home based self-employment in public housing
- o receipt of unemployment benefits during period of business training and start-up (DOL currently moving in this direction based on earlier testing)

Additionally, SBA requirements regarding matching funds to intermediary providers should be altered to include language allowing for local public matching funds based on the numbers of Welfare clients assisted by intermediary lenders and technical assistance providers.

B. SBA service providers (intermediary lenders and technical assistance providers) should be seen as partners in the reform of the Welfare system. Intermediary lenders under this program offer both capital and technical assistance/ business training. Technical assistance providers offer training, loan packaging services and follow-up. They could be tapped to provide state-by-state training coordination. In addition, based on the peer group lending model utilized by a number of intermediaries, SBA participants could be tapped as IDA monitors for EITC level clients.

III. **Participation Incentives must be made available to both target clients and service providers.**

A. Client incentives include:

1. Self Employment as a job option:
   - o greater flexibility and decision making power to the client
   - o adds to tax base through creation of jobs as well as creation of new markets for domestic products as new businesses begin to purchase equipment, inventory, furniture, fixtures and supplies
   - o adds to base of employers for future job needs

2. Self Employment as an equalizer:
   - o elimination of penalties for self-employment income (as above) will encourage legalization of businesses currently operating "under the table"
   - o legalization will allow for business growth as broad based marketing is introduced and revenues increase

B. Service Provider incentives should include:
1. Interest rate buy-downs on loans from SBA to Intermediaries based on the percentage of dollars loaned to Welfare clients
2. Increased technical assistance grant funding based on the number of Welfare borrowers
3. Additional grant funding based on the provision of technical assistance to Welfare clients not becoming borrowers under the Program or obtaining financing from outside the program from other sources (banks, S&Ls, Credit Unions, Private programs)

IV. Required Legislation/Regulatory Changes (Reference Section II, above, Design Items)

A. HHS
- o elimination of asset and revenue restrictions
- o graduated calculation of net worth
- o health care protection during interim phase between transfer dependent and self sufficient
- o child care protection during interim phase between transfer dependent and self sufficient

B. HUD
- o encouragement of home based businesses in HUD housing
- o enforcement of microenterprise, business development programs currently on the books
- o develop CDBG use of funds guidelines encouraging to SBA microlenders

C. DOL
- o continuation of current initiatives

D. SBA
- o lift cap on allowable number of intermediaries

- o increase cap on number of allowable technical assistance grantees to include one per state and territory
- o move SBA Program from a direct loan program to a guaranteed loan program to aid in better use of authorized funding
- o authorize creation of a secondary market for loans made to intermediary lenders
- o authorize interest rate buy-down incentives for intermediaries making microloans to the target population
- o authorize increased grant funding to participants providing technical assistance to target market
- o alter matching fund restrictions to include client by client matches from public sources (some funding could be federal)
- o allow for expenditure of funds for interagency training costs
- o allow for expenditure of funds for general outreach costs
- o authorize staffing and funding increases

E. SBA/CDFI/Treasury

- o coordinate IDA legislation for utilization by SBA program participants

V. Funding Authorization Options

A. Option One-- Increase number of intermediaries by thirty (30). Manage new intermediaries under same rules as current intermediaries. Ensure funding to target population through lending incentives. Target technical assistance to indicated population through increased grant funding for interagency outreach, improved and expanded training curriculum, client identification initiatives, intensified follow-up services.

Authorization levels for lending will require additional increases of $38,750,000 over three years and direct subsidy by $7,750,000 over the same period. Yearly <u>increases</u> in authorization levels are suggested as:
FY95 increase Loan Authority by $11,000,000 and Subsidy by $2,200,000.
FY96 increase Loan Authority by $12,750,000 and Subsidy by $2,550,000.
FY97 increase Loan Authority by $15,000,000 and Subsidy by $3,000,000.

Authorization levels for technical assistance will require additional funding of $3,080,000 in FY95, $3,570,000 in FY96, and $4,200,000 in FY97. (current 25% grant level plus additional 15% for assumed target participation of 20%)

Authorization levels for staff and travel/oversight will require an additional four persons to effectively increase program delivery to a level of 30 additional intermediary lenders. Staffing authorizations will require an additional four persons at an additional cost of $228,000 in salary and $57,000 in benefits. Travel costs, based on average cost of $800 per trip will require $132,000 (one trip per year to each of a total of 165 providers).

Option Two-- Increase number of intermediaries by sixty (60) with program design as in Option One. Increase loan, grant and travel authorizations accordingly. Increase staffing authorizations by an additional seven persons at an additional cost of $399,000 in salary and $99,750 in benefits.

Option Three-- Increase number of intermediaries to thirty (30) as above. In addition, increase number of Technical Assistance Grantee sites by 30 which will allow for one per state and territory (two sites in USVI). Increased intensity of business readiness training, loan packaging and follow-up costs for target populations will require that the current level of $125,000 per year per grantee be increased to $175,000 per year per grantee. This will require additional grant funding of $6,500,000 during the first year of expansion. Subsequent years would follow at $9,625,000 per year. Loan, grant, travel and staffing authorizations as in Option Two.

VI. Meeting Reform Goals

A. Increased access to technical assistance and business capital for target population
   1. Current Intermediaries will increase provision of service to the target population both as federal deterrents are lifted and as incentives are put into place.
   2. Additional Intermediaries in target areas, both rural and urban, will increase service and capital delivery to the target market.

B. Enhanced Outreach and Marketing of Self-employment options
   1. SBA participants as providers of "business basics" orientation to appropriate Federal Employees for universal, base level, understanding of business concepts
   2. SBA participants as providers of training in "potential spotting"
   3. Pre-technical assistance orientation information and outreach to potential program candidates
   4. Referral of clients to SBA intermediaries and technical assistance providers by HHS/HUD/DOL

VII. Targeting Issues (OPEN ISSUES)

A. Do we target increased funds for Microloan Program specifically towards welfare recipients or more generally towards low income individuals?

B. Do we target increased funds for technical assistance/outreach purposes <u>or</u> should increased funds be used only to increase amount of capital available for microloans?

WR- Econ Devel

THE WHITE HOUSE

WASHINGTON

January 18, 1994

MEMORANDUM FOR GENE SPERLING

FROM: Sheryll Cashin
Bonnie Deane
Paul Dimond
Paul Weinstein

SUBJECT: Individual Development Accounts (IDAs) and Microenterprises

For the past two weeks, our Economic Development Subgroup of the Welfare Reform Task Force has been drafting legislative specifications for an IDA and Microenterprise component to the welfare reform initiative (the Subgroup includes CEA, Treasury, SBA, HHS, and OMB). As you are well aware, the President proposed during the campaign to establish 1,000 microenterprise programs and to set up an IDA program that would "encourage savings (among low-income individuals) -- the first necessary step to economic self-sufficiency."

While these programs are the kind of "New Democrat" policies that the President has long supported because they economically empower people rather than provide handouts, a microenterprise and IDA initiative also has appeal to more traditional Democrats. Representative Tony Hall has introduced microenterprise and IDA legislation (Secretary Espy's bill from the last Congress) and Congressman Mfume's staff has indicated to us some interest in both these proposals. We believe including these proposals as part of our welfare reform initiative may help us pass welfare reform.

The chief criticism of IDAs has been that a program would be too expensive to run on a national scale (during the campaign we promised a five year demonstration). We believe we have found a solution to that problem by limiting the total Federal matching amount to about $3,000 per person and linking participation to EITC households (Bruce refers to this proposal as an "EITC For Savings"). Benefits would be targeted on families with income below $15,000. We would have the Community Development Bank and Financial Institutions Fund ("Fund") administer the demonstration program. The Fund would accept proposals for demonstrations from State or local governments, traditional banks, or CDBFIs. We would provide the Fund with the authority to try a range of matches (anywhere from a 4 to 1 to a 1 to 1 match). This will allow us to see what match is the most cost-effective in encouraging savings among low-income individuals.

We are working with the Small Business Administration on developing a proposal to expand their current microloan demonstration program by adding 30 or more additional "welfare reform" microloan pilot sites. The additional pilot sites would be devoted to providing microenterprise loans in conjunction with a State or locality's overall time–limited welfare reform strategic plan. The Micro–Loan Program would be matched with a well–designed personal evaluation program where the skills of welfare recipients are evaluated for technical as well as management skills. The technical skills that are recognized in the evaluation could be matched with the specific types of businesses needed in the geographic area and microloans would be issued to support the start–up or expansion of businesses that would be owned or operated by the welfare recipient.

The SBA, HHS and the Department of Labor would work together on developing this pilot demonstration to integrate it with other components of welfare reform and include other relevant programs or resources. A critical component of this demonstration would be a provision to raise asset limits so that the welfare recipient can accumulate assets to start a microenterprise, without penalty or loss of welfare benefits, during the two–year time limit. Any savings accumulated in an IDA could be withdrawn to start a microenterprise.

The total cost of both of these programs would be $100 million per year and $400 over four years.

cc: Bruce Reed
Kathi Way