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EFFECTIVENESS OF ENTERPRISE ZONES

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BEFORE THE

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UNITED STATES SENATE

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SECOND SESSION

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EFFECTIVENESS OF ENTERPRISE ZONES

WEDNESDAY, JUNE 3, 1992

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Bradley, Pryor, Riegle, Daschle, Breaux, Packwood, Dole, Roth, Danforth, Chafee, Symms, Grassley, and Hatch.

[The press release announcing the hearing follows:]

[Press Release No. H-29, May 26, 1992]

BENTSEN ANNOUNCES HEARING ON ENTERPRISE ZONES; FINANCE CHAIRMAN CITES NEED FOR JOBS IN URBAN AREAS

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Finance Committee, Monday announced a hearing on the effectiveness of enterprise zones as a spur to investment in economically distressed areas.

The hearing will be at *10 a.m., Wednesday, June 3, 1992* in Room SD-215 of the Dirksen Senate Office Building.

Bentsen (D., Texas) noted growing interest in the creation of enterprise zones—areas where tax incentives and reduced government regulation could be used to encourage the investment needed to help create jobs.

"Congress passed legislation creating enterprise zones as part of the tax cut bill the President vetoed last March. There is a clear need for job creating investment in our country, especially in economically distressed areas. That has become even more apparent in the aftermath of the Los Angeles riots," Bentsen said.

"This hearing will enable the Finance Committee to further explore the potential of enterprise zones for helping disadvantaged Americans get jobs and boosting development in areas of our cities that sorely need it. We'll also look to our witnesses for recommendations on the most effective ways to structure enterprise zones," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. If you will please be seated and cease conversation, the hearing will get under way. There is a growing consensus in the wake of the Los Angeles riots on the need for incentives to spur job-creating investment in America's economically troubled areas.

Investors are fleeing the inner cities, and jobs are following them. Unemployment was 13 percent in south central Los Angeles last year, nearly 50 percent in some of the pockets. The same kind of disproportionately high jobless rates are to be found in city after city across this land, as well as in rural America; in such areas as our border with Mexico, where we have the lowest wages you find anyplace in the United States.

One potential tool for helping turn this situation around is the creation of enterprise zones, with tax incentives to encourage investments that will create jobs in economically distressed areas. Congress, in fact, voted for enterprise zones in the last tax bill that was vetoed by the President. I believe we need to try again.

I intend to introduce legislation in coming days to create enterprise zones, but with a difference.

While existing proposals are aimed at steering investment to specific places, my bill will focus more on the people living in those areas. My primary goal would be to create jobs for residents of enterprise zones—the people who would live in those areas, not the outsiders. The folks who live there should be the beneficiaries of those tax incentives.

Enterprise zones, by themselves, are no panacea. If we had created them last March, as Congress proposed, that would not have prevented last month's riots, and enacting a bill this summer will not resolve all of the economic and social problems that afflict America's cities.

But enterprise zones can serve as a down payment. They can help provide the investment that is needed to create jobs and boost development in some of America's most hard-pressed areas.

The need for action is clear, and the time to start is now. Working together, Congress and the President can enact legislation that will offer a helping hand to millions of Americans in troubled areas. And I look forward to hearing the perspectives of our witnesses today on how we can best accomplish that goal.

[The prepared statement of Senator Bentsen appears in the appendix.]

The CHAIRMAN. I turn, now, to my colleague, Senator Packwood.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Thank you, Mr. Chairman. And thank you for calling this hearing and giving us a chance to hear from some of the nation's urban leaders on the benefits of enterprise zones.

Almost every State is struggling with cities that have pockets of severe unemployment and economic hardship. In my own State of Oregon, the city of Portland has neighborhoods in the north, the Albina District, with minority populations that are suffering from staggering unemployment and communities that are disintegrating around them.

Unemployment rates in these areas are significantly higher than in the rest of Portland. Forty-five percent of African-American men in Portland are unemployed, and the unemployment rate for minority teenagers is 65 percent.

No city, of course, is exempt from these problems. We will hear more about Portland from Jan Burreson, of the Portland Development Commission, who will testify later today.

Bringing jobs into the cities can begin a cycle of success and hope that will turn the tide of violence and despair that has been so destructive. Decent jobs and locally-owned businesses that give people a stake in the community can make a difference.

No one disputes that our area's inner cities are in distress. The time is now to explore every possible avenue that might bring some relief to this situation.

And, therefore, Mr. Chairman, I look forward to the testimony today from experts in this field to see whether or not enterprise zones can bring in jobs and help the economically disadvantaged of our urban areas. I thank the Chair.

The CHAIRMAN. Thank you, Senator. I would like to hear now from Senator Daschle, who comes from a State that does not have the enormous cities, but still has some of the concerns and some of the problems from a different perspective. Senator Daschle.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Thank you very much, Mr. Chairman. Let me commend you for your leadership on this issue and for the approach that you have just indicated you intend to take as you introduce enterprise zone legislation. I look forward to co-sponsoring it.

I also would welcome our colleague, Senator Lieberman. He has been involved in this issue for a long period of time, and we are delighted that he is our lead-off witness this morning.

I have four concerns as we begin the hearing this morning. The first is that we do not over-sell the idea. There has been a lot of talk around the country about the importance of this particular tool.

I think it is an important tool, but it is not the panacea. It is not going to provide the solution. It will simply provide us a tool to acquire the solution, and that is all it can do.

So, it is extremely important that we do not over-sell the concept of enterprise zones in this hearing, or during the debate about the issue in the coming months.

Second, I hope we learn from the past. Enterprise zones, like many other tax tools, are subject to substantial abuse. It is critical that we write this legislation to avoid the abuse, that we learn from the past, and that we recognize that there is going to be a substantial need to monitor how enterprise zones are going.

The third concern is that we pay for this tax tool. On the books today we have tax expenditures that now approach $500 billion. That is with a "B"; $500 billion of tax tools that we are paying for this year. We have got to pay for tax tools, and certainly that is going to be one of the challenges before this committee.

Finally, if it works well in urban areas, as the Chairman has indicated, it had better work well in rural areas, too. We have Indian reservations in my State with over 50 percent unemployment. I cannot think of a better place with which to attempt to use enterprise zones than on a reservation with that level of unemployment.

We have rural areas that are virtually being wiped off the map; towns that virtually no longer exist. I cannot think of a better place with which to attempt to use a tax tool like this than rural areas, reservations, and other places in great need of economic vitality.

So, Mr. Chairman, again, let me applaud you for your work and your leadership. I look forward to working with you to accomplish our task.

The CHAIRMAN. Thank you very much. Well, we are very fortunate this morning to have, I think, a very knowledgeable and capable U.S. Senator, who has long been concerned with this issue.

Senator Lieberman.

STATEMENT OF HON. JOSEPH I. LIEBERMAN, A U.S. SENATOR FROM CONNECTICUT

Senator LIEBERMAN. Thank you very much, Mr. Chairman. I am honored for the opportunity to testify at the hearing this morning. And I thank you for convening it and for your interest in introducing legislation on this subject matter because, for me, the best news we have had in a long time is that we are actually going to get these enterprise zones adopted.

It has been my privilege to have been an original sponsor of enterprise zone legislation in the two sessions of Congress that I have been a member of the Senate.

Of course, this idea has been bouncing around since the late 1970's when Bob Garcia and Jack Kemp began talking about it and introducing it in the House of Representatives.

Although Jack Kemp, whom I gather will testify today, continues with his normal youthful enthusiasm and commitment, I think even he may someday begin to show signs of aging, Mr. Chairman. And, therefore, I think it is everyone's interest before that happens to see if we can get these enterprise zones adopted into law.

I have a prepared statement which I would ask be included in the record.

The CHAIRMAN. That will be done.

[The prepared statement of Senator Lieberman appears in the appendix.]

Senator LIEBERMAN. And I would just like to speak with you a few moments informally about why I think this is such an important idea.

As you have said so well, America is focused in the aftermath of Los Angeles once again on the problems of urban and rural America, and looking for not so much rhetoric, but some real solutions to those problems.

You are absolutely right that enterprise zones are not the cure-all, but they can and have dealt successfully with one of the profound problems that is weakening particularly urban America.

And that is the flight of businesses, both manufacturing and commercial, from the central cities of our country, who take with them not only jobs, but the tax base.

And as they take that tax base, it forces the mayors of our cities to increase the taxes on the remaining residential property owners, which, in its turn, puts pressure on those often middle-class property owners to leave the cities. This deepens the social problems and the pressure on those who remain and on the government that is supposed to serve them.

We have to figure out a way to break through that cycle. And it seems to me that there is no better way to deal with this part of the problems of urban America than giving businesses tax incentives to locate in our cities and to bring back some of those jobs and some of that tax base.

Mr. Chairman, this is not an untested idea. It is an idea that has been tried generally by Governors throughout our country for decades.

And it is not a partisan idea. It is not a Republican idea. There are a lot of Democratic Governors out there who have used tax incentives and regulatory relief to attract businesses to their States. And that is just what we are asking through this legislation that mayors be authorized to do.

It is also a cost-effective way to do that. Clearly, there are many other problems that we need to deal with, the problems of people in urban and rural poverty. But enterprise zones take the spending of tax reduction, and, with those costs, invite in a multiplier of private investment.

So, we spend a certain amount of public money, but, in doing so, we induce in many times more in private money. And our aim here is to create the best government response to poverty that I know of, and that is, as you have said at the outset, to give people a job.

This is an idea, not a theory. It is an idea that is working. In fact, since Connecticut adopted enterprise zones in 1982, the first State to do so, 35 other States, plus the District of Columbia, have done so.

And in reports that they have made, their Departments of Economic Development have shown that in the last 10 years enterprise zones have created or protected 250,000 jobs and induced more than $28 billion worth of capital investment in these enterprise zones.

It is an extraordinary result, and it has been achieved without the most powerful sweetener incentive that the government can provide, and that is the Federal tax incentive and regulatory relief that would be offered in enterprise zone regulation that you are considering.

Mr. Chairman, there are a lot of different ideas that have floated around and will float around about enterprise zone legislation.

I do not really want to burden you by dealing with those details, but what I would like to do is state what I think are a few policy principles that ought to be part of any enterprise zone legislation.

The first, is that it ought to focus on both reducing capital and labor costs. In reducing capital costs, we bring in the possibility of creating new businesses in our central cities which are the real creators of jobs so that the reduction of capital cost is really a way of giving people jobs.

Reduction of labor costs is a way to make sure that those jobs are taken by people who either live in the enterprise zone, or are themselves economically disadvantaged. So, I think we have got to go at this in both ways: capital cost reduction, and labor cost reduction.

Secondly, it seems to me, though, I know there have been suggestions that the administration is going to take the cap off the number of enterprise zones. And earlier legislation this year had it capped at 50, and may take that cap off. And, of course, that is a step in the right direction because the need is well beyond 50 among the cities and rural areas of our country.

But I think it is important, no matter what the number, that there be some element of competition involved here. In other words, that the various cities and rural areas that want an enterprise zone feel that they have to put a package together to compete for enterprise zone designation from the Federal Government

The point is that we ought to try to make sure that these enterprise zones are not just trying to build on the Federal tax incentives, but that the States and localities feel that they have to offer incentives as well as part of a package, which is the strongest way to create real economic growth.

I would like to see the cities, for instance, considering offering special police protection within the proposed enterprise zones, or the States offering various forms of regulatory relief which will increase the effectiveness of Federal tax incentives that will be offered as part of the enterprise zone legislation.

Mr. Chairman, let me just say in concluding that, again, the problems of poor people in this country, those who are centered in urban and rural areas, are profound and deep and they are not going to be solved with a single program, or in a single year. But this is a way—the enterprise zones—to get at an important part of the problem.

In the last couple of days as activity on this issue has hastened, we begin to hear disagreements about how exactly it should take shape. And I know that that is part of the legislative and political process.

But at a time when the people of this country are clearly saying to us here in Washington that they do not want words, they want some action; they do not want political partisanship, they want us to produce some programs that can really make life better in this country, I hope that we will not stand in the door and let partisanship or disagreements on details block action.

I have been thinking lately, if you will allow me the liberty to indulge myself, Mr. Chairman, of a song that was the anthem of a generation when I was in college back aways.

Bob Dylan's old song, which had the line, "Come Senators and Congressman, please hear the call. Don't stand in the doorway, don't block up the hall. For the times, they are a'changing."

I think we all know that the times are a'changing. It is critically important that we do not stand in the doorway. And I am confident that with your very decent and strong leadership that we are not only not going to stand in the doorway on this one, but perhaps in true Texas fashion we are going to kick it open and get something done that will really make life better in urban and rural America. Thank you, Mr. Chairman.

The CHAIRMAN. Well, Senator, that is a very thoughtful statement. You are talking about taking off the cap, and I understand that. And I would like to have it without limits. But, we have to pay for it.

Senator LIEBERMAN. Absolutely.

The CHAIRMAN. So, part of the problem is going to be choosing between whether we intensify what we do in those areas we so designate or whether we dilute it some to cover more areas? And that will not be an easy decision. And there is no exact answer to that.

But, in discussing this yesterday at the White House, one of the problems was in trying to determine how to pay for it. And that we have to do, too. Because there are so many of these things we would like to do, but we have a limitation from a budgetary standpoint.

And part of the concerns we have today and part of the lack of flexibility is because of the extravagances of the past that the administrations and the Congress have indulged themselves in. Senator Packwood, do you have comments?

Senator PACKWOOD. Mr. Chairman, I might say if we were to pass the administration's unemployment bill and the way they pay for it, there is enough money left over to pay for the administration's enterprise zone program, too. And you could wrap them all into one and send it out very quickly.

Joe, let me ask you a question on the Connecticut success you have had with the enterprise zones.

Senator LIEBERMAN. Yes.

Senator PACKWOOD. You know the argument that is raised: there are simply jobs that move from one place to another, not a net increase. And maybe in some cases it is a net increase for Connecticut because they might have come from New York, or something like that. I am going to support the enterprise zone effort.

Senator LIEBERMAN. Right.

Senator PACKWOOD. But do you have any evidence that these are net increases and not just shifts?

Senator LIEBERMAN. I do. I cannot give you the exact numbers, but I can tell you that in Connecticut my Department of Economic Development tells me that our enterprise zones have created 13,000 jobs and over $400 million in capital investment in the 10 years we have had the zones.

But I will give you this anecdotal evidence. I have been to several of the zones that we have in Connecticut. I am thinking, particularly, of the one in New Haven. It is loaded with new businesses.

There are a few that moved from elsewhere, but the majority are new businesses. And they are there because they needed a little bit of that extra help that the enterprise zone legislation gave them to get going.

For instance, our enterprise zone legislation, among other forms of relief, gives a stipend, a certain amount of money per new job created in an enterprise zone. That extra money made it possible for some of these small businesses, often high-tech businesses, to get going.

In my opinion, if we adopt Federal enterprise zone legislation with either of the capital cost reduction sweeteners—either the zero capital gains, or, in my opinion, even more powerfully, though I favor capital gains generally, the $50,000 reduction or expensing of an investment in an enterprise zone business—you are going to find a dramatic surge of new businesses being created, not ones moving from elsewhere, in these enterprise zones.

All of us know as we wander around we meet a lot of people with great ideas, entrepreneurs in the best American sense, who, today, are having trouble either borrowing from a bank—almost impossible still—or finding adequate venture capital.

But the tax incentives here will create that stimulus. And I am absolutely confident it will create enormous numbers of new businesses and new jobs, not just move them.

Remember, there are still a lot of disincentives, unfortunately, to bringing a business into the central city. There are fears about crime and concerns about the adequacy and sufficiency of the work force.

So, you have got to create some pressure on the other side, some sweeteners, through these tax incentives and regulatory relief to bring those businesses in.

I do not think it is plausible to think that a lot of big businesser are going to move into the enterprise zones. No. These are going to be for small and very often start-up businesses that will create absolutely new jobs for people.

Senator PACKWOOD. No. You are right about the expensing. If you were to talk to a small business person, if they could write off $25,000, $35,000 or $45,000 immediately, that is a fair investment in a small business.

Senator LIEBERMAN. It sure is.

Senator PACKWOOD. And it is an immense incentive. And it is simply an ability to capitalize that they could not otherwise do.

Senator LIEBERMAN. Absolutely right. Mr. Chairman, if may respond briefly to your statement. Respectfully, if I had my druthers—and I know it is one of the central questions here about whether you try to make the package real strong for a small number of communities, or a little weaker for a larger number—I would try to spread it out as far as possible with the understanding that with the incentives that the Federal legislation can provide will build on these State and local incentives, and also then draw in more private capital across the country and just help more communities.

I mean, I have got three cities in my State that are in the bottom 10, which is to say, among the 10 poorest cities in America in terms of proportion of impoverished people within them.

And I know if there are only 50 enterprise zones in the country, we are probably not going to get more than one of those cities qualified. I think it is better to spread out the incentives and cover more communities.

The CHAIRMAN. Well, in response to that, I would have to say we still have to pay for it. And I happen to disagree with my colleague's statement about accepting the administration's unemployment compensation extension.

That is a dramatic reduction in the weeks, and I have yet to hear the administration tell me the cost of what their new proposal would be.

Senator LIEBERMAN. Well, I agree with you, Mr. Chairman. And perhaps it belabors the obvious, but when we had the enterprise zone legislation in the tax bill we passed earlier, we paid for it with tax increases.

The CHAIRMAN. Yes.

Senator LIEBERMAN. And that is the responsible way to do it.

The CHAIRMAN. Are there other comments to be made to Senator Lieberman? Senator Daschle.

Senator DASCHLE. Thank you, Mr. Chairman. Joe, from the experiences that we have had thus far in the States, is there any indication as to whether the enterprise zones work better or worse in one area over another, or do they work equally as well in urban and rural areas alike?

Senator LIEBERMAN. It is my experience—and, of course, I have more personal experience in the urban areas because that is what we are dealing with in Connecticut—looking at the national literature, they have been proven to work in both places.

Let me make it clear, these enterprise zones are not a success every time they are tried. We have one in my own State, in Hartford, that has not worked as well as it could have for a lot of local reasons that have to do, in part, with the number of residences within the enterprise zone as opposed to commercial property opportunities.

But your opening statement is absolutely correct. If you are dealing with the kinds of unemployment and poverty that you are dealing with on an Indian reservation, for instance, there is no reason why the same basic principle here, which is to give businesses an incentive to move in, cannot work there and has not worked in rural poverty areas as well as it has in cities.

So, in terms of the general category, the idea, I think, is successful in urban and rural areas. Where it has not worked it has been more due to local peculiarities of the enterprise zone.

Senator DASCHLE. That was going to be my second question. To the extent that we already have a data base from which to draw in writing Federal legislation, how do we avoid the pitfalls? How do we avoid the failures, especially the abuses that some of us are concerned about? How would you write into law ways with which to treat abuse more effectively than what we have seen in the States?

Senator LIEBERMAN. Well, in my opinion, there has been very little abuse of the existing tax incentives that have been offered by State and local governments in enterprise zone.

And I think that, while the risk is always there, in my opinion, the kinds of incentives we are talking about—expensing of investments in enterprise zone properties and businesses; zero capital gains tax; a tax credit for hiring a resident of an enterprise zone or an economically disadvantaged person—the risks there are much less than the tremendous potential for investment in job creation.

So, in my opinion, the best thing to do here is to go with a strong package of incentives. Let us make it as powerful as we can afford to make it. And then just make sure we police it closely.

And I think that is the real protection against abuse rather than putting too many conditions or qualifications in the program which may hamstring it before it has a chance to take off from the starting blocks.

Senator DASCHLE. In the remaining time that I have, do we have any experiences where businesses side by side, one in an enterprise zone, one just outside an enterprise zone, call upon the State or some local governmental entity to equalize the tax burden as a result of their proximity to one another?

Do we see cries of inequity on the part of some who may fall right outside an enterprise zone who want the same tax treatment and make a case, for example, that in certain areas maybe their economic situation rises and falls. It may not be as consistently poor as one might find in an enterprise zone, but a case could then be made for similar tax treatment.

Senator LIEBERMAN. Well, we have heard that a little bit in Connecticut, but it has been a very soft voice and not a very powerful voice mainly because the factors that exist outside of the enterprise zone that make it easier to do business—the availability of a skilled work force; even the cosmetic qualities of the environment where the business is located—are so powerful that people understand that the special incentives that are being given in the poor city areas do not even really come close to ultimately equalizing the attraction for business.

There have been a lot of studies done that show that the cost of doing business, the tax climate is only one of the many factors, and often down a ways on the list of factors that a business considers in deciding where to locate. So, I have not heard too much of these cries of inequity.

And the other thing I would like to say, just to repeat briefly what I said before, which is, the enterprise zone idea, which is to create tax incentives to locate business in the cities and poorer rural areas is really just taking an idea that Republican and Democratic Governors have been using for the last couple of decades to try to bring businesses into their States.

And if it is good enough, generally speaking, we ought to direct it and target it to where we have our most profound problems in this country, and that is in the poor urban and rural areas.

Senator DASCHLE. Well, I thank you for your excellent answers. Mr. Chairman, thank you for the time.

The CHAIRMAN. Thank you. Senator Breaux.

Senator BREAUX. I have no questions.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you very much, Mr. Chairman. Let me just say, we are having a markup in the Banking Committee. I had to get that started, and so I may have to leave in the course of the morning.

I appear here today as a co-sponsor of the enterprise zone legislation that is now many years standing.

We have an enterprise zone in Michigan in Benton Harbor. It has been under way now for more than 4 years. I was out there last week to meet with the people to review precisely where we are.

And what they are telling us, and what I see in other enterprise zones, is that the tax incentives to attract business helps up to a point, but then, at a certain stage, if other things are not done in the crime area, education area, and housing area, you run into impossible barriers for making the kind of progress that is needed.

For example, in Benton Harbor, there has been an investment over the years of about $40 million in job creation—about 700 jobs—nearly half of which go to the people in the zone. The other half go to people from outside.

But the people who have led that effort say now, that unless something is done in the area of housing—and they have approached the State Government for special housing credits to assist in either buying their homes or upgrading their homes—crime, infrastructure, education, and health, that the enterprise zone cannot really succeed. In other words, we have got to enhance it and expand it.

Yesterday there was a meeting. Secretary Kemp, who is here now, was there. So was Mr. Darman. And, as it was described by the administration people yesterday—and it is very important that these cards get out onto the table—the theory focused on what communities might have opportunities to go with larger expanded enterprise zone. Maybe certain criteria of poverty, unemployment, distress, and so forth would identify such communities, large and small. And if they met the criteria, they would automatically be eligible.

And I asked Secretary Kemp at that time, as I think he will describe, if this was sort of the vision that is forming in the President's mind. That, in effect, becomes an entitlement. Because if you have objective criteria that allow a community to participate, it is in effect, somewhat of an automatic thing.

Once you find out how many communities participate, then the question is, how do you pay for it. This is the issue that you raise. When I asked Mr. Darman that question yesterday, there was an uncharacteristic silence as a response.

Now, I am convinced that Secretary Kemp wants to get this job done, and I want to get it done. And I think it is a concept, if it is in a broad enough form and if it has the financial commitment behind it, that we can make work.

If it is anything less than that, if it is a narrow concept with no funding, then it is going to be cosmetic and it is not going to work. In fact, it will mislead the country and we cannot have that.

I think it is time to do this, and do it right. I think the concept is right. The country is waiting for it. And I appreciate the testimony given by our colleague from Connecticut. I know from our experience in Michigan that this is a route we need to travel, but we have got to beef it up.

When the Benton Harbor people tell me they need 20 additional police officers in that community and have no money to pay for it, that tells me that there is a component of economic re-development and strengthening that is going to have to come in in addition to just the tax incentives for new businesses.

So, I am hopeful that Secretary Kemp will be able to lay out that kind of a plan today and tell us that the administration is committed to it, and that we can work on a bipartisan basis in business and government and get this done. Thank you, Mr. Chairman.

Senator LIEBERMAN. Mr. Chairman, if I may, very briefly.

The CHAIRMAN. Sure.

Senator LIEBERMAN. I think Senator Riegle is right on target. We ought to try to cover as many communities as we can with the enterprise zones, but they ought not to become entitlements. And they ought not to for the reason that they are going to be a lot better off if the local communities feel that they have to compete with one another for designation.

And competing will mean having those local communities, for instance, offer some more police protection in that community, or some more State regulatory relief so that we multiply the effectiveness of the Federal tax incentive in that way.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Welcome, Senator Lieberman.

Senator LIEBERMAN. Thank you, Senator.

Senator MOYNIHAN. I look forward to hearing Secretary Kemp, sir.

The CHAIRMAN. Thank you. Thank you very much, Senator.

Senator LIEBERMAN. Thank you, Mr. Chairman, and members of the committee.

The CHAIRMAN. Mr. Secretary, we are pleased to have you this morning. Recalling your last appearance before this committee, Mr. Secretary, you were such an interesting witness you took all morning. All of the members of this committee wanted to discuss it.

And I have several panels of very additionally able witnesses. So, I am going to ask your indulgence. If you would limit your statement to 10 minutes, then we will go at length in asking you your thoughts on the various issues.

STATEMENT OF HON. JACK KEMP, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary KEMP. It would be very uncharacteristic, Mr. Chairman, for me to be able to say hello to my friends on the committee in less than 10 minutes, but I certainly will do my best.

The CHAIRMAN. Thank you.

Secretary KEMP. And I very much appreciate your holding the hearings. Let me say to my friend, Don Riegle, in answer to his question, I have been coming to this committee now for 3½ years and saying that I did not speak for anyone but myself.

I am pleased to say today that I am here speaking on behalf of the President of the United States, and I will clear up any questions that Don Riegle has about our proposal and the bipartisan spirit to pass immediately an enterprise zone bill that will, in the President's own words, entitle any community, any neighborhood, any inner city or rural pocket of poverty in America that qualifies, to have an enterprise zone with extensive incentives for entrepreneurship and the creation of jobs.

It broadens it to make sure that whether it is in Tom Bradley's Los Angeles—and he is sitting behind me—or Henry Espy's Clarksdale, Mississippi, or whether it is in east L.A. or east New York, or Benton Harbor, or Liberty City, Miami, or the colonias, Mr. Chairman, from your home State of Texas, if there is endemic poverty, chronic unemployment, a shrinking tax base, and the type of despair and joblessness and hopelessness that we witnessed in South Central L.A., or Compton, or Inglewood, or Watts, or Korea Town, or the barrio of East L.A., that those communities, too, can qualify.

It is an entitlement in the sense that there are objective criteria that can be identified in the pocket of poverty that would allow for a mayor from a big city or a small town to have the opportunity to become an enterprise zone.

So, that is a significant change, but it requires a significant response. This is a problem that is endemic to inner cities all over the country.

One other thing I wanted to add, Mr. Chairman. There are a couple of stories going around, one of which is in the morning New

York Times. It says, "Enterprise zones are intended to lure businesses into impoverished areas by means of tax cuts." Not so.

The New York Times has yet to get it right. The incentives are not designed as a zero-sum contest between the inner city of Los Angeles or the inner city of San Antonio, and the suburbs, or to try to lure businesses to move from Detroit to any other city. The purpose of the incentives will be, as I explain it in my testimony, Mr. Chairman, to encourage entrepreneurship; to give men and women—particularly minority men and women—access to capital and seed corn, and venture capital so they can begin to become part of the system themselves.

I will make the case in my testimony which I presented for the record that black Americans represent 13 percent of the population, but own less than one-half of 1 percent of the total capital stock of America.

I do not know if the exact parallel case is true of Latinos and Hispanics, but there is a similar problem for all men and women of color in America.

The rules of the game have been to shut the inner cities of America, through red-lining, out of access to property, access to credit, access to capital, access to the seed corn necessary to become a part of our democratic capitalistic, private property-based, market-oriented economy.

So, the President was very clear about this. He wants to deepen incentives within a zone, and he wants to broaden the number of cities that would have access to that type of enterprise zone.

It is not intended to lure businesses; it is intended to create businesses. We are not trying to get jobs to move from the suburbs to the city; we are trying to create more jobs. And the answer to creating more employees is to create more employers. And there is no fundamental, Marxian class warfare between labor and capital.

We have a surplus of men and women looking for jobs, we have a shortage of capital investment in the inner cities, and the purpose of the bill is to flood impoverished areas of America with capital, and credit, and seed corn.

One other quick misinterpretation of the bill in the Wall Street Journal. It said this morning, ". . . after weeks of internal wrangling." There is no internal wrangling. There is a debate—always a debate. There is no wrangling in the administration. The President has supported it for 3 years.

And, after meeting with Tom Bradley, Mayor Walter Tucker of Compton, Mayor Eddie Vincent of Inglewood, and other outstanding men and women who are mayors from Hispanic and black areas of L.A. to rural areas of Mississippi, like Henry Espy, he wants all of the mayors to have a chance to get one.

Finally, someone said it is complicated. It is not complicated; that is the beauty of it. It is ready to go instantaneously.

And it is non-bureaucratic, it is non-trickle down, it allows for grass-roots capitalism to grow out of the neighborhood and give people a stake in this American system that is drawing adherents all over the world, but has not yet been allowed to work in all too many of our own inner cities.

Mr. Chairman, I mentioned in my remarks on page 3 that we have spent $3.2 trillion on social welfare programs since 1965, and with the very best of intentions. Many people have been helped by these programs, but we must admit that there have been people left behind.

The problems of poverty, joblessness, crime, drug abuse, violence and despair which these programs were meant to address are, by many measures, if not most measures, worse today than they were before.

Now, this is interesting. We cannot leave anyone out, for, as the President said in his speech—and I think every man and woman on this panel recognizes—we are one nation, one people, one family, and you cannot have a family where only the fittest survive.

You have got to have a family in which even the weaker elements are allowed to move forward. And that is the purpose of enterprise zones, to go back and help pick up—not pick up by paternalism, but to create the type of opportunities that will allow people to become part of this mainstream economy.

The rules need to be changed, Mr. Chairman. The rules in America today on welfare discourage families, encourage the breakup of families, discourage savings, encourage and subsidize consumption, discourage work, and subsidize welfare.

And there is a rule against starting a business in the inner city. And you say, well, Kemp, that is impossible. It is not impossible.

The de facto rule today is that if you live in the inner cities of America and you are a man or woman of color, you will not have access to the capital so necessary to start that business. And we have to change that.

We have to change the rules that prevent people from going to work—I was pleased that Joe Lieberman is a co-sponsor, and a great friend of all of ours, and alluded to the fact that he wants to pass this before I get old.

I was going to say I have testified now for 3 years on this. I hope this is my last time testifying. I would be glad to go anywhere, anytime, Mr. Chairman.

But do not do it for Jack Kemp, do not do it for George Bush, do not do it for Joe Lieberman, do not do it for Rangel, or anybody else. Do it for the people that have got to believe that this government can move and take some decisive action to put some hope and opportunity back into the areas in which red-lining has occurred.

The first, and essential step—and let me get right to the five points, Mr. Chairman, and then answer questions.

The President wants to completely eliminate the capital gain tax on anyone who invests his or her capital and savings and puts it at risk in a green-lined area of the inner city.

No tax on the tangible asset that is improved upon, or the intangible asset, and no alternative minimum tax. A zero tax on the gain from anyone who is willing to put his or her capital at risk and who wants to live, work, and invest in the inner city.

Second, Congressman Rangel pointed out to us a number of years ago, and to my friend, Pat Moynihan, that one of the biggest problems in black businesses—and I know it is true of other Hispanic and minority businessmen and women—is no access to seed corn.

What do you do about the guy or the gal that does not have access to capital? Not everyone like John Johnson of Ebony and Jet Magazine, or Earl Graves, of Black Enterprise Magazine, or Bob

Johnson of Black Entertainment Television, has the capital to start a business today.

So, Charlie Rangel came up with an amendment, we accepted it, and we believe in it, that you can expense your investment in the stock, the debenture, or the equity of a minority enterprise, or any enterprise in an enterprise zone, up to $50,000.

Fred Goldberg, of Treasury, will be here in a few minutes, Mr. Chairman, to clear up any of the tax consequences. I am hitting the highlights.

Individual investors in enterprise zones can elect either to expense their investment in the stock, or to receive the capital gains exclusion, but not both. If you live in the inner city you can both expense and have a zero capital gain tax.

Small businesses in the enterprise zone can expense up to $20,000 a year in their capital equipment. Start a widget factory in Watts, you can expense your investment in the capital equipment.

Frankly, I think we might want to look at expanding that. Passive loss relief up to $10,000 per year of any kind of passive loss on an enterprise zone investment, not just real estate.

No tax on the sale of a primary residence; no tax on the capital gain of a home as a primary residence. We want to encourage not only job creation, but home ownership. People need to be given a stake in the community.

In fact, people were policing and guarding that which they had a stake in in their neighborhoods, whether it was public housing, or even where the resident were in charge of private homes.

One other point. In the meeting, with Peter Ueberroth, Mr. Chairman, of Rebuild L.A., and Tom Bradley, and Governor Wilson, of California, they made the point that there are incredible levels of unemployment among black and Hispanic males. The estimates are 70 percent.

The lack of businesses. Blacks represent 11 percent of the population of Los Angeles County; own less than 5 percent of the businesses.

Is it any wonder that some people have lost some faith and belief in our democratic, capitalistic economy when they do not have access to capital? We have got to create more minority entrepreneurs.

John Jacob, in his book, State of Black America, suggested that, with 14.6 million small businessmen and women in America, less than 425,000 are black; less than 400,000 are Hispanic.

Now, I do not favor—nor does anyone in this panel—taking the business of one person to give it to another. That is not what this is all about.

It is not a zero sum game; it is a win-win solution to change the tax laws to be compensatory enough to flood the inner cities of America with capital formation and job creation.

Finally, one last point, and then I will stop, Mr. Chairman. One of the greatest disincentives, one of the rules that makes me the most upset, having traveled the country for the last 3 years for President Bush, and one that we need to radically change, is the fact that when a woman on welfare takes a job, her income goes down.

I do not need to tell you, Mr. Chairman, because you have been very sensitive to this in your efforts to increase the credit for families. Senator Moynihan has tried to lower the payroll tax.

The payroll tax is a disincentive for taking a job because the combination of the payroll tax, coupled with the loss of welfare benefits, and health benefits, and assistance creates a marginal tax rate of about 120 percent on the earnings of a woman that leaves AFDC to go to work.

I get a kick out of the debate over values. Thrift is a value. We want to encourage the value of thrift among people. The laws of AFDC say it is against the law to save.

How dare we say in America that we are going to preach values to poor people, and then say if you save and are thrifty, as Sandra Rosado of New Haven, CT was, according to the New York Times that the government will discover a savings account, and tell low-income people its against the law to save. Can you imagine, we have police that discover things that you are not supposed do. You are not supposed to save.

They discovered her savings account. They took her $4,000 and made her spend it immediately, and they took $9,000 back from her mother in a fine.

The rules of the welfare system say, if you have children, do not work. If you have a family, in effect, it says, break it up. You can get more by breaking up your family. And it definitely says that work is not as well-compensated as welfare.

I appreciate the fact that there are many men and women in this Congress that want to do something about this. The time is now. It is urgent. The one thing I heard from Tom Bradley and Peter Ueberroth, is that there are thousands of investors in the private sector who want to invest in the areas of L.A.

He says, they are going to take a walk. They are going to leave. They are going to go elsewhere if something is not done by the Congress and the administration to get an immediate passage of some incentivized enterprise zone approach to creating jobs.

Lastly, Mr. Chairman—and I said that once before and you may not believe me—I am reminded of the rabbi who said one time, before I speak, may I say a few words. [Laughter.]

May I conclude with this thought. There are those on the left who say that people are poor out of some perpetual condition, and the most that we can do is anesthetize them from the marketplace. They will not be able to compete. They will not be able to respond. They do not want to respond.

Michael Kinsley, of New Republic, represents this elitist attitude. Well, he attacks me daily for trying to pass enterprise zones, so I thought I would give him a dose of his New Republic nonsense.

On the right, Mr. Chairman, we have the 18th century social Darwin theory that says, hey, I picked myself up by my bootstraps, why can't they? They do not want to. They do not have the right values. Nonsense. This is no time for elitism on the left, and it is no time for elitism on the right.

It is time, it seems to me, between our administration and your committee, to pass a bill that can inject incentives for the entrepreneur, for the venture capitalist, and for the creation of jobs in our Nation's inner cities all over this country.

And I hope, someday, Mr. Chairman, by the time we get through we will have an enterprise zone from sea to shining sea.

The CHAIRMAN. Well, if that is the case, Mr. Secretary, I would want one all along th- Mexican border. [Laughter.]

Secretary KEMP. Pass the bill, and I will come down and help you cut the ribbon.

The CHAIRMAN. We are knee deep in problems, high unemployment, and low wages—problems that have to be addressed through education and incentives.

But as a former businessman, one of the things that would concern me most if I was making an investment in one of these areas where, for whatever the reasons, you have had a high incidence of crime, and riots, in some instances, would be, first, the availability of capital, which would be extremely sensitive to those problems.

Secretary KEMP. Yes, sir.

The CHAIRMAN. And then I would wonder about the availability of insurance. How do we get that? That is what I would want first from my investment. And then I would talk about tax incentives to encourage me to choose that one above another one. But I would want some degree of safety for the burning out of my store. Do you have any thoughts on that?

Secretary KEMP. Well, I do not disagree with the emotion that you feel about this issue, and I do not disagree, necessarily, with the premise. And there is no doubt, Mr. Chairman, you are putting your capital at risk to a certain degree. And I think insurance is a problem.

So, having said all that, the whole de facto red-lining problem in the inner cities of America is what you are talking about. Whether it is lack of insurance; Don mentioned crime, education, and job training. Obviously, we have to address that.

But there is a very important point that has to be made, it seems to me, which is, it is exactly the fact that people do not own a stake in the system that undermines their respect for property, and particularly other people's property.

I am not excusing or condoning violence, I am simply explaining the fact that if you have but the shirt on your back, no job, no chance to feed your children, put bread on the table at night, have a normal family life, go to school, get a job, if you never owned anything in your life, it undermines your respect for the system, it undermines the stability of the community, it undermines all the values that we talk about in a Judeo-Christian society, such as ours is predicated upon.

And I believe, Mr. Chairman, if people felt we were taking radical demonstrable steps to introduce hope and opportunity and begin to green-line these areas, you would begin to see the type of stake in the community and the neighborhood that would lead to a more stable condition, and you would find banks willing to loan on signature, you would find people willing to insure, you would find, I believe, elements that are now unstable becoming stable.

But do not ask Kemp, ask Mayor Bradley. He is a far better expert on this than am I. But I observe it is precisely the lack of access to property and ownership that undermines people's respect for other people's lives and property.

The CHAIRMAN. Thank you, Mr. Secretary.

Senator Dole.

Senator DOLE. Mr. Chairman, if I could just include in the record my statement in support of enterprise zones, not as a panacea, but at least something we have looked at for a number of years here. I am not certain it is going to work; I am not certain how it is going to be paid for. I have not heard that. Maybe I arrived late.

But there might be an opportunity while we are looking at the extensive unemployment compensation to put the enterprise zone legislation, if we cannot make it permanent, maybe make it for a period of years if it is a matter of cost.

And maybe we add to that repeal of the luxury tax and some of the extenders, though I think some of the extenders ought to be forgotten.

But, in any event, if we can figure out a package, I think there would certainly be a willingness on our part, Mr. Chairman, to work with you and others to keep other amendments off, get it done, get it passed as quickly as we can.

Because I think one thing that Mayor Bradley and others will agree on is that the longer we wait, the less the chances are of getting any satisfactory legislation done.

So, I just wanted to include my statement and pledge my support to the Chairman in efforts to work out something on a bipartisan basis.

[The prepared statement of Senator Dole appears in the appendix.]

The CHAIRMAN. Well, Senator, I very much appreciate that. And I share that thought with you that I do not want it to become a Christmas tree. And that is going to be the problem for us in trying to bring this about.

Let me say, Mr. Secretary, I share many of the concerns you are talking about. And I have supported a cut in capital gains for a long time; perhaps not as enthusiastically as you have.

But I think you really make a very interesting statement when you say that capital gains tax perpetuates divisions in our society and prolongs the legacy of Jim Crowism and racial discrimination. That is an interesting statement. I think that is reaching out there a bit, I must say to you.

Secretary KEMP. Do you want me to explain it?

The CHAIRMAN. There is a lot of discrimination in this society of ours, but I do not really think capital gains perpetuates Jim Crowism and racial discrimination. We all know that the vast majority of capital gains is realized by the wealthy in our society.

I think there are other things that we can do here that are even more important. The one thing I do not want to see is the tax benefits all siphoned off out of that enterprise zone to people outside of those areas to the extent that we can avoid that.

I want to see those things in job creation within that zone. I want to share with you the thought that we have small businesses owned within that zone to the extent we can get them.

I want to see what we can do to give some protection to the corpus of the investment by insurance. I want to get away from that red-lining to the extent that we can.

All of those things I strongly agree with; I think those things can, and should be done. But I am sure by now the administration has made some decision on how much they want to spend on this on their version of the enterprise zones.

Secretary KEMP. Could I just make one brief comment in response to your very thoughtful question?

The CHAIRMAN. Yes.

Secretary KEMP. Mr. Chairman, I share your view that we do not want to turn an enterprise zone into a tax haven. I am not looking for a Cayman Islands in Watts.

The benefit of a zero capital gain tax would only go to an investor and an entrepreneur who increases the wealth of the community.

Unless you add value to the business and the enterprise and create the jobs in the inner city, you are not going to benefit from a zero capital gain tax. That is the way the law will be drafted, and I share that.

Two, you cannot form capital by wages alone. You must earn, save, take surplus income, invest it, make a profit, roll it over, and maybe put it at risk some day in an enterprise. You cannot do it if the government confiscates your gain.

And an unindexed capital gain tax in the United States of America is confiscatory not on wealthy people, because they will shelter their income. It prevents people from getting access to capital and access to wealth.

So, if you take that and tie it red-lining, Mr. Chairman, it is discriminatory against the inner city residents, many of whom are black and Hispanic, and men and women of color and ethnicity, and immigrant Americans.

It is discriminatory to have a tax system that locks up the wealth of America and the capital of America into relatively few hands. And if you want grass-roots entrepreneur capitalism, as Jesse Jackson pointed out—he did not point out cutting capital gains tax—America is capitalistic without a capital.

And I thought, well, that is a strange statement. But he is right; we do not have enough capital. You have got to go offshore to get it. You have got to sell your mother's furniture, as John Johnson did, to start Ebony Magazine. And we are opening up the tax system to give people access to the formation of capital.

Finally, in response to your question about the cost. I am sorry Senator Dole left; I appreciated his strong support for enterprise zones. But it seems to me that he does not know if it will work.

The CHAIRMAN. Well, I just want a number.

Secretary KEMP. Goodness gracious. If he does not know——

The CHAIRMAN. Mr. Secretary, I am just asking you for the number.

Secretary KEMP. What?

The CHAIRMAN. I am just asking you for the number, because we have to raise the money.

Secretary KEMP. Well, Mr. Chairman, I will let Fred Goldberg talk about this. Mr. Darman has talked about it. I mean, if the budget comes in the way of providing an answer to getting growth and prosperity into our Nation's inner cities, what irony it would be if a $2.5 to $3 billion so-called tax cut in static terms defeats a bill in a budget of $1.5 trillion or more. I mean, that would be an excuse for inaction.

I put growth and opportunity ahead of the budget; there is no secret about that. Mr. Goldberg will give you the answer to how the offsets can pay for it.

But, in my view, Mr. Chairman, with all due respect, that is no excuse. That is no excuse. $2.5 billion or $3 billion in static revenue loss over 3 years. If it does not work, it will not cost a thing, Mr. Chairman. And if it does work, it will add to the tax base of Newark, NJ, Los Angeles, CA, the State of Michigan, and the U.S. Government.

We may lose a little on capital gains, but we will make it up on property values, corporate taxes, income taxes, sales taxes, and saving America and its families and its children from the disastrous consequence of the poverty into which people have been allowed to fall in this country.

And I think it is immoral. I think it is immoral to preach democracy and capitalism in Eastern Europe and not allow it to work in Eastern New York, or East St. Louis, or East L.A. Excuse my passion on this subject.

The CHAIRMAN. No. Mr. Secretary.

Secretary KEMP. But $2.5 billion.

The CHAIRMAN. Mr. Secretary, I have been listening to that argument for 22 years since I have been on this committee.

Secretary KEMP. This is the best investment you can make, Mr. Chairman.

The CHAIRMAN. And let me further state, we now have a $400 billion deficit. All I am saying is, I want to know how much it is going to cost and how we are going to pay for it. That I want to do. And I do not want to see us bust the budget in the process. Surely there are other things we can do to pay for these things that have to be done.

Secretary KEMP. Well, I am sure you can find them.

The CHAIRMAN. But I want to hear those answers from the administration.

Secretary KEMP. Thank you.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Chairman, I am not going to argue with you and Jack as to the $2.5 billion. But I want to go back to this $400 billion deficit and remember where this committee was, and where the Ways and Means Committee was in 1981 when we made the tax cuts.

And if there is anybody here from the Joint Committee, or CBO, or OMB, they will remember that from roughly August of 1980 until about August of 1981, we were projecting immense surpluses that were going to come due in 1984, 1985, and 1986.

And those were bipartisan. This was still when the Democrats controlled the Congressional Budget Office. And we thought if we did not cut the taxes, we would have these surpluses and we would spend the money as the government always does. If it has got the money, it spends it. It does not rebate it.

And when we made the cuts, the Treasury was predicting static estimates and they were predicting that we were going to lose the revenues from the taxes we were cutting, but we were going to lose them by their predictions and by CBO's predictions of surpluses of $185 to $200 billion by 1985.

What happened was two things nobody foresaw. And, remember, the Tax Code was not indexed at the time. And we were projecting 13, 14, 15 percent inflation. The government gains a great deal of money when we do not index the Tax Code.

Secondly, we were not predicting the recession. And we were not predicting the fall of inflation. I do not mean the Republicans; nobody was. We did not think inflation was going to fall from 13 to 4 or 5 percent in a year and a half.

But when we passed those tax cuts, no one was predicting—maybe there were some, but not many—a supply side revolution. We were assuming almost, from Treasury estimates, a dollar-for-dollar loss in revenue, and we hoped to cut the surplus so we would not spend the money. I am not going to say anything more, and I have no questions for the Secretary. But at least I would like that record to be straight about the cuts that were made in 1981.

The CHAIRMAN. If I might just make a comment. I was very careful to not blame either the administration or the Congress. I said we both shared in the results, and that is what it takes. Senator Grassley.

Senator GRASSLEY. Thank you, Mr. Chairman. I want to put a short statement in the record, since I was not here to give that. And I will refer to my statement a little bit in some questions that I ask you.

But, before I ask a question, I want to thank you, Secretary Kemp, for your leadership. I want to thank you for your ideas, and these ideas preceded disasters we had in this country.

And I think it is kind of a sad commentary that we have to have these disasters before this administration recognizes you as a member of the Cabinet and brings your issues to the fore. And it is kind of nice that that happens, but it is a sad commentary that it happens because of disaster.

But I think it does speak to the point that you have been consistent in your approach to the solution of urban problems, maybe economic problems generally, throughout your tenure as a Congressman, and now as a member of the Cabinet.

And it is that sort of consistency, that sort of infrastructure approach that you have that does make you credible as you approach solutions to these problems.

I mention in my remarks for opening remarks that I had introduced what is referred to as micro-enterprise legislation to help the poor get off of public assistance through opportunities for self-employment. And you referred to the fact that there are not enough incentives to get off welfare. One of those disincentives is the asset test.

Secretary KEMP. Right.

Senator GRASSLEY. Micro-enterprises, I describe as a self-employed person who might also employ one to five other people. My question deals with this approach, and I know the administration has supported an increase in the exclusion limit for AFDC recipients to encourage micro-enterprises.

Secretary KEMP. Yes.

Senator GRASSLEY. Why should we not consider this as part of an economic development package?

Secretary KEMP. We should. It is in the President's budget.

Senator GRASSLEY. All right.

Secretary KEMP. And, with all due respect, the higher profile that you alluded to that I might have subsequent to the Los Angeles riot, let me remind you as a good friend, this has been in the President's budget for 3 years. And it has been disappearing down dark holes for 3 years.

And, with all due respect to the administration, Congress and the administration are now in sync with at least the recognition that we must act.

And one of the things we must do, Senator Grassley, is to increase the asset test for AFDC recipients from $1,000 to at least $10,000. You have co-sponsored it. Congressman Mike Espy of the Delta of Southern Mississippi has co-sponsored it.

I think this gives us a moment of critical mass and a window of opportunity upon which to move to reform the welfare system, to change the inner city economic climate, and begin to privatize public housing so people can own, and manage, and control their own units of State-owned housing, as opposed to being perpetually dependent upon the welfare plantation.

Senator GRASSLEY. There are some demonstration programs in five States of America that have been proven successful. and we have also used this in some international programs to develop entrepreneurship in under-developed nations.

Secretary KEMP. Sure. Yes.

Senator GRASSLEY. So, this is not a new policy for our government.

Secretary KEMP. Of course not.

Senator GRASSLEY. It just has not been applied to the right programs across the board.

Secretary KEMP. A form of this was introduced by Governor Luis Muños Marin of Puerto Rico in the 1930's and 1940's.

Senator GRASSLEY. Yes.

Secretary KEMP. Section 936 of the Tax Code allows credits and offsets against a profit for corporations that invest particularly pharmaceuticals on the island of Puerto Rico. That was Operation Bootstrap.

Now, we are not trying to lure businesses away from the suburbs to shift them to the inner city; we are trying to have an entrepreneurial, venture capital, work-oriented incentive that can build grass-roots capitalism from the bottom up as opposed to letting it trickle down, which is, I think, one of the mistakes we made in 1981.

We passed the tax rate cuts on capital and labor, and I was very proud to be a part of bringing down the high rates in the 1970's to what it is today, 28 or 31.

Senator GRASSLEY. Yes.

Secretary KEMP. The lower rates came down as well. But we did not pass enterprise zones. And that is one of the burdens that I carry with me, that I was not able to get it through in 1978 or 1989 when Garcia, Rangel, and Bill Gray, and, goodness gracious, some of the conservative opportunity society members introduced it. But we have got to do it now.

Senator GRASSLEY. There are some counties in Iowa that only have around $7,500 per capita income, which is similar to what is in South Central L.A. This, I think, is evidence enough that there are also problems of poverty and entrepreneurship and diversification of agriculture in rural America where this principle ought to be applied, as well as to urban areas.

Secretary KEMP. Senator Grassley, I would refer back to the President's statement that I quoted earlier. The President said in Los Angeles last Friday, he wants every mayor, every unit of government that has a neighborhood or a community that has the type of conditions, be they in urban America or rural America, to qualify.

It is an entitlement, and I am using that word with a small "E." But they are entitled to it, the objective criteria being fulfilled. There would be one in any community in the country in which there were high levels of poverty, high levels of welfare, high levels of unemployment, and a shrinking tax base.

An Indian reservation. The Native American communities; Guadalupe, Arizona, where I visited. A perfect area to green-line and give people some hope that they, too, can take part in our democratic, capitalistic system. Right now, they have been shut out to a large degree.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. I thank the Secretary for his persistence, perseverance, and dedication to this issue. It looks like he has finally gotten the White House to listen to his recommendations and join in this joint venture. Let me ask you a couple of questions.

Secretary KEMP. John, it has been in our budget for 3 years, but is the first time we have gotten your attention.

Senator BREAUX. I am glad you are speaking for the White House. Let me ask a question about a feature of the plan. There is a tax incentive supposedly intended to encourage home ownership by excluding from the sale of a home in an enterprise zone—any of the capital gains that may be earned from the sale.

It seems to me, if I lived in an enterprise zone and I could sell my home and get the heck out and not have to pay capital gains on it, I would be encouraged to get out of the zone—just leave—rather than reinvesting in the zone. If I had a chance to sell my house and go move somewhere else, isn't that would this provision encourages?

Secretary KEMP. Well, I worry more about the people who are poor and without any property and without any homes. And they ought to be able to live wherever they want. And if somebody sells a home, the profit from that home sale should not be confiscated by the U.S. Government.

We ought to give people a chance to take their palace and get some capital. That is how my papa and mamma leveraged their home in the 1930's into a small trucking company.

Senator BREAUX. I understand.

Secretary KEMP. But, frankly, we are shutting out people from that dream. And I do not think that we ought to say, you can only live here the rest of your life.

Senator BREAUX. Well, all I am saying is, how does that improve a zone area and give any benefits to the people who live in the zone by encouraging them to leave which is what this does?

Secretary KEMP. You are not encouraging them to leave. You are just saying that if you own a home and it is your primary residence and you sell, the government is not going to confiscate the profit from the sale of that home. I would hope that they would invest it. If they invest it in a zone, there would be no capital gain tax on their investment in the zone. So, I would imagine they might even want to roll it over. That is the American Dream, by the way.

Senator BREAUX. But there is no tie to the sale of the home in the zone to reinvesting in the zone, is there?

Secretary KEMP. No. Because you do not want to say to somebody who makes a profit in the inner city, you can only spend your profit in one area of the country. I mean, that is not free enterprise, or freedom of choice, or democratic.

Senator BREAUX. I do not disagree with that. I am just trying to figure out how letting them sell their house in a zone and move out helps the zone.

Secretary KEMP. We should want people to have the same opportunity to make a profit who live in the inner city as people make a profit living in the suburbs. And, frankly, we are confiscating the profits from the sale of a home.

Senator BREAUX. I have no argument about the capital gains aspect. I am just saying——

Secretary KEMP. Well, I do not think there should be any tax on anybody for the capital gain from the sale of their primary residence in the whole country, by the way. But the only way I can get from here to there and sneak up on you in the tax writing committee is to do it from the inner city out. I call it Fabian Capitalism.

Senator BREAUX. Sneaking up on Bentsen is going to be quite a trick.

Secretary KEMP. Sneaking up on what?

Senator BREAUX. Sneaking up on Bentsen is going to be quite a trick. Let me ask a couple of questions.

Secretary KEMP. Well, he asked for an enterprise zone in every colonia.

Senator BREAUX. Let me ask you some questions. How do we tie the benefits that a business would get to the work in a zone? I am concerned about a business that is on Wall Street that just puts up a building to make widgets in an enterprise zone——

Secretary KEMP. Can not do it.

Senator BREAUX [continuing]. And brings in their employees from outside the zone and the capital goes back to banks on Wall Street. And there is no real tie to the zone, other than the fact they have their plant located there.

Secretary KEMP. Fred Goldberg, who will testify after me, will go into the details of the Tax Code. I am not an expert on the Tax Code, I am an expert on incentives.

But I can tell you that we do not want to turn this into a warehouse or a tax shelter, as I said in response to Senator Bentsen's earlier question. You would have to realize the benefit.

The only way you could realize the benefit from a zero capital gain tax would be to do the vast majority of your business in the zone, create the jobs for the residents in the zone, and realize the profit from the investment in the zone, although we want you to be able to sell throughout the country.

Senator BREAUX. All right.

Secretary KEMP. We want to integrate the inner city economy to the whole economy.

Senator BREAUX. One of the faults that I see is that there is no direct requirement of what I would like to see, a youth apprenticeship-type program, with the businesses that invest in a zone.

Say I am a business person that comes in and I make something that is fairly technical. There is nobody in that zone, which is a riot-torn area, with low education, and people have had a real difficult time. I cannot find anybody to do my business in that zone, and I cannot locate there. There is no training program, there are no incentives to do that in you proposal.

Secretary KEMP. All right. There is a training program. Don Riegle mentioned this yesterday. In the Weed and Seed program, which is linked to the enterprise zone—I do not like the word, but suffice it to say—four-fifths of all money for Weed and Seed will be spent for job training and social service delivery systems in the enterprise zone.

Two, do not, John, underestimate the talent that exists in the inner city of America. It needs to be unleashed. We need job training, to be sure. But there is tremendous talent. Haime Escalante discovered engineers in the gangs of east L.A. Everybody else had given up on them. You cannot give up on those youths who live in the barrio or in ghettos of America. There is tremendous talent there.

I will tell you what, there is a lot of entrepreneurship. Unfortunately, it has been pushed underground and it manifests itself in illicit capitalism. We need to reincentivize the system to make democratic capitalism work in a legal form. And if you do not do it in the legal economy, people are going to go into the underground economy.

The CHAIRMAN. Thank you. Senator Riegle.

Senator RIEGLE. Jack, you and I both feel passionately about getting this done. We come from different party perspectives, but we are of one mind in wanting to craft an enterprise zone concept that really works and that spreads out across this country. We have been working together on it, and I want to continue to do that.

Let me take you to Benton Harbor, in terms of the situation we have there. Benton Harbor is the one enterprise zone that we have in Michigan that has been under way now for some good 4 years.

Here is one of the problems we are facing, and I want my colleagues on the committee to hear this. We are now graduating out of the high school in Benton Harbor a very high minority population. We are, however, only graduating about 300 students a year. We should be graduating about 600, but about half, or 300, are dropping out before they ever finish the high school program.

Of the 300 that are graduating, over half are not finding jobs. They are coming out into a chronic unemployment situation. And the figure may well be as high as 70 percent, as you describe in other inner cities. We have some in Michigan that are that high.

So, there is no incentive for the students who are still back in the ninth or 10th grade for sticking it out through school when they look ahead and see so many kids that are graduating not finding work.

Secretary KEMP. Yes.

Senator RIEGLE. I only cite that as a practical illustration as to where we presently are in one city where we have had an enterprise zone for 4 years.

As I have gone in there, what is clear to me is that we have to tackle the education issue, as well as the job opportunity problems at the other end if we are going to provide incentives for people to come on through that program.

Secretary KEMP. Absolutely.

Senator RIEGLE. We have a new mayor in Benton Harbor, Mayor Hulls. He indicates that the one thing she feels they need most right now—she is a very on-top-of-things mayor with good public support and clear vision—are these 20 police officers that I mentioned.

She feels that right now, this would be one of the most helpful things they could have in the community, because they have got a number of enterprise zone operations now going. But she does not have any money to pay for that. The tax base is so depleted that there is no way for her to get those resources.

The point I am getting to is this. It is clear to me that to make an enterprise zone work, you need to do more than just structure the tax incentives to bring in the private sector investment and stimulate the internal capital starts by people within the community.

Secretary KEMP. Right.

Senator RIEGLE. We need to tackle these related issues of health services, educational systems, job training, job placement, and housing. It is very interesting in the housing area, the Benton Harbor people are now going to the State of Michigan to ask for a special tax credit for people who live in the zone if the buy their home or upgrade their home in order to encourage home ownership at that level.

It is now clear as a bell to me that if we are not moving on these things in combination, the enterprise zone just with the business incentives cannot succeed by itself. It can take you a certain length, but these other things connect to it.

And if the whole community is going to come alive and get lifted, we have got to move on all of these things at once. It is sort of the point that John Breaux is making in terms of the job training and the job placement.

Now, we can do that, and we should do that. And the government programs that have to be targeted and brought in to do that have to do their part; the private-sector investment has to do its part. These things have to lace together.

Here is my point. To move on all of these things at once to really lift off and get this thing going, and really get these communities coming back into the economic system and into the mainstream, it could cost as much in a year or two as $10 billion. $10 billion.

I think we are going to save money, frankly. Because I think when you invest and you get a return, and there is going to be an enormous return here, that you are actually going to save more than you spend on the front end. We do not account for it that way.

Suppose it costs $10 billion in the first year, or 2 years. Should we not do it anyway?

Secretary KEMP. Before I answer the question about the $10 billion and should we do it anyway, one of the problems you alluded to in Benton Harbor was a shrinking tax base.

Part of the reason that the tax base of the cities from New York to Benton Harbor is shrinking—and sitting right behind me is Rev. Keith Butler, a city councilman from Detroit, MI who deals with this every day because the inner city of Detroit, the high rates of joblessness and unemployment that he wants to help find a solution to and has been a strong supporter of enterprise zones, it will add to the tax base, Don. You cannot create a tax base without creating value added to the assets of that base.

Senator RIEGLE. That is right. But that comes later.

Secretary KEMP. And that is where taxes come from. That is where taxes come from.

Senator RIEGLE. Sure. But that comes later. To get going on the front end, you have got to front load this thing.

Secretary KEMP. Well, you have got to be careful that we do not front load it with all of this Federal Government spending and turn it into a bureaucracy.

Senator RIEGLE. No. Now, look.

Secretary KEMP. The nice thing about an enterprise zone is that it is ready to go, Don, without any bureaucracy.

Senator RIEGLE. I understand that. But we need this answer. We need this answer. I know there is a fight going on within the administration. There is a great tension as to whether or not enough resources in both forms—both tax expenditures and this targeted assistance through education and job training—are going to amass to really do this thing the way you want to do it and the way I want to do it, or whether there will be an effort to sort of dress it up, make it look like something, but not provide the resources that it takes to get the job done.

Secretary KEMP. Well, now, wait a minute.

Senator RIEGLE. And that is why I am asking the question. If it takes a certain amount of money to get it done, do we not have to commit ourselves to getting that done? I think the answer is yes.

Secretary KEMP. I think we have to commit ourselves to getting the job done. I just do not want to agree with the premise upon which your question is based, that I know it is $10 billion or $2 billion. I do not know that.

Senator RIEGLE. I am not saying it is. I am saying hypothetically.

The CHAIRMAN. Gentlemen.

Secretary KEMP. Yes. We should do it.

Senator RIEGLE. I am saying if it turns out that the amount of money that we need is something beyond a $2 billion figure, or some figure that the OMB is coming up with——

Secretary KEMP. Yes.

Senator RIEGLE. Do we not have to commit ourselves to do it?

Secretary KEMP. Well, we have to commit ourselves——

Senator RIEGLE. Otherwise I do not think we are honest to the concept.

The CHAIRMAN. All right, gentlemen. We have some others that want to ask questions, and they are just as concerned with the issues involved. Thank you very much. Senator Moynihan.

Senator MOYNIHAN. Jack, I have never had much of a feeling for economics. It is too complicated for me.

Secretary KEMP. You should have played pro-basketball or pro-football. You would have gotten a good feel for it.

Senator MOYNIHAN. The one proposition I have retained is from the classical economist, Joan Robinson, and people like that when they really got down to the question of what made capitalism work. They said, animal spirits. That is all. I mean, all of the other things are inconsequential. And, Jack, you have got them. [Laughter.]

Is it not interesting? Really, I want to say that I am glad this moment came to you, that you could come up here and say you are speaking for an administration.

I do also want to say, however—let us get clear, Jack, you like these things—that enterprise zones were the idea of a British Socialist named Peter Hall.

And he was head of the Fabian Society in the 1970's, and he came up with this. And Jeffrey Howe picked it up in the Thatcher government as a way to do something in the East End in the Docklands of London.

Secretary KEMP. Yes.

Senator MOYNIHAN. And the next thing you know, we got Canary Wharf. Now, maybe that is good, or maybe not. Something happened.

Secretary KEMP. Have you ever been to Docklands?

Senator MOYNIHAN. I have, indeed. Let me just say two things, Jack, and then ask you one more. On your point about welfare, without any recriminations, the proposition that a welfare family can only have $1,000 in assets, in savings, that is absolutely true. But let us be clear, Jack. That is in the statute because the Reagan administration insisted on it in its first year in office in 1981. I will say no more, but that is where it came from.

In your statement here, because this is sort of my beat on this committee. I am for you. I had better tell you that before I ask you this. You say, "we need a broad-based and bipartisan program that begins with the President's entire urban agenda."

His entire urban agenda. You mentioned Weed and Seed, increase low income housing home ownership opportunity, and radical reform of the welfare system.

Jack, are we going to get a bill from the administration proposing radical reform? Because if we are not—and I have sent every signal I know how to send down there—if you have got something in mind, let us know.

But if you have nothing in mind, will you stop talking about it? Because the people we are talking about, 80 percent of black children will be on welfare before they are age 18. That is now the current experience. Do you know, have they got a program?

Secretary KEMP. Yes. Do you want to hear it?

Senator MOYNIHAN. Yes.

Secretary KEMP. Yes. Let every public housing resident in the United States of America on welfare begin to manage, control, and ultimately own their own home. Two, double or triple the amount of income that people can earn as they move from welfare to work so they face no tax on the payroll or the income tax.

Senator MOYNIHAN. Jack, is that a bill the President will send us?

Secretary KEMP. Yes. As a matter of fact, it is in the enterprise zone bill that you just applauded with a left hand. Because, frankly, it did not come from a British Socialist.

Senator MOYNIHAN. I applauded with both hands.

Secretary KEMP. It came out of the 1930's and 1940's by an equally Socialist Governor of the island of Puerto Rico, Luis Muñoz Marin.

Senator MOYNIHAN. No, Jack. It did not.

Secretary KEMP. It has nothing to do with British Fabian Socialism.

Senator MOYNIHAN. Jack, we love you in this committee. But Section 936 was put in the Tax Code in the 1920's to promote investment in the Philippines.

Secretary KEMP. Operation Bootstrap was in Puerto Rico. At least that is where I got it from.

Senator MOYNIHAN. From Munos Marin.

Secretary KEMP. Yes.

Senator MOYNIHAN. Another good Socialist, incidentally.

Secretary KEMP. Yes, he was.

Senator MOYNIHAN. That is all right by me.

Secretary KEMP. Well, what is the point?

Senator MOYNIHAN. Are you going to send us a real bill——

Secretary KEMP. We have put in our budget every year for 3 years enterprise zones, tenant management and ownership of public housing, increasing the asset test for people on welfare, lowering the tax on people who take jobs, allowing people to use IRA's without paying any penalty when they want to put it into a home. There is a $5,000 tax credit for buying a first-time home. I mean, there are a lot of things in the budget that we agree on.

And we are not up here saying, Mr. Moynihan, that it is Kemp. Do not do it for Kemp, do not do it for Bush. Do not do it for anything other than the people. And if we do not do it, I am not going to suffer. Do it for the people.

And it is not Kemp, and it is not Bush, it is not Munos Marin. It is a good idea. And if it is a good idea, do it. And if it is not a good idea, do not do it. That is why I supported the Moynihan cut in the payroll tax.

Not because it was Moynihan, but I just do not like the idea of taxing away the fruits of the working man and working woman who make a contribution to their own family. That is why I supported the Bentsen tax credit. Not because it was a Bentsen idea. Excuse me for getting Moynihan-like excited.

Senator MOYNIHAN. Thank you.

Secretary KEMP. How did we get off on the Docklands?

The CHAIRMAN. Let us get over to Senator Hatch and let him speak now.

Senator Hatch.

Senator HATCH. Thank you, Mr. Chairman. Jack, I support the idea that this is a bigger problem than just the enterprise zones. But I want to compliment you and the administration for fighting for enterprise zones.

I think it is a tremendous fight, and I think it is something that needs to be done. And I think most people in those inner cities understand, the whole concept of empowerment that you have been fighting for for all of these years.

You point out in your written remarks that over the past 25 years, government has spent $3.2 trillion on all kinds of programs. You say, on social programs with the best of intentions. Many people have been helped by these programs.

But, we must admit that, for many, the problems of poverty, joblessness, crime, drug abuse, violence, and despair which these programs were meant to address are, by most measures, worse today than before. I think that kind of says it all.

And if I interpret you correctly, you have been fighting all of these years for some concepts, that although they may not be totally new, are new to this body up here called the Congress, in the sense of enactment.

And I want to compliment you for it, because you have fought a lonely fight. You have come through this whole administration pushing these things, and now the administration is behind them.

And I think it is time for all of us to realize that these are bipartisan ideas—these are not just Republican ideas, these are bipartisan ideas—in the best interests of people in these inner cities where we are having so much turmoil.

And, like I say, I support other ideas, as well. And this may be just one step to the solution of these inner city problems. But we need further reform on welfare, education, job training, health care, et cetera. All of those things are needed. But you are talking about one basic, important problem here today with a solution.

Now, Jack, I do not care whether it is a Socialist's idea. or a dictator's idea, or a progressive Republican idea, or a progressive Democrat idea; it is a good idea. And I want to personally thank you for being willing to stand up all over America and articulate it.

Now, tell me. What do you think will happen if we pass the enterprise zone concept, as you have written it and as you are suggesting here today, in an inner city like Los Angeles within 5 years? Give us some idea what you think would be the result, and any other inner city you would care to discuss.

Tell us what is going to happen. Tell us what hope there is out there for us. Tell us why Democrats and Republicans ought to put aside their differences and do something here instead of just playing ideological games up here in an ideological year.

Secretary KEMP. Right.

Senator HATCH. And tell us how we are all going to benefit from this, but especially those people who are in despair in those inner cities.

Secretary KEMP. Well, Tom Bradley is going to testify, so he will probably do so with much more specificity.

Senator HATCH. I want to hear it from you, and I still want to hear it from Mayor Bradley, too.

Secretary KEMP. When Tom Bradley, Peter Ueberroth, Governor Wilson, and Henry Espy of Clarksdale, MS, the southern Mississippi delta, national chairman of the Black Mayors of America, all 335 of whom support enterprise zones, met, we heard Peter Ueberroth say there were vast numbers of men and women, entrepreneurs and business investors who want to help rebuild Los Angeles. And he said for every $1 of tax incentive, there would be $20 of private investment.

Senator HATCH. That sounds pretty good to me.

Secretary KEMP. But that is subjective. I cannot quantify it.

Senator HATCH. Let us say it is 5. Let us say it is $5 for every $1. It is still pretty good, is it not?

Secretary KEMP. Well, I believe it is good. And I think, (a) it would begin to show that the Congress and the administration can work together to get something done.

Senator HATCH. That is a lot better than just shoveling money in there and giving it to them rather than giving them the blessings that come from rebuilding the infrastructure.

Secretary KEMP. I do want to say, Orrin, I share Don Riegle's and your concern about job training and social services.

Senator HATCH. I know you do. Your statement says that.

Secretary KEMP. I am told by Fred Goldberg there is $100 million that would be directed into enterprise zones for job training alone. We need a summer youth JOBS program. We do need many of those things. Don, I just did not want to get trapped into how much we ought to spend at the Federal level, because it is an endless game.

Senator RIEGLE. No, I understand.

Secretary KEMP. Because it is an endless game. And it becomes a Christmas tree. And, as the Chairman said, he does not want to turn this into a Christmas tree. And I think the one way to save enterprise zones is to keep it from being turned into a grab bag. Now, I know you do not want to do that, either.

Finally, I believe, with all my heart, I do not have empirical, historical, objective evidence other than from what I have read in the history books. I believe the answer to Senator Moynihan's question is not animal spirits.

I do not believe that capitalism should be sold on the basis of greed, avariciousness or selfishness. It is the faith of the entrepreneur. It is the incentive of people who respond to rewards for productive human behavior.

Mr. Chairman, I want to say it from the bottom of my heart and from the marrow of my bones, in the inner city economy we have shattered the link between effort and reward. We have taken the reward out of the system for productive human behavior and we are rewarding unproductive human behavior.

And I do not blame the victim, I blame the system. And I never thought I would say that. The system is turned upside down for those children, black, white, brown, minority, and low-income who are living in the inner city. And they need someone to speak for them.

And there is no one speaking for them, other than people like Mr. Bradley and Mr. Espy and men and women who are on fire to get something done in this Congress. And I think we have got about 2 weeks to act.

If we do not act within 2 weeks, we are going to end up without a low-income housing tax credit, we are going to end up without mortgage revenue bonds, we are going to end up without industrial financing bonds, we are going to end up without enterprise zones.

That would be a tragedy for the Congress, for the administration, but, worst of all, it would be a tragedy for the city of Los Angeles and the city of Clarksdale, MS and the city of Detroit.

Senator HATCH. Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator HATCH. Mr. Chairman, could I just make one ending remark? Could I just put my statement in the record?

The CHAIRMAN. Yes, of course you can.

Senator HATCH. And could I just say this. As you know, Senator Kennedy and I have filed a bill for $1.45 billion for Head Start to summer youth job programs, and the Weed and Seed program. I think that is essential.

But I think as part of this, it would be wonderful if we could look past ideology and put the enterprise zones in there, as well. Then we would be giving real hope—financial hope, plus the enterprise zone hope that you are talking about. I want to compliment you for it, and I really personally appreciate your leadership.

The CHAIRMAN. Thank you very much. Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman. Mr. Secretary, I compliment you on your positions this morning. I have enjoyed listening to you.

Secretary KEMP. Thank you.

Senator PRYOR. I was very interested in your discussion of your hopes in the overall concept of enterprise zones as well as your hope, in the existence of enterprise zones from, in your words, "sea to shining sea."

Now, I do not know whether you meant that this is an all-50 State proposition, or whether it would be a proposition limited to all urban America like the Los Angeles' of our country. Senator Grassley discussed enterprise zones for rural America.

Secretary KEMP. Right.

Senator PRYOR. I would like to enter an excerpt from a study, Mr. Chairman, in the record, stating according to the Center on Budget and Policy Priorities, the poorest of the poor in this country do live in rural America.

The CHAIRMAN. That will be accepted.

[The study appears in the appendix.]

Senator PRYOR. Mr. Chairman, we also have a report on May 21st of another segment of our economy, of our society, that on a daily basis, we will be losing 1,000 jobs a day in defense-related industry for the next several years according to the Office of Technology Assessment.

A democratic defense transition task force, reported May 21 on this subject. We recommended that enterprise zones be examined very strongly. A week later, the President made a recommendation on how to deal with the transition from defense to domestic economy. He did not recommend, nor mention enterprise zones in these defense-dependent communities, counties, and areas.

Now, is the administration going to deal separately with urban America and rural America, and separately with defense-related problems and job losses, or is this just going to be a blanket sweep across the country? What are we talking about?

Secretary KEMP. Senator Pryor, I said earlier, I think it was the first statement that I made to the committee, that I spoke for the President today in my testimony before this committee for the very first time, and that I was pleased to announce that he had spoken to this issue in his speech in Los Angeles last Friday.

And our enterprise zone bill will reflect this in legislation. Any neighborhood community in the United States of America, defense-related or not, that has high levels of unemployment, endemic poverty, a shrinking tax base, and a population with levels of chronic unemployment that you talk about, would qualify and be entitled—entitled—to take part in an enterprise zone.

He said he wanted every mayor in the country, from Tom Bradley, sitting behind me, to Mayor Espy, of Clarksdale, MS, or from rural Arkansas to rural New York, to have an opportunity to have an enterprise zone bill.

So, if we draft the criteria correctly, make it as objective as we humanly, politically can, we can address the issue you have articulated so well here this morning.

Senator PRYOR. Mr. Secretary, we have talked some this morning about section 936. Senator Moynihan said he knew nothing about economics, and I do not know much about section 936. However, I do know that section 936 for one segment of our economy, the pharmaceutical manufacturers.

This is in the category of unintended consequences, because what we have created in Puerto Rico is a tax haven for the drug companies. Now, Mr. Secretary, what we do not want to create in our own country is a tax haven as Senator Breaux alluded to a moment ago.

What we do not want to create is a situation in our own country where we cannot monitor the number of jobs created, nor what input that particular tax treatment is having on that economy. And I think we have got to be very careful——

Secretary KEMP. I do, too.

Senator PRYOR. We must not give away the store to a few companies or a few industries——

Secretary KEMP. I do, too.

Senator PRYOR.We must not shelter one particular segment of our economy at the expense of answer.

Secretary KEMP. David, you and I have been friends a long time. I appreciate that friendship. Let me just tell you eyeball to eyeball. I was not suggesting that section 936 be a model for the inner city.

I was suggesting that I got the idea, along with Bob Garcia and Bill Gray, of Philadelphia, from Operation Bootstrap, that was the so-called operation tax-driven incentives for Puerto Rico. It was just the idea that you took an area that was underdeveloped and Third-World-like and you apply tax incentives.

But I said in my opening statement on behalf of the President, we do not want to lure businesses from one area of the community or country to another by using credits or gimmicks. There. I said it again.

Senator PRYOR. My time has expired. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Secretary KEMP. We are eliminating the capital gain tax, the alternative minimum tax, the tax on the wages of the working man and woman. You are creating an incentive for entrepreneurship at the grassroots neighborhood level instead of trying to get people to move around the country in a zero sum contest. So, be assured, we do not want to create tax havens and Cayman Islands in the inner cities of America.

[The following information was subsequently received for the record:]

DISTRIBUTION OF RURAL AND URBAN HOUSEHOLDS WITHIN NATIONAL INCOME QUINTILES, 1987

National income category	Rural (percent)	Urban (percent)
Richest fifth	11	23
Next richest fifth	17	21
Middle fifth	21	19
Next poorest fifth	25	19
Poorest fifth	26	18
Total	100	100

Source: Center on Budget and Policy Priorities.

The CHAIRMAN. Thank you very much.

Secretary KEMP. Thank you.

The CHAIRMAN. Senator Symms.

Senator SYMMS. Thank you very much, Mr. Chairman. I would ask unanimous consent that my statement at the beginning of the program be put into the record.

The CHAIRMAN. That will be done.

[The prepared statement of Senator Symms appears in the appendix.]

Senator SYMMS. Mr. Chairman, as another Republican who supported with enthusiasm the Moynihan payroll tax bill in 1989 and 1990 and I just want to say first off that the President does have a domestic policy.

I think Congress has a responsibility to show that we can help the U.S. Government in its transition from the old Cold War world to the new world we are living in now, by creating an area to get the capital to start up these enterprises. We have that responsibility, and we have not done it.

I would also say that had the President had Mr. Kemp speaking on his domestic policy for the last 3 years; the President would not have the continual question being asked, "does George Bush have a domestic policy?" because the answer is that he does have a domestic policy. And I appreciate the testimony and the debate that we are having here this morning, the dialogue, if you will.

Because I am sometimes amazed when I watch people like Bryant Gumble talking about negative things that the 1980's showed people. In my view, what the 1980's showed people is that capitalism and freedom works and it creates and produces wealth, and big government and State command and controlled economies fail and do not create any wealth, and their people live in a very bad situation.

I made the comment in Idaho recently, Mr. Chairman, that when Ronald Reagan called the former Soviet Union the "Evil Empire," he was actually being very kind to them, and generous, and probably over-stating the case and over-complimenting them. After just having visited Vladivostoc and seeing how poorly they have done with a resource-rich country, and with wonderful people that live there, what a lousy job their economy has done.

So, I really compliment you, Mr. Kemp, on the statement you have made here this morning and the position that you spell out for what the President's position actually is, and I support it.

Back in the 1970's, I used to support your bill when I was in the House, and I supported it here in the Senate. But I always questioned it, because what I want for the United States is an enterprise zone for the whole United States.

And I have to say, I see no reason, and there is really no justification as to why there is a tax on someone who sells their house. At least there could be no economic justification for taxing the inflationary gain of someone's home.

It is an absolute outrage. It is a confiscation of capital; it denies low-income people an opportunity to convert their house into a business. And we in this committee should fix that.

I think that there have been some criticisms and I just would close with two questions, Mr. Secretary. The question was asked to Senator Lieberman by Senator Packwood about the transfer of wealth. Would it just go from one community to another, and would it be new wealth created in these enterprise zones.

The other question I have is, is there any thought on the part of the administration that in the bill we have before the committee that we should say that there should be one enterprise zone in every State so that all people in America could have a chance to see that capitalism really does work if it is given a little bit of a chance; (a) how do you respond to the critics that it will be only a transfer and that someone else will suffer, and then, (b), do you think we should consider guaranteeing that each State at least gets one enterprise zone?

And then, I would say in closing, Mr. Chairman, that I agree with the Secretary that if we could pass this bill. My eventual goal would be that a day would come when we would be enlightened enough in Congress to see that we should get rid of capital gains taxes totally, or at least for people who are middle-income with respect to their homes.

Secretary KEMP. Yes.

Senator SYMMS. That would be a minimum we could do.

Secretary KEMP. Yes. It was interesting, Steve. The President was with me, or I was with him in a public housing community in St. Louis called Cochran Gardens with a young tenant organizer by the name of Bertha Gilkey.

And Bertha Gilkey introduced the President and he got up and talked about the capital gain tax as not a tax on the wealthy, but a tax on poor people who want to get wealthy, and as a tax on the American Dream. And he looked down at his notes, and the whole audience was standing and applauding his statement.

I am convinced that low-income people have been shut out of the democratic capitalistic system in such a way that they have lost faith that it will work for them. And if we make it work for them, we can prove that it will work in the Third World; work anywhere it has been tried.

Two, I think it should be an entitlement. I think any neighborhood in the country that has the type of chronic unemployment and endemic poverty ought to qualify. So, not just one per State, but any neighborhood and community, as the President said in his speech out in Los Angeles.

And, finally, the incentives are not to shift businesses. There is no lure to the zone. You are saying to the entrepreneur or potential entrepreneur, we want you to get access to the seed corn and the capital necessary to start a business and create new wealth in the inner city. And if you do it, you have a zero tax on the capital gain from that investment.

You only get it if you invest it in the inner city and add value to the business or the enterprise of the inner city, and hire people and create jobs in the inner city.

The CHAIRMAN. Mr. Secretary.

Secretary KEMP. So, in effect, it is not a 936-type incentive.

The CHAIRMAN Mr. Secretary, I have witnesses from the West Coast that are going to have to catch a plane.

Secretary KEMP. I am ready to leave anytime you want.

The CHAIRMAN. Well, if we would observe the time limits.

Secretary KEMP. I do not want to stay a minute longer than you want, Mr. Chairman.

The CHAIRMAN. I understand. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman. Let me welcome Jack to the committee. I appreciate his voice, because I think that that voice is an important one nationally, and within the administration in particular.

Secretary KEMP. Thank you.

Senator BRADLEY. And I know that it has not always been easy within the administration in the last several years. And I think probably there are elements of the administration that regret it that they did not listen to you more.

But, as we have discussed in different times, I think that if we are serious about doing something that is going to improve the life chances of people who live in urban America and we are going to confront the reality that is out there in terms of the increasing absence of meaning and a larger and larger number of people's lives, and the violence that is all over the streets, and the lack of real economic opportunity, that we are really going to have to take the best of the conservative agenda and the best of the liberal agenda and make it an American agenda.

And just as you need candor when you are talking about the reality of urban America, you also need candor when you are trying to formulate that American agenda.

So, I believe that urban enterprise zones should be enacted into law. I think it is long overdue. You have my full support for urban enterprise zones.

Secretary KEMP. Thank you. Thank you.

Senator BRADLEY. And, for lack of a better way to characterize that, let us say that is the best of the conservative agenda. Not that it is the only aspect of the conservative agenda, not that there are not other good aspects of a conservative agenda, but it is one.

Now, when we move to the other side, I would like, if you could, to share with us what you think is the best of the liberal agenda.

Secretary KEMP. I must admit that you are putting me into a box of sorts, or a corner, rhetorically, at least, in now that I am supposed to say I am a conservative and you are liberal.

Senator BRADLEY. No, no. Let me try it a different way.

Secretary KEMP. Frankly——

Senator BRADLEY. No. Let me try to do it a different way.

Secretary KEMP. All right. I think it is radical.

Senator BRADLEY. I think that if we are serious, we have to address urban enterprise zones and more.

Secretary KEMP. Yes. Right.

Senator BRADLEY. Now, we are going to hear from mayors later in this hearing, and the mayors have said what is common sense to anybody who has driven from La Guardia into Manhattan, or anybody who has driven in north Philadelphia, or anybody who has driven through a lot of urban America, and that is the infrastructure is rotting away.

Secretary KEMP. Yes.

Senator BRADLEY. So, the question is, do we need more investment in infrastructure, more than we now have? That would be a suggestion.

Secretary KEMP. I think infrastructure is important not only for the cities, but for the country. I think Head Start is essential to every public housing community in the United States of America.

When Mrs. Bush and I went over to Kenilworth Parkside and talked about early childhood development, things you have been interested in, and other members of this committee, and Head Start and public housing—do you know we have public housing communities not only with no early childhood development center or health care facility or Head Start program, there are no playing fields. I am shocked. I found some basketball courts, but there were no football fields. Bill, can you imagine little boys growing up in America without a chance to play football?

Senator BRADLEY. Yes. [Laughter.]

Secretary KEMP. That is the trouble with you, you are too narrow-minded. [Laughter.]

Seriously, I do not think that is liberal. The President is a strong supporter of Head Start. Senators Hatch and Kennedy are strong supporters. Senator Bradley is. Look, we are going to lose if we make this left or right. It is either moving forward, or going backwards.

Senator BRADLEY. Right. It is.

Secretary KEMP. And I believe the most progressive, compassionate, bleeding heart, liberal, radical, conservative thing we could do is to begin to use entrepreneurial capitalism to answer some of these vexing social and economic problems of the inner cities of America.

And your support is absolutely critical to this, because Newark, and Trenton, and East Orange, and cities of New Jersey have long been, at the State level, termed enterprise zones, thanks to Governor Tom Kean. And now we need to do it at the Federal level.

Senator BRADLEY. If you take the one program that you mentioned, Head Start, we now fund about 25 percent of the eligible children. How many of the eligible children do you think we ought to fund, 50 percent, 75 percent?

Secretary KEMP. Are you talking about Head Start?

Senator BRADLEY. Yes.

Secretary KEMP. My hope is that Head Start will be expanded in a fashion that is consistent with all of the budget priorities that the Congress and the administration have said in such a way so that every child can have access if they are at risk.

Senator BRADLEY. One hundred percent funding, I support that.

Secretary KEMP. Now, do not get me into a battle with that. I am in enough trouble as it is.

Senator BRADLEY. I know.

Secretary KEMP. This is the first time I have ever had a chance to speak for the President, so I do not want to——[Laughter.]

Senator BRADLEY. Well, but it is where the rubber meets the road. I mean, are we going to fully fund the program that the President feels——

Secretary KEMP. Wait a minute, Bill. Come on, now. I am the Secretary of Housing and Urban Economic Development, I am not the Secretary of Education. Now, give me a break. Do not put me to the test as to whether I am committed to inner city health care when I am not HHS Secretary.

I am simply trying to come today to say, of all the problems that exist in America, the overriding problem is the high levels of unemployment among black males, and teenaged youths, and Hispanic, and low-income people in our inner cities.

And the most pro-family, pro-education, pro-growth, pro-American investment you can make is to give them jobs and create opportunities for them to get a stake in the American system.

Then we will have a tax base, if we do it, that will allow us to spend more for education, more for infrastructure, more for health care, and more for the other very important necessities that have been talked about this morning.

The CHAIRMAN. Gentlemen, let me tell you what my problem is. We are going to have two roll call votes that are going to be scheduled here at 12:20.

I have got Mayor Bradley, who has got to get back to California to catch a plane, and I have a number of patient committee members who have been trying to question. So, if we would observe the time limitations, it would be of great assistance to the Chairman. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman. I want to join my colleagues in congratulating you for your splendid leadership in this area of enterprise zones and inner city problems. It is nice to see your idea really gaining a broad consensus again.

One of the questions, of course, is how are we going to pay for it? And I think it is important that people understand, that in talking about how much we should be spending in this area, that we are currently spending at all levels of government on safety net programs something like $210 billion. That is a lot of money by any standards. And that works out to be more than $6,000 per poor person, or $24,000 for a family of four.

It has been pointed out that since the war on poverty has begun, we have spent $2.5 trillion on these programs. But, as a practical matter, we have not begun to solve the problem. One reason I like what you are talking about, is you are talking about, jobs and opportunity. I think that is critically important.

But my question is, given this information, should the government continue these programs and even increase their funding, or should we be moving in some new directions? Not only as you are suggesting here, with the enterprise zones.

You may recall a few years ago Mr. Nixon proposed what they called a "negative income tax." So much of this money is not going to the poor, and instead it is being used on the way to the poor. What would be your answer to that?

Secretary KEMP. Bob Woodson, in this morning's Wall Street Journal, wrote that somewhere between two-thirds and 70 percent of all of the social welfare spending is going to empower the bureaucracy. It does not go, as you pointed out, Senator Roth, to empower people.

Now, having said that, I do not favor cutting the safety net. And I think enterprise zones is a part of building a ladder of opportunity up and out of poverty.

And we should measure the compassion of our society not by how many people need the safety net, but by how few people are dependent upon the government.

And I think we have a mistaken premise. We judge our compassion and our caring about people by how many people are on food stamps, whereas, in both of the major, great religions—Judaism and Christianity—compassion is measured by how few people need to be dependent upon someone else. I was looking for some agreement from Reverend Danforth.

Maimonides, the Talmudical philosopher, said the highest form of charity was to prevent someone from having to take charity. So, in that sense, we need government charity, but we need ultimately to create a system of opportunity in this country in which people can not be dependent on charity, but be independent.

And I want to say, Mr. Chairman, talking about independence, I hope with all of my heart that this July 4th where we celebrate America's independence we can equally celebrate creating a chance for independence in the inner cities of America by creating more jobs in enterprise zones. I really hope so. I do not think there is much time after that.

Senator ROTH. One of my concerns is this question of how do we pay for it, because of the rules of how we judge the cost. Now, as I understand it, your program will actually result in growth so that it pays for itself.

Secretary KEMP. Well, I do not want to get into that trap that I got into in 1981, because then someone is going to go back.

The CHAIRMAN. Let me interrupt for a moment. Senator Roth, I think Secretary Goldberg will be speaking in specifics on that, and that is why I delayed questions on that, unless you want to probe it with Secretary Kemp. But Secretary Goldberg will speak on that particular point.

Secretary KEMP. I just found out that Mayor Tom Bradley has to leave at 12:00.

The CHAIRMAN. That is right. I had announced that earlier.

Secretary KEMP. I would like to give up the chair to him. And I know Fred Goldberg would, too. I think it is very important that you hear from Mayor Bradley.

Senator ROTH. I would be happy to yield any time I have remaining.

The CHAIRMAN. Fine. Senator Danforth, then.

Senator DANFORTH. Mr. Chairman, I am beginning to get the idea that maybe you would like to move the hearing along.

The CHAIRMAN. Well, I am trying to take care of the problems of transportation of some of our people from the West Coast.

Senator DANFORTH. I thought I caught that. Therefore, I will not ask the witness any questions.

The CHAIRMAN. Thank you. Senator Chafee.

Senator CHAFEE. Mr. Chairman, first, I want to say thanks to you, and to Secretary Kemp. I have long been interested in enterprise zones. I believe I introduced the first enterprise zone measure in the Senate around 1981.

Also, I would like to say briefly, Mr. Chairman, that I believe the Secretary is absolutely right. That, whereas a whole host of proposals and programs are important for the inner city, none exceeds the important of the ability to have a job. And that is what the enterprise zone proposal is all about.

In view of the fact that we have nine succeeding witnesses to go, Mr. Chairman, I will help you out by not questioning Secretary Kemp.

The CHAIRMAN. Thank you very much.

Secretary KEMP. Thank you, Senator.

The CHAIRMAN. Let me say, Mr. Secretary, you have been forceful in your presentation, and I think you have been productive. And, just for the record, our old friend, Luis Muñoz Marin, was a friend of mine. [Laughter.]

No, no, no, no. I didn't say that. I used to stay with him at Fortulesa, but it was in the 1950's, not in the 1930's and 1940's when he was Governor.

Secretary KEMP. I missed by a decade.

The CHAIRMAN. Yes. Thank you.

Secretary KEMP. I am thrilled that Mayor Bradley is going to take my spot, because it is more important that you hear from him as a mayor on the spot in L.A.

And I want to thank him for his tremendous and courageous leadership on this issue in speaking out so forcefully. We have been talking about it for a long time.

And I see Mayor Rendell of Philadelphia, over there; another supporter. So, I will leave you the key man, Tom Bradley of Los Angeles, and thank you for your support.

The CHAIRMAN. Thank you very much, Mr. Secretary.

Secretary KEMP. By the way, let us put one in every colonia along the border of Texas.

The CHAIRMAN. I am interested in that one. You know how to get there, fella. [Laughter.]

The CHAIRMAN. Mayor Bradley, we are very delighted to have you. We are sorry about the delay. After the conclusion of this panel, we will reconvene at 1:30 for the remaining panels, because we have two votes scheduled. I am delighted to recognize a fellow Texan, Mayor Tom Bradley, of Los Angeles.

STATEMENT OF HON. TOM BRADLEY, MAYOR, CITY OF LOS ANGELES, LOS ANGELES, CA

Mayor BRADLEY. Mr. Chairman and members of the committee, thank you for permitting me to break into the testimony of others in order to bring you a brief message.

I am impressed, and I want to compliment Jack Kemp, because he and I have been talking about enterprise zones for 11 years, and, frankly, we at times wondered if we would ever see this day come when not only he speaks for the administration, but he speaks eloquently for the concept, the principle. We did not always agree on every facet of the enterprise zone concept, but certainly on the urgency of the issue.

I compliment him also on his wisdom, his vision, and his tenacity. He is a great name-dropper, and I say that in the most complimentary terms. I have never seen a man who could use more names in more places in this country in shoring up his arguments about a concept in which he believes than Jack Kemp.

And it is used in the fashion because he is so immersed in the issue that he has come to know the people and the places. And when he speaks, he speaks fervently for them and their concerns.

We, in Los Angeles have gone through a month of experiencing of one of the most traumatic events in the history of our city, if not the nation.

And I want to point out that, while the riot that broke out immediately after that verdict of not guilty against four police officers who were involved in the beating of Rodney King, this was just a spark that was set off by the verdict. But it really lit up the underlying causes which exist in many cities of America.

And when we talk about finding solutions, I do not want you to think that I am focused solely on Los Angeles, because I recognize that what happened in Los Angeles could have happened in many cities in this Nation. And if we do not keep that in mind, we will have missed the whole point.

There are problems that we must deal with, and I look back for over 40 years of how the cities of the nation have lost power and influence, have lost their viability because business and industry moved out of major sections of these cities; how the educational process deteriorated, and many young men dropped out of school at an early age. They essentially were drop-outs by the time they got to the fourth grade.

So, when they became an adult they did not even know the concept, the experience of a job. The figures of 50, 60, 70 unemployment among many of the young men of our cities is absolutely true. It may vary a little bit here and there. But that is at the heart of why we are here today.

There is a sense of hopelessness out there on the part of many young men who have no reason to have any regard for the system, for their neighbors, for the property of others, because they do not have any and they have no hope of ever getting any. They do not think of a job, because they have not had one ever in their lives.

That is why we come to the issue of how we create jobs, how we develop enterprise systems in those areas of our city that have been depleted because the leaders of business and industry have simply driven around them, driven out of them, flown over them, without recognizing the accumulation that that kind of neglect has produced areas of the major cities of America, large and small, that do not offer any incentive, do not offer any hope for those that are suffering.

So, if I may, I have introduced some written testimony. I am going to depart from that. Many of the things in my testimony have already been said by others, and I appreciate the fact that there seems to be a consensus on this committee for much of what I was going to say and have thought of.

This is not a panacea for all of the problems of our city; all of us recognize that. But there is an urgency about the issue and we must deal with it, I think, quickly.

Those young men who were so angry and furious and dissatisfied with the verdict in the Rodney King beating case reacted not solely about that issue, but about the neglect, and about their problems, and about many other things.

And they want to see from their government—Federal, State, and local—some action—real action; a demonstration of our commitment to deal with their problems and to try to solve them.

Let me, if I may, focus on one issue. I know there is not enough money available in this budget, no matter how much you may have or how much you spend, to deal with the entire problem.

And even if you pass the enterprise zone with the limited amount of money that you have, that is not going to solve the entire problem. But we have got to start somewhere, and I suggest that the enterprise zone which has been debated for so many years is now ready for action on your part.

And if we can avoid loading it up like a Christmas tree, if we can resist the temptation to try to solve all of the problems with this one bit of legislation, I think we can get it done, and I think it can be done quickly.

Every city in America may be entitled, but every city and town in America is not going to be able to participate. There is not enough money.

But I think the same standards ought to apply that will let everybody measure up against those standards, whether it is poverty, or lack of education, or vast areas or zones of the city that have no economic life and no enterprise.

I am content to compete along with every other city and town in this country. But I think if we use the standards, if we talk about the problems of people rather than talk about jobs, or shops and stores, and industries, we will get closer to finding a solution that will satisfy the masses of this Nation.

I believe that we are going to have to deal with the issue of who is going to be benefitted. If we pass this legislation and you do not have a very significant requirement for the people who live in these zones being able to get jobs, you will have done nothing.

You will still have an angry group of people out there who see no hope and are going to continue to destroy our system and our Nation. So, I will plead with you. I am not going to set a figure or percentage, but I plead with you that you give a very large percentage of those jobs guaranteed for the people who live in those zones.

Do not let some company, some industry move into my city and pick off what may look like a very enticing and inviting opportunity and then bring in somebody from outside from the suburbs to take those jobs. If you do it, you are in for trouble, and so are we.

This has to be something that deals both with small and medium-sized businesses, but let us not overlook, let us not forget the major corporations in this country.

One of the things which I did immediately in the wake of the fires and the looting still going on in Los Angeles was to call upon Peter Ueberroth, who came to our aid in connection with the 1984 Olympics and did such a marvelous job.

And I asked him if he would take on the task as sort of serving as a czar to rebuild L.A. And we recognize that that meant not just our city, our county, but it also meant an opportunity for that pilot to touch the rest of the nation, and where we succeed, use it to help others.

One of the elementary features of that plan, Rebuild L.A., is to get a commitment and the involvement of private corporations in this country, large ones, as well as small; give an opportunity for them to come back into those areas of the city that they have been driving through, around, and avoiding for so many years.

It is true, they are going to have to deal with the problems of crime, the problems of education and job training. There ought to be a lot of the on-the-job training, because we will never be able to get enough private and separate job training facilities. There is so much that needs to be done that must be done.

And I am confident, based upon statements that have been made here, this is the time in history when this concept is going to get passed, will get funded, and we in the cities and town of this Nation can come together to try to reverse a trend which has been going on for well over 40 years.

It is a unique opportunity and I hope that the members of this committee will be the launching pad for what we talked about for so long. Thank you very much.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mayor Bradley appears in the appendix.]

The CHAIRMAN. Our next member of the panel is the distinguished mayor of the city of Philadelphia. Mayor Rendell, Senator Harris Wafford wanted to be here to introduce you, frankly, but he is caught in another committee. We are pleased to have you.

STATEMENT OF HON. EDWARD G. RENDELL, MAYOR, CITY OF PHILADELPHIA, PHILADELPHIA, PA

Mayor RENDELL. Thank you, Mr. Chairman. I am not going to repeat what Senator Bradley said so eloquently, but suffice it to say that he is 100 percent correct that what happened in Los Angeles could have happened in Philadelphia, New York, Newark, anywhere else, and we had all better understand that.

Secondly, the best statistic I can give you to show you what has happened to the city of Philadelphia and why enterprise zones are so desperately needed, in my judgment, is a statistic which I think directly relates to a question that Senator Riegle asked earlier.

Our tax base in the city of Philadelphia has been shredded. In 11 years, our tax base has gone from $5.7 billion to $3.4 billion. We have lost $2.3 billion of our tax base; some to the suburbs, some to the Sun Belt, some to foreign counties, and some just went up in smoke.

In that 11-year period, our city has been forced to raise taxes 19 times. It has not worked. I took over as mayor of the city of Philadelphia on January 6 of this year, and I inherited a quarter of a billion dollar cumulative deficit.

Unless we do something to broaden the tax base, we are finished. Absolutely finished. And I know that Senator Breaux and Senator Riegle expressed a concern which Mayor Bradley addressed about we do not want big companies to come in and bring outsiders. And you are all right.

But we want investment. We want that tax base broadened. Because if I get that tax base broadened, I can do something about homelessness. I can do something about AIDS. I can do something even to supplement your job training programs.

I need that tax base broadened, number one. Number two, I need people to come back to work. The best answer to the concerns that you and Senator Breaux expressed, Senator Riegle, were in a suggestion Senator Bradley made, or in a suggestion in one of the earlier House bills.

I do not know whether it was Representative Rostenkowski or Representative Rangel. There was a provision that does not appear to be in the administration bill that gave a tax credit for employers up to a certain amount—I think it was $10,000. I would make that $30,000, but only a tax credit for hiring a previously unemployed worker, or, as Mayor Bradley suggests, a worker indigenous to the enterprise zones.

But enterprise zones do work in that fashion. We have three State enterprise zones. They have not been a big success because the incentives just are not good enough. The tax incentives that the State and the city can offer together are a smidgen of what you are offering, the administration is offering in this bill.

But, even in our enterprise zones, 65, 70 percent of the workers can walk to work. They do attract indigenous workers, even without those incentives. But Mayor Bradley is right: let us key it to hiring unemployed people and let us key it to hiring people from those zones themselves.

The administration bill, I think, is great. It is better than my testimony. The incentives are greater. I call for a cap of $50 million per zone. This would leave the cap open.

And I think the point that Secretary Kemp made cannot be overly stressed. When you assess your tax implications—and I guess you are going to do that with the next witness—understand, if this works, we will be generating taxes to offset some of the tax bite that you are going to take.

So, I think that is a very, very important point to keep in mind. But you are not going to help us on the cheap. You are not going to help us without paying. I think Senator Riegle said $10 billion.

I know you do not have $10 billion for this bill right now, or for any other urban aid package. But we in the cities are very confused. We see a great deal of support and we believe it is meritorious for an aid package to the Russian people of $5.2 billion. I may be wrong on that, but it was reported as $5.2 billion.

We are perplexed why you do not give at least a similar amount of aid to American cities that are on the brink. $2.3 billion of our tax base is gone in the last 11 years. It is staggering.

The implications for that are all across the board. And Philadelphia is not unique in that. L.A. may be doing a little bit better because it is a Sun Belt State, but I am sure they have lost tax base as well.

Northern and midwestern and southern cities have gotten the daylights knocked out of them over the last few years because of businesses that have moved out. You cannot help us on the cheap. We do not need rhetoric. We need a bill that has real substance.

And, Senator Bentsen, I know that you are grappling with cost implications. But, again, let me speak for our people. I said they are confused about the aid to Russia. They are also confused about how readily—again, not unmeritoriously—you found money for savings and loan.

And that was their money, too, and they are appreciative that you did. They are confused at how readily we found money for Desert Storm, and every American supported what we did in Desert Storm.

We are not asking for a fraction of that money right now. We are asking for significant aid which is a fraction of what we spent in those two enterprises, and I think we deserve it. And I think that something has to happen, and something has to happen soon.

So, I appreciate the opportunity to come. We have a lot of technical changes I would suggest, Senator, but those are minor and we will work with your fine staff to suggest those.

[The prepared statement of Mayor Rendell appears in the appendix.]

The CHAIRMAN. Well, that is interesting testimony; good testimony. When you talk about how readily we did it, we had no choice when it came to the S&Ls. No choice. We either protect the depositors, or not. Nothing for stockholders, but the depositors.

Mayor RENDELL. I would submit, respectfully, if you saw what happened in L.A.——

The CHAIRMAN. Yes.

Mayor RENDELL. And it could happen anywhere. I submit that we have no choice but to come to the aid of those hundreds of thousands of people in each American city that Mayor Bradley said do not have a job and never held one. They are lost. They look down the road toward their future, Senator.

The CHAIRMAN. I hear you. You do not have to sell me; I am for it. I am trying to find the money. I would like to say—and I have not had the pleasure of knowing you as long, Mayor—something about this fellow, Tom Bradley, whom I have known a long time.

You know, in this day of cynicism toward public officials, I think you stand out as a great example of a fine public official, and I compliment you on the work you do. And I know you must have those down days as a mayor of a major city; all of you mayors do. Thank you for that work.

Let me ask you one thing about the size of an enterprise zone. You have an enterprise zone in South Central Los Angeles now, do you not?

Mayor BRADLEY. We have five enterprise zones in the Los Angeles community.

The CHAIRMAN. Yes.

Mayor BRADLEY. They were State-authorized. They have not been marketed. And that is a split responsibility between State and local government. But there are not the incentives, so they are not working as well as they might.

The CHAIRMAN. And, as Mayor Rendell is saying, the intensification of the incentives is what you are speaking to in trying to further concentrate those things that will create the jobs in the area.

I have heard some stories about trying to set these up for a limitation on size. How do you react to that?

Mayor BRADLEY. I heard a figure of 12.5 square miles. It would not have helped us at all.

The CHAIRMAN. You have 48 square miles or so, I understand it, in South Central Los Angeles.

Mayor BRADLEY. Already, yes.

The CHAIRMAN. Yes.

Mayor BRADLEY. So, I think the size limitation would only hurt our effort to do a service, and I would hope that you would not impose size limitations.

The CHAIRMAN. Amongst those incentives tax-wise, what would you put number one and number two? Where would capital gains rate in that?

Mayor BRADLEY. Capital gains, I think, would be a big incentive. And I support that. I have not tried to quantify which is going to produce the most, which is the number one priority.

But, certainly, the capital gains inducement—tax inducements are things that you can offer through this legislation that we do not have now in our State legislation, and that has been a major failure.

Mayor RENDELL. Senator, if I can respond to that.

The CHAIRMAN. Yes.

Mayor RENDELL. Capital gains would clearly be number one. But the whole slew of incentives that are in the administration bill are very, very attractive. And you talked about marketing, and so did Mayor Bradley. Things like passive loss; $10,000 of passive loss covered for investment in enterprise zones.

If this legislation were to going to pass today—and obviously it is not—I would call a meeting of most of the major developers and business people in the city of Philadelphia for Friday morning, and I would go through with them one, by one, by one, all of the incentives that are in this bill.

Passive loss; the ability to expense investment; the $20,000—and Secretary Kemp said we should raise that $20,000 for business equipment, and I would do that for small- and mid-sized businesses, I would raise that to at least $50,000.

The CHAIRMAN. I must tell you, Mayor, I do not really agree on that as far as the priority. I really agree that one of those things that you have to be more comfortable with as an investor is you are not going to get burned out; that you have the availability of some kind of insurance, and then take the risk on whether the venture will succeed economically, otherwise.

But to get some limitation there, some comfort that you are not going to lose the whole ball game and get wiped out. I think that is the major consideration.

Mayor BRADLEY. Mr. Chairman, may I respond to your question about insurance?

The CHAIRMAN. Yes.

Mayor BRADLEY. I heard you ask that question earlier. Shortly after the riots occurred, I called Farmer's Insurance, which covers about 80 percent of the commercial properties in South Central Los Angeles.

First of all, I wanted to know how quickly they were going to pay off the losses. And they said, we have already made the assessment, we are prepared to go. And this was a week after the fire had started.

And I said, now, what are you going to do about re-insurance? Are these people who are going to be paid off for the losses they suffered going to be able to get replacement insurance when they rebuild? And they said, absolutely; we guarantee it.

And I think that through job hunting in places other than Los Angeles where we have had that commitment, we can get the attention and we can get the reinsurance that is absolutely essential. If they cannot get reinsured, there is no point in our——

The CHAIRMAN. They are not coming in if they cannot get it. I hope you are right on that, Mayor. All right. Senator Packwood.

Senator PACKWOOD. Mayor Rendell, let me ask you a philosophical question. In the administration's bill, you have an exemption from the minimum tax for investments.

Capital-intensive industries in this country are never going to get out from under the minimum tax. They are complaining about it, and they have some justification.

All of the colleges and universities want donations of appreciated property to be exempt from the minimum tax, and these are all legitimate goals.

How do we square that with the fact that we want rich people to pay some taxes, and if we let them out under the minimum tax often enough for legitimate things, they will not pay any taxes?

Mayor RENDELL. Well, I would say, Senator, if you look at the history of the Internal Revenue Code, it has always been an instrument affecting social policy. It has always been something that has provided incentives for growth and development.

Senator PACKWOOD. Well, I understand that.

Mayor RENDELL. And how did we do it?

Senator PACKWOOD. Yes.

Mayor RENDELL. We are number one on your list. I do not mean just cities, I mean rural areas. Senator Pryor made that point.

Senator PACKWOOD. All right.

Mayor RENDELL. We are number one on your list. Before we give any incentives to investors in foreign countries.

Senator PACKWOOD. Or colleges.

Mayor RENDELL. Or anyone on the list.

Senator PACKWOOD. Or before we give the incentive to donate appreciated property to colleges.

Mayor RENDELL. They are behind us.

Senator PACKWOOD. All right. I understand now. There may be another panel that testifies here some day that may have a different priority, but I understand.

Let me ask you the next question. Over the last 40 years, Federal, State, and local governments have increased the amount of spending of our total gross domestic product.

I will put it in these terms. In 1950, Federal, State, and local government spent about 22 percent of the Gross Domestic Product. We taxed about 20 percent, so we had a deficit. But we spent 22 percent.

Forty years later, instead of 22 percent, we are spending 34 percent of the Gross Domestic Product. And in that time, if you were to divide it, in 1950, 16 percent of it was Federal and 6 was local; now it is 24 and 10. I mean, it has gone up at both levels.

And, in addition, without getting into the argument as to whether or not the cities have been short-changed in the last decade under the Reagan-Bush administration, in 1990 they get infinitely more per capita by any other measure than they got in 1950. There was almost no local government.

Mayor RENDELL. Right.

Senator PACKWOOD. What has gone wrong with the money we spent that has allowed us to go from where we were in the cities in 1950 downhill? What did we do wrong?

Mayor RENDELL. Well, Senator, I am a dyed-in-the-wool Democrat, but I agree with Secretary Kemp. Instead of into job creation, we put the money into sort of maintenance programs that did not really maintain any standard of living that is fit for a human being anyway. We did not incentivize.

He could not be more right about scaling people who get off welfare so they do not lose all their benefits so that they can take those minimum wage jobs and begin to get into the work force without costing themselves.

I mean, we have set up a system to disincentivize people working. We have got to create jobs. We have got to do things. It is amazing. You know, you hear all of this political talk about, people do not want to work, they want to be on welfare permanently. Follow us anywhere in our cities.

The toughest problem, whether it is a restaurant, ball game, or a fair in the neighborhood without people literally pulling at my shoulder. Mayor, can you help me get a job. I want to work. I will do anything.

And we just made a mistake; we have all made that mistake. This is not Republican or Democrat. By the way, one of the most refreshing things to hear, at least here, is that you are not approaching this as a partisan issue.

I talked about our people being confused; they are also angry about the partisanship. They want action. Even in a Presidential year, they want us to put aside that stuff and do something. And hearing what we hear now is very refreshing, but I think we spent the money, in many instances, unwisely.

Senator PACKWOOD. I just want you to do me a favor. When the education panel is here and the President of Temple of University wants this, I am going to say I gave it to you first.

Mayor RENDELL. Absolutely.

Senator PACKWOOD. All right.

Mayor RENDELL. Absolutely. Before we start worrying about college education—college education, understand, the people who are in college have a fighting chance.

What we are here today telling you about is the people who, (a) do not have a chance, substantively, and, (b) look down that road, see they do not have a chance, and there is nothing to anchor them to your rules, my rules, and Mayor Bradley's rules. Nothing.

Senator PACKWOOD. Damn good answer. I want the transcript is all, when he comes. Thank you, Mr. Chairman.

The CHAIRMAN. Surely. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. Thank you, Mayor Bradley and Mayor Rendell. My son lives in Los Angeles, and I am losing a daughter to Los Angeles this summer. They believe in the California dream, and they have loved it out there. And, Mayor Rendell, I have been to Philadelphia.

Mayor RENDELL. Yes. [Laughter.]

I did not attend a fundraiser that Senator Breaux was hosting. [Laughter.]

But, in fairness, I was running for office myself at the time. [Laughter.]

Senator BREAUX. It is never too late. [Laughter.]

No. I thank both of you. You both have really made some clear statements. Other cities are the same. We have 1,000 potential Los Angeles's out there.

We spent a whole weekend in New Orleans looking at the problems in law enforcement, housing, the projects, and the lack of hope in the inner city. They have lost their tax base to the suburbs, just like you spoke of, Mayor Rendell.

Let me ask you—my concern is that we can have the finest enterprise zone in America, and we can have every widget company in America move to the zone.

But, Mayor Bradley, they are not going to hire any member of the Crips or the Bloods if they do not have the skills to work in the plant. And we can create all the jobs, but until we start creating good employees, we are not putting the two together.

My concern is that we have these incentives in the administration's proposal to bring the plants into an enterprise zone.

But I do not know if we have paid enough attention to training, namely, the youth apprenticeship concept of putting businesses and schools together and training young men and women to perform certain skills so they can work in these businesses that locate in the zone to bring the workers into the zone with them from somewhere else, which I think is a real concern.

I would like to see, Mr. Chairman, since we passed a youth apprenticeship bill in the tax bill that got vetoed, that program that would give incentives to businesses to form partnerships with schools to actually train these kids and give them some training in the businesses that are located in the community.

Half the people in high school never graduate. In some inner cities it is 75 percent. These kids hit the street. They get thrown out, flunked out, kicked out of schools.

They do not have a high school diploma. They do not have a skill. They do not have a trade. They do not have anything. So, they turn to gangs and a life of crime, because that is all they know.

And I think that we have to marry the bringing in of the jobs with the training of the people living in the zones who are going to work in the jobs. If we do not do that, we have only done half of what I think we need to do. Do you have any comment on that?

Mayor BRADLEY. Yes. I see the need for both on-the-job training, but some training, in some cases, that are separate and apart from the job site. You cannot do it with only one approach; it requires all of them.

We have had commitments from the labor unions in our town, we have had commitments from the private sector. They are willing to train people on-the-job. They recognize you cannot do it all off-site.

I think it is a combination of all of these factors. The pre-apprenticeship training program is one good example of how it can work. We are doing that with our Private Industry Council. We are doing that.

And I think that we are going to have to do more, and with a shift in funding in the Weed and Seed program to more training is a recognition that that has to take place.

Senator BREAUX. Well, hopefully this bill, when it finally comes out, can have some incentives for businesses to work with the schools to try and train the individuals for the jobs that are actually out there.

And let me ask you another question. I am concerned about one the administration's provisions which would have zero capital gains for people who sell their homes who live in an enterprise zone.

To me, if I was looking at that, I would say, hell, this is a way for me to get out of here. I am going to sell my home, and I am out. I do not have to pay any capital gains if I sell my home. If I live in a bad area and I can sell my home and not pay capital gains, I am out of here. Any thoughts on that?

Mayor BRADLEY. Well, maybe somebody can explain that one to me. I do not understand it to be beneficial, because I can just see people selling their homes and moving out. We have had too much of that already.

Senator BREAUX. Yes.

Mayor BRADLEY. So, I have a real concern about that kind of capital gains approach.

Mayor RENDELL. I agree with both you and Mayor Bradley. If anything, it might be the reverse, that if you bought a home in an enterprise zone and kept it for a 5 or 10-year period and then sold it, you would get a capital gains exemption. But, let me tell you, this is a theoretical argument, because in most of our zones, nobody is buying. Theoretical.

Senator BREAUX. Sure. Well, I thank you all. I really want to work with you. It is not just Los Angeles, every city in America is in the same situation. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman. I appreciate very much the statements you both made and the leadership you are giving, and the difficulty of the jobs you have.

My father was mayor of Flint at one time, so we understand in sort of a family way something of what that job requires. That is really front-door politics. I mean, people really are with you each day.

I am struck by something you said that we have not focused on here today, and that is, what happens if we do not do this?

And it is clear to me, we need to have an aggressive economic strategy, call it enterprise zones or call it expanded enterprise zones that really reverse these trend lines where you are losing your tax base almost faster than you can calculate it in your city, Mayor Rendell. And I assume you are probably seeing something like that in Los Angeles, too, particularly after the recent problems.

I think the implication of doing nothing is an increase in civil anarchy, and we are getting it now. Not just in the riot situation, which is so dramatic and draws so much attention, but in the rising level of violence, random shootings, car-jackings, and just the general terrorism that is occurring.

The civil anarchy is not just somebody assaulting somebody else or somebody giving up on life and becoming an alcoholic, or surrendering to drugs. It can also be a house that loses its value, a business that loses its value, or a city that crumbles.

I mean, what is happening here is our cities are being destroyed. They are literally being destroyed. We have got a war going on in our own country. It is partly a war of violence, but it is partly a war of neglect and of things just deteriorating on us.

I am convinced that if we do not act, it is going to cost us a lot more money. I think the cheapest thing to do is to respond to the problem. I think to invest the money now is the smartest thing we can do.

We can either wait and have a much larger bill come due in terms of the waste, the damage, and the destruction of our country in all of these different forms, or we can spend a small amount on the front end and invest in a intelligent strategy like every other country is doing, and we can have a civilized society where there is hope, opportunity, and the prospect for people to make something out of their lives.

You mentioned all of the money going to foreign aid. People are sick to death of that in this country. We have got an economic plan for every other country except America. That is the problem. There is a plan for Kuwait, a plan for Mexico, a plan for the old Soviet Union; but no real plan for our own country.

There was a request last week in the House of Representatives from the administration—from the Defense Department—to buy another 20 B–2 bombers, price tag, $44 billion to build 20 additional airplanes—that I would submit to you we do not need. The threat has changed out there. This is corporate socialism of the worst kind.

We are talking about a tiny fraction of the $44 billion to finance an effort to turn our cities around to make them livable places and give people some hope and some prospect of being able to do something with their lives.

So, the idea that we do not have the money is nonsense. We have the money. We are spending it on others things. We need to spend it on this. And the notion that we can avoid spending it and not, in the end, have to spend a whole lot more, is also nonsense.

I mean, the best bargain around right now is to be able to invest in a future that gets better rather than stand off on the side and watch a future that is going to get worse, and worse, and worse.

And we are going to end up with a Clockwork-Orange-type society, which we are seeing more and more. We had something like, I think, eight homicides here in the city of Washington just over the last 2 or 3 days. A major story. I think that is probably more homicides than they have in Japan in an entire year.

We cannot let our communities be torn to shreds because we are out to lunch on these questions. Of course we have to invest. When I asked Secretary Kemp, what if it is $10 billion, and he did not want to get into a problem of the in-fighting in the White House right now, I understand that problem.

But if we are not going to make a commitment to back the idea with the resources that are needed, then the concept does not mean anything. It is just sophistry, it is just imagery, it is cosmetic, and it is a device to basically mislead people.

I mean, the problem is, we have got a war going on in our own country and we are not dealing with it. That is the issue. We saw it in one manifestation the other day in Los Angeles. We are seeing it in every city in America every single day.

There was a young 12-year-old boy the other day, honor student in school, shot to death in a random killing. What does that say about our future? He does not have a future. And this country is not going to have a future if we do not respond to this thing now. And that is why I want a serious program.

I want an enterprise zone that is strong enough to really bite into this problem and has the financial muscle to make it happen. If we do not have that, then all of this is just a lot of empty discussion.

Mayor RENDELL. I agree. I think you have answered, basically, your own question. I do not know if you have seen the television commercial for the auto repair guy who leers at you and says, you pay me now a small piece of change, or you pay me later hundreds of dollars. Clearly, that is what is involved here, number one.

And, number two, the violence that is going on cities, it is very interesting. I grew up in the West Side of Manhattan in the late 1950's.

And I am sure everyone saw the West Side Story, and there were what we call rumbles. But when we rumbled, it was with rocks and sticks. Now, the same activity occurs and it is always with guns and knives and it is always fatal.

Senator RIEGLE. Automatic weapons.

Mayor RENDELL. And automatic weapons. And why? The reason is—it goes back to my answer to Senator Packwood—those kids do not see a future. They do not see that their lives mean anything. And when you do not have that rule, not only do you not play by the rules, but you take chances and you do just reckless, horribly destructive things.

Mayor BRADLEY. Senator Riegle, we believe in and agree with you on that issue. Thank you.

The CHAIRMAN. Senator Roth and Senator Chafee, you have both been very patient.

Senator ROTH. Thank you, Mr. Chairman. Gentlemen, in answer to a number of Senator Packwood's questions, there was an agreement that the programs on the books had not accomplished the good that was desired, and I would be interested in knowing either today, or at a later date, which of those programs should be curtailed or modified.

As I mentioned, all levels of government are spending something like $6,000 per poor person, and yet, are not achieving the goals or objectives of all of us. Under our rules in adopting a new program, we have to pay for it by one form or another.

And it does seem to me if we are in agreement that some of the programs are not working or they are being mismanaged, or whatever, we need to know that so we can eliminate that unnecessary spending.

Because, to be candid with you, you go back home and you talk to your constituents, yes, they are unhappy about aid, say, to the Soviet Union, or any other country, for that matter. But they also do not understand why our programs for poverty are not working better.

So, I would be very interested now in any comments you might have. Where are any areas where we could make savings or significant changes?

Mayor BRADLEY. If I may, I will offer you a general answer to your statement or your question. Just because a program did not meet our expectations—and this one may not reach the heights that we have been talking about—that does not mean we should not do anything.

Senator ROTH. I agree.

Mayor BRADLEY. That we should simply sit by and just let it happen. We know that that is a request for disaster, if we do nothing. If we offer some innovated program, we cannot absolutely guarantee it is going to work. But there is a lot better chance that we will have some improvement if we try that program than if we did nothing.

And the problem is so complicated, starting, as I indicated earlier, with early childhood education; taking these youngsters through high school so that they are prepared to get a job and to have some hope in life.

If we move in that direction, I think we will avoid catastrophe. We have seen the piecemeal approach to solving our problems, and it does not always work. But I would far rather have some failures or some imperfect programs than to have done nothing and have an absolute guaranteed war on our hands.

Mayor RENDELL. Senator Roth, I would go back to much of the testimony of Secretary Kemp. I think you look at programs, and we obviously do not have time to go over them one by one.

But programs that maintain the cycle of hopelessness without giv[illegible] a way out, those programs are not worth, in many instances, [illegible]r keeping at the level we keep them at. We have got to loo[illegible] some new answers.

Like, for example, you are all obviously familiar with the McKinney Act. The McKinney Act makes sense. For the first time, we are spending some money to prevent homelessness rather than to try to deal with the consequences of homelessness. It is a lot cheaper to prevent homelessness than it is to deal with the consequences of homelessness.

The Healthy Start program, that is an administration initiative that the Congress approved. A great idea. For the first time, we are spending money up front during pregnancy and in the first year of life because we know that by spending that money up front we are going to reduce our costs that come from low birth weight babies and ill children being born; the costs are astronomical.

I can give you an analogy. You know, Senator Roth, that I was District Attorney for years. And as District Attorney, I had a reputation for being pretty tough. But I said, let us take that 16-year-old, first-time offender who has burglarized a house and did not do any personal injury, let us take that juvenile and let us give him a probation officer that lives with him every day.

What we do now is, that fellow gets the same amount of attention from his probation officer as the 32-year-old who has committed five robberies, two rapes, six assaults, and you could have all the probation services in the world and you are not going to change him. Let us just be smarter. Let us spend the money where we get the biggest bang for the buck.

Head Start. Senator Bradley is right, we should fully fund Head Start, because you can demonstrate empirically that Head Start works down the line. And we spend less money because we have less dropouts. Spend the money more wisely; let us spend it up front. Children in the early stages of life is where I think we need to——

Senator ROTH. I do not disagree in philosophy to what you are saying. My concern is this, that the practice here tends to be: continue everything in the past and add to it.

The fact is, we are out of money. The Federal Government has a serious deficit. And we do need new initiatives. I think we are all in agreement on that. But we also need to be vigilant.

I am asking that you who are on the front lines, so to speak, in the weeks and months ahead, please give us advice as to what is working and what is not, where the money is being spent usually, where it's not helping. We have got to make some changes. The public is not going to continue to pour out more and more money without results or without eliminating the inefficients.

So, I am asking you for your help in identifying where savings can be made that make these enterprise zones possible.

In closing, I would just say, Mayor Bradley, I agree very much that this program should expand the tax base. Both of you spoke about the tax base, and that is also true here.

The program should expand the tax base for the same reasons. Unfortunately, because of the ridiculous rules we have, that growth cannot be used as a means of financing these new, imaginative programs.

Senator ROTH. Thank you, Mr. Chairman.

Mayor BRADLEY. We have made some assessments of a number of Federal programs, both the National League of Cities and the

U.S. Conference of Mayors, and we have provided those to various committees of the Senate and the House. I would be happy to dust those off and be sure you get some of them.

The CHAIRMAN. Thank you. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. Gentlemen, I have a question for you that is going to be a tough one. Let me start of by saying that I have been a supporter of enterprise zones for many years.

I think that what we are really looking to do here is to create jobs in the inner city which is exactly what both of you have recommended. And I am very sympathetic to the cities; I grew up in a city.

I was thinking as you were talking here about my father who lived and worked in a manufacturing plant in the city. He took the trolley every day to work, as did my uncle who also worked in a manufacturing plant in the city.

Now, I live in the suburb. Both of those manufacturing plants have moved 15 miles outside of Providence, so we no longer have that manufacturing base in this city.

But you are asking us for substantial sums of money. And let me ask you my tough question, starting with you, Mayor Rendell. How efficiently are you running your cities? Specifically, how long do the firemen serve in your city before being able to retire with a full pension. Twenty years?

Mayor RENDELL. Twenty.

Senator CHAFEE. Twenty years, full retirement for the rest of his life. And at his retirement, on the date he retires he can get his full pension?

Mayor RENDELL. It is 20, 45 years of age.

Senator CHAFEE. I see. So, you start at the age of 25, serve 20 years, and you can retire with a full pension for the rest of your life.

Mayor BRADLEY. Well, in Los Angeles it is 20 years and 40 percent of the pension.

Senator CHAFEE. Forty percent of the pension.

Mayor BRADLEY. Exactly.

Senator CHAFEE. Let me stick with you, Mayor Rendell. [Laughter.]

How many firemen do you have in the city of Philadelphia, including overtime, that are making over $50,000 a year?

Mayor RENDELL. Well, we have right now our lowest amount of firemen ever in the city's recent history: 2,300. And I would say the base salary is about $30,000. We have a terrible problem, because we have something called longevity pay and you can reach the upper stages far too quickly. With overtime, probably out of that 2,300 you probably have 200 or 300 who make $50,000.

Senator CHAFEE. Two or 300 making over $50,000. And have you ever compared the number of firemen—and I am not picking on firemen, but I am just curious because this is an indication of the problems that cities have—you have got per capita with, say, Atlanta, or some other cities?

Mayor RENDELL. We all have that comparative study. On firemen, we are about in the middle. On police—you could not convince our citizens—we are real high. We are swapping police commissioners—not swapping, excuse me. [Laughter.]

We are sending our police commissioner out to L.A., and he is going to do a great job there as he has done for us. But we have 6,300 uniformed officers in a city of 1.6. And Commissioner Williams, who has been shuttling back and forth, told me a couple of weeks ago that Los Angeles has 8,300 for a city more than double that size.

Senator CHAFEE. But the point I am making is that the financial problems of the Federal Government are very serious, as you know. We are running a terrible deficit.

For every dollar we spend, we are borrowing 20 cents of that. And who is paying for that? Our children: your children, my children, our grandchildren.

And I do not believe it is right. Therefore, when somebody comes to us and asks us for substantial sums of money, I think it is quite fair to us to ask how well you are running your store.

Mayor RENDELL. And I think the answer to that is—and I do not deign to answer for anybody else but Philadelphia—we have done a lousy job. I inherited, as I said, a quarter of a billion dollar deficit. We have produced a five-year plan because we have a State agency now that oversees our finances. We have to produce a 5-year plan.

In that 5-year plan, Senator Chafee, I have cut the cost of the operation of government over the next 4 years by $580 million in Philadelphia. Cut our costs. In addition, I have asked for $508 million in reductions in labor costs through benefit givebacks, and things like that.

Your point is well-taken. But I would submit to you that while you hold us to that standard—and you should, absolutely. You have every right to hold us to that standard.

By the way, I think the old revenue sharing programs created an attitude that led to the bad management that exists in a number of American cities.

Senator CHAFEE. Now, that is an interesting point. Because it seems to me that follows up on what Senator Roth was saying to you. I remember when we ended the revenue sharing. It is curious that we were sharing revenue we did not have.

But I suspect if you had come before us at that time we would say, what do you think about revenue sharing, should we end it, that there is not a chance in the world you would have said yes.

Mayor RENDELL. No. Because everyone speaks for their own immediate self-interest. But I look back and see the cause of that largess, what was created vis-a-vis just in negotiations with our labor unions. It was just easy to hand things out. It was easy to expand benefits, to change work roles. We were not held to a very strict management standard. But if it is any consolation—and I am sure Mayor Bradley will agree with this—those days are over. We are all fighting for our very lives and we know we have to start at home. Those days are over.

But even if you think that we are part of the problem—and I would submit to you, in many cases we are—remember, this is a program that is not being administered by us. That is very important.

This is a program that goes to what is a fundamental doctrine of all of us, what hopefully makes our country the greatest in the free world. That, given the right type of incentives and direction by government, the private sector can respond and deal with the problem. And I believe that that will happen.

Senator CHAFEE. You are talking about the enterprise zones.

Mayor RENDELL. Right. The enterprise zones. There is no bureaucracy in this program. There is no bureaucracy in this program. Not one city of Philadelphia job.

Senator CHAFEE. Can I ask one quick question?

The CHAIRMAN. Oh, of course. You have been very patient.

Senator CHAFEE. Gentlemen, both of you. As I have mentioned, I have been involved with this enterprise zone business for about 12 years now. I always thought it would work, but I am not sure. And, of course, you cannot be sure, either.

As you say, you have had a State enterprise zone problem. And, Mayor Bradley, as you indicated, it has not been pushed properly either by the city or by the State. So, it has not produced much. And you said the same, Mayor Rendell.

My question is, what do you think? Do you think it is going to work? The problem, as I see it, is that there is a lot of down side. First of all, there is not excess capacity in our Nation now.

If you are IBM or Hewlett-Packard, you probably got all your plants on at top speed now. So, the suggestion of building a new one in Los Angeles probably is not the first thing that comes across their mind.

Do you have any suggestions or anecdotal evidence that these things are going to work? Can you tell me, Mayor Bradley?

Mayor BRADLEY. Well, I have to tell you, when I became Mayor I looked at a downtown part of our city that was deteriorating; businesses leaving, corporations leaving. That heart was beginning to shrivel and die. And as it died, the rest of the city was going to follow.

And we used the Community Redevelopment Agency and its efforts to rebuild the heart of our city, and it has worked. Anybody who has been to that city and seen that skyline today will acknowledge that it was not there 20 years ago.

We believe that the same kind of incentives to bring business and industry to the areas where it fled many years ago is something that can work. We could not guarantee that the approach we took 20 years ago is going to work, but it has.

We will do our utmost to ensure that the enterprise zone will work in Los Angeles as it will in other parts of the nation if it is adopted.

Mayor RENDELL. Yes. Mayor Bradley is right, Senator. I can give you more recent anecdotal evidence. Before the 1986 Tax Code changes which took away a tremendous amount of the investment incentives, there were things like the historic tax credit and others, in the years from 1978 to 1986, Philadelphia downtown was significantly rebuilt by investment using those credits, literally one closed historic building after another that had been vacant and off the tax rolls for 20, 30 years; was brought back to life again.

Sure. Do the people in those syndicates make money? Absolutely. Did they make a lct of money? Some of them made a ton of money.

And do you know what? For the people who were put to work in all of those buildings who were earning $17,000, $18,000 then, they could not give a hoot if somebody made a little extra money. And, again, there is a price for every initiative we do. But incentives do work.

And, as a Democrat, I am against removing the capital gains tax entirely. I know some people talked about it here. But to remove it for targeted areas where people desperately need to get back to work, where we need to rebuild a tax base, yes, it worked. I can send you reams of evidence on that.

Senator CHAFEE. But, can I ask you this? Those jobs, was it not in insurance, banking, real estate? Were there any manufacturing jobs? Were there any jobs for those living in the cities? I am under the impression that 90 percent of those buildings were filled by people that came in from outside the city on the mainline. Is that true?

Mayor RENDELL. Actually, mostly in Philadelphia it was used mostly for real estate. There were some processing firms and things like that. But real estate, not available for people with hundreds of thousands of dollar incomes, real estate available for young, middle-class folks. And it brought a tremendous amount of buildings back on the tax rolls. It did create jobs that were held by non-college graduates. There is no question about it.

And even our enterprise zones, ironically, there was a study published in the Philadelphia Enquirer about the success or lack of success of our three-State enterprise zones. And what they have done in about an 8-year period is they have created only about 4,000 new jobs.

But evidence is, they have maintained about 13,000, 14,000 jobs in the city of Philadelphia. Those are all blue-collar jobs, all non-college graduate jobs, and all fairly indigenous neighborhood jobs.

Now, that is not a terrific record of success, and I will be happy to send you the article. But the incentives that the State and the city offer, regardless—and I agree with Mayor Bradley, we probably have not done a good job marketing them anyway—the incentives are nothing compared to it.

In fairness to the administration, if you want a bill that has a chance to work, there are some eye-popping incentives in this bill.

The CHAIRMAN. Gentlemen, thank you very much.

Senator CHAFEE. Send me a copy of that article, please.

Mayor RENDELL. Yes. In fact, I can leave you one.

The CHAIRMAN. I see our vote has started. Gentlemen, you have made a substantial contribution with your testimony and we are very appreciative of that.

Our hearing will reconvene at 1:30 and Secretary Goldberg will be the first witness.

[Whereupon, the hearing was recessed at 12:40 p.m., to reconvene at 1:30 p.m.]

AFTER RECESS

The CHAIRMAN. This hearing will come to order. We are appreciative of your patience and are looking forward to hearing from you.

STATEMENT OF HON. FRED T. GOLDBERG, JR., ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary GOLDBERG. Thank you, Mr. Chairman. I would like to add my thanks to the others this morning for your interest in this subject and your support of prompt and immediate action. I would like to submit my statement for the record.

The CHAIRMAN. That will be done.

[The prepared statement of Secretary Goldberg appears in the appendix.]

Secretary GOLDBERG. And I would like to talk through very briefly from the charts that are attached in my written testimony. If you go back past page 6, you will see an outline. Then, if you turn beyond that, you will see Chart I, Frame of Reference. I think this will be an easier way to go through the subject.

I will only spend a few minutes on the Frame of Reference question, but I think it is terribly important. I believe that we too often dive into programmatic issues and do not think, first, what we are trying to accomplish, and how we intend to go about accomplishing those goals.

You can hang an awful lot of words on the subject, but I believe that our objective is to create stable and secure communities where economic opportunity and upward mobility are the norms. That will be the measure of our success.

With respect to the strategies, I think there is widespread consensus that we must eliminate barriers to achieving this goal, principally through ensuring that individuals in these communities are living in a secure and safe environment, through substantial investments in human capital, and through stimulating economic growth through access to equity capital and entrepreneurial opportunities.

Some of the many programs that are designed to achieve these objectives include Weed and Seed, with its focus, for example, on law enforcement, eliminating criminal activity; programs such as Hope, America 2000, the Agenda for Education, summer jobs and job training, and enterprise zones. I am not an expert in any of these subjects outside the tax area—I sometimes question whether I am an expert in the tax area.

And I will limit my comment to enterprise zones. But I think it is terribly important to keep in mind that a tax-based strategy alone cannot and will not succeed.

We must have a comprehensive, broad-based, long-term commitment to addressing the problems of these pockets of intense and debilitating poverty, whether they exist in urban or rural areas. It is a commitment that is required from all of us, and it is a commitment that matters most to our children.

The CHAIRMAN. When you make that statement you are talking beyond the enterprise zones.

Secretary GOLDBERG. Far beyond the enterprise zones, Mr. Chairman.

The CHAIRMAN. All right.

Secretary GOLDBERG. And I think that it is important to continue to view enterprise zones in a broader context of a far more broad-reaching effort.

Enterprise zones are designed to reach one piece of a broader based strategy. Enterprise zones are intended to stimulate entrepreneurial activity and access to capital that will provide jobs, goods and services, and will provide entrepreneurial opportunities for residents of enterprise zones.

We have got to, beyond that, create the climate where those business activities can be conducted. Chart II of my testimony is a listing of the major provisions in the administration's modified enterprise zone proposal.

As a preliminary matter, as Secretary Kemp indicated this morning, rather than simply impose an artificial cap of 50 zones phased in over a specific schedule, we are attempting to develop objective criteria such that all distressed areas meeting those criteria will be eligible for enterprise zone status.

The concept here is that we ought to be able to define what concerns us and those areas that meet those concerns ought to qualify rather than permitting the choice to rest in the hands of a government bureaucracy allocating benefits.

The CHAIRMAN. There are only the two of us here, and I would like to interrupt you then, if I might.

Secretary GOLDBERG. Sure.

The CHAIRMAN. You raised some points there, and I would like to better understand it. You, too, Senator, if you have any points. When you are talking about this kind of an approach, are you talking about developing an entitlement here?

Secretary GOLDBERG. Senator, what we are saying is that there are pockets in our country where chronic unemployment, chronic poverty rates, substantial welfare dependency, perhaps crime rates, that those objective measures of a complete breakdown in the system are available.

Those objective measures are what should define eligibility for enterprise zone status. Now, whether you call that——

Senator PACKWOOD. Let me pursue this question.

Secretary GOLDBERG. Yes, sir.

Senator PACKWOOD. And if you fall within that, though, it is an entitlement program, then.

Secretary GOLDBERG. You are eligible if you choose to participate. Yes, sir.

The CHAIRMAN. It is hard for you to say that, is it not?

Secretary GOLDBERG. As the Secretary said this morning, it is an entitlement program. And it is very difficult to come up with those criteria. I agree with that.

The CHAIRMAN. Yes. I think it is, too. And one of the points I guess Mayor Bradley was making, and that was the question of having these cities in competition on these things to get it so there is pressure on the cities to do the things to supplement, to add to, to make it work.

Now, do you agree with that, or do you think you have a rigid set of requirements that once you fulfill those you are automatically entitled to these benefits?

Secretary GOLDBERG. Both Mayor Bradley and Senator Lieberman made that point. In contrast, your colleague, Senator Riegle, made the opposite point. Our judgment and our proposal retains the course of action requirement that was included in the original proposal.

So, State and local governments are still required to have a course of action plan that represents meaningful commitment and meaningful participation on their part.

However, if a distressed area meets the objective criteria and if that distressed area has the requisite commitment to a program in terms of local tax relief, local law enforcement activities, local educational initiatives, so that that program is in place, the fact that it is the 51st community should not preclude that 51st community from qualifying.

The CHAIRMAN. All right, then. If you have that kind of a situation, then what the cities are going to do, you do not know. You are going to try to get them to put the incentives in and supplement all this.

But if you have that, it is not under the administration of the Federal Government and it is difficult to quantify. Yet, that makes more of these areas eligible. How can you make an estimate as to what the total cost is going to be for the Federal Government, for the Treasury.

Secretary GOLDBERG. Senator, whenever we make a revenue estimate—common myth to the contrary notwithstanding—we do take into account behavioral responses. For example——

The CHAIRMAN. Oh, I understand that.

Secretary GOLDBERG. Well, in our view, this is no different. What we are saying is, here are objective criteria, here are the expectations of the communities involved.

It is our estimate, based on these criteria, and our review of Census track data, and our review of what State and local governments have and indicated they are willing to do, that somewhere between 100–150 areas, communities, will meet those objective criteria and will participate. It is an estimate. If your criteria were different, you would have one zone. If your criteria were different, you might have 2,000 zones.

But, as with any revenue estimate, what you do is you take those criteria, you apply them to the facts as best you can, and you make an estimate as to the number of zones that will qualify. And that is no different from the process that we follow in every single revenue estimate that we generate.

The CHAIRMAN. It is pretty tough to work that one out.

Senator PACKWOOD. Let me ask you a couple of questions, Mr. Secretary, on your chart VI, if I can.

Secretary GOLDBERG. Yes, sir.

Senator PACKWOOD. First, do I understand the total is in error on the last column?

Secretary GOLDBERG. No, sir. The footnote is in error.

Senator PACKWOOD. Oh. The footnote is in error. All right.

Secretary GOLDBERG. I always blame the footnotes.

Senator PACKWOOD. All right.

Secretary GOLDBERG. The version of Chart VI, Senator, is the scoring of the Packwood-Dole-Michael unemployment bill.

Senator PACKWOOD. Right.

Secretary GOLDBERG. One difference is that under that bill, the 115 percent estimated tax safe harbor was permitted to expire in

1997. That resulted in a $700 million revenue loss for that proposal for that year under the unemployment bill.

Senator PACKWOOD. Now, wait. I am still confused.

Secretary GOLDBERG. If you look to footnote 3.

Senator PACKWOOD. Yes.

Secretary GOLDBERG. The individual tax safe harbor proposal is to replace the current temporary rule, and it says with a temporary 115 percent safe harbor.

Senator PACKWOOD. Yes.

Secretary GOLDBERG. That should read, with a permanent 115 percent safe harbor.

Senator PACKWOOD. No. It is the totals that I do not understand.

Secretary GOLDBERG. Oh. The arithmetic is wrong?

Senator PACKWOOD. Yes, that is what I mean.

Secretary GOLDBERG. That could well be.

Senator PACKWOOD. On the last total, as I understand it, the subtotal of your revenues is $9,772,000. Is that right?

Secretary GOLDBERG. Yes. That is what it says. I will have to add it up. The 9772. Yes.

Senator PACKWOOD. Yes. And then you have got two reductions.

Secretary GOLDBERG. Oh. All right. I see. You are correct.

Senator PACKWOOD. All right. That is fine. Because there is still a surplus of $5 billion.

Secretary GOLDBERG. Thank you very much. You are absolutely correct.

Senator PACKWOOD. All right. Now, let us go through this very quickly and tell me what conform book and tax accounting for securities inventories is.

Secretary GOLDBERG. Under current law, securities dealers are entitled to the best of both worlds. What this means is, when they are carrying a security in their inventory at the end of the year, if that security has gone down in value, they can take that as a reduction in income, even though they have not sold the security.

On the other hand, if a security has gone up in value, they do not have to report that as income. So, for example, if a security dealer is holding and one security has gone up 100 and one security has gone 100, they take a tax loss.

Senator PACKWOOD. Yes. Do I expect that securities dealers will be opposed to this, or do they agree with it?

Secretary GOLDBERG. They have expressed opposition. However, they have also acknowledged that the proposal makes a great deal of policy sense.

Senator PACKWOOD. All right. The double dipping, I understand. Explain to me the individual safe harbor. And I see the footnote 3, but explain to me what it is.

Secretary GOLDBERG. Under current law, as of last year, folks who have to make estimated tax payments who have adjusted gross income $75,000 or more and whose income is expected to go up by $40,000 or more——

Senator PACKWOOD. All right. I know what that is.

Secretary GOLDBERG.—have to figure out what their taxes are going to be.——

Senator PACKWOOD. All right. I know what that is, and I remember the controversy on it. The taxable years of partnership, I assume, is just a shift of dates.

Secretary GOLDBERG. That is an elected shift of dates with a makeup tax.

Senator PACKWOOD. Now, if we were to do those four taxes, therefore, we could pass the administration's unemployment bill which Senator Dole and I have sponsored, and the administration's enterprise zones and still have $5 billion left over.

Secretary GOLDBERG. That is correct.

Senator PACKWOOD. To use for extenders, or anything else.

Secretary GOLDBERG. Or deficit reduction. Yes, sir.

Senator PACKWOOD. Yes. All right. Thank you. That is all I have.

Secretary GOLDBERG. Great.

The CHAIRMAN. Let me get to this estimate of yours again, to better understand it. As I understood the original proposal of the administration, they were talking about 50 enterprise zones.

Secretary GOLDBERG. Yes, sir.

The CHAIRMAN. Now you tell me you are anticipating 100–150 enterprise zones.

Secretary GOLDBERG. Yes, sir.

The CHAIRMAN. And, also, as I recall, the first 50 by the administration were phased in. And, as I recall, it was about an $1,800,000,000 estimate.

Secretary GOLDBERG. Yes, sir.

The CHAIRMAN. Now, you more than double the number. You get substantially more generous in the incentives that you are talking about than you did originally. Yet, the cost only goes up to, what was it, $2.2, something like that. How can you do that?

Secretary GOLDBERG. There are several reasons why that happens, Senator. First, in the real world, it will take time to administer this program. So, I do not think you necessarily assume all 100-odd zones will qualify the first day. They will have to apply, they will have to qualify. So, it is not instantaneous. I mean, in the real world, programs take time to administer.

Secondly, the original proposal, as you know, included a stock expensing provision of up to $50,000. We have created an alternative regime that permits complete exclusion of capital gains and permits ordinary loss treatment on the sale of assets at a loss.

It is our judgment that a significant percentage of those taxpayers who otherwise would have taken the up-front stock expensing will elect, instead, the capital gains exclusion/ordinary loss treatment. We believe that that is a far more effective incentive for a significant number of investors.

The CHAIRMAN. You believe that is a lot cheaper. Is that what you are saying, insofar as cost of revenue to the Treasury?

Secretary GOLDBERG. Yes. Yes, sir; it is.

The CHAIRMAN. You are using the OMB approach on capital gains. Is that it?

Secretary GOLDBERG. No, sir.

The CHAIRMAN. No?

Secretary GOLDBERG. No.

The CHAIRMAN. Then who makes the judgment?

Secretary GOLDBERG. Well, it has nothing to do with the "argument" over capital gains. What it has to do with is, under the old proposal, my tax benefit was a $50,000 deduction in year one. Under the new proposal, my tax benefit is an exclusion of a capital gain of an asset that I will not sell for 5 or 10 years.

The CHAIRMAN. At some later period. I see. So, you do not pay for it until later, or it is not a cost to you until later. All right.

Secretary GOLDBERG. The second factor that is in operation is that the change in the wage credit from a $525 credit for all eligible employees to a credit of up to $1,800 for a smaller group of employees, which I believe Mayor Bradley and others have indicated is the hardest and most important community to reach. The increase in the dollar credit is more than offset by the reduction in the number of eligible taxpayers.

The CHAIRMAN. Let me ask you, did the administration get into this question that I asked Mayor Bradley? Frankly, I was quite surprised at his response about the insurance and the renewal of the insurance in those areas. One thing I forgot to ask him was what did they do to the rates? Have you had a chance to get into that, or has the administration? I know that is a bit out of your field.

Secretary GOLDBERG. That is out of my field, Mr. Chairman. This is why I think it is important that all of us emphasize the point that this has got to be a comprehensive strategy.

For example, the Weed and Seed strategy, in reducing or eliminating criminal activity within a zone, that will reduce the cost of insurance. So, again, I think that it has to be a comprehensive strategy to address the problem.

When you talk to folks in the business, they will agree that insurance is a very real concern and one that ought to be addressed.

The CHAIRMAN. Now, we have a problem of using CBO estimates as opposed to OMB, up to a point. These estimates that you have here, do you know if CBO or Joint Tax has had a chance to make an estimate on these?

Secretary GOLDBERG. I believe that they have not estimated the enterprise zones proposal, as you know. With that exception, I believe they have estimated all of these proposals.

The CHAIRMAN. Yes. A number of these, though, that you are talking about in the way of paying, we have experienced these before, to some degree. So, insofar as the 115 percent on safe harbor on the estimate, we have some Joint Tax committee numbers, or CBO numbers in addition to Treasury. Do we?

Secretary GOLDBERG. Yes, I believe we do. Several points on that. First, with respect to the extension of unemployment on two prior occasions. The judgment has been made to accept the administration's scoring. But, beyond that, I think we need to get out of the acrimony of trying to blame each other in ways that make us unable to move forward. I believe that there are——

The CHAIRMAN. I am trying to figure out what numbers we are going to be faced with, how we will pay for it, and what the options will be. So, I am just probing to better understand it.

Secretary GOLDBERG. I believe that the Joint Committee—and I do not know if there is a representative here who can answer the question—scoring of the conformity of book and tax accounting is somewhat lower than our estimate.

And I believe that their individual estimated tax safe harbor estimate is somewhat lower, as well. But I think that the differences are not that substantial and I would hope that we could either, (a) work them out to our mutual satisfaction, or, (b) develop modifications to the proposals that would result in a consensus.

The CHAIRMAN. Well, I would hope we can. Now, I interrupted you along the way here. So, why do you not go ahead now through your chart?

Secretary GOLDBERG. Again, I know this has been a long day. I will try to keep this brief. But if you turn back to Chart II, it is a description of the various incentives that we intend to provide. And we have broken down those incentives by the objective that we have in mind.

The first set of objectives is to encourage investors to invest capital in enterprise zone activities. The initial incentive is a capital gains exclusion for investments in enterprise zone businesses. This is an exclusion for both regular and AMT purposes.

Unlike other proposals, there is no dollar limit on the amount of the investment or exclusion; there is no limit on the form of business in which the taxpayer can invest.

In other words, they can invest in a corporation, partnership, or an S-corporation, and that provision is not limited to individual investors.

Secondly, a loss on investments of this sort can be deducted as an ordinary loss, and, therefore, offset against ordinary income, including earned income.

Third, the passive loss limitations of Section 469 would not apply to the first $10,000 per year of losses resulting from investments in enterprise zone businesses.

Fourth, enterprise zone residents and owner/employees of enterprise zone businesses would also be entitled to the $50,000 stock expensing contained in our original proposal.

For investors who do not live in the zone and who are not owner/employees, those investors may elect either the capital gains exclusion, which is a back-end benefit, or the front-end expensing of up to $50,000.

At the business level, the issue is providing incentives for businesses to invest and providing businesses access to capital. As a preliminary level, by providing investor-level incentives to invest, we facilitate business-level access to capital. Beyond that, the same capital gains exclusion provisions and ordinary loss deduction provisions apply.

We have also increased the expends provision from $10,000 to $20,000 under Section 179 for qualifying small businesses. And, finally, we have provided that enterprise zone businesses have access to tax-exempt financing through the exempt facility bonds program, subject to the current overall volume cap limits.

At the employee level, we have modified our original proposal and we provide that enterprise zone employees who are otherwise not eligible for the earned income tax credit would be eligible for the EITC.

The effect of that is to increase the maximum credit from $525 to approximately $1,800 in 1994. However, it reduces the portion of the population eligible. Finally, we have added a homeowner's incentive that excludes gain on the sale of an enterprise zone residence up to——

The CHAIRMAN. Do you think there is any reality to that?

Secretary GOLDBERG. Which?

The CHAIRMAN. In trying to sell a home for a $200,000 capital gain in an enterprise zone. Pretty tough. Must be quite a salesman. Go ahead.

Secretary GOLDBERG. Mr. Chairman, this goes to Senator Breaux's point before. If the program is successful—programs such as Hope,- where residents acquire ownership of their housing through equity—the value of these residences will increase and then the exclusion is both realistic and meaningful.

We have structured the program as best we can in a way that says, if the tax costs associated with this program are contingent on the success of the effort, we benefit, the society benefits, and the individuals of the community benefit if housing values appreciate. That is where the tax cost comes, but that is also where the success of the program comes.

So, yes, I believe it is, in that sense, realistic in that it says if we are collectively successful in what we are trying to accomplish, the intended beneficiaries will benefit.

The CHAIRMAN. That applies to homes in being—it is not used just as an encouragement to buy homes then.

Secretary GOLDBERG. There is a requirement that it be the principal residence. There is a requirement that it be the principal residence for 5 years after zone designation, and the gain that is excluded is only gain attributable to appreciation during the period of enterprise zone status.

The CHAIRMAN. But he has to have owned it 5 years prospective.

Secretary GOLDBERG. Yes. Correct. An individual who is living there now has to live there another 5 years. Someone who moves in has to live there for 5 years, and has to satisfy the principal residence requirement.

The CHAIRMAN. Moving beyond the 5-year budget window.

Secretary GOLDBERG. We are looking for long-term stability in the neighborhood, Mr. Chairman.

The CHAIRMAN. I understand. I understand very well. All right. If you would proceed, Mr. Secretary.

Secretary GOLDBERG. All right. Now, that is obviously a very quick and brief summary of the proposal. The next chart compares this modified proposal to——

The CHAIRMAN. What is the next chart?

Secretary GOLDBERG. It compares the——

The CHAIRMAN. Which number?

Secretary GOLDBERG. I am sorry. Chart III.

The CHAIRMAN. Three. All right.

Secretary GOLDBERG. Yes. The next page. It compares the new proposal to the original proposal, and I will not run through all of that.

The CHAIRMAN. No.

Secretary GOLDBERG. But I think there are several points that are very important to emphasize. This is too important to find ourselves in the mid or late 1990's with enterprise zones as the scandal of the day. This has got to be a program that confers meaningful and real benefits to the zones we are trying to serve.

So, the issue is, if you have all of these very attractive investment incentives and very attractive tax relief provisions, how can you be sure that you are not either creating a tax shelter industry, or conferring tax benefits on those that do not benefit the zone?

And I would just like to mention a couple of provisions there that we have included that are intended to achieve this result. First, unlike the prior proposal, in order to get any of these tax benefits, you have to be an enterprise zone business.

In order to be an enterprise zone business, one-third of your employees have got to be enterprise zone residents. Now, we picked one-third because that seemed to be a reasonable number. There are those that suggest it should be 50 percent; others suggest it should be 20 percent.

Obviously, you can collectively figure that out. But Mayor Bradley and others have all indicated that you want to have a requirement of employing zone residents to assure the benefits flow in that direction.

Secondly, 80 percent of an enterprise zone's gross income must be derived from enterprise zone business activities. Third, substantially all of the enterprise zone's employees and property must be directly involved in the conduct of the trade or business in the enterprise zone. This means that your property, your payroll, and your sales have to be derived from what it is you are doing in the zone.

Now, you can certainly sell things to folks who live outside the zone, you can deliver things to folks that live outside the zone, but the locus of your activity has got to be within the zone.

Finally, we have added a requirement that says the tax benefits that you derive must be commensurate with the benefits conferred on the enterprise zone community.

What that means is, if I am building a facility, or a storefront, or a retail outlet, or a franchise in the zone, I am serving zone residents and I am employing zone residents. That is the easy case, and that is what we intend.

On the other hand, the clever lawyer that figures out a way to put nothing at risk in the zone, employ no one in the zone, confer no benefit on zone residents, yet purports to get the tax benefits will not qualify.

The one other change I would like to talk about briefly because I think it is a terribly significant policy issue is the change from a $525 credit for all low-income employees of the zone business to a credit that goes to employees who are not otherwise eligible for the earned income tax credit.

The policy behind the original proposal was premised on the notion that those who were employed by zone businesses ought to see a direct and meaningful benefit from the program across the board.

The change here is intended to say that what we have learned is that the most important population to reach in so many of these communities are the young, chronically unemployed individuals.

And we are far better focusing our scarce tax dollars on increased benefits and increased incentives for that subset of the population. And that is a conscious policy choice and there are trade-offs, either way.

I might note that the Democratic version of H.R. 4210 included a wage credit that went to the employer. That, also, has a compelling policy justification because it reduces the cost of doing business in a high-cost area. All of these are principled policy judgments. There are strong justifications for each of them; there are distortions associated with each of them.

We have made our best judgment, and, because we have scarce dollars, we accept the fact you have to make a choice, and this is the choice that we have made.

The CHAIRMAN. Well, Mr. Secretary, let me ask you another one. I am intrigued by the fact that you come up here with offsets totalling $9.7 billion, and, in fact, expenditures of $4.7 billion, or as my colleague said, some $5 billion surplus. That is unusual for the administration to come up with that kind of an offer. What do you have in mind for the other $5 billion?

Secretary GOLDBERG. Senator, I would like to go back a step. If you recall in a meeting the day before yesterday, you were very adamant about the need for us to pay for what we want to do.

The CHAIRMAN. That is right.

Secretary GOLDBERG. And the need for us to be specific about what we have in mind.

The CHAIRMAN. And I am impressed.

Secretary GOLDBERG. I applaud you. I think you are absolutely right. And this is what we are trying to do.

It is my judgment that, if we decide we want to, we can extend the extenders; we can pay for meaningful unemployment benefits; we can repeal the luxury tax; we can pursue a meaningful urban agenda and we can pay for every nickel of it. And we can do so in a way that is acceptable to you and your colleagues, acceptable to the Republicans in Congress, and is acceptable to us.

The CHAIRMAN. This is very interesting to me. Because what we had here was a discussion, as I recall, at the White House, on the one side, of let us just do enterprise zones, period. All this other is clutter and may impede the passage.

Frankly, I, as one member, have not decided. We have got to do the unemployment benefits extension; have to do that. I have concern about the extenders. I want to do something about the luxury tax.

And the question is whether to try to package it, or try to do these things individually, how they complement each other. I want it to be successful, obviously. And trying to evaluate that from a technical standpoint is a consideration.

So, it is interesting to me that you are apparently saying you are ready to look at some options in the way of packaging.

Secretary GOLDBERG. Senator, I do not want to be too far out on the thin ice.

The CHAIRMAN. I know you do not, Mr. Secretary.

Secretary GOLDBERG. But let me go through what we have here. Chart V shows you how to do enterprise zones and only enterprise zones and pay for it. Chart VI shows you how to do a meaningful version of unemployment and enterprise zones, and pay for it.

Chart VII shows you how you can pursue an issue that I think you have assumed leadership on, to the benefit of all of us, which is health care reform. And it takes an issue where I believe there is general concurrence that we ought to permit self-employed individuals to deduct the full cost of health insurance.

It takes the President's proposal that has been submitted to the Congress, it includes pay-fors that are included in the President's budget, and it includes an enterprise zones proposal and it fully pays for all of those initiatives which I believe have genuine bipartisan support each year of the budget window.

Now, I am not here and I am not authorized to say, we want this one, and only this one. I am certainly authorized to say we would sign any one of these measures the minute it landed on the President's desk. And I think that what frustrates me is that there is a way through the forest if we choose to find it.

The CHAIRMAN. Mr. Secretary, I think this has been very productive. And I have been asking for some definitive terms, and payfors, and proposals, and you have given me some. It does not mean I buy all of them, but it is helpful for us. Thank you.

Secretary GOLDBERG. Mr. Chairman, you asked the President of the United States a very direct question, and I believe he gave you a very direct answer, that we would provide you with this information. I hope that it advances the process.

The CHAIRMAN. This has been helpful.

Senator PACKWOOD. No other questions.

The CHAIRMAN. Thank you very much.

Secretary GOLDBERG. Thank you.

The CHAIRMAN. All right. Let me have as the next panel Hon. Frank O'Bannon, Lieutenant Governor of the State of Indiana; Jan Burreson, director of economic development, and I would like to ask Mr. Marcus Alexis to join us, since I understand he has a 3:00 o'clock plane and we want to try to help him make it.

Senator Packwood, I would like to defer to you at this time.

Senator PACKWOOD. I would like to welcome to the committee Jan Burreson, who is the director of economic development for the Portland Development Commission. The commission is responsible for implementing the city of Portland's economic development program.

Jan has 14 years of experience in the trenches as an economic development expert, and has spent the last 3 years focused almost exclusively on revitalizing Portland, Oregon's inner city neighborhoods.

Additionally, she has worked with her counterparts across the country to develop an urban economic development agenda as a member of the Council on Urban Economic Development Federal Policies Task Force.

Ms. Burreson has a unique perspective on the urban problems of my city of Portland, as well as useful insights on the success of our enterprise zone program. I am delighted she is going to be a member of the panel today, Mr. Chairman.

The CHAIRMAN. Thank you. Governor O'Bannon, we are very pleased to have you. Will you proceed?

STATEMENT OF HON. FRANK O'BANNON, LT. GOVERNOR, STATE OF INDIANA, INDIANAPOLIS, IN

Lt. Gov. O'BANNON. Thank you, Mr. Chairman. I am Lt. Governor of the State of Indiana, and, by law, also director of the Department of Commerce of the State of Indiana which oversees Indiana's enterprise zone program.

And I am here today to support the Federal assistance for the country's blighted areas, both in the rural and urban areas, and to support a Federal enterprise zone program as a part of that effort, and I have some suggestions I would like to give a bit later.

I would like to echo Mayor Bradley's statement that an enterprise zone is not a panacea, but if it is properly designed, it can help communities help themselves. And I think that is what we hear more of the talk all day here in the testimony has been very, very good.

In my comments today I want to share our experience in Indiana and suggest what elements we believe to be critical to success. And I have prepared remarks that have been submitted to the committee.

The CHAIRMAN. That will be received.

[The prepared statement of Lt. Gov. O'Bannon appears in the appendix.]

Lt. Gov. O'BANNON. And I will reduce my remarks here to hold them to a minimum to answer questions and give the other testifiers time.

In Indiana, we have had a program since 1984. Six enterprise zones were established in 1984, and since that time we have added nine. So, there are now 15 enterprise zones in the State of Indiana.

The tax benefits go to the businesses, particularly property tax exemption on inventory, but also tax advantages to the zone residents who are employees, some tax advantage to investors, and to lenders to help the development in a revitalized industrial and residential area.

We do have some aggregate figures. From 1986 to 1990, 4 years, we start with probably the figure that most people look at: $66 million have been provided in benefits. And that goes to businesses, to residents, some to investors and lenders in Indiana's 15 zones.

New employment in the zone businesses during that same time is estimated conservatively at 17,000 people, and zone residents—and not all the employees are zone residents, by a long shot—have earned more than $175 million in wages and between 1986 and 1990.

During the last 2 years, 1989 and 1990, of this period, new capital investment in the zones exceeded $400 million. So, these aggregate numbers embody individual stories in each zone, and some I have specifically put in my written testimony that you might refer to.

Let me say, when I say zone residents, our experience in Indiana has been that about 10 percent of the employees in the zone are zone residents.

And it is my opinion, after hearing testimony here today, if you raise that to 30 percent in areas that are much more difficult to get workers with the basic skills, you are not going to have much expense to the Federal Government because a lot of it just will not work at 30 percent, or whatever figure they are talking about. So, I would look at that very closely.

But I want to mention two other things.

The CHAIRMAN. Let me get that again. You say you do not think we can get the 30 percent, that that will not work insofar as people from the area. Is that your statement?

Lt. Gov. O'BANNON. It will depend on the zone, but that will be very difficult. Because you have to get an employer that will either train and spend the money to train, or part of your program has got to train those workers. And that takes time. It takes time.

If there is any weakness in Indiana's program, it is that we only have about 10 percent of the zone residents that were employed in the zone. And the tax benefits go only to employees that are zone residents. Outside of zone employees, there is no tax benefit, as far as the employer is concerned.

Senator PACKWOOD. Let me make sure I understood. So far, only 10 percent of the employees are zone residents.

Lt. Gov. O'BANNON. That is right.

Senator PACKWOOD. But even they have gotten $175 million in wages over 4 years.

Lt. Gov. O'BANNON. That is right. That is exactly right. So, there is a benefit there. We, first, look at zone residents and jobs and how we can get them jobs. And that is public policy number one. Number two, is how to revitalize a distressed area. And if I were giving an opinion today, the importance has been revitalizing the distressed areas and creating jobs. Now, you say, would they be created without the tax incentives?

Well, there have been studies done on that, and we look at that. We think there have been—when we look at shift-share analysis on how many jobs in the area have grown anyhow outside the zone, how the particular industry that is in there has grown, remove that, and then see what tax incentives have done there.

Let me mention two things that I think are very important to a successful program. First, we insist that every tax saving earned through the district must be reinvested in the zone.

If a company gets $10,000 in inventory tax credits or $10,000 in employment expense credits, that $20,000 has to be spent in the zone.

The CHAIRMAN. Is that forever? Is that always?

Lt. Gov. O'BANNON. It can be spent in capital improvements of their business, employee benefits of some type, employment training, or it can be spent with the local zone board to improve the zone that will increase the value. If they do not do that, then they are decertified and get no tax benefits. In the past 3 months, we have decertified about 15 companies.

The CHAIRMAN. Out of how many?

Lt. Gov. O'BANNON. Well, the number of companies——

The CHAIRMAN. Give me a round number.

Lt. Gov. O'BANNON. We have around 1,400.

The CHAIRMAN. All right.

Lt. Gov. O'BANNON. Now, once you start to decertify, you can work out a settlement and they can stay on the tax benefits, and we had three work that out. So, there is a system that you monitor it all the time.

That brings me to my second point, that part of that system of monitoring is having a local enterprise association, a local enterprise zone board.

In Indiana it is made up from some residents from the zone, business people that are operating in the zone, and local elected officials. They set up a not-for-profit corporation. Then, they decide how the money is going to be spent.

Now, once they get a tax benefit in the zone, 1 percent of that tax benefit the company pays to the government to run the State board that oversees all of the boards.

Then, the local board also says, all right, a certain percentage of your tax benefits you are going to pay the local board. And they do. That runs from 20–25 percent, on an average. Of the company's tax benefit, they make a direct payment to the local board.

Then the local board can use that for the zone in many ways. It can be training programs, crime prevention programs, 20 more policemen in Benton Harbor, it could be apprentice programs that Senator Breaux was talking about.

Senator PACKWOOD. These boards are little governments.

Lt. Gov. O'BANNON. They are little governments. That is exactly right. Where they originally start is doing a master plan for that zone and why it is needed, and how they can leverage other monies to recover that blighted area, that distressed area, and, at the same time, give jobs.

Senator PACKWOOD. Well, I am intrigued. Did I see in your testimony the zones cannot be any bigger than 8,000 people?

Lt. Gov. O'BANNON. Yes. The zones that we set up in Indiana in 1983 legislature had certain thresholds. One, was that a zone had to have at least 25 percent of people in poverty, was one requirement.

Another one was it could be three-fourths of a square mile to 3 square miles. It is very small. And, also, the population from 2,000 to 8,000 people. That fit Indiana at the time.

I think what Jan will talk about, and you are talking about, are big cities with horrible problems. You are going to talk about rural areas with not many people, and how you do that. And I think we are talking about our experience in Indiana right now with middle-sized cities. And Jan is much more expert in big cities.

But the key is, it is more than tax incentives. It is a community economic development program. And you say you set up another board; that is true.

And we do not look at it as bureaucracy. The only thing is, you are having a much more direct focus in an area, in a zone, than you have at the statewide, or that you have at the citywide. And that is where your long-range planning, that is where the accountability comes in.

Senator PACKWOOD. Let me ask this question. I am not familiar with Indianapolis. Do you have a number of zones in Indianapolis?

Lt. Gov. O'BANNON. One.

Senator PACKWOOD. Just one in the whole city?

Lt. Gov. O'BANNON. Just one in the whole city. And it was put in place only 2 or 3 years ago.

Senator PACKWOOD. And, yet, you must have an awful lot of these around the State, then, if you have got 1,400 businesses involved.

Lt. Gov. O'BANNON. Yes.

Senator PACKWOOD. How many?

Lt. Gov. O'BANNON. 1,200.

Senator PACKWOOD. In how many zones around the State?

Lt. Gov. O'BANNON. Fifteen.

Senator PACKWOOD. Fifteen zones. All right.

Lt. Gov. O'BANNON. Fifteen different zones. One in each city. You cannot have more than one.

The CHAIRMAN. Governor, I have got Professor Alexis, who is getting a little nervous. His plane is about to leave. If you will forgive me.

Lt. Gov. O'BANNON. Let me say, those are the two things that I wanted to give to the committee. One, that the benefits should be reinvested in the zone with a plan that is put together by a local board, two, that oversees it and makes recommendations to the State board, or whatever, as in our case.

The CHAIRMAN. Well, I am sure there will be more questions of you.

Lt. Gov. O'BANNON. Yes.

The CHAIRMAN. Professor, would you proceed?

STATEMENT OF MARCUS ALEXIS, BOARD OF TRUSTEES PROFESSOR OF ECONOMICS, MANAGEMENT AND STRATEGY, NORTHWESTERN UNIVERSITY, EVANSTON, IL

Prof. ALEXIS. Thank you very much, Mr. Chairman. My purpose in being here today is to take a look at what has been happening in the State programs, and, perhaps, to give some perspective on what has been learned by State experiences with enterprise zones.

As you know, 37 States and the District of Columbia have enterprise zones of some form. There have now been some studies done of the performance of those enterprise zones, and I think that the Federal programs can learn some things from them.

Some of the things that these studies have revealed have been discussed here by the previous people who gave testimony, but I would quickly like to try to hit the highlights and then to answer any of your questions.

One of the difficulties with enterprise zones is that, in practice, they are quite heterogeneous. There is a great variety in stimulus packages, administration, and the potential for success in the more than 200 enterprise zones in the country that are in operation.

Enterprise zones are used both as a means of invigorating the economics of distressed areas, and also a tool for economic development. They do reduce the cost of capital significantly, but these reduced costs of capital are relatively less important to other economic considerations. Location decisions are influenced by more than simply tax credits and incentives.

Tax incentives emphasizing reductions in income and property taxes without commensurate incentives to hire zoned residents or disadvantaged workers can easily become windfall profits and create few, if any, new jobs.

Properly constructed, a tax incentive package can be an inducement for firms to select some locations over others. Better paying, non-professional jobs are to be found in manufacturing. The capital subsidies do not attract as many of the non-manufacturing firms, and, therefore, tend to be of much less value.

In a study of enterprise zones in Illinois, which has 82 zones, it was concluded, after 3 to 5 years' experience with the operation of enterprise zones that local officials and business community leaders tend to think of enterprise zones almost exclusively as a general economic development tool rather than as an anti-poverty or targeted program.

Only a few of the States' program statements of intent mention neighborhood revitalization and community redevelopment as explicit goals of the enterprise authorization. In practice, there is little regulatory relief given in enterprise zones.

Many of the previous people have emphasized that enterprise zones are not panaceas for economically distressed areas. There is a limited number of high performers, and many more that have achieved far less success.

The typical zone attracts investments of several new and expanding businesses. Zones are less successful in preventing contractions and closures than they are in attracting new investment.

More than 30 percent of the 66 zones for which baseline employment data are available had gross annual growth rates, however, that were higher than for the U.S. economy as a whole.

Another encouraging aspect of enterprise zones is that manufacturing firms which are more likely to provide high-paying jobs for non-professionals dominated the set of investing businesses. And they represented nearly 73 percent of all the job gains in enterprise zones in the States.

States that designate a large number of areas do not do as well as States that target a small number of areas. A large number of investment or job creation incentives in the enterprise zone package is a positive inducement for firms to locate, expand, or retain operation within the zone.

Pennsylvania has a unique set of enterprise zones which were created by administrative, rather than legislative, action. Pennsylvania's coordinated packaging of existing State incentives and services has been strongly associated with zone job gains.

A question that is often asked is, how does a large minority population affect the success of zones? In the study of the zones in the 37 States, it has been found that high minority population was not an impediment to zone investing and job gains.

A general finding is that enterprise zone programs cannot be freestanding. They must be part of a larger development package that involves several line agencies.

They must be sufficiently attractive to achieve visibility for the area and development package, but no so large as to induce establishment from other areas or a depressed perimeter around the zone to relocate within the zone.

Recommendations for a Federal program include that Federal programs should limit the number of zones initially. Each zone should receive sufficient stimulus in a package of tax, cost saving, and employment-creating incentives to encourage startups and expand existing establishments in the zone.

Zones should be targeted to distressed, but salvageable areas. Program incentives should be directed towards employing area residents and encouraging local businesses.

Zones should include job training and retraining programs, counseling, day care, health benefits, and incentives to welfare recipients and discouraged workers to re-enter the job market. There should also be incentives to reduce crime against persons and property.

The initial program should be in distressed settings of metropolitan areas. The program should encourage minority business involvement.

There is an interesting six-point program recently announced on May 12 by the Federal Reserve System for the Los Angeles area which I think represent a kind of a model or blueprint for how the private sector, together with governmental assistance, can provide credit and other support for distressed areas.

Enterprise zones can be a positive element in a national urban policy, but enterprise zones alone will not do the job required. Coordination of Federal, State, and local programs targeted to distressed areas is essential, and attention must also be paid to infrastructure needs and to providing a safe, crime-free environment. Enterprise zones can contribute to get this country going in the right direction. Thank you.

[The prepared statement of Professor Alexis appears in the appendix.]

Senator DASCHLE. Thank you, Professor Alexis. Is my understanding correct that you need to be excused in order to catch an airplane?

Prof. ALEXIS. Yes. I have a few minutes if you have any questions, but then I have to get running.

Senator DASCHLE. Given that circumstance, Senator Packwood, did you have any questions of the Professor?

Senator PACKWOOD. I do not have any questions of the Professor.

Senator DASCHLE. We thank you again for coming this afternoon.

Prof. ALEXIS. You are welcome.

Senator DASCHLE. We appreciate very much your testimony, and we hope you catch your airplane.

Prof. ALEXIS. Thank you. So do I.

Senator DASCHLE. Ms. Burreson, welcome.

STATEMENT OF JAN BURRESON, DIRECTOR OF ECONOMIC DEVELOPMENT, CITY OF PORTLAND, PORTLAND, OR

Ms. BURRESON. Thank you very much. I would like to join my other panelists in thanking you for holding this hearing today. I think many of us who have been out there in the trenches have felt for a long time that enterprise zone legislation would be very helpful to us, and this hearing provides impetus in that discussion.

I am here today to underline the importance of Federal enterprise zone legislation. I want to talk a little bit about middle-sized cities and about the value that I see from including middle-sized cities in enterprise zone legislation.

And I would also like to give a little feedback on what I think is most important to include, from my perspective, as far as incentives.

While Congress has done a lot to provide tools within inner city neighborhoods for affordable housing—the HOME and HOPE programs are very positive—the counterpart programs to address the issues of unemployment, disinvestment, and community ownership of businesses have been absent.

And I would submit that Federal enterprise zone legislation would be an important part of the equation to actually make the housing programs work. Home ownership really starts with a job.

I further would submit that I agree on the importance of Head Start, but kids that go through Head Start head off to high school successfully but who live in a home where mom and dad are not working are not going to be successful. So, I think the jobs part of the equation is vitally important to our cities.

We are concerned as we reviewed the scope of H.R. 4210, and as we listened to the discussion, that Federal enterprise zone benefits are going to be extended only to the very large cities and to rural areas.

I think there is a perception problem. There is a perception that middle-sized American cities have escaped the urban ills of the larger cities. This simply is not true. I think Portland is a very good case.

We have certainly won our share of the Most Livable City Awards. And, yet, drive through north and northeast Portland—I think Senator Packwood, earlier in the day very eloquently outlined the statistics of unemployment among that particular population, more than twice the unemployment of the rest of the metropolitan area; an area that has seen very serious crime, gang activity which has moved up from Los Angeles; and, I think of most concern, a growing frustration and bitterness on the part of citizens who live in this part of a healthy economic region who have been bypassed.

In the days immediately following Los Angeles as there started to be a response, the most respected minority leaders in our community, the head of the Urban League, the head of the Black United Fund, the head of Head Start, called together business and government leaders and said, do you not realize that the very same conditions exist in our city that existed in Los Angeles, just on a difference scale.

And is the message that, in order to have some action, that we, in fact, need to see civil disobedience? This cannot be the message.

We are talking about a city which has done a great deal. I think Portland has been very aggressive in both using State programs to provide job training, and using city resources to provide tax abatement in our enterprise zone.

And we have been successful in combining our government, and our business strategies, and utilizing all of the Federal tools that are out there: special grants to get rid of drug labs; we have got a Nehemiah program. We have tried to combine all of these things—Federeal, State, and local resources.

In spite of that, while we are making progress in housing and we are making progress in crime, unemployment within the inner city is, in fact, increasing and per capita income is dropping.

We have learned a lot. We do have a State enterprise zone that covers this area. This is an enterprise zone that was adopted a decade ago. And we learned from our enterprise zone that it is important to hire zone residents.

And, initially, it was required that for a company coming in to receive this 3-year property tax abatement, they needed to hire 60 percent from the zone. No one took advantage of it; it was unrealistic. It did not work.

We changed the State legislation. We lowered the requirement to 30 percent, and, in fact, now companies are starting to use it.

We have, over the last several years, seen eight major employers come in, create a couple of thousand jobs, and start to create new investment. So, I think you have got to be very careful as you look at how you are going to bring the benefit back to the communities.

What we particularly support is the wage credit. In cities, we have seen that being close to disadvantaged populations does not ensure that companies will, in fact, hire those people from the community. And I think that the wage credit would work very well for that.

While the administration's proposal of a third might work, I think the trade-off there is encouraging lower-wage, lower-skilled jobs. And I think that it is important to, within enterprise zones, offer an opportunity for residents to access a broader variety of jobs.

In looking at the middle-sized cities, we are very concerned about the criteria. I think you can either write the criteria so that it is realistic. It is either inclusive or exclusive.

We would like to see more cities designated, but we think that in order to do that, it would be realistic to set caps for the maximum amount of investment, and also to shorten the term. Fifteen years seems like a very long time. That could be shortened to 10 years, or even 5 years.

Finally, I would like to say that certainly the jobs and job training tax benefits are, in my mind, the most important. Secondly are those which encourage companies to invest in themselves and to stay within the inner city.

I have used my time, and I would be very happy to answer questions.

[The prepared statement of Ms. Burreson appears in the appendix.]

Senator DASCHLE. Thank you very much for your testimony.

Senator Packwood.

Senator PACKWOOD. Jan, I want to make sure I read one word right. Take a look at page 5 of your testimony, because I honestly was misreading it. Does the word "dedication" mean deduction?

Ms. BURRESON. In which section, sir?

Senator PACKWOOD. "Under the dedication for purpose of enterprise zone stock."

Ms. BURRESON. Yes.

Senator PACKWOOD. Should that be deduction?

Ms. BURRESON. Yes.

Senator PACKWOOD. All right.

Ms. BURRESON. That proposal which came out of H.R. 4210, in our opinion, was probably one of the lowest priorities.

Senator PACKWOOD. All right. Now, let me ask you. You heard Mr. Goldberg testify. The administration is now talking about not putting a limit on the number of zones, but they are going to have a series of criteria.

Ms. BURRESON. Yes.

Senator PACKWOOD. I do not know whether Portland or Indianapolis would fit the criteria; I am not sure. But what should be the criteria so that medium-sized cities fit in?

Ms. BURRESON. I think that setting criteria is vitally important. I might be useful to establish a set of criteria only for mid-sized cities and designate a limited number of mid-sized city zones.

You certainly do not want something that is a scheme to market an industrial park and has not benefit back to inner city residents.

I think criteria can be established which are inclusive. It may not be as restrictive as has been proposed. I noticed a big disparity. If you look at the previously proposed legislation, whereas there were, I think, six criteria that cities or major metropolitan areas would need to reach. There were very general criteria set for rural areas. So, I think there is a balance there of setting the criteria so that a significant number can be selected.

To me, if you select 10 cities, what you have got is, at best, a demonstration, perhaps a band-aid approach. I think you need the experience of selecting, in my opinion, at least initially, a minimum of 25 cities.

I think cities should compete based on meeting the criteria, but, also, I totally support the notion that enterprise zones cannot do it in and of themselves.

And I think that communities that are willing to bring State tax and other benefits to that area, cities who are willing to put other resources on the table and take a comprehensive approach should be rewarded for doing that because that is where we will see successful payoff.

Senator PACKWOOD. Well, let me ask you this very specifically. What appropriate criteria should be used in establishing the zones? And if they are generic, the programs are going to cost more money than the administration wants to spend.

Ms. BURRESON. I think you can look at unemployment numbers, I think you can look at per capita income numbers. I think that the criteria that Secretary Kemp has talked about are fine. It is just, what are those criteria going to be? Is it going to be that you must have more than 50 percent unemployment within your zone?

Then, obviously medium-sized cities like Portland are not going to qualify. So, it is a question of not what criteria is proposed, but how restrictive it is.

And I am assuming that you are going to want to do what was proposed, take a look and say, does this criteria mean we are going to have 40 or 50 enterprise zones, or does it mean we are going to have thousands? And I understand that. Not every city that thinks they need one is probably going to qualify initially.

Senator PACKWOOD. Thank you, Mr. Chairman.

Senator DASCHLE. Thank you, Senator Packwood. Let me ask you. You have both worked with enterprise zones to a very significant degree. What confidence do you have that you can calculate that the jobs created and the investments made were a direct result of the incentives?

Ms. BURRESON. Well, in our enterprise zone, we require that the jobs be tracked. A company who is going to get the tax abatement must sign an employment agreement. In fact, the city refers the potential employees from the zone to the company.

And what we have seen is that companies who come in and utilize enterprise zone benefits, or any other public incentives that we offer them have, in fact, hired 60 percent—higher than the requirement—of their employees from the zone.

So, we do not see a reluctance on the part of the companies to hire zone residents. But we also have a job training component.

Our State puts its incentives into training people, so we have used State lottery dollars to put the training in place in order to make that match, and I think that is critically important.

We talk about depreciating equipment. One of the things we would like to see added, we have skills out there that are depreciating, too. And we would like to see a tax benefit to companies who would come in and would train residents.

But I think you have to track it. I think you do not just hope that they will hire. We know that if that occurs, you are not going to see the results.

Senator DASCHLE. Governor O'Bannon, do you have anything to add to that?

Lt. Gov. O'BANNON. Yes. I think you have to look at places such as Portland, or a city in Indiana, and see what the increase in jobs is naturally and whether or not that is factored in to what has happened in an enterprise zone.

Or, to reduce it even more down, has there been an increase in industry jobs, or a certain classification of industry.

Then, when you move those off and say whatever that has been, 5 percent, or 3 percent over the past 2 or 3 years, then has the enterprise zone added to that?

And that is how you determine where the tax incentive is. It is called a shift-share analysis. It is very difficult to figure that exactly. And I think we have to judge ours, then, by what jobs are created.

And if there are 17,000, and there had been $66 million in benefits, plus other factors that go in, we figure that for each dollar of tax benefits it leverages about $15 in investment. And the overall cost is $1,500 to $5,000 a job, which is better than most public-sector kind of job programs.

Senator DASCHLE. I did not mean to interrupt. Ms. Burreson said something for which I find myself in complete agreement: you have got to track it. And I thought her answer implied that you could track it, and track it with a certain degree of accuracy.

The impression I have from what you have just said is that it is very difficult to come to any complete understanding as to the degree to which those jobs have actually been created by the incentive. Did I misunderstand what you said?

Lt. Gov. O'BANNON. Yes.

Senator DASCHLE. All right.

Lt. Gov. O'BANNON. I mis-explained, I guess. We know exactly how many jobs there are.

Senator DASCHLE. All right.

Lt. Gov. O'BANNON. We get that report all the time. It is whether those jobs would have come without tax incentives.

Senator DASCHLE. All right. I misunderstood.

Lt. Gov. O'BANNON. That is what we are trying to figure out.

Senator DASCHLE. All right.

Lt. Gov. O'BANNON. But if you give tax incentives and say, would those jobs have expanded in Portland or expanded in Evansville, IN, without tax incentives—that is where you are trying to make the determination, because probably some of them would.

Senator DASCHLE. Let me ask you this. Do you support providing benefits in cases where employees do not work within the enterprise zone? I should say do not live within the enterprise zone.

Ms. BURRESON. There needs to be a tie, yes. I am not opposed to saying that a company, if you decide you are going to set a 20 percent, a 30 percent, or whatever the number is—if you set it too high it will not work—I think the better way to go is to say that companies will not receive tax incentives to go with the tax credit route; that they, in fact, will receive the tax benefits for those people that they do employ.

Senator PACKWOOD. Now, say that again. I did not follow that.

Ms. BURRESON. All right. You are better off to offer a tax credit to a company who hires enterprise zone residents. Now, let me explain the reason for that. Let us take——

Senator DASCHLE. Well, that was my question. Let me rephrase it just to be sure. Should you exclude from any benefit businesses that hire employees who are living outside of the zone itself?

Ms. BURRESON. I see no reason to give them a tax benefit if they hire a non-zone resident.

Senator DASCHLE. So, the answer would be yes.

Lt. Gov. O'BANNON. Well, yes. If your purpose is to hire people in the zone, and that is your only purpose, you are exactly right. If your second purpose is to revitalize a distressed area, then you are not going to revitalize the distressed area. It is very, very difficult.

And Professor Alexis hit it on the nose: you are not going to do it with tax incentives. You have got to have a comprehensive community development program which emphasizes job training.

And, more important than that, that the people who cannot get a job now, many of them lack the basic skills; reading, writing, problem analysis; that type of thing.

That has got to be a part of the whole program. If you are going to do it just with tax incentives and set thresholds at a certain thing, I do not think it is going to work in very many places.

Senator DASCHLE. But you can see how whatever value there is in constructing a new business within a zone, how that might be offset—the benefit, that is—by employing people from outside, getting resources from outside.

What good, really, does it do that local community if everything is imported and exported? Then no vitality within the community itself is realized.

Lt. Gov. O'BANNON. Yes. In Indiana in the past 2 years, $400 million of investment. That is an advantage.

Senator DASCHLE. But an investment for whom?

Lt. Gov. O'BANNON. For jobs. Now, the key is to set the tax benefit for employing people who live in a zone high enough that that is who they will hire, and that is what we do in Indiana, although it has not worked as well as it should because we have only hired a little over 10 percent from the zone.

But it sure has revitalized the area, it sure has put investment in the community, and it has created jobs even for those outside the zone.

Senator DASCHLE. Would you not agree that it is important to discourage the hiring of people outside the zone, Governor O'Bannon?

Lt. Gov. O'BANNON. I would not say discourage, I would say encourage hiring the employees that live in the zone. And you encourage that with your tax incentives.

Senator DASCHLE. Let me ask you what you think the great shortcoming of enterprise zones has been, in your experience.

Lt. Gov. O'BANNON. Well, in Indiana, it is that we do not hire enough people that live in the zone, has been our biggest shortcoming.

Senator DASCHLE. That has been the problem?

Lt. Gov. O'BANNON. Well, because part of the intent of the State Legislation was to hire zone residents.

Senator DASCHLE. Yes.

Lt. Gov. O'BANNON. And we did not have a percentage like Jan had. We just have not been able to make it. If you hire zone residents, you get a tax advantage, and the zone resident also gets a tax advantage on his or her income tax.

Senator PACKWOOD. Well, there is kind of a balance here. If you say, hire only zone residents, you are not likely to get much development.

And if you say, do not hire any, just bring in the money and build whatever you are going to build and hire who you want, you are not hiring the residents.

You have got to have a balance here someplace. And Indiana has ended up being more model city-oriented than it has employment-oriented for the residents.

Lt. Gov. O'BANNON. That is probably right.

Senator DASCHLE. How do you strike that balance?

Lt. Gov. O'BANNON. Well, I think you should require an application from any city or any rural area that wants to establish an enterprise zone. And from that, it should come from a pre-existing local board that says these are the problems in this enterprise zone.

Now, you will find that they are different than they are in Portland than they are in Los Angeles. They are different in Gary, IN than they are in Evansville, IN.

But the local people are making that choice. They are going to tell you how they can leverage their plan if they have the tax benefits to bring in the job training programs through the JPTA, to bring local schools, to bring in day care centers, to bring in 20 more policemen that will make that zone work.

Ms. BURRESON. I think that you look at the mix of benefits that you are going to offer. I believe you need to accomplish two things in distressed inner city neighborhoods. Jobs is number one, but number two is community ownership of businesses.

So, I would support any Federal incentives that rewards those businesses who re-invest in themselves within that zone to buy new equipment. Secretary Kemp talked about entrepreneurship. Entrepreneurship and ownership of business by small minority concerns is important.

What it does not do by itself is it does not create the significant number of jobs, because, at least in my State, minority entrepreneurs are real small. They hire themselves, their wives, a few people. If that is the only tool you have, you are not going to address the bigger problem.

So, I think you need two things. You need to take a look at your check-list of Federal incentives that both encourage and reward the investment, the access to capital, at the same time which really do create an incentive for hiring zone residents.

Because, if you are in an area like Portland, which sees, in any given year, 30,000 people move in from other States because we are an attractive place, the jobs will not go to the inner city residents.

They will get the jobs last and we will be sitting here 10 years from now with the same people unemployed. So, you have got to do both and you have got to have a balance within your program.

Senator DASCHLE. Let me just ask you, finally, Governor O'Bannon. Leslie Papkey's study was interesting in its findings. It claimed that enterprise zone residents cost taxpayers on an average of $33,000. Do you share that assessment?

Lt. Gov. O'BANNON. Yes.

Senator DASCHLE. Is that an accurate calculation?

Lt. Gov. O'BANNON. Yes. Professor Papkey is very able and has an excellent report that we hired by our State board to do the reports for us. He looked at zone residents only, the 10 percent. That is the $33,000.

If you take the 17,000, it is between $1,500 to $5,000 a job. He also does not include the new investment, the $400 million in the past 2 years that has been attracted into the community zones.

So, he had a very narrow conclusion there on the statistics that he put together that was looked at. The intent of the legislation is to hire people in the zones and how much the tax benefits have been expended. And when you compare it to those, you come up with his figure of over $30,000.

But, actually, when you look at the whole development program and when you look at all the employees hired, it is between $1,500 and $5,000 a job which is very reasonable; generally under what public-sector job programs have been.

Senator DASCHLE. When you say all of the people employed, are you talking about all of the people in the zone?

Lt. Gov. O'BANNON. I am talking about all of the people who work in a business in a zone that gets tax benefits, which includes the 90-percent living out of the zone. Papkey's figure was based on 10 percent—the people that live in the zone—divided then into the $66 million of tax benefits.

Senator DASCHLE. So, what he is saying is——

Lt. Gov. O'BANNON. So, when you look at 100 percent, we are down to around $4,000, $4,500 a job.

Senator DASCHLE. His scenario is that you have got a business which comes to a zone, obtains all the benefits, 90 percent of those who work in the zone under that program come from outside the zone. So, only those jobs created within the zone are calculated. And if you use that calculation, it comes to $33,000 a job.

Lt. Gov. O'BANNON. That is right. So it is leaving out 90 percent of the jobs created by going in the zone.

Senator DASCHLE. But is it safe to assume that all of the jobs in that zone are now created, or are they shifted from another place from which a business may have moved?

Lt. Gov. O'BANNON. Well, let me say that we think it is not $33,000, but from around $4,500 a job. The Lilly Endowment, which is now run by John Mutz, who was former Lieutenant Governor and helped set up these enterprise zones, he had a study done and it said that Indiana exhibited unparalleled success at producing revitalization; the point we were talking about there.

Another study, Rubin and Wilder said that the program in Indiana has been cost-effective job generation, with lower cost per job levels than most public-sector programs.

And a third study, Elling and Schelding said, compared with the nationwide program, it is most successful in creating investment by expanding firms in the zone area.

So, I am mentioning the successes that have been very successful in Indiana, still pointing out the biggest weakness that it does not hire enough zone residents. So, that is where the tax advantage has got to be, to the employer and the employee, to hire more zone residents.

But, to do that, you have got to pull together training programs, apprentice programs that prepare people to work in any of those businesses in a zone area, and that is a nagging problem for all of us all over the United States that we have got to recognize that, and certainly expend our money.

And we are doing that with local enterprise zone association boards. The local boards are doing that, pulling in that element that will add to that success. And you will not do it with just tax incentives from the Federal level or the State level. It has got to be done locally.

Senator DASCHLE. Well, I have no further questions. Senator Packwood?

Senator PACKWOOD. A very, very good panel.

Senator DASCHLE. Governor O'Bannon and Ms. Burreson, thank you very much for your testimony and waiting as long as you did to testify.

Ms. BURRESON. Thank you.

Lt. Gov. O'BANNON. Thank you.

Senator DASCHLE. Our final panel consists of C. Eugene Steuerle, senior fellow of the Urban Institute; Chairman Greg Bourland from Cheyenne River Sioux Tribe from Eagle Butte, SD; and Terry Jones, the president of SYNCOM Capital Corp. in Silver Spring. If those three gentlemen could come forth, we will take their testimony.

Gentlemen, we are pleased you could join us. We appreciate very much your patience in waiting to appear before the committee this afternoon. We thank you for coming, and we will take your testimony at this time.

Let me call on my constituent and very respected chairman of the Cheyenne River Sioux Tribe, Chairman Bourland, for his testimony at this time.

STATEMENT OF GREGG J. BOURLAND, CHAIRMAN, CHEYENNE RIVER SIOUX TRIBE, EAGLE BUTTE, SD

Mr. BOURLAND. Thank you, Senator Daschle and members of the Finance Committee. As this is the first time I have ever testified before the Finance Committee, I would like to introduce myself in the proper, respectful Lakota tradition.

My name is Wambli Awanyankapi, which, translated, means "eagles watch over him." I am chairman of the Cheyenne River Sioux Tribe of Indians located in Eagle Butte, SD. I represent the Ohenupa Minekoju Sihasapa Enetosicho bands of Lakota Sioux.

Our tribe has long supported enterprise zones. Most recently, when Senator McKain introduced Senate bill 383, which is the Indian Economic Development Act, which was introduced and referred to this committee last year, that act had within it 12 enterprise zones.

Specifically, those zones were to be located on Indian reservations. I think they provided a lot of the tax incentives that have been discussed here today.

I come before the committee and I see this opportunity today as an opportunity to express not only my concern, but to relay information to the committee; information about the state of the Indian nations.

The basic state of our Nation is very sad, indeed. Indian reservations have tremendous, absolutely outrageous unemployment rates, in most cases, far exceeding 80 percent.

The Cheyenne River Sioux Tribe, for example, we have 3 million acres of land, 10,000 tribal members, and unemployment rates which exceed 85 percent. Where we were once a great, proud Sioux nation, we have been devastated and we have never enjoyed a piece of the great American dream, a piece of the great American pie.

I come before this committee today and I am very thankful that this committee is addressing enterprise zones. Because this same legislation that Senator McKain introduced last year unfortunately died in this committee.

When it died, some of my dreams for the Lakota people died with it; dreams of economic self-esteem for the Indian people on reservations.

But now that President Bush has reintroduced the concept of enterprise zones on a national level, and, upon hearing Secretary Kemp this morning explain that the enterprise zones may extend beyond the previous limit of 50.

And I see that the introductory statement of Secretary Kemp's written testimony mentions the Indian nations or the Indian reservations in there.

This is refreshing, and it does give me a lot of hope and encouragement. To be very cliche, I see enterprise zones as being part of the solution, not part of the problem. They are not the overall solution, indeed.

Senator Simon introduced the Job Training Consolidation Act last year, which, again, is an integral part of the solution to train the untrained or the unskilled labor, not only on Indian reservations, but overall.

I believe, unlike some of the others who have testified before me, that on an Indian reservation you are going to see high percentages of individuals who will be employed. I think we just heard a gentleman say that only 10 percent out of that enterprise zone. I believe you will find on an Indian reservation it will be far in excess of 50 percent of the people in that area will be employed in that zone.

I would like to conclude—and I realize it has been a long day, so I am going to conclude at this point—by saying that it was only 2 short weeks ago that I sat on the south lawn of the White House and I listened to President Bush initiated the Healthy Start Program.

I heard it mentioned here today about the Healthy Start Program. And our reservation is one of the only tribes—matter of fact, we are one of the few tribes in the whole United States—to have a Healthy Start Program.

But that initiative, the Healthy Start to deliver the fetus clear through the phases of pregnancy and produce a living, healthy child. But that healthy child has got to have something to look forward to.

And that something has got to be long-term employment and economic stability. I believe that the enterprise zone bill can be an economic healthy start program for the entire United States.

I heard it mentioned about Head Start today; Head Start taking the toddlers and instilling in them basic skills that they will need throughout life.

But if those skills are going to be cast aside because that child has nothing to look forward to but food stamps, welfare, and government subsidies, then I believe that something is very wrong with our system.

I believe that the enterprise zone program can be a head start—an economic head start—program for, again, the entire United States. I support the passage of this legislation, and I thank you very much. I made it just on time. Thank you very much.

[The prepared statement of Mr. Bourland appears in the appendix.]

Senator DASCHLE. Thank you, Chairman Bourland.

Dr. Steuerle.

STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Dr. STEUERLE. Thank you, Senator Daschle. Today the Nation may be experiencing what I believe is a beginning stage of a fundamental shift in the way it thinks about and adopts programs to improve social welfare.

In recent years, it seems to me, are witnessing and attempt to shift the balance back toward worrying about what people do rather than simply what they are.

There is a re-emphasis on investing in people, not merely caring for them; on a quality of opportunity, rather than simply result; and provision of preventive care, rather than acute care after problems have festered.

In many ways, I am excited about the potential contained within the shifting of emphasis. When I put on my research hat, however, I am compelled to admit that what we know is quite limited.

Even among existing programs, such as earned income credits, targeted jobs credits, and work requirements in welfare—provisions, generally, that I support—there are a number of significant difficulties that have not been ironed out and the jury is still out on the success of many of these efforts.

Enterprise zone legislation attempts to place itself in the midst of this emphasis on opportunity. But it attacks problems on a spatial or geographic basis.

Such legislation should be aimed at eliminating disadvantages rather than creating new sources of discrimination or distinctions in the expenditure and tax laws.

In point of fact—and this is one of the great difficulties—such legislation cannot help but create certain inequities and inefficiencies because it tends to define eligibility on the basis of geographic location.

For example, it might serve some in a geographic area who are less worthy than those who reside just over the boundary. Or it might give a tax break to capital owners who operate on one side of a street, but not to those who are on the other side.

Because of the special distinctions created by spatial and geographic boundaries, this type of program can probably only be justified on the basis of either experimentation or of trying to achieve sufficient mass in attacking a problem.

This is an extraordinarily important point, because if enterprise zones are not set up properly, either as an experiment or to conduct a more massive assault on problems, then they are likely to be failures.

Especially troublesome would be enterprise zone legislation that tends to limit the mobility of the poor, subsidizes providers and current owners of assets, subsidizes intangibles, allocates benefits through pork barrel politics, creates a dependency relationship, finances through hidden or deferred budget costs, or is merely a smorgasbord of tax breaks that have only loose relationship to the problems supposedly being addressed.

Many existing welfare programs—for instance, public housing as opposed to portable housing vouchers—tend not to tear down walls, but to maintain them.

A great danger for enterprise zones is that they must not appear simply to throw trinkets over a wall as long as people remain segregated on the over side of the wall.

Thus, we do not want to set up programs that might discourage someone from looking for the best job, wherever its location.

As another example, another danger for enterprise zone legislation is that the monies will be dissipated before ever reaching intended beneficiaries.

Thus, many capital gains proposals would increase the value of land for existing owners and make it more expensive to start a business in an enterprise zone area.

Some efforts, such as Head Start, Weed and Seed programs, and summer youth job programs are therefore worthy of strong consideration because they do not have these problems.

With respect to taxes, both explicit and implicit, difficult choices are required to expand opportunities for home ownership for low-income individuals and to remove the strong signal sent by our tax and welfare laws that a low-income welfare recipient who works or marries is going to be poorer as a result.

As I am sure this committee is aware, the signals and symbols set by our tax and welfare laws is quite clear. If you are poor and have children, do not marry. And if you are going to work, work off the books.

If a typical single parent on welfare with two children would be so bold as to marry a minimum wage worker, for instance, their combined income would have to be reduced by about $4,700, or close to 30 percent.

Tackling these problems in housing and in welfare and tax programs, however, requires a much more extensive effort than is being considered today. The difficulty facing this committee is to try to decide how to prevent enterprise zones from being nothing more than a frayed patchwork on a system in need of major re-design and overhaul.

This takes me back, again, to arguing that the legislation must be aimed either at experimentation or as a massive attack on particular problems in selected areas.

Perhaps the most important experiment that could be performed with enterprise zones would be to try to create significant job opportunities for both women and men, as well as jobs and activities for youth after school and during the summer, although I do not want to pretend that job subsidies are sufficient to meet all needs, or even easy to design.

In the end, the successful enterprise zone initiative will be one where local residents, community leaders, and civic officials combine to conduct massive attacks on a variety of related problems.

The amount of resources—effort, time, money, commitment—that they require are quite large, so the modest amount of revenues being considered for Federal enterprise zone legislation can, at best, serve as a catalyst for those more important local efforts.

Finally, let me add, Mr. Chairman, that any experiment, no matter how good its initial design, will fail if it is not properly evaluated.

I hope this committee will give strong consideration to setting up an evaluation design before the start of the program rather than afterwards, in particular because many ex-post evaluations tend to try to justify what has already occurred. Thank you.

Senator DASCHLE. Dr. Steuerle, thank you very much for your testimony.

[The prepared statement of Dr. Steuerle appears in the appendix.]

Senator DASCHLE. Mr. Jones.

STATEMENT OF TERRY L. JONES, PRESIDENT, SYNCOM CAPITAL CORP., SILVER SPRING, MD

Mr. JONES. Thank you, Mr. Chairman. I am glad to be here and be able to offer my testimony, which is submitted in written form into the record today. And I will, rather than read that testimony, talk to you more or less off the top based on what I have heard today, as well as on what I have come to believe.

By way of introduction, my name is Terry Jones. I am the president of SYNCOM Capital Corp., which is an investment company, a venture capital company located in Silver Spring, Maryland.

I have been in the venture capital business for the last 15 years. I, and my colleagues invest exclusively in minority "small" businesses. We now manage assets in excess of $55 million, having started in 1977 with less than $2 million in capital to invest, specifically in communications properties to be owned by minority individuals.

We have grown the company over that period of time because we have been able to tap into and address a vast pool of minority entrepreneurs—black, Hispanic, American Indiana, and others that existed and still exist—who are badly in need of capital.

As a practitioner, therefore, who, every day works in the business of investing capital in the kinds of enterprise zones that you are talking about here, I really want to talk about what I believe are the realities that will, in my experience and opinion, either make capital flow, either create jobs or not create jobs from an investor, from an employer, and from a business operator's point of view.

As I said, one fact that I can establish is that there exists a vast pool of entrepreneurs in the cities of this country, in rural areas of this country, on reservations of this country, who do not have access to capital.

The ones that I am concerned about, the ones that I finance and work with, are minority entrepreneurs. These people want what any entrepreneur or businessman wants, and that is the ability to operate a for-profit business basically in a free and open manner without restrictions, without red tape, without tests, qualifications, et cetera, et cetera.

And, when allowed to do that and provided with capital, these people, with their human capital and with the financial resources we and others in our industry put behind them, create miracles, create jobs, create enterprise zones, create wealth, create tax bases.

The fact is, there already are enterprise zones. There are what I call natural enterprise zones. Silver Spring, Maryland is a natural enterprise zone. Reston is a natural enterprise zone. Anywhere business tends to operate with vitality is an enterprise zone.

What we are talking about today seems to be the creation of legislated enterprise zones to compete with or to operate alongside these natural enterprise zones.

And for that to work, these legislated enterprise zones have to be relatively as attractive, or more attractive, for the capital that is now flowing to natural enterprise zones to flow to these legislated zones, or it will not flow.

Those zones have to be as attractive for a businessman to operate and set up shop there, or he will not set up shop there. Or he will set up shop there initially for some benefit, but, because of the cost and other disincentives of being in that zone, will not last.

So, there already are zones. And the structure to create these new zones have to be measured, it seems to me, relative to the zones that already exist, the market places that capital now flows toward.

There is often the perception in the inner cities and in rural America that there are not dollars for minority deals. We are really talking, by and large, about a scarcity of money for minority businesses. Generally, dollars do exist for ventures in this country.

Between 1980 and 1990, venture capital dollars for investment rose from about $6 billion to $36 billion, and that money was invested in startup businesses and other venture capital financed enterprises in this country.

Unfortunately, only about $10 million of that $36 billion, or about one-thirtieth of 1 percent—which is mentioned in my testimony on page 4—flowed to minority businesses.

Our industry, which was created by an act of Congress, I believe by an executive act after the Watts riots of 1966 and the other problems in the late 1960's, was set up to address the capital needed to create businesses in areas such as the zones we are talking about.

And that program that still exists today is the Small Business Investment Program. Specialized small business investment companies, or what used to be called MESBICS, exist. They exist in most markets and in most major cities in this country, even in rural areas of this country.

And the network of these investment companies have at their disposal venture capital executives who can efficiently aggregate the capital we are talking about, incentivizing the flow, and efficiently invest it in enterprise zones and enterprises.

I will wrap up and let you, perhaps, ask some questions, if you want, by saying that it seems to me what we are talking about here is creating a "field of dreams."

Some questioners, it appears to me, want to have assurances that that field will have this type of ball player in it—i.e., certain residents employed, this kind of non-player, i.e., not the guy from outside who can make a windfall profit—before they will create the field.

I believe enough in the American system to believe that if we create the field, probably most people will play by the rules; probably the creativity of the entrepreneurs of the businesses in that area will create the dynamic growth that will create jobs without those jobs being regulated or legislated, if they are given a free hand.

In summary, I believe that what we are talking about here is the efficient aggregation or pooling of capital, and then the professional investment of that capital into enterprise zones and businesses.

I believe that the existing small business investment community is a natural place that those funds should flow towards. Therefore, there should be tax incentives to provide investors the ability to invest their dollars in professional small business or minority investment companies who, then, would invest those funds efficiently into the businesses in either zones or in minority business enterprises, generally.

I will stop on that point and again refer you to the testimony which perhaps a little more coherently describes my views.

Senator DASCHLE. Well, I thought you were very coherent, Mr. Jones.

Mr. JONES. Thank you.

[The prepared statement of Mr. Jones appears in the appendix.]

Senator DASCHLE. Thank you for your comments, all of you. Let me clarify a point you just made that caught my attention, because I share your observation. I do not know if I share your perception of what you consider to be the lay of the land.

The observation you made is that you anticipate most Americans will play by the rules. I think that is accurate.

Mr. JONES. Yes.

Senator DASCHLE. I guess the concern some of us have is that the rules could be written in such a way so as to really make a mockery of this whole tax tool.

And I say mockery just based upon the situation described by the prior panel wherein you have a business which really moves its entire operation to an enterprise zone, maybe picks up an extra 10 percent additional employees, and has a gargantuan new tax break that they can apply to their operation that they did not have before, creating what was described by the study by—I do not recall the man's name—wherein you have about a $33,000 per person cost to the Federal taxpayer.

I mean, that is the kind of rule we want to avoid to the extent we can. We do not want to create a situation that is so lucrative for a business with such minimal impact within an area that this whole thing, for what little it draws back into the enterprise zone, is too costly and has very minimal effect. Would you not share that concern?

Mr. JONES. No, I do not share it. First of all, I do not believe the incentives we are talking about are all that gargantuan.

Senator DASCHLE. Would you not say that $33,000 a job is gargantuan?

Mr. JONES. I do not understand or have any opinion on that figure. I really do not know where that comes from. And I think even the gentleman described that it was not——

Senator DASCHLE. Well, let me describe it for you. It was the entire amount of tax break the business was entitled to, divided over the number of new jobs created for people who live within the zone.

Mr. JONES. But, on the other hand, if that business that settled in that zone now creates a tax base of, I do not know, $10 million a year for which the local government gets 10 percent, was that taken into account? That money did not exist before.

What we are talking about is creating opportunity, creating business, creating jobs. If that is created, you have to believe, if you believe in this system, that social good flows.

You cannot legislate, in my view, or regulate that social good. You should not say that, in order for you to qualify, you have to have this many employees, X, Y, and Z.

Remember, we are talking about marginal decisions of where to locate, where to invest. A businessman will invest where he can—

and I believe this is why we want private-sector involvement—make the most profit and operate the most efficiently. Right? And if he can operate efficiently by hiring local people, he will.

I believe, in fact, that the experience described earlier was that most of these businesses find that, by locating in the Indiana enterprise zones, they reduce their costs by hiring local people than they do outside. It is a market-driven decision. You cannot, in my view, legislate it correctly, effectively, or whatever.

Senator DASCHLE. Well, you see, it is not just market-driven, because we are talking about tax dollars here.

Mr. JONES. Well, are we?

Senator DASCHLE. Yes, we are.

Mr. JONES. In what form?

Senator DASCHLE. We are talking about a substantial investment here.

Mr. JONES. We are talking about potential tax dollars. We are talking about capital gains relief if the gains are created, one.

Senator DASCHLE. We are talking about a $2.5 billion operation per year.

Mr. JONES. Well, I am not talking about a specific bill. I am talking about creating incentives that redirect money, capital, which exists in this economy towards the communities that we all describe as needing capital, saying that what exists in those communities are entrepreneurs; what exists in those communities is the potential for a labor base; what exists in those communities is a need for revenue from taxes.

If that capital finds a relatively attractive reason to direct itself to those communities, good will flow, or it will not. I believe it will. I think that is the premise we are all operating under.

Now, the other problem is, how does that money get effectively invested? There seems to be a lack of specifics in understanding of what happens in the creation of a business.

Just because you create tax incentives it does not mean that someone from outside who can get a $50,000 expensing of his or her investment will come and invest in Joe's Printing Shop in the barrio. That is a very inefficient way to believe that an enterprise will develop.

It is much more efficient to believe that there are vehicles that exist—i.e., specialized small business investment companies, which happens to be a Federal program already in place, a public-private sector model that works and has been there for 20 years—and if that money is directed, for example, into those funds that are managed by professional investment private venture capital managers and they, then, are incentivized to invest in businesses, work with those managements, provide the kinds of returns to the $50,000 investor who wants to invest and take advantage of this. If this happens. Incredible amounts of capital can flow. If it does not happen, all of the things in the marketplace that do not exist to create that link between the capital and the entrepreneur will prevent the flow of capital to these businesses.

And I am here to bring that view to this committee, that there is a link that needs to be understood and established as being necessary to create enterprise.

And that is the ability to aggregate capital efficiency with incentives, and the ability to deploy that capital professionally and prudently by venture capital investment managers.

And unless those two are tied together, unless those are made a part of legislation, I believe you are going to end up with the fears of many people that there will be some sort of bureaucracy that will try to legislate the way this thing should work.

Senator DASCHLE. Well, the question is, what is prudent deployment and prudent investment?

Mr. JONES. Prudent management are people who are required by their investors, the people that they get money from, to provide a return or they do not get money to invest.

Senator DASCHLE. Now, that is not prudent investment from a taxpayers's point of view. From a taxpayer's point of view it is how do we, as policymakers, create the kind of opportunities through public policy to create jobs, to create the kind of economic vitality that you have heard so much about all through this hearing. That is the real issue.

Partly it is market-driven, partly it is budget-driven, partly it is driven by choices that we have to make in public policy. It is multifaceted. It is not just a question of what makes the most sense in terms of the bottom line from a profit point of view. It has a lot more consequence than that.

And what I thought I heard you say is that it really does not matter whether an employer hires 100 percent of people who work outside the zone, or whether that employer hires all the people inside the zone; that is a market-driven decision the employer has to make. And I am saying I disagree with you. Because I really think that there is a fundamental choice here that has to be made with regard to how much it is worth, per job, in tax dollars to create the kind of economic vitality we are talking about.

Chairman Bourland.

Mr. BOURLAND. Yes. I would like to add maybe a new perspective to what is being said here. I think when you look at the administration's presentation, and what appealed to me about the most recent proposal was the fact that it does somehow make a distinction between urban and what I would like to call semi-urban—your smaller cities—and, of course, rural. And, of course, in our case, we are very rural, which is the Indian reservations.

And I realize that there is a fear that there is going to be an excessive burden to the taxpayers and that enterprise zones could be established and that big business could come in, say, move from a place like St. Louis to an Indian reservation, establish a big plant, hire all outside people, and the Indians would still be poor.

I guarantee you that on an Indian reservation—and I cannot speak for the urban or other rural settings—I really do not feel it is going to be nearly as a big a burden to the taxpayers as the current social programs on reservations.

And, of course, my other fear is some of the other ways that we go about on Indian reservations in this day and age of having to acquire our revenue to survive on.

Senator Pressler said at a hearing about a week or two ago that Indian reservations are becoming the dumping ground for nuclear wastes, the place where people want to dump their solid or nuclear waste. And that is very true.

Or Indian reservations are the places that people go to gamble, or to play Bingo. Well, I have said it before and I will say it again, I will take a factory any day over a casino. And definitely there is going to be no nuclear dump waste sites within the boundaries of our reservation.

But I think that the one point that I did not hear brought out here today at the hearing is something that, I do not know, maybe everyone has taken for granted. And that is, where are all the jobs currently located? The low-paying jobs, the kind of jobs that people in the inner cities, rural areas, and the Indian Reservations can do?

Where are they? They are all overseas. They are gone. I look around, I see all these cameras here. I see some video recorders. I have owned a video business since 1985.

I guarantee you, not a single one of these cameras or any of this equipment is made in the United States today. There is none. Not a color TV, not a boom box; nothing. These microphones, made overseas.

All right. Why is that? Think about that. Because those low-paying jobs, either nobody wanted them, or, let us face it, they were unioned to death.

I do not want to bring the unions down on this committee, but, let us face some simple facts. People on the reservations will work for $4, $5, $6 an hour, and they will be quite thrilled with those dollars.

They will get off the welfare rolls and they will get on to the income tax rolls. And they will be able to take that $6 an hour salary and put this microphone together or build those cameras. And it is our hopes and dreams on the reservation—and I have met with a couple of industrialists; one is a mutual friend of ours.

We have discussed bringing industry back home; bringing industry back from Taiwan and the Dominican Republic, and some of the other areas, Mexico, to do some of the menial jobs that nobody else wants to do in this day and age.

They may be menial to some people in the United States, but they will put bread and food on the table of Indian families on the reservations.

Senator DASCHLE. Let me ask you something, Chairman Bourland.

Mr. BOURLAND. It is my concern that hopefully we can accomplish that, bring some of the jobs home.

Senator DASCHLE. Let me just ask you something. You are a very strong advocate of the Buy Indian concept, I know. We have talked about it, and that is the law of the land, that we maximize the opportunities for Indian employment with programs at the Federal level where Federal dollars are used. Here, you have got an enterprise zone program which would, for the first time, not be Buy Indian.

In fact, what some advocates are saying—and do not get me wrong, I do not want to be misunderstood; I am an advocate of enterprise zones. I think we just have got to be very careful as we draft this legislation so as not to create something that none of us really want created a couple of years from now.

But I envision the menial jobs going to the Indians and good paying jobs going to people who are imported into the zone just to take advantage of the enterprise zone concept.

How will that make Indian people feel when any time a high-paying job is at stake people are brought in and Indian people are told, "well, you ought to be happy with that because that is going to create economic generation."

The claim will be that the situation is going to create economic vitality. Never mind that 90 percent of the jobs are not Indian. They'll tell you the fact is, it is a factory right there, and you may get some revenue from it. So, be happy with that.

I would be very amazed if any tribal chairman would be very happy with that. But that is what we are told now some of these zone governmental leaders ought to be happy with. And I would be interested in your reaction to that.

Mr. BOURLAND. Yes. First off, I would like to say that I see it two ways on the reservations. One, is us developing our own enterprises. Naturally, I see that, if it is developed with Indian dollars, the bulk of those employees will be Indian.

I think that it is probably a sad fact of life that if an outside industry comes on the reservation, the bulk of upper management, middle management personnel are going to be, so-called, exported in.

But I think that this company is going to discover something very quickly on the reservation. We have a lot of trained, college-educated people on the reservation living on welfare.

Many of these individuals have business degrees in administration, management, you name it. This all comes from the years of social programs. Let us send them off to school and educate them.

All right. We have got some very well-educated people on the reservation. They come back to the reservation and they are unable to find a job on the reservation. I can give you an instance of one individual living in Green Grass, SD who has a degree in Business Administration and has spent the last 10 years on social services programs.

Why? Because her elderly mother lives there. In our traditional way, we take care of our elders. She is taking care of her mother until her mother passes on.

This, I realize, is socially different than the norm of the rest of the United States. But we have got to somehow blend that. I think that if the company that wants to locate on a reservation is really sincerely interested in an area, they will sit down with tribal leaders and they will have to realize some of the social differences, some of the cultural differences.

But I think that business, overall, is used to this. After all, they had to go over across the seas and get used to Taiwan or working in the Hong Kong markets, or a number of the Oriental markets. And those markets, of course, were culturally different.

Getting used to the work habits and lifestyles of those people, in many cases, may be very similar to what they will encounter on the reservations.

Senator DASCHLE. Dr. Steuerle, let me just ask you a final question. Given your experience and the concerns you expressed in your testimony, do you think that there ought to be an effort to rely more on wage-based incentives, such as wage credits, or capital incentives, like accelerated depreciation or even capital gains? Which, in your view, would be the most effective kind of incentive?

Dr. STEUERLE. Well, Senator, in terms of both your question and the previous discussion, it seems to me what we are talking about is opportunity cost.

Thus, even if every single enterprise zone initiative that we could put forward would work or do some good, we still want to find out which proposal does the best, which proposal gives us the most bang per buck.

And if we have one that gives more bang per buck than another, then we do not want to do the latter, no matter what its success or its failure.

In that sense, I think the usual rule of thumb is that you want to target the benefits at those people whom you want to help most directly. So that it is better, for instance, to give a wage subsidy to the people you want to help, whether in an Indian enterprise zone, or in an urban area, or a rural area. You want to target the people.

If you give the subsidy in a blanket way to someone who interacts with the intended beneficiaries—say, through a capital gains tax break for owning a house nearby, or for some related investment—it is less likely that that money is going to inure to the benefit of the people you want to help.

So, in that sense, I believe very strongly that this committee ought to turn in the direction of wage subsidies. Although I cannot guarantee that all wage subsidies work. I do not want to state the case absolutely.

As I say, research is very mixed on many of the effects. But I think a wage subsidy has potential of being much better, as both of the previous speakers mentioned, than a number of welfare programs.

So, in that sense we are going to get more bang for buck with a wage subsidy, and I think it is going to be more effective than many of the capital subsidies. I would put my money basically behind wage subsidies.

Senator DASCHLE. Well, very good. It is a good answer. Yes, Mr. Jones.

Mr. JONES. Yes. I did not want to be misunderstood with regard to your concern about local employment. I guess the point I am trying to make, though, is I believe, based on my experience in venture capital and business capital investing and generating capital for the last 15 years, that what happens is that this natural pool of human capital that exists, as you described on your reservation, that I know exists because I have invested in it successfully—our companies have—for the last 15 years in the inner cities, will, in fact, be employed if you provide the opportunity for businesses to locate there because it is relatively attractive to operate there.

Not because they are required to do any particular thing other than, if you are talking about enterprise zones, to invest in that zone. And if that investment is to be made and managed professionally and is deployed by professional investment managers, then the returns will happen, which will again generate more capital, because capital will seek returns.

And the vitality that you are talking about, which none of us will be able to describe exactly how it will or will not happen, will probably happen because of the laws of the marketplace. Relative attractiveness will prevail and capital will flow, jobs will be created, people will be hired, without any of us legislating them.

Senator DASCHLE. Well, I appreciate your answers, and I find them very helpful. You have made an important contribution to this debate. I am sure there may be additional questions in written form that some of you may be receiving in connection with the hearing this afternoon.

But, again, my thanks to each of you for your persistence in waiting this long to testify, and for your excellent presentations this afternoon. With that, this hearing stands adjourned.

[Whereupon, the hearing was concluded at 3:35 p.m.]

APPENDIX

Additional Material Submitted

Prepared Statement of Marcus Alexis [1]

Mr. Chairman, members of the committee, my purpose in testifying today is to report what has been learned from the experience of 37 States and the District of Columbia with respect to the efficacy of enterprise zones in stimulating private investment and job creation. The record is mixed; there have been successes and failures. We can learn from the successes and possibly replicate them in a Federal program. The failures can also be instructive; they can pinpoint mistakes that are to be avoided.

One of the difficulties with enterprise zones is that in practice they are quite heterogeneous; there is great variety in stimulus packages, administration and potential for success in the more than 200 enterprise zones in operation. In some cases enterprise zones have been used as a means of invigorating the economies of distressed areas; in others, the use of enterprise zones has been a tool of state economic development—to attract new industry or to dissuade exodus. This mixture of purposes accounts in part for the generally lukewarm evaluation accorded enterprise zones.

The prevailing view among academics who study firm location decisions is that tax credits and incentives designed to reduce capital costs do not significantly influence where firms locate. The size of these incentives is relatively shall compared to other economic considerations—an ample supply of productive labor at competitive wages, proximity to customers and suppliers, attractive transportation alternatives, affordable land and construction costs, and necessary infrastructure. Tax incentives emphasizing reductions in income and property taxes without commensurate incentives to hire zone residents or disadvantaged workers can easily become windfall profits and create few, if any, new jobs.

Properly constructed, a tax incentive package can be an inducement for firms to select some locations over others, at least at the margin. Capital subsidies are likely to be attractive to firms with relatively high capital requirements, i.e., manufacturing. The better paying nonprofessional jobs are in manufacturing. But experts question the ability of enterprise zones to attract manufacturing concerns. And capital subsidies for non-manufacturing firms are of much less value.

Though all State enterprise zone programs are targeted and require some distress measures for zone designation, a study of enterprise zones in Illinois in the December, 1990 issue of *Chicago Enterprise,* the publication of the Civic Committee of the Commercial Club, an organization of the CEOs of major Chicago businesses, cited a study of the Illinois Tax Foundation.

> . . . nowadays, much of non-rural Illinois is an enterprise zone. The list includes poor or job starved communities such as East St. Louis, Maywood, Decatur, Cicero, and much of Chicago's west side. It also includes areas that are, if not affluent, comfortably prosperous—Champaign-Urbana, Elgin, Springfield, Bloomington, and Hoffman Estates.
>
> . . . enterprise zones that cover such mega-projects as the Sears Development in Hoffman Estates or the Diamond Star auto plant in Normal are created by legislative decree. Four of the state's 82 zones were born that way.

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[1] Board of trustees professor of economics, professor of management and strategy, Center for Urban Affairs and Policy Research, Northwestern University.

> . . . the Taxpayer Foundation study asserts that "after three to five years' experience with the operation of enterprise zones, local officials and business community leaders tend to think of enterprise zones almost exclusively as a general economic development tool rather than an antipoverty or targeted program."

An inescapable conclusion is that some programs are more targeted to disadvantaged workers and others focus on encouraging investment and economic development. Zones in Illinois do both.

Surprisingly, only a few of the states' program statements of intent mention neighborhood revitalization and community redevelopment as explicit goals of the enterprise authorization. Also, though a fundamental concept of enterprise zones is minimization of governmental intervention, in practice there is little regulatory relief.

Michael Allan Wolf's op-ed article in the June 1, 1992 *Wall Street Journal*, "How to do Enterprise Zones Right," is in many ways a thoughtful, even insightful reading of the enterprise zone literature. He is incorrect in suggesting, however, that baseline studies which measure the *incremental* effects of enterprise zones have not been made. A rather good one is reported by Rodney A. Ericson in *Sources of Economic Growth* (1992). Ericson finds:

- Enterprise zones are not panaceas for economically distressed areas
- Notable improvements were made in many zones
- There is a limited number of high performers and many more that have achieved far less success
- The typical zone attracts investment of several new and expanding businesses
- Zones are less successful in preventing contractions and closures than they are in attracting new investment
- The median number of job gains resulting from the new investment is 175, the average is 464 per zone between the time of designation and the survey year, either 1985 or 1987
- Average new capital investment in the zones was $23.4 million; the median was a less impressive $4.5 million
- More than 30 percent of the sixty-six zones for which baseline employment data were available had gross annual growth rates higher than the U.S. economy as a whole
- An average of nearly nine new establishments were formed more than nine existing establishments expanded, but fewer than two contractions or closures were prevented. The median numbers were lower. But large numbers of jobs were saved in the contractions or closures prevented
- Firms investing in the zone were neither large nor relocations from outside the zone. Relocations were only 9.1 percent of the investing establishments
- Average increase was 46 jobs per establishment
- Manufacturing firms dominated the set of investing businesses, representing nearly 73 percent of all job gains

Ericson's findings with respect to state enterprise zone policy are also noteworthy:

- States that designate a large number of areas do not do as well as states that target a small number of areas
- A large number of investment or job creation incentives in the enterprise zone package is a positive inducement for firms to locate, expand or retain operations in the zone
- Pennsylvania's coordinated packaging of existing state incentives and services (achieved without special enterprise zone legislation) was strongly associated with zone job gains
- Zone performance was not related to general regional economic development
- Zone growth was positively related to having a prevailing industrial land-use character
- High minority population was not an impediment to zone investment and job gains
- Sunbelt zones did grow faster
- Little support for creating zones in non-metropolitan areas

High performance zones—average of 10 or more firms investing per year and with 150 or more jobs created or saved per year had in common:

- Could not be described as "irretrievably derelict"
- The enterprise zone programls direct effect was marginal but catalytic in conjunction with other development programs

- Incentive package was significant enough to get business people's attention and focused on one or a few major incentives
- Strong local participation of local and business interests

A general finding is that enterprise zone programs cannot be free-standing; they must be part of a larger development package that involves several line agencies. The enterprise zone incentives must be sufficiently attractive to achieve visibility for the area and development package, but not so large as to induce establishments from other areas or from a depressed perimeter around the zone.

RECOMMENDATIONS

The Federal Government should learn from the experience of the state enterprise zone programs:

- Federal programs should limit the number of zones, initially.
- Each zone should receive sufficient stimulus in a package of tax, cost saving and employment creating incentives to foster start-ups and expand existing establishments within the zone.
- Zones should be targeted to distressed but salvageable areas.
- Program incentives should be directed toward employing area residents and encouraging local businesses.
- Zones should include job training and retraining programs, counseling, day care, health benefits and incentives to welfare recipients and discouraged workers to reenter the job market.
- Areas in the zone and on the periphery should receive additional resources to reduce crime against persons and property.
- Provisions should be made for the active involvement of local and state agencies and local business people to identify needs and to deliver services and incentives.
- Initial programs should be in distressed sections of metropolitan areas.
- The program should encourage minority business participation.
- Encouragement should be given to the six point program announced on May 12 by the Federal Reserve Board to help rebuild areas of Los Angeles and other cities affected by the recent civil disturbances (attachment).

The Federal Government can play an important role in revitalizing our urban areas. The lessons from the states is clear. Enterprise zones can be a positive element in a national urban policy. But enterprise zones alone will not do the job required. Coordination of federal, state and local programs targeted to distressed areas is essential. Viability of revived areas will require complementary job training, child care and health programs. Attention must also be paid to infrastructure needs and to providing a safe crime-free environment. There is much that cries out for attention in our cities; enterprise zones can contribute to get this country going in the right direction.

ATTACHMENT

FEDERAL RESERVE PRESS RELEASE

[May 12, 1992]

The Federal Reserve Board today announced a series of steps designed to expedite the provision of financial services and help rebuild areas of Los Angeles and other cities affected by recent civil disturbances.

Steps include a supervisory statement adopted by the Federal regulatory agencies regarding banks and thrifts that are working in a constructive and prudent fashion with borrowers experiencing temporary difficulties.

The statement from the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Office of the Comptroller of the Currency and the Office of Thrift Supervision says that efforts to restructure debt or extend repayment terms—so long as these efforts are consistent with safe and sound banking practice—should not be subject to examiner criticism.

Other steps approved by the Federal Reserve include:

1. Investments in the affected areas by state member banks located outside those areas will be taken into account when assessing CRA performance and evaluating applications submitted to the Federal Reserve.
2. Provide human resources to the Ueberroth program and provide space, to the extent possible, at the Los Angeles branch of the Federal Reserve Bank of San Francisco.

3. Support the development of a multi-bank community development corporation to focus on south central Los Angeles. This corporation would provide technical assistance, loans and equity investments for small business which are rebuilding, relocating or expanding in South Central Los Angeles.

4. Seek passage of an amendment to the Federal Reserve Act to grant clear authority to state member banks to make equity investments in community development projects and corporations. Presently, bank holding companies and national banks are authorized to make debt and equity investments in projects and corporations for public purposes such as low-income housing, small business development and job creation.

5. Develop and sponsor training programs for bankers and members of the community on the specific programs that will be available to business and property owners who are rebuilding in Los Angeles.

6. Expedite the applications process for state member banks and bank holding companies that are expanding into the affected areas or are undertaking new activities designed to assist in the economic redevelopment of affected areas.

Prepared Statement of Senator Lloyd Bentsen

There is a growing consensus, in the wake of the Los Angeles riots, on the need for incentives to spur job-creating investment in America's economically troubled areas.

Investors are fleeing our inner cities and jobs are following them. Unemployment was 13 percent in south central Los Angeles last year, nearly 50 percent in some pockets. The same kind of disproportionately high jobless rates are to be found in city after city across the land, as well as in rural America, such as the area along our border with Mexico, where wages are among the lowest in this country.

One potential tool for helping turn this situation around is the creation of enterprise zones, with tax incentives to encourage investments that will create jobs in economically distressed areas. Congress, in fact, voted to create enterprise zones as part of tax legislation it enacted last March. That legislation was vetoed by the President, but I believe we need to try again.

I intend to introduce legislation in coming days to create enterprise zones, but with a difference. While existing proposals are aimed at steering investment to specific places, my bill will focus more on the people who live in those places. My primary goal will be to create jobs for residents of enterprise zones. The families who live in these areas—not the outsiders—should be the beneficiaries of these tax incentives.

Enterprise zones by themselves are no panacea. If we had created then last March, as Congress proposed, that would not have prevented last month's riots, and enacting a bill this summer won't resolve all the economic and social problems that afflict America's cities.

But enterprise zones can serve as a down payment. They can help provide the investment that is needed to create jobs and boost development in some of America's most hard-pressed areas.

The need for action is clear and now is the time to start. Working together, Congress and the President can enact legislation that will offer a helping hand to millions of Americans in troubled areas. I look forward to hearing the perspectives of our witnesses today on how to best accomplish that goal.

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[JOINT COMMITTEE PRINT]

PROPOSALS AND ISSUES RELATING TO TAX INCENTIVES FOR ENTERPRISE ZONES

SCHEDULED FOR A HEARING

BEFORE THE

SENATE COMMITTEE ON FINANCE

ON JUNE 3, 1992

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

JUNE 2, 1992

U.S. GOVERNMENT PRINTING OFFICE
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JCS-12-92

INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on June 3, 1992, on issues relating to enterprise zone tax incentives.

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, provides a description and analysis of enterprise zone proposals contained in several introduced bills. Part I is a summary. Part II is a brief description of related present-law provisions. Part III is a description of the enterprise zone provisions contained in S. 2217, S. 1920, S. 1603, S. 1032, and H.R. 4210, and other proposals relating to enterprise zones, including S. 686 ("Rural Business Revitalization Act of 1991") and S. 383 ("Indian Economic Development Act of 1991"). Part IV discusses issues relating to proposed tax incentives for economic activity located in enterprise zones.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Proposals and Issues Relating to Tax Incentives for Enterprise Zones* (JCS-12-92), June 2, 1992.

For prior coverage of this topic see Joint Committee on Taxation, *Description of S. 1310 Urban Jobs and Enterprise Zone Act of 1981* (JCS-33-81), July 10, 1981; Joint Committee on Taxation, *Description of S. 2298 Enterprise Zone Tax Act of 1982* (JCS-9-82), April 13, 1982; Joint Committee on Taxation, *Description of Bills (S. 863, S. 98, and S. 634) Relating to Enterprise Zones* (JCS-7-83), April 20, 1983; Joint Committee on Taxation, *Description of Enterprise Zone Proposals (H.R. 6 and Administration Proposal)* (JCS-16-89), October 14, 1989; and Joint Committee on Taxation, *Description and Analysis of Proposals Relating to Tax Incentives for Enterprise Zones (H.R. 11, H.R. 23, and Other Proposals)* (JCS-9-91), June 18, 1991.

I. SUMMARY

Present Law

Tax incentive provisions

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas for the purpose of increasing the rate of credit applicable to such areas. In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States as a means to encourage the conduct of trades or businesses within these areas.

Tax credits for employers

Under present law, the income tax liability of an employer does not vary based on where an employee performs services on behalf of the employer. The targeted jobs tax credit under present law, however, provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program.

Tax credits for employees

Under present law, the income tax liability of an employee does not vary based on where the employee performs services in the United States on behalf of an employer. However, an eligible individual who maintains a home for one or more qualifying children is allowed an advance refundable income tax credit based on the earned income of the individual and the number of qualifying children.

Tax credits for investment

An income tax credit is allowed under present law for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings that were originally placed in service before 1936. In addition, under present law, an income tax credit is allowed in annual installments over 10 years for certain expenditures incurred in substantially rehabilitating or constructing qualifying low-income rental housing. Under prior law, a 10-

percent investment tax credit was allowed for the cost of eligible tangible personal property that was used in a trade or business or for the production of income.

Capital gains

Net capital gains are taxed as ordinary income under present law, subject to a maximum marginal rate of 28 percent in the case of individuals. Before 1987, net capital gains were taxed at a reduced rate. All taxpayers other than corporations could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income—effectively establishing a maximum 20-percent tax rate. The maximum tax rate for net capital gains of corporations was 28 percent.

Private activity bonds

Although interest on State or local government bonds used to finance trade or business activity generally is taxable, various exceptions are provided for what are termed private activity bonds. These include bonds issued as qualified small-issue bonds, as qualified redevelopment bonds, or to finance certain other private activities. Tax-exempt private activity bonds generally are subject to State volume limitations.

Non-tax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on goods imported into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States.

Regulatory flexibility

Under present law, government agencies must follow certain procedures in promulgating regulations that are designed to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Summary of S. 2217, S. 1920, S. 1603, and S. 1032

In general

S. 2217, S. 1920, S. 1603, and S. 1032 are substantially similar (except as otherwise indicated below), and also are substantially similar to the enterprise zone proposal contained in the President's fiscal year 1993 budget proposals.

Designation of enterprise zones

The bills would authorize the Secretary of Housing and Urban Development (HUD) to designate up to 50 enterprise zones from areas nominated by State and local governments (and Indian reservation governing bodies). The designations would be made over a four-year period, with not more than 15 designations being made during each of the first three years, and 5 in the last year. Designation of an area as an enterprise zone generally would be effective for 25 years.

Tax incentives for enterprise zones

Employee wage credit

The bills would provide a 5-percent refundable tax credit to enterprise zone employees for the first $10,500 of wages. The maximum credit would be $525; it would be phased out between $20,000 and $25,000 of total wages. The credit would be reduced for individuals subject to the alternative minimum tax.

Deduction for purchase of enterprise zone stock

Under the bills, individuals could elect to deduct up to $50,000 per year of the purchase price of certain enterprise zone stock, subject to a $250,000 lifetime limitation.[2] Stock would qualify for this deduction only if the issuing corporation used the proceeds from the stock issuance to acquire qualified enterprise zone property within 12 months following issuance. Any gain on the sale of the stock would be recaptured as ordinary income. In addition, the tax benefit of the deduction would be reduced if the stock were held less than five years when sold. The deduction would be treated as a preference for purposes of the alternative minimum tax (except under S. 1920).

Exclusion of enterprise zone capital gain

The bills would exclude from income certain long-term capital gain realized from the disposition of enterprise zone property (generally including real property and tangible personal property). The property must have constituted enterprise zone property for at least two years prior to disposition. Only gains attributable to periods that the property was used in an enterprise zone business would be eligible for the exclusion. The gain exclusion would not be a preference for purposes of the alternative minimum tax.

Other provisions

Preference in establishment of foreign trade zones

The bills would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve the establishment of a foreign-trade zone in an enterprise zone. Similarly, the Secretary of the Treasury would be required to consider on a priority basis the processing of any application that involves the establishment of a port of entry that is necessary to permit the establishment of a foreign-trade zone in an enterprise zone.

Regulatory flexibility

The bills would expand the definition of a small entity for purposes of the Regulatory Flexibility Act to include any qualified enterprise zone business, and certain other enterprises.

Repeal of Title VII of 1987 Housing Act

The bills would repeal Title VII of the Housing and Community Development Act of 1987.

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[2] Under S. 1920, the annual limitation would be $100,000, subject to a $500,000 lifetime cap.

Summary of H.R. 4210

In general

H.R. 4210 ("Tax Fairness and Economic Growth Act of 1992"), as reported by the committee of conference (H. Rept. 102-461), contained provisions establishing an enterprise zone demonstration program. The bill was passed by the House of Representatives and the Senate on March 20, 1992, but was vetoed by the President on that date.

Designation of tax enterprise zones

H.R. 4210 would authorize the designation of 35 tax enterprise zones from areas nominated by State and local governments (and Indian reservation governing bodies). The Secretary of HUD would be authorized to designate 10 areas as urban tax enterprise zones, and the Secretary of Agriculture would be authorized to designate 25 areas as rural development investment zones. Designation of an area as a tax enterprise zone generally would be effective for 15 years.

Tax incentives for tax enterprise zones

Employer wage credit

The bill would provide certain small employers with a credit equal to 7.5 percent of qualified enterprise zone wages paid to an individual who (1) does not receive annual wages or salary exceeding $30,000, (2) resides in the zone, and (3) performs substantially all services for the employer's trade or business within the zone. The credit would be a general business credit and, as such, could not reduce an employer's tentative minimum tax.

Deduction for purchase of enterprise zone stock

Under H.R. 4210, individuals could elect to deduct up to $25,000 per year of the purchase price of certain enterprise zone stock, subject to a $250,000 lifetime limitation. Stock would qualify for this deduction only if the issuing corporation used the proceeds from the stock issuance to acquire qualified enterprise zone property within 12 months following issuance. Any gain on the sale of the stock would be recaptured as ordinary income. In addition, the tax benefit of the deduction would be reduced if the stock were held less than 10 years when sold. The deduction would be treated as a preference for purposes of the alternative minimum tax.

Additional first-year depreciation allowance

An additional depreciation allowance equal to 25 percent of the adjusted basis of certain qualified zone property (generally tangible personal property and real property other than buildings) would be allowed for the taxable year that the property is placed in service in an active trade or business in an enterprise zone. The additional depreciation allowance would not be a preference for purposes of the alternative minimum tax.

Limitation on tax incentives

H.R. 4210 would impose an overall limitation on the amount of tax incentives available in each tax enterprise zone for each calendar year. Each urban tax enterprise zone would be subject to a maximum annual limitation of $14.3 million, and each rural development investment zone would be subject to a maximum annual limitation of $5.5 million. The local governments and the State in which a tax enterprise zone is located would be required to designate a government official who would be responsible for allocating the tax incentives of the zone among taxpayers. Unused allocations of tax incentives could be carried forward (with certain limitations).

Studies

H.R. 4210 would require the Secretary of the Treasury and the Comptroller General to conduct separate studies on the effectiveness of the tax enterprise zones provided for by the bill. An interim report of each study would be required to be submitted not later than July 1, 1996, and a final report by July 1, 2001, to the House Committee on Ways and Means and the Senate Committee on Finance.

Summary of S. 686

Designation of rural enterprise zones

S. 686 would authorize the Secretary of the Treasury to designate certain rural areas as rural enterprise zones. The bill would not limit the number of areas that could be designated as rural enterprise zones. Zone designations generally would be effective for 15 years.

Tax incentives for rural enterprise zones

Employer wage credit

The bill would provide a 10-percent tax credit to employers in rural enterprise zones for certain wages paid to qualified employees who perform at least 50 percent of their services for the employer during the taxable year in a zone. The 10-percent credit would apply to (1) the amount of qualified wages paid by an employer in a rural enterprise zone during a taxable year that exceeds the qualified wages paid during the 12 months prior to the date the zone was designated, and (2) wages paid employees during any portion of the taxable year during which the employer is training or retraining such employees.

Investment tax credit

The bill would provide a 10-percent tax credit for certain personal property and depreciable real property placed in service during a year in which an area qualifies as a rural enterprise zone and used in an active enterprise zone trade or business. The credit would be subject to the present-law general business credit limitations.

Increased research credit

The bill would provide a 40-percent credit rate (in lieu of the present-law 20-percent credit rate) for qualified research expenditures that exceed a taxpayer's base amount with respect to research conducted in a rural enterprise zone.

Deferral of capital gain reinvested in zone property

The bill would allow taxpayers to defer the recognition of long-term capital gain from the sale or exchange of any property up to 10 years if the amount realized from the sale or exchange is used to purchase certain property used in the active conduct of a trade or business in a rural enterprise zone. The capital gain deferral would not be a preference for purposes of the alternative minimum tax.

Summary of S. 383

Designation of Indian enterprise zones

S. 383 would authorize the Secretary of Housing and Urban Development to designate up to 12 Indian enterprise zones between 1992 and 1995. The designation of an area as an Indian enterprise zone generally would be effective for 25 years.

Tax incentives for Indian enterprise zones

The proposed tax incentives for Indian enterprise zones would include the following: (1) an employment tax credit generally equal to 10 percent of wages and health insurance costs; (2) a capital gains deferral of up to 10 years for amounts reinvested in Indian enterprise zone property; (3) a 25-percent tax credit for constructing child care facilities; and (4) a tax credit for a portion of the Federal income taxes attributable to income from Indian enterprise zone business. The bill would limit the amount of annual tax incentives that would be available within an Indian enterprise zone.

The bill would also permanently extend the authority to issue qualified small issue bonds for Indian enterprise zones.

Other provisions

The bill would give preference to the establishment of foreign-trade zones within designated Indian enterprise zones. In addition, the bill would require the Secretary of the Treasury and the Comptroller General each to prepare a study on the overall impact of the bill, and to submit their studies not later than July 1, 1995, to the House Committee on Ways and Means and the Senate Committee on Finance.

Summary of Issues Relating to Tax Incentives for Enterprise Zones

Effect of tax incentives on the location of investments

In theory, favorable tax treatment of investment and employment within a specified geographic area should induce more economic activity to be located within that area. Because there are no Federal programs offering tax incentives targeted at specific geographic areas (other than Puerto Rico and other U.S. possessions), existing analysis has attempted to examine the effects of State and local financial incentives on location decisions. Econometric evidence on the effects of such programs on location decisions is inconclusive.

Surveys of business managers usually conclude that tax and other financial inducements are of secondary importance to a firm's location decision. However, many economists suggest caution in interpreting the findings of survey research because responses to survey questions may not accurately forecast the economic behavior of decision makers.

Some case study analyses of business location decisions have concluded that financial incentives are relatively important to the decision. Others have concluded that such incentives are relatively unimportant.

Efficiency and neutrality of tax incentives for enterprise zones

If investment in enterprise zones merely replaces investment that would have taken place elsewhere, the primary effect of the investment incentives would be redistributional. If the investment is redistributed from local labor markets with low unemployment to local labor markets with high unemployment, the incentives may generate efficiency gains for the economy as under-utilized resources are tapped.

Preferential tax treatment for certain investments or for employment within enterprise zones creates economic inducements that may lead to an inefficient allocation of resources. Such efficiency losses must be weighed against the social goal of increasing economic growth and opportunity in distressed areas.

Incidence of enterprise zone benefits

The ultimate division of the tax benefits associated with enterprise zones among the potential beneficiaries depends on demand and supply conditions in the affected markets and the particular characteristics of the proposals. In general, the incidence of a tax (or subsidy) falls most heavily on the factor of production that is least mobile. Within an enterprise zone, land is an immobile factor and it may be expected that tax benefits granted for economic activity undertaken in an enterprise zone will tend to result in higher prices for land in the enterprise zone. Persons living within the enterprise zone or employed within the enterprise zone and entrepreneurs also may gain some of the tax benefits provided.

Complexity

Proposals to create tax preferences for taxpayers located within certain geographic areas may create complexity for both taxpayers and tax administrators. Such complexity may impose a relatively larger burden on small businesses and individual taxpayers than on larger businesses.

II. PRESENT LAW

Tax incentive provisions

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, targeted areas are defined under the qualified mortgage bond provisions of the Code as a means to promote housing development within economically distressed areas. Within these areas, which are defined on the basis of the income of area residents or the general economic conditions of the area, the rules for the financing of owner-occupied homes with qualified mortgage bonds are less restrictive than the generally applicable rules. Similarly, for purposes of the low-income housing credit, certain geographic areas are designated as high cost or difficult to develop areas. In these areas, the amount of the low-income housing credit is 130 percent of the amount that would otherwise be allowed.

In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States. Under these rules, a U.S. corporation that satisfies certain conditions may elect to eliminate U.S. tax on certain foreign source income that is related to the operation of a trade or business in Puerto Rico, the U.S. Virgin Islands, or a possession of the United States. These special rules were enacted in order to encourage U.S. corporations to establish and maintain trades or businesses within these areas.

Tax credits for employers

Under present law, the income tax liability of an employer does not vary based on where an employee performs services on behalf of the employer. The targeted jobs tax credit under present law, however, provides a tax credit for a portion of the wages paid to individuals from nine targeted groups. These groups generally are defined according to the individual's physical condition, participation in a specified education or rehabilitation program, or economic status.

The credit generally is equal to 40 percent of the first $6,000 (or, in the case of a qualified summer youth employee, $3,000) of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit allowed with respect to any employee generally is limited to $2,400. The employer's deduction for wages must be reduced by the amount of the credit claimed.[3]

Tax credits for employees

Under present law, the income tax liability of an employee does not vary based on where the employee performs services in the United States on behalf of an employer. However, an eligible individual who maintains a home for one or more qualifying children is allowed an advance refundable income tax credit based on the earned income of the individual and the number of qualifying children. For 1991, the earned income tax credit equals 16.7 percent (in the case of an individual with one qualifying child) or 17.3 percent (in the case of an individual with two or more qualifying children) of the first $7,140 of earned income.[4] For 1991, the credit begins to be phased out if adjusted gross income (or, if greater, earned income) exceeds $11,250 and is completely phased out if adjusted gross income (or, if greater, earned income) exceeds $21,240.

In addition to the regular earned income tax credit, present law provides for two supplemental credits: a supplemental young child credit for taxpayers with a qualifying child under the age of one (a 5-percent credit rate), and a supplemental health insurance credit for taxpayers who purchase insurance coverage for their qualifying children (a 6-percent credit rate). These supplemental credits are computed using the same earned income base (including phaseouts) as is the regular earned income tax credit.

Tax credits for investment

An income tax credit is allowed under present law for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings that were originally placed in service before 1936. The credit rate is 20 percent for expenditures incurred in rehabilitating certified historic structures and 10 percent for expenditures incurred in rehabilitating buildings originally placed in service before 1936. The basis of any building with respect to which the rehabilitation credit is claimed is reduced by the full amount of the credit.

Before 1986, a 10-percent investment tax credit was allowed for the cost of eligible tangible personal property that was used in a trade or business or for the production of income. The basis of the property was reduced by one-half of the amount of the credit. The investment tax credit was not allowed with respect to real property.

Low-income housing tax credit

An income tax credit is allowed in annual installments over 10 years for qualifying low-income rental housing. Both substantially rehabilitated existing housing and newly constructed housing are eligible for the credit. The credit percentage is adjusted monthly to maintain a present value of 70 percent for the costs of most new

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[3] Under present law, the targeted jobs tax credit is scheduled to expire after June 30, 1992. The President's fiscal year 1993 budget proposal would extend the credit for 18 months (i.e., the credit would expire after December 31, 1993).

[4] For 1994, these credit percentages are scheduled to be 23 percent for individuals with one qualifying child and 25 percent for individuals with two or more qualifying children.

construction and rehabilitation. The credit percentage (similarly adjusted) has a present value of 30 percent for the costs of acquiring existing property that is substantially rehabilitated and for creditable costs associated with property that receives other Federal subsidies (e.g., property that is financed with the proceeds of tax-exempt bonds).

Housing projects qualify for the credit only if one of two low-income tenant occupancy requirements is continuously satisfied for a period of 30 years (a 15-year compliance period followed by a 15-year extended use period). These restrictions require that (1) at least 20 percent of the housing units be occupied by individuals having incomes of 50 percent or less of the area median gross income or (2) at least 40 percent of the units be occupied by individuals having incomes of 60 percent or less of the area median gross income.

The basis on which the tax credit is claimed is equal to the "qualified basis" in the project, defined as the basis of the housing units actually occupied by low-income tenants plus an allocable share of the basis of common elements. No credit is allowed for the basis of (1) housing units occupied by nonqualifying tenants, (2) common elements allocable to such units, or (3) other facilities.[5]

Expensing of certain investments

There is no provision under present law that allows the amount of an investment to be expensed (i.e., deducted for the year in which the investment occurs) based on the location of the investment. Present law, however, provides that in lieu of depreciation deductions, a taxpayer (other than an estate or trust) may elect to deduct all or a portion of the cost of qualifying property for the taxable year in which the property is placed in service. The maximum amount that may be expensed under this provision for any taxable year is $10,000. In general, qualifying property is any tangible personal property that is predominantly used in the active conduct of a trade or business.

Depreciation deductions

The depreciation deduction for any tangible property used in a trade or business or for the production of income is determined under the accelerated cost recovery system as modified by the Tax Reform Act of 1986. Under this system, the depreciation deduction for nonresidential real property generally is determined by using the straight line method and a recovery period of 31.5 years and the depreciation deduction for residential real property generally is determined by using the straight line method and a recovery period of 27.5 years. The depreciation deduction for tangible personal property generally is determined by using a recovery period that is based on the class life of the property and the 200-percent (or 150-percent) declining balance method (with a switch to the straight line method for the taxable year that the straight line method yields a higher depreciation deduction).

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[5] Under present law, the low-income housing tax credit is scheduled to expire after June 30, 1992. The President's fiscal year 1993 budget proposal would extend the credit for 18 months (i.e., the credit would expire after December 31, 1993).

Nonrecognition provisions

A sale or exchange of an asset generally is a taxable event. In a number of instances, however, gain or loss realized by a taxpayer upon the sale or exchange of an asset is not recognized for Federal income tax purposes. For example, no gain or loss is recognized if property held for productive use in a taxpayer's trade or business, or property held for investment purposes, is exchanged solely for property of a like-kind that also is to be held for productive use in a trade or business or for investment. As another example, a taxpayer generally may defer recognition of gain on the sale of a principal residence if the sales price of the old residence is reinvested in a new principal residence within a specified period of time. Present law does not provide for nonrecognition of gain or loss in the case of the sale or exchange of an asset solely because the asset is located within a particular economically distressed area.

Capital gains

Net capital gains are taxed as ordinary income under present law, subject to a maximum marginal rate of 28 percent in the case of individuals. In general, a capital asset is any property held by the taxpayer except certain specified types of property, such as inventory or property held primarily for sale to customers in the taxpayer's trade or business. Before 1987, net capital gains were taxed at a reduced rate. All taxpayers other than corporations could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income—effectively establishing a maximum 20-percent tax rate on this income (40 percent of the gain included in income multiplied by a 50-percent maximum marginal income tax rate). The maximum tax rate for net capital gains of corporations was 28 percent. This reduction in tax was treated as a preference item for purposes of the minimum tax.

Private activity bonds

Although interest on State or local government bonds used to finance trade or business activity generally is taxable, various exceptions are provided. For example, interest on State or local government bonds generally is tax-exempt if the bonds are qualified small-issue bonds (used to finance manufacturing facilities or property acquired by first-time farmers) [6] or qualified redevelopment bonds. Tax-exempt private activity bonds issued by State and local governments generally are subject to State volume limitations. In addition, the depreciation deduction for property financed with tax-exempt bonds generally is determined by using the straight line method over the class life of the property.

Losses with respect to certain securities

The loss resulting from the worthlessness of a stock, bond, or other evidence of indebtedness issued by a corporation is generally treated as a loss from the sale or exchange of a capital asset. Consequently, the loss is subject to the general rules that limit the

[6] Under present law, the authority to issue qualified small-issue bonds is scheduled to expire after June 30, 1992. The President's fiscal year 1993 budget proposal would extend the authority to issue first-time farmer bonds for 18 months (i.e., through December 31, 1993).

amount of capital losses that may be allowed as a deduction for any taxable year.[7]

If an individual incurs a loss with respect to certain small business stock, the loss is treated as an ordinary loss rather than a capital loss. The maximum amount that may be treated as an ordinary loss for any year under this provision is limited to $50,000 ($100,000 in the case of spouses who file a joint return).

Non-tax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on imported goods shipped into a foreign trade zone until the time that the goods leave the foreign trade zone for shipment to other areas of the United States. The Foreign Trade Zone Board is responsible for approving applications for the establishment of foreign trade zones, while the Secretary of the Treasury is responsible for approving applications for the establishment of ports of entry.

Designation of enterprise zones under the Housing and Community Development Act of 1987

Pursuant to the Housing and Community Development Act of 1987, the Secretary of Housing and Urban Development (HUD) may designate not more than 100 nominated areas as enterprise zones (42 U.S.C sec. 11501 et. seq.).[8] An area may be so designated after being nominated by one or more local governments and the State or States in which it is located, and after the Secretary of HUD consults with (1) the Secretaries of Agriculture, Commerce, Labor, and the Treasury, (2) the Director of the Office of Management and Budget, (3) the Administrator of the Small Business Administration, and, (4) in the case of an area on an Indian reservation, the Secretary of Interior. An enterprise zone designation is to remain in effect for 24 years (or until an earlier termination date designated by the State or local government, or until the designation is revoked by the Secretary of HUD).

A nominated area may be designated as an enterprise zone only if it meets the following requirements: (1) the boundary of the area is continuous; (2) the area has a population of not less than 4,000 if any portion of the area (excluding certain qualifying rural areas) is located within a metropolitan statistical area with a population of 50,000 or more; and (3) the area's population is at least 1,000, or the area is entirely within an Indian reservation. In addition, the State and local governments (or Indian reservation governing body) must certify, and the Secretary of HUD must accept such certification, that (1) the area is one of pervasive poverty, unemployment, and general distress; (2) the area is located wholly within the jurisdiction of a local government that is eligible for Federal assistance under section 119 of the Housing and Community Development Act of 1974; (3) the unemployment rate is at least 1.5 times the national

[7] Generally, an individual may use no more than $3,000 per year in net capital losses to offset ordinary income. Unused net capital losses may be carried forward indefinitely.

[8] Prior to January 1, 1989, HUD received 270 nominations of areas seeking to be designated as enterprise zones. Thus far, no area has been designated as an enterprise zone.

unemployment rate; (4) the poverty rate within the area is at least 20 percent; and (5) either (a) at least 70 percent of the households in the area have incomes below 80 percent of the median income of households of the local government, or (b) the population of the area decreased by 20 percent or more between 1970 and 1980.

At least one-third of the enterprise zones must be within rural areas, meaning such areas (1) are within a local government jurisdiction(s) with a population of less than 50,000, (2) are outside of a metropolitan statistical area, or (3) are determined by the Secretary of HUD, after consultation with the Secretary of Commerce. to be rural areas.[9]

No area may be designated as an enterprise zone unless the local government and the State (or, in the case of a nominated area on an Indian reservation, the reservation governing body) in which the area is located agree in writing that, during any period during which the area is an enterprise zone, such governments will follow a specified course of action designed to reduce the various burdens borne by employers or employees in such area, including, but not limited to: (1) a reduction of tax rates or fees applying within the area; (2) an increase in the level of public services, or in the efficiency of the delivery of public services, within the area; (3) actions to reduce or simplify paperwork requirements within the area; (4) program involvement by public authorities, private entities, organizations, neighborhood associations and community groups, particularly those within the area (including a commitment to provide jobs and job training for, and technical, financial, and other assistance to, employers, employees and residents of the area); (5) providing special preference to contractors owned and operated by minorities; and (6) providing surplus land in the area to neighborhood organizations agreeing to operate a business on the land.

[9] A rural area may be designated as an enterprise zone only if it is certified as being an area of pervasive poverty. unemployment. and general distress; but such a rural area need not satisfy all of the specific criteria which a non-rural area must satisfy to be designated an enterprise zone.

III. DESCRIPTION OF PROPOSALS

A. Description of Enterprise Zone Provisions of S. 2217 (Enterprise Zone-Jobs Creation Act of 1992),[10] S. 1920 (Economic Growth and Family Tax Freedom Act of 1991),[11] S. 1603 (Economic Growth Act of 1991),[12] and S. 1032 (Enterprise Zone-Jobs Creation Act of 1991) [13]

Designation of enterprise zones

The enterprise zone provisions contained in S. 2217, S. 1920, S. 1603, and S. 1032, are substantially similar (except as otherwise indicated below).[14] Under these bills, up to 50 enterprise zones would be designated over a four-year period from areas nominated by State and local governments.[15] The Secretary of HUD would begin to make the designations four months after the date of enactment of the legislation. Not more than 15 designations would be made during the first 12 months, not more than 30 within 24 months, not more than 45 within 36 months, and not more than 50 within 48 months.

Under the bills, a nominated area (other than a rural area) would be eligible to be designated as an enterprise zone only if the area: (1) has a continuous boundary with a population of at least 4,000 (1,000 for enterprise zones located within a metropolitan statistical area with a population of less than 50,000); (2) has pervasive poverty, unemployment, and general distress; (3) is located within a jurisdiction that is eligible for Federal assistance under section 119 of the Housing and Community Development Act of 1974; (4) has an unemployment rate of at least 1.5 times the national rate; (5) has a poverty rate of at least 20 percent for each populous census tract within the area; (6) has at least 70 percent of its households with incomes below 80 percent of the median income of households located within the jurisdiction of the local government, or had a population decrease of at least 20 percent between 1970 and 1980.

A nominated area that is a rural area [16] would be eligible to be designated as an enterprise zone only if the area: (1) has a continu-

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[10] Subtitle B of Title III. S 2217 was introduced (by request) on February 7, 1992, by Senators Dole and Domenici. This is the President's fiscal year 1993 budget proposal.

[11] Title VI. S. 1920 was introduced on November 6, 1991, by Senators Kasten, Wallop, Mack, Lott, Nickles, Symms, Smith, Burns, and Coats.

[12] Subtitle C of Title I. S. 1603 was introduced on July 31, 1991, by Senator Gramm.

[13] S. 1032 was introduced on May 9, 1991, by Senators Danforth, Lieberman, Kasten, Grassley, McCain, Johnston, Bond, Garn, Mack, Cochran, Smith, Lott, Craig, McConnell, Gorton, Seymour, and D'Amato.

[14] These bills also are substantially similar to the enterprise zone proposal included in the President's fiscal year 1993 budget proposals.

[15] In the case of a nominated area on an Indian reservation, the reservation governing body would be deemed to be both the State and local government with respect to the area.

[16] A rural area would be defined as an area that is (1) within a local government jurisdiction with a population of less than 50,000, (2) outside of a metropolitan statistical area, or (3) determined by the Secretary of HUD (after consultation with the Secretary of Commerce) to be a rural area.

ous boundary with a population of at least 1,000; [17] (2) has pervasive poverty, unemployment and general distress; (3) is located within the jurisdiction of a local government that is eligible for Federal assistance under section 119 of the Housing and Community Development Act of 1974; and (4) meets at least one of the other criteria set forth above with respect to nonrural areas.

In addition, in order for any nominated area to be eligible to be designated as an enterprise zone, the local government and the State in which the area is located would be required to agree that they will follow a specified course of action that is designed to reduce the various burdens borne by employers or employees in the nominated area. A specified course of action would include (but would not be limited to) tax benefits, increases in the level of efficiency of local services within the area, involvement in the program by private job training and community groups, mechanisms to increase equity ownership by residents and employees within the area, donation of real estate to benefit low and moderate income people, provision of supporting public facilities and infrastructure improvements, and other financial incentives and assistance programs provided by State and local governments to encourage local entrepreneurship and improve the quality of life in the nominated area.

Under the bills, at least one-third of the areas designated as enterprise zones would be required to be rural areas. In addition, the Secretary would be required to designate enterprise zones from eligible nominated areas on the basis of the following selection criteria: (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the course of action; (3) the level of commitment by private entities; (4) other factors, including relative distress, determined by the Secretary of HUD to be consistent with the intent of the enterprise zone program; and (5) reasonable geographic distribution of enterprise zones.

In general, the designation of an area as an enterprise zone would remain in effect for 25 years, unless the designation provides otherwise or the Secretary revokes the designation.

Tax incentives for enterprise zones

Refundable wage credit for low-income zone employees

The bills would provide a 5-percent refundable tax credit to enterprise zone employees for the first $10,500 of wages [18] paid to an employee. To qualify for the full credit, an employee must perform substantially all of his or her services within an enterprise zone for an enterprise zone business [19] and have total wages below $20,000. The maximum credit would be $525; the credit would be phased out between $20,000 and $25,000 of total wages. In addition, the credit

[17] There would be no population requirements if the zone is entirely within an Indian reservation.

[18] For these purposes, "wages" generally would have the same meaning as for FUTA purposes.

[19] An employee of the Federal Government or any State or local government would not qualify for the credit.

would be reduced for individuals subject to the alternative minimum tax.

In general, a business would qualify as an enterprise zone business if: (1) at least 80 percent of its gross income is attributable to active business activities conducted within the zone; (2) less than 10 percent of its property is stocks, securities or property held for use by customers; (3) no more than an insubstantial portion of the property is collectibles, unless held for sale to customers; (4) substantially all the property (whether owned or leased) is located within the zone; (5) substantially all the employees work within the zone; and (6) less than 50 percent (by value) of the business activity's property or services are obtained from, or provided to, related persons that are not enterprise zone businesses. Rental real estate located within an enterprise zone would be treated as an active business and could qualify as an enterprise zone business without regard to the 10-percent test described above.

Exclusion of enterprise zone capital gain

The bill would exclude from gross income certain long-term capital gain realized from the disposition of enterprise zone property. Enterprise zone property would be defined as real property and tangible personal property (other than financial property and collectibles) located in an enterprise zone and used in an enterprise zone business. To qualify for the exclusion, the property must have constituted enterprise zone property for at least two years prior to disposition.

Only those gains attributable to periods that the property was used in an enterprise zone business would be eligible for the exclusion. In addition, the gain exclusion would not apply to sales or exchanges of property between persons controlled by the same interests.

The gain exclusion would not be a preference for purposes of the alternative minimum tax.

Deduction for purchase of enterprise zone stock

Under the bills, individuals could elect to deduct up to $50,000 per year of the purchase price of enterprise zone stock, subject to a $250,000 lifetime limitation.[20] In order for stock to qualify as enterprise zone stock, the following requirements would have to be met: (1) the individual's purchase is on the original issue of the stock; (2) the amount of proceeds must be used by the issuer within 12 months to acquire (or maintain) newly acquired enterprise zone property; and (3) the issuer must be a subchapter C corporation (a) which does not have more than one class of stock, (b) which is engaged solely in the conduct of an enterprise zone business, (c) which does not own or lease more than $5 million of property,[21] and (d) more than 20 percent of whose stock is owned by individuals, partnerships, estates or trusts. In addition, a corporation could not issue more than $5 million of enterprise zone stock.[22]

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[20] Under S. 1920, the limitation would be $100,000 per year, subject to a $500,000 lifetime cap.
[21] Under S. 1920, the limitation would be $50 million.
[22] Under S. 1920, the limitation would be $50 million.

If the stock is sold (or the stock or the corporation ceases to meet the qualifications discussed above), the gain (or the full deduction in the case of a disqualification) would be recaptured as ordinary income. In addition, if the stock is disposed of before being held for 5 years (or a disqualification occurs within 5 years of purchase of the enterprise zone stock), interest would be charged on the decrease in tax that resulted from the deduction. Under S. 2217, S. 1603, and S. 1032, the deduction would be treated as a preference for purposes of the alternative minimum tax.[23]

Regulatory flexibility

The bills would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified enterprise zone business, any unit of government designating an area as an enterprise zone to the extent any regulatory rule would affect carrying out projects within the zone, and any not-for-profit enterprise operating within such a zone.

Establishment of foreign trade zones in enterprise zones

The bills would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve the establishment of a foreign-trade zone in an enterprise zone. Similarly, the Secretary of the Treasury would be required to consider on a priority basis the processing of any application that involves the establishment of a port of entry that is necessary to permit the establishment of a foreign-trade zone in an enterprise zone. In evaluating applications for the establishment of foreign-trade zones and ports of entry in connection with enterprise zones, the Foreign Trade Zone Board and the Secretary of the Treasury would be required to approve the applications, to the maximum extent practicable, consistent with their respective statutory responsibilities.

Repeal of Title VII of the Housing and Community Development Act of 1987

The bills would repeal Title VII of the Housing and Community Development Act of 1987, effective upon enactment.

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[23] In contrast, under S. 1920, the deduction would *not* be treated as a preference for purposes of the alternative minimum tax.

B. Description of Enterprise Zone Provisions of H.R. 4210 (Tax Fairness and Economic Growth Act of 1992) [24]

Designation of tax enterprise zones

In general

Under H.R. 4210, 35 tax enterprise zones would be designated during the period 1993 through 1995. Tax enterprise zones would be either urban tax enterprise zones or rural development investment zones. The Secretary of Housing and Urban Development would designate 10 areas as urban tax enterprise zones. The Secretary of Agriculture (in consultation with the Secretary of Commerce) would designate 25 areas as rural development investment zones.[25] All designated areas would be selected from areas nominated by State and local governments, a State-chartered economic development corporation (or similar entity), or the governing body of an Indian reservation. Designation of an area as a tax enterprise zone generally would remain in effect for 15 years.

Eligibility criteria for urban tax enterprise zones

To be eligible for designation as an urban tax enterprise zone, a nominated area would be required to have all of the following characteristics: (1) a population of at least 4,000; (2) a condition of pervasive poverty, unemployment, and general economic distress, which may include the distress resulting from a high incidence of crime and narcotics use; (3) with respect to size, (a) does not exceed 12 square miles, (b) consists of not more than three noncontiguous parcels, and (c) is located entirely within one State; (4) an unemployment rate of at least 1.5 times the national unemployment rate; (5) poverty rates of at least 20 percent in each of 90 percent of the area's census tracts; and (6) a satisfactory course of action (described below) adopted by the State or local governments for the nominated area designed to promote economic development in the zone.

Eligibility criteria for rural development investment zones

To be nominated as a rural development investment zone, an area would be required to be either outside a standard metropolitan statistical area or determined by the Secretary of Agriculture (in consultation with the Secretary of Commerce) to be a rural area. To be eligible for designation, a nominated rural area is required to possess the following four characteristics: (1) a population of at least 1,000; (2) a condition of general economic distress; (3) with respect to size, (a) does not exceed 10,000 square miles, (b) is located within not more than four contiguous counties, (c) consists of not more than three noncontiguous parcels, and (d) is located entirely within one State;[26] and (4) a satisfactory course of action

[24] H.R. 4210, as reported by the committee of conference (H. Rept. 102-461), was passed by the House of Representatives and the Senate on March 20, 1992, but was vetoed by the President on that date.

[25] The Secretary of Agriculture would be required to designate at least one rural development investment zone located on an Indian reservation.

[26] In the case of a nominated area which is located on one or more Indian reservations, the nominated area need not be located entirely within one State.

(described below) adopted by State or local governments for the nominated area. In addition, a rural area is required to meet at least two of the following four requirements: (1) an unemployment rate of at least 1.5 times the national unemployment rate; (2) poverty rates of at least 20 percent in each of 90 percent of the area's census tracts; (3) a decline in employment (as measured by total wages) of more than five percent over the five-year period prior to the zone's designation; and (4) a decline in population of 10 percent or more over the period from 1980 to 1990.

Course of action

In order for any nominated area to be eligible to be designated as a tax enterprise zone, the local government and State in which the area is located would be required to agree in writing that they will follow a specified course of action designed to reduce burdens borne by employers or employees in the area. A specified course of action could include one or more of the following actions with respect to a nominated area: reduced tax rates or fees; increased delivery of local public services; simplified government paperwork requirements; involvement in the program by public or private entities (e.g., community groups), including a commitment to provide jobs and job training, and technical, financial, or other assistance to employers, employees, and residents of the area; special preferences granted to minority contractors; donations of surplus land to community organizations agreeing to operate businesses on the land; programs to encourage employers to purchase health insurance for employees on a pooled basis; certain programs to encourage local financial institutions to make loans to area businesses (with emphasis on start-up firms and other small businesses); and special preferences for projects within the area in allocations of the State's low-income housing credit ceiling and private activity bonds ceiling. Programs which serve as part of the required course of action with respect to a nominated zone could not be funded from proceeds from any Federal program.[27]

Selection process and criteria

The Secretary of Housing and Urban Development would designate a total of ten urban tax enterprise zones, consisting of five urban zones designated in 1993, three in 1994, and two in 1995. The Secretary of Agriculture (in consultation with the Secretary of Commerce) would designate a total of 25 rural development investment zones, consisting of 12 rural zones designated in 1993, seven in 1994, and six in 1995.[28]

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[27] In addition, the course of action implemented generally could not include any action to assist any business establishment in relocating into the zone from another area. However, this limitation would not be construed to prohibit assistance for the expansion of an existing business if the Secretary of Housing and Urban Development (in the case of an urban tax enterprise zone) or Secretary of Agriculture (in the case of a rural development investment zone) finds that establishment of a new branch or subsidiary will not increase unemployment in an area where the existing business conducts business operations and that there is no reason to believe that the new branch or subsidiary is being established with the intention of closing down the operations of the existing business in other locations.

[28] For both urban tax enterprise zones and rural development investment zones, any shortfall in designations below the annual maximum for 1993 and 1994 could be carried forward by the respective Secretaries, but could not be carried beyond 1995.

A designation made during any calendar year would be treated as made on January 1 of the following calendar year if so provided in the designation.

All designated tax enterprise zones would be selected from nominated areas on the basis of the following criteria (each of which would be given equal weight): (1) the strength and quality of promised contributions by State and local governments relative to their fiscal ability; (2) the effectiveness and enforceability of the guarantees that the promised course of action actually will be implemented; (3) the level of commitments by private entities of additional resources to the economy of the nominated area, including the creation of new or expanded business activities; (4) the average ranking (relative to other nominated areas) with respect to (a) in the case of a nominated urban tax enterprise zone, the degree of poverty and unemployment, or (b) in the case of a nominated rural development investment zone, two of the following criteria that give the area a higher average ranking: poverty, unemployment, job loss, or population loss; and (5) the potential for revitalization of the nominated area (including the potential reduction in the incidence of crime and narcotics use and traffic), taking into account particularly the number of jobs to be created and retained.

Period designation in effect

Designation of an area as a tax enterprise zone generally would remain in effect for a period of 15 years. However, an area's designation as a tax enterprise zone would be revoked if it is determined (after a hearing on the record) by the Secretary of Housing and Urban Development (in the case of an urban tax enterprise zone) or the Secretary of Agriculture (in the case of a rural development investment zone) that the local government or State in which the area is located has significantly modified the boundaries of the zone or is not complying substantially with commitments made as part of the required course of action.

Tax incentives for enterprise zones

Employer wage credit

A 7.5-percent nonrefundable tax credit would be provided to certain small employers for qualified enterprise zone wages. Qualified enterprise zone wages would be defined as wages paid to an individual who (1) does not receive annual wages or salary exceeding $30,000, (2) resides in the tax enterprise zone, and (3) performs substantially all services for the employer trade or business within the tax enterprise zone. However, wages would not be eligible for the credit if paid to certain relatives of the employer or, if the employer is a corporation, certain relatives of a person who owns more than 50 percent of the corporation. In addition, wages would not be eligible for the credit if paid to a person who owns more than five percent of the stock of the employer (or if the employer is not a corporation, more than five percent of the capital or profits interest in the employer).[29]

For purposes of this credit, a "small employer" would be defined as an employer that, on average, did not employ more than 100

[29] In addition, wages would not be eligible for the credit if attributable to services rendered by an employee during the first year he or she begins employment if any portion of such wages are qualified wages for purposes of the targeted jobs tax credit (sec. 51).

full-time employees during the taxable year.[30] If an employee is terminated less than one year after initial employment, the amount of credits previously claimed by the employer with respect to that employee generally would be recaptured.[31]

The wage credit would not be available for wages or salary paid to an employee beyond five years after the date such employee first began work for the employer (whether or not in a tax enterprise zone). The total wage credit that could be claimed by any small employer for any taxable year cannot exceed the credit amount allocated to that employer by the tax enterprise zone allocating official (whose functions are described below). The employer's deductions for wages or salaries paid would be reduced by the amount of credit determined for the taxable year. For alternative minimum tax (AMT) purposes, the wage credit would not be allowed to offset tentative minimum tax.[32]

Deduction for purchase of enterprise zone stock

An individual would be allowed an itemized deduction for the amount paid in cash during any taxable year to purchase enterprise zone stock. The amount allowed as a deduction for any taxable year would be limited to the lesser of (1) $25,000, or (2) the enterprise zone stock amount allocated to the taxpayer for the taxable year by the tax enterprise zone allocating official (whose functions are described below). If the amount paid in cash during any taxable year to purchase enterprise zone stock exceeds the limitation for such year, then the excess amount would be treated as paid for such stock during the immediately succeeding taxable year. In no event, however, would the amount of the deduction allowed under the provision with respect to any one individual to exceed $250,000.[33] In addition, the maximum amount of enterprise zone stock that may be issued by any corporation would be limited to $5 million.

Enterprise zone stock would be defined as stock of a C corporation which is acquired on original issue from a corporation that is a qualified issuer, but only to the extent that the cash paid for the stock is used by the corporation within a 12-month period to acquire qualified enterprise zone property. A qualified issuer would be defined as a domestic C corporation that satisfies the following requirements: (1) the corporation does not have more than one class of stock outstanding; (2) the sum of (a) the unadjusted bases of the assets owned by the corporation and (b) the value (as determined under Treasury regulations) of the assets leased by the corporation does not exceed $5 million; (3) more than 20 percent of the total value and total voting power of the stock of the corporation is

[30] For purposes of the credit, certain related employers that are considered to be part of a controlled group under section 52(a) or (b) would be treated as a single employer.

[31] However, this rule would not apply if the employee voluntarily leaves the employment, becomes disabled to perform the services of such employment (unless the disability is removed before the close of the one-year period and the employer fails to offer reemployment), or if it is determined under applicable State unemployment compensation law that the termination was due to misconduct by the employee.

[32] The wage credit would be a general business credit subject to the limitations of section 38.

[33] For purposes of the $25,000 annual limitation and the $250,000 lifetime limitation, an individual and all members of his or her family (as defined in section 267(c)(4)) would be treated as a single individual.

owned by individuals (directly or through partnerships or trusts) or by estates; and (4) the corporation satisfies the enterprise zone business requirements.

A corporation would satisfy the enterprise zone business requirements for any taxable year if: (1) at least 80 percent of the gross income of the corporation for the taxable year is derived from the active conduct of a trade or business within a tax enterprise zone; (2) substantially all of the use of the tangible property of the corporation (whether owned by the corporation or leased by the corporation) during the taxable year occurs within a tax enterprise zone; (3) substantially all of the services performed for the corporation by employees of the corporation during the taxable year are performed in a tax enterprise zone; (4) less than 10 percent of the average of the aggregate unadjusted bases of the property owned by the corporation during the taxable year is attributable to securities (as defined in section 165(g)(2)); and (5) no more than an insubstantial portion of the property owned by the corporation during the taxable year constitutes collectibles that are not held primarily for sale to customers in the ordinary course of an active trade or business.

For purposes of determining whether a corporation satisfies these requirements, leasing real property that is located within a tax enterprise zone to (or otherwise holding real property for use by) persons that are not related to the corporation would be treated as the active conduct of a trade or business. In addition, a corporation would be treated as failing to satisfy the enterprise zone business requirements for any taxable year if either: (1) more than 50 percent of the property or services acquired by the corporation during any taxable year is acquired from persons that are related to the corporation and that are not qualified issuers; or (2) more than 50 percent of the gross income of the corporation for the taxable year is derived from property or services provided to certain persons that are related to the corporation and that are not qualified issuers.

Qualified enterprise zone property would be defined as tangible property (whether real or personal) to which section 168 of the Code applies, but only if the original use of the property commences with the qualified issuer and substantially all of the use of the property is in the tax enterprise zone.

Special "recapture" rules would apply if, at any time after the acquisition of the enterprise zone stock, the stock is disposed of, or, if, at any time during the 10-year period beginning on the date of the acquisition of the enterprise zone stock, either (1) the issuer of the enterprise zone stock ceases to satisfy the definition of a qualified issuer; [34] or (2) the amount paid for the enterprise zone stock ceases to be invested by the qualified issuer in qualified enterprise zone property. First, the amount realized on the disposition of the enterprise zone stock would be required to be recognized notwith-

[34] The determination of whether a corporation ceases to satisfy the definition of a qualified issuer would be made without regard to the requirement that the sum of (1) the unadjusted bases of the assets owned by the corporation and (2) the value (as determined under Treasury regulations) of the assets leased by the corporation does not exceed $5 million. In addition, a corporation would not be treated as ceasing to satisfy the definition of a qualified issuer solely by reason of a termination or a revocation of a tax enterprise zone designation.

standing any other provision of the Code and would be treated as ordinary income to the extent that the amount realized does not exceed the amount allowed as a deduction. Second, if enterprise zone stock is disposed of within five years after the date of acquisition of the stock, the taxpayer would be required to pay interest on the amount of tax that would otherwise have been due if a deduction had not been allowed for the purchase of the enterprise zone stock.

The basis of enterprise zone stock would be reduced by the amount of the deduction allowed under this provision. In addition, the deduction for the purchase of enterprise stock would be an adjustment that is required to be taken into account by individuals in computing alternative minimum taxable income (i.e., the deduction would be added to taxable income in determining alternative minimum taxable income).

Additional first-year depreciation allowance

An additional depreciation allowance equal to 25 percent of the adjusted basis of certain qualified zone property would be allowed for the taxable year that the property is placed in service. The additional depreciation, however, would be allowed only with respect to the adjusted basis of qualified zone property for which the taxpayer has received an additional first-year depreciation allowance from the tax enterprise zone allocating official (whose functions are described below). In addition, the adjusted basis of any qualified zone property with respect to which the additional first-year depreciation allowance is allowed would be reduced by the amount of such allowance before computing the amount otherwise allowable as a depreciation deduction with respect to the property for the taxable year that the property is placed in service and for any subsequent taxable year.

For this purpose, qualified zone property would be defined as any tangible property to which section 168 of the Code applies (other than property that is required to be taken into account under the alternative depreciation system of section 168(g)) but only if: (1) the property is section 1245 property (generally tangible personal property and certain real property other than buildings and structural components of buildings); (2) the original use of the property commences with the taxpayer in a tax enterprise zone; and (3) substantially all of the use of the property is in a tax enterprise zone and in the active conduct of a trade or business by the taxpayer in a tax enterprise zone.

The additional depreciation allowance would be taken into account for regular tax purposes and for purposes of the alternative minimum tax (i.e., it would not be a preference for AMT purposes).

Overall limitation on zone tax incentives

In general

Each tax enterprise zone would be subject to an annual overall limitation on the amount of tax incentives that can be provided with respect to that zone. Urban tax enterprise zones generally would have an annual limitation of $13 million, and rural development investment zones generally would have an annual limitation of $5 million. However, this annual limitation would be increased with respect to a zone by up to an additional 10 percent (i.e., an additional $1.3 million for an urban tax enterprise zone, and an additional $.5 million for a rural development investment zone) if certain expenditures are made to promote development in the zone (e.g., for public improvements or additional police protection) and certain incentives are provided (e.g., property or sales tax abatements) by the local governments and State in which the zone is located.

Allocation of tax incentives

With respect to each tax enterprise zone, the local governments and the State in which the zone is located would be required to designate a government official (the "allocating official") with responsibility for making allocations of employment wage credits, deductible enterprise zone stock amounts, and additional first-year depreciation allowance amounts. Enterprise zone tax incentives would be available to a taxpayer only if the allocating official provides a specific allocation to that taxpayer. For instance, a wage credit could be claimed by a small employer only up to the amount for which that employer has received an allocation for that taxable year. Similarly, the allocating official would be required to specify the particular stock purchases for which the deduction provided for by the bill may be claimed, as well as the specific property for which the additional first-year depreciation allowance may be claimed.

The allocating official for each tax enterprise zone could make total allocations for each calendar year up to an amount which corresponds with the overall zone limitation on tax incentives for that year. Total allocations made in a year could be for one or more of the three tax incentives provided in the bill, depending on the combination of incentives determined by the allocating official to be appropriate for the particular enterprise zone during that year. To the extent the allocating official allocates less than the total amount of allowable tax incentives for any year, unused allocations could be carried forward to the following year (except that total unused allocations carried forward from previous years may not exceed 70 percent of the otherwise applicable zone limitation). Allocations of tax incentives made by the allocating official would be counted towards the annual overall zone limitation in the following manner: for each allocated dollar of employment wage credit, the zone limitation would be reduced by 67 cents; for each allocated dollar of deduction for enterprise zone stock, the zone limitation would be reduced by 35 cents; and for each allocated dollar of adjusted basis of property with respect to which the additional first-year depreciation is allowed, the zone limitation would be reduced by 1.5 cents.[35]

Studies

The Secretary of the Treasury and Comptroller General each would be directed to submit an interim report by July 1, 1996, and

[35] These amounts by which the overall zone limitation would be reduced were designed to represent the approximate revenue cost of each of the enterprise zone tax incentives provided for by the bill.

a final report by July 1, 2001, to the House Committee on Ways and Means and the Senate Committee on Finance, analyzing the effectiveness of the tax enterprise zones.

Effective date

Tax enterprise zone designations could be made only during calendar years 1993 through 1995. Designations generally would remain in effect for 15 years.

C. Other Proposals

Among other proposals to promote the economic development of certain geographic areas, S. 686 and S. 383 would establish enterprise zones in certain rural areas and Indian reservations.

1. Description of S. 686 (Rural Business Revitalization Act of 1991) [36]

Designation of rural enterprise zones

The Secretary of the Treasury (after consultation with the Secretary of Agriculture, Secretary of Commerce, Secretary of Labor, and the Administrator of the Small Business Administration) would be authorized to designate an area as a rural enterprise zone if such area was nominated as such by one or more local governments and the State in which the area was located.[37] The bill would not impose a limit on the number of areas that could be designated as rural enterprise zones. Zone designations generally would be effective for 15 years.

A nominated area would be eligible to be designated as a rural enterprise zone only if the area met the following requirements: (1) the area is a county or political subdivision with an aggregate population of 50,000 or less (or the Secretary of the Treasury determines that the area is a rural area); (2) the boundary of the area is continuous; and (3) general economic distress exists within the area as shown by at least one of the following factors: (a) evidence of high rates of poverty or unemployment, reduced incomes, or the number of jobs in the area has dropped from year-to-year; (b) the area is located within the jurisdiction of a local government that the Secretary of the Treasury finds is experiencing a high number of farm or small business bankruptcies, loss of private investment in the business sector, or other factors determined to be relevant in assessing the comparative degree of economic deterioration in the rural area; or (c) during the period after 1974 and before nomination, there are five years during which the population of the area (as determined from the most recent Department of Commerce estimates) decreased by at least two percent from the prior year.

An area could not be designated as a rural enterprise zone unless the local government and the State in which it was located agreed that, during any period that the area was a rural enterprise zone, they would follow a specified course of action designed to reduce the various burdens borne by employers or employees in the area. This course of action could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. The course of action could include, but would not be limited to: (1) a reduction of tax rates or fees applying within the area; (2) an increase in the level or efficiency of local services within the area; (3) elimination, reduction, or simplification of governmental requirements applying within the area; (4) program involvement by private entities, organizations, neighborhood associations and community groups, par-

[36] S. 686 was introduced by Senator Baucus on March 19, 1991.

[37] In the case of a nominated area on an Indian reservation, the reservation governing body would be deemed to be both the State and local governments with respect to the area.

ticularly those within the nominated area (including a commitment from these private entities to provide technical, financial or other assistance to, and jobs or job training for, employers, employees and residents of the area); and (5) mechanisms to increase the equity ownership of residents and employees within the rural enterprise zone.

Tax incentives for rural enterprise zones

Employer wage tax credit

The bill would provide a 10-percent tax credit to employers in rural enterprise zones for certain wages paid to qualified employees who perform at least 50 percent of their services for the employer during the taxable year in a zone. The 10-percent credit would apply to (1) the amount of qualified wages paid by an employer in a rural enterprise zone during a taxable year that exceeds the qualified wages paid (with certain inflation adjustments) during the 12-month period that preceded the date on which the zone was designated, and (2) wages paid employees during any portion of the taxable year during which the employer is training or retraining such employees. Qualified wages for purposes of this credit generally would follow the definition of wages currently applicable for FUTA tax purposes, with certain adjustments. One such modification would be the exclusion from the wage base of any Federally funded payments the employer received or accrued for on-the-job training. Special rules also would be provided for agricultural and railway labor.

A taxpayer's deduction otherwise allowed for wages paid would be reduced by the amount of wage credit allowable for the taxable year. In addition, the credit would be subject to the present-law general business credit limitations of section 38.

Investment tax credit

S. 686 would provide a 10-percent credit for the taxpayer's basis in zone personal property and new zone construction property acquired and first placed in service during a taxable year in which the area qualifies as a rural enterprise zone. For purposes of this credit, zone personal property would include property used or located in an active trade or business within a rural enterprise zone, and which is either three-year, five-year, seven-year, 10-year, 15-year, or 20-year property under section 168(e). New zone construction property would consist of depreciable real property located in a rural enterprise zone and used by the taxpayer predominantly in the active conduct of a trade or business within the zone. If acquired by the taxpayer, the first use of the property must commence with the taxpayer during the period the area is a rural enterprise zone. Otherwise the construction, reconstruction, or rehabilitation of the property by the taxpayer must be completed during the period that the area is a rural enterprise zone. For purposes of this credit, the ownership of rental real estate would constitute an active trade or business.

Increase in research credit for research conducted in rural enterprise zones

The bill would provide a 40-percent credit rate (in lieu of the present-law 20-percent credit rate) [38] for qualified research expenditures that exceed a taxpayer's base amount with respect to research conducted in a rural enterprise zone.

Deferral of capital gain reinvested in zone property

The bill would allow taxpayers to defer the recognition of long-term capital gain from the sale or exchange of any property up to nine taxable years after the year in which the sale or exchange occurs if the amount realized from the sale or exchange is used to purchase qualified zone property within two years after the close of the taxable year of the sale or exchange.

For this purpose, qualified zone property would be defined as (1) any tangible property if substantially all of the use of such property occurs in a rural enterprise zone and in the active conduct of a trade or business by the taxpayer in the zone, (2) certain depreciable real property located in a zone and used in an active trade or business, and (3) any stock in a corporation or a partnership interest if two conditions are satisfied. First, at the time that the stock or partnership interest is issued, substantially all of the activities of the corporation or partnership must involve (or, in the case of a new corporation or partnership, will involve) the active conduct of one or more trades or businesses in a rural enterprise zone. Second, the stock or partnership interest must be issued by the corporation or partnership for money or other property (other than stock or securities).

If a taxpayer disposes of qualified zone property (or the property otherwise ceases to be qualified zone property) before five years after the date that the property is purchased, then (1) the amount of gain that was deferred under this provision would be taken into account for the taxable year in which the disposition (or cessation) occurs, and (2) interest would be payable by the taxpayer on the amount of deferred tax for the period of deferral.

The capital gain deferral would not be a preference for purposes of the alternative minimum tax.

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[38] The present-law research tax credit currently is scheduled to expire after June 30, 1992 (sec. 41(h)).

2. Description of S. 383 (Indian Economic Development Act of 1991)[39]

Designation of Indian enterprise zones

Under S. 383, the Secretary of Housing and Urban Development would be authorized to designate up to 12 Indian enterprise zones between 1992 and 1995. No more than five Indian enterprise zones could be designated in 1992 and no more than nine Indian enterprise zones could be designated in 1992 and 1993. All designated areas would be selected from areas nominated by the governing body of Indian tribes. Designation of an area as an Indian enterprise zone generally would be effective for 25 years.

To be eligible for designation as an Indian enterprise zone, a nominated area would be required to have all of the following characteristics: (1) a population of at least 75 Indian residents; (2) a condition of widespread poverty, unemployment, and general distress; (3) with respect to size, the area (a) does not exceed 200 square miles, (b) consists of not more than five noncontiguous parcels, (c) is accessible to a labor force of Indian employees, and (d) is located entirely within one Indian reservation; (4) an unemployment rate for the reservation within which the area is located of at least 1.5 times the national unemployment rate; and (5) a poverty rate for the reservation within which the area is located of at least 20 percent.

The Secretary of Housing and Urban Development would select among nominated areas on the basis of specific selection criteria including: (1) the willingness of the tribal government to make efforts to attract business to the zone; (2) the level of private enterprise commitment; (3) the effectiveness and enforceability of tribal commitments; and (4) the economic and social conditions and potential for the nominated zone.

Tax incentives for Indian enterprise zones

Employer wage credit

The bill would provide a 10-percent income tax credit to employers in Indian enterprise zones for wages paid to qualified zone employees and for certain health insurance costs paid or incurred with respect to qualified zone employees.[40] A qualified zone employee would be defined as an employee who (1) receives annual wages from the employer of $30,000 or less, (2) resides on or near the reservation within which the Indian enterprise zone is located, and (3) performs substantially all services for the employer trade or business within the Indian enterprise zone.

The wage credit would not be available for wages paid to an employee beyond seven years after the date such employee first began work for the employer (whether or not in an Indian enterprise zone). The total wage credit that is claimed by any employer for any taxable year could not exceed the employment credit amount allocated to that employer for the taxable year by the Indian enter-

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[39] S. 383 was introduced on February 6, 1991, by Senators McCain, Inouye, Domenici, Burdick, Gorton, Simon, Murkowski, Cochran, and Conrad.

[40] The credit rate would be 25 percent in the case of an employer with at least 60 percent Indian employees.

prise zone allocating official (whose functions are described below). The employer's deductions for wages would be reduced by the amount of credit determined for the taxable year. For alternative minimum tax (AMT) purposes, the wage credit would not be allowed to offset tentative minimum tax.[41]

Deferral of capital gain reinvested in zone property

The bill would allow taxpayers to defer the recognition of long-term capital gain from the sale or exchange of any property up to nine taxable years after the year in which the sale or exchange occurs if the amount realized from the sale or exchange is used to purchase qualified zone property within two years after the close of the taxable year of the sale or exchange. The amount of gain that is deferred for any taxable year could not exceed the capital gain deferral amount allocated to the taxpayer for the taxable year by the Indian enterprise zone allocating official (whose functions are described below).

For this purpose, qualified zone property would be defined as (1) any tangible property if substantially all of the use of such property occurs in an Indian enterprise zone and in the active conduct of a trade or business by the taxpayer in the zone and (2) any stock in a corporation or a partnership interest if two conditions are satisfied. First, at the time that the stock or partnership interest is issued, substantially all of the activities of the corporation or partnership must involve (or, in the case of a new corporation or partnership, will involve) the active conduct of one or more trades or businesses in an Indian enterprise zone. Second, the stock or partnership interest must be issued by the corporation or partnership for money or other property (other than stock or securities).

If a taxpayer disposes of qualified zone property (or the property otherwise ceases to be qualified zone property) before five years after the date that the property is purchased, then (1) the amount of gain that was deferred under this provision would be taken into account for the taxable year in which the disposition (or cessation) occurs, and (2) interest would be payable by the taxpayer on the amount of deferred tax for the period of deferral.

The capital gain deferral would be a preference for purposes of the alternative minimum tax.

Child care facility credit

The bill would provide an income tax credit equal to 25 percent of the cost of acquiring, constructing, or rehabilitating a child care facility that is (1) located in an Indian enterprise zone, (2) operated by a taxpayer for the care of enrollees who reside in the zone, and (3) licensed or accredited to operate as a child care facility. The amount of costs taken into account in determining the credit would be limited to $400,000 per taxpayer. In addition, the amount of the credit for any taxable year could not exceed the child care facility credit amount allocated to the taxpayer for the taxable year by the Indian enterprise zone allocating official (whose functions are described below).

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[41] The wage credit would be a general business credit subject to the limitations of section 38.

The credit would be recaptured upon the occurrence of certain events. In addition, the basis of any property with respect to which the credit is allowed would be reduced by the full amount of the credit. The credit would be a general business credit and, as such, would not be allowed to offset tentative minimum tax.

Tax payment credit

The bill would provide an income tax credit equal to the lesser of (1) the portion of the income tax of any taxpayer that is attributable to 50 percent of the taxable income that is derived from the active conduct of a trade or business in an Indian enterprise zone, or (2) $8,000 multiplied by the number of full-time Indian employees of such trade or business. The amount of the credit for any taxable year could not exceed the tax payment credit amount allocated to the taxpayer for the taxable year by the Indian enterprise zone allocating official (whose functions are described below). The credit would not be allowed to offset tentative minimum tax.

Overall limitation on zone tax incentives

Each Indian enterprise zone would be subject to an annual limitation on the amount of tax incentives that could be provided with respect to that zone. The annual limitation would equal $10 million plus an amount that is based on the population of the reservation within which the Indian enterprise zone is located.[42] In addition, the limitation may be increased by up to an additional 10 percent (i.e., an additional $1 million) if certain expenditures are made to promote development in the zone (e.g., for public improvements or additional police protection) and certain incentives are provided (e.g., property or sales tax abatements) by the tribal government, local government, or State in which the zone is located.

With respect to each Indian enterprise zone, the tribal government would be required to designate a government official (the "allocating official") with responsibility for making allocations of employment credit amounts, capital gain deferral amounts, child care facility credit amounts, and tax payment credit amounts. Enterprise zone tax incentives would be available to a taxpayer only if the allocating official provides a specific allocation to that taxpayer. The allocating official for each tax enterprise zone could make total allocations for each calendar year up to an amount which corresponds with the overall zone limitation on tax incentives for that year.

Other tax provision

The bill would permanently extend the authority to issue qualified small issue bonds for Indian enterprise zones.

Other non-tax provisions

The bill would require the Foreign Trade Zone Board to consider on a priority basis the processing of any applications that involve

[42] The additional amount generally would equal $50 million multiplied by a ratio, the numerator of which is the population of the reservation within which the zone is located and the denominator of which is the population of all reservations containing Indian enterprise zones designated during the calendar year.

the establishment of a foreign-trade zone in an Indian enterprise zone. Similarly, the Secretary of the Treasury would be required to consider on a priority basis the processing of any application that involves the establishment of a port of entry that is necessary to permit the establishment of a foreign-trade zone in an Indian enterprise zone. In evaluating applications for the establishment of foreign-trade zones and ports of entry in connection with Indian enterprise zones, the Foreign Trade Zone Board and the Secretary of the Treasury would be required to approve the applications, to the maximum extent practicable, consistent with their respective statutory responsibilities.

The bill would also require the Secretary of the Treasury and the Comptroller General to submit a report to the House Committee on Ways and Means and the Senate Committee on Finance not later than July 1, 1995, on the overall impact of the bill.

IV. ISSUES RELATING TO TAX INCENTIVES FOR ENTERPRISE ZONES

A. Overview of Issues

As a geographic matter, economic growth and development have not occurred evenly across the United States. While differences in resources and climates may explain part of the geographic diversity, within States and cities the pattern of economic growth is uneven. Some areas have high unemployment and decaying structures, while nearby areas enjoy full employment and economic growth. Some analysts have argued that this uneven pattern of growth is evidence of a failure of the market and that government intervention may be appropriate to encourage a more geographically even pattern of growth. In addition, other analysts observe that areas of high unemployment and blight often are characterized by higher crime rates, poorer health of residents, and other social ills. They note these problems represent additional costs to society at large and that efforts to aid economic development in such areas would improve social welfare beyond that which would be measured by job creation, wages, or output.

Enterprise zone tax incentives are intended to encourage economic activity within a particular geographic location. Almost all enterprise zone proposals provide tax incentives for the location of certain activities within certain economically distressed areas.[43] The proposals differ with respect to economic activities that are provided tax incentives and the manner in which the incentives are provided. For example, enterprise zone proposals may provide incentives for certain types of employment through an employer or an employee wage credit, or for certain types of capital investment through accelerated capital recovery methods or capital gains tax relief. In addition, the proposals often target relief to small businesses. Therefore, not only do enterprise zone proposals target tax incentives to particular geographic locations, but also within each enterprise zone the proposals direct tax incentives to particular types of activities.

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[43] In many respects, the tax treatment of certain businesses located in U.S. possessions is analogous to tax provisions of enterprise zone proposals. The Puerto Rico and possessions tax credit shelters from U.S. income tax business income and qualified passive investment income earned by certain U.S. corporations operating in U.S. possessions ("section 936 corporations"). Almost all section 936 corporations operate in Puerto Rico. The Finance Committee Report accompanying the 1976 Tax Reform Act states that the purpose for the special tax status accorded possession-source income is "[to] assist the U.S. possessions in obtaining employment producing investment by U.S. corporations." Like enterprise zone proposals, section 936 provides tax incentives to encourage the location of economic activities within a limited geographic area exhibiting economic distress. See, for example, Ramon E. Daubon and Jose J. Villamil, "Puerto Rico as an Enterprise Zone," in Roy E. Green, editor, *Enterprise Zones: New Directions in Economic Development*, (London: Sage Publications), 1990.

Possible goals of geographic tax incentives

Enterprise zone proposals intend to provide economic aid to distressed areas. However, the aid may be intended to achieve several distinct and perhaps disparate goals. One goal may be to rebuild a blighted urban area. Another goal may be to attract business activity to the area. Yet, another goal may be to increase the employment opportunity and incomes earned by those people who currently live in the designated area.

Policies designed to address one goal, if not carefully crafted, may work against the attainment of another goal. For example, gentrification [44] of a blighted urban neighborhood may rebuild the area, but it may provide no jobs or increase in income to those who were area residents prior to gentrification. The increase in property values which accompanies gentrification may further impoverish those who were area residents prior to the gentrification or force them to move to other areas. A policy that successfully attracts businesses to a particular geographic location may return some economic vitality to that area. However, if the businesses utilize labor skills not possessed by residents of the area, there may be few gains in income to those residents. Similarly, a business may be attracted to an area to utilize the base of low skilled, low wage labor. While such businesses provide employment opportunities, they may not promote significant income growth for area residents. Without income growth there may not be significant rebuilding of the area's physical structure. As a further example, siting a business within a specific geographic area may result in the displacement of current residents from that area. Alternatively, a policy which successfully promotes income growth of residents of an area may enable those residents to choose to leave the area which may result in further blight.

The effect of tax incentives on the location of investments

Enterprise zone proposals contemplate that economic incentives provided through Federal income tax relief can redirect investment toward economically disadvantaged areas. In theory, the provision of financial incentives should be able to induce economic activity to be located in designated areas. However, empirical research is inconclusive and, in any event, even if investment is redirected, cost benefit analysis might show that society does not benefit from the relocation of investment. As there are few Federal programs that provide economic incentives to redirect investment geographically, most existing studies are based on State and local initiatives and the British experience. The State and local initiatives may not be relevant to analysis of a Federal program, if it is contemplated that the Federal program will offer larger economic incentives than do existing State and local initiatives. Moreover the types of tax incentives offered may be fundamentally different. For example, sales and property tax exemptions have no direct Federal counterpart. Similarly, the British experience may not be relevant to proposals for the United States.

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[44] Gentrification generally refers to the immigration of middle and upper income individuals into a deteriorating or recently renewed area.

Research on the impact of State and local tax factors on the location decisions of firms is inconclusive. On the one hand, lower local property taxes or lower State or local income taxes act directly to lower the cost of doing business in a particular area. This could make low tax jurisdictions relatively attractive to businesses. On the other hand, relatively high tax jurisdictions may provide more and higher quality public services and are often associated with highly educated and/or highly skilled local labor forces. These factors could offset the higher tax cost of doing business in a high tax jurisdiction. Separating these conflicting forces is a difficult task and conclusive econometric evidence has not yet been provided on this issue.[45]

The General Accounting Office (GAO) has attempted to measure empirically the employment changes resulting from the tax benefits provided under one State's enterprise zone program.[46] The GAO measured monthly employment changes in three enterprise zones over a four-year period and concluded that while increases in employment did occur, "factors other than the [enterprise zone] program seemed to account for these increases." [47] The empirical analysis of the GAO study has been criticized.[48] For example, it is difficult to specify a correct counter-factual hypothesis of what employment levels would have been in the absence of the enterprise zone program. This makes it difficult to determine which, if any, changes in employment result from enterprise zone benefits. Also, four years may be too short a time period to assess the economic effect of an enterprise zone program.[49]

Another study has taken a broader approach by attempting to empirically account for the sources of employment growth in 37 disaggregated sectors across United States metropolitan areas over the period 1977 to 1984.[50] The authors found that the presence of enterprise zones was positively related to employment growth in some sectors, specifically, total manufacturing, hospitals, legal serv-

[45] For examples on both sides of the issue, see Dennis Carlton, "Why New Firms Locate Where They Do: An Econometric Model", in *Interregional Movements and Regional Growth* (William Wheaton, ed.), Urban Institute, 1979; Leslie E. Papke, "Interstate Business Tax Differentials and New Firm Location: Evidence from Panel Data," *Journal of Public Economics*, 45, June 1991; Breandon O hUallachain and Mark A. Satterthwaite, "Sectorial Growth Patterns at the Metropolitan Level: An Evaluation of Economic Development Incentives," photocopy, Department of Geography, Arizona State University and Kellogg Graduate School of Management, Northwestern University, August 22, 1989; and Robert Newman and Dennis Sullivan, "Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know and How Do We Know It?", *Journal of Urban Economics*, March 1988.

It is important to note that empirical studies of location decisions also investigate other factors besides taxes. For example, one study concludes that generally lower taxes and higher levels of public services influence firm location decisions. See, Timothy J. Bartik, *Who Benefits from State and Local Economic Development Policies*? (Kalamazoo, Michigan: W.E. Upjohn Institute for Employment Research), 1991. A common finding is that a high prevailing wage scale discourages new business location. See, for example, Papke, "Interstate Business Tax Differentials." Other factors which such studies examine are quality of the labor force, energy costs, and access to the transportation networks and raw materials.

[46] United States General Accounting Office, *Enterprise Zones: Lesson From the Maryland Experience*, GAO/PEMD-89-2, December 1988.

[47] *Ibid.*, p. 4.

[48] Jerry Wade, "The Maryland Enterprise Zone Program: A Progress Report and Response to GAO," Maryland Department of Economic and Employment Development, April 17, 1989.

[49] See, Edward V. Regan, "Report of Examination: Economic Development Zone Program," State of New York, Office of the State Comptroller, September 1, 1990. The report concluded that it was not possible to evaluate the effectiveness of an enterprise zone program initiated in 1986 without allowing several more years to pass.

[50] O hUallachain and Satterthwaite, "Sectoral Growth Patterns at the Metropolitan Level."

ices, and engineering and architectural services. However, their results explicitly reject any employment effects resulting from changes in taxes or subsidies. The authors suggest the presence of enterprise zones may represent government responsiveness to firms seeking to expand or relocate.

As an alternative to empirical studies, a number of surveys have been undertaken to address the effectiveness of tax incentives on location decisions. Many economists suggest caution in interpreting the findings of survey research since responses to survey questions may not accurately forecast the economic behavior of decision makers. Nor may survey results based on State and local programs be applicable to a Federal program if the Federal program offers larger financial incentives. Nevertheless, surveys may provide some insight into the motivation of business managers who make decisions concerning location of investment. Generally, these surveys explicitly ask managers of firms about the importance of financial factors on location decisions. For the most part, these surveys have found that governmentally provided financial incentives (e.g., low interest loans, property tax abatements, income tax credits) are of secondary importance to a firm's location decision. Primary factors for location decisions have included items such as proximity to markets, availability of suitable raw materials, an appropriately trained labor force, and access to transportation networks. For example, the GAO surveyed employers in two of the enterprise zones in its study. The GAO reported that 60 percent of respondents rated financial incentives, including grants, subsidized interest rates, and other subsidies as of little or no importance to their location decision, while market access, community characteristics (community service, crime rate, etc.), and site characteristics each were listed as important by more than half the respondents.[51] Researchers hypothesize that the primary factors, such as proximity to markets, attract a firm to a particular geographic region and that the secondary factors, such as financial incentives, may affect the particular choice of location within that region.[52]

A third research approach to determining the effect of tax incentives on the location of investments is the case study method. While case studies are, by nature, anecdotal they may reveal general trends. Several States and outside analysts have used case studies to analyze the effects of State enterprise zone programs.[53] One case study has argued that the economic benefits of enterprise zones are important to firm location decisions. A study of Maryland's enterprise zone program cites financial incentives as important to Tandy Corporation's decision to locate a distribution center in Hagerstown, Maryland.[54] On the other hand, a case study of the General Motors' Saturn plant location decision concluded that tax incentives were a minor consideration in General Motors' final de-

[51] GAO, *Enterprise Zones, op cit.*

[52] Other examples of survey research in this area include Michael Wasylenko, "The Location of Firms: The Role of Taxes and Fiscal Incentives", in Roy Bahl (ed.), *Urban Government Finance: Emerging Trends* Sage Publications, 1981; and Larry Ledebur and William Hamilton, "The Failure of Tax Concessions as Economic Development Incentives," in Steven Gold (ed.), *Reforming State Tax Systems*, National Conference of State Legislatures, 1986.

[53] For examples of case studies of several State programs see Roy E. Green, editor, *Enterprise Zones: New Directions in Economic Development*, (London: Sage Publications), 1990.

[54] Wade, "The Maryland Enterprise Zone Program."

cision to locate in Spring Hill, Tennessee. Spring Hill's central location and proximity to transportation and cost reducing interstate highways were the primary considerations.[55]

Efficiency of tax incentives for enterprise zones

Even if tax incentives can significantly affect the location decisions of firms, it is unclear whether the induced investment in enterprise zones constitutes net new investment or whether it is merely investment shifted from another locale. If investment in enterprise zones replaces investment that would have taken place elsewhere (for instance, if investment moves away from established centers of economic activity and toward designated enterprise zones), the primary effect of the investment incentives would be redistributional. To the extent that investment in enterprise zones is investment which is redistributed from local labor markets with low unemployment to local labor markets with high unemployment, the enterprise zone programs may direct investment from expensive local labor markets to those with an excess of relatively less expensive, under-utilized labor. In this event, the enterprise zone programs may generate welfare gains for the economy as under-utilized resources are tapped. Efficiency gains also may result if reductions in unemployment lead to reductions in social ills such as crime, which some analysts view to be an externality associated with unemployment and blight.

Some attempts have been made to determine the extent to which investments in State enterprise zones represent relocations of existing businesses from outside the zone. A survey of businesses located in enterprise zones by the Department of Housing and Urban Development found that only 9.1 percent of the businesses had relocated from outside the zone. An additional 7.5 presented branches of an existing establishment located outside the zone, 26.4 represented new businesses, 2.2 percent represented businesses which had been kept from closing, and 54.8 percent of investments represented expansions of existing zone businesses.[56] The small percentage of business relocations understates the extent to which enterprise zone investments are potentially redistributional. The HUD survey also revealed that such relocations of existing businesses averaged more new hires than either new firms or existing firm expansions. Moreover, the survey is not able to discern, except perhaps in the case of those businesses which would have otherwise shut their doors, whether these enterprise zone investments would have occurred outside the zone in the absence of the zone benefits. British enterprise zones have been found to experience a greater rate of relocations, 37 percent.[57]

By design an enterprise zone will provide benefits to a business located within an enterprise zone while a similar business located just outside the enterprise zone boundary may not be eligible for

[55] Andrew Kolesar, "Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development," *Tax Lawyer*, vol. 44, Fall 1990.

[56] Rodney A. Erickson and Susan W. Friedman, with Richard E. McCluskey, "Enterprise Zones: An Evaluation of State Government Policies," Final Report prepared for U.S. Department of Commerce, Economic Administration, April 1989.

[57] Peter Hall, "The British Enterprise Zones," in Roy E. Green, editor, *Enterprise Zones: New Directions in Economic Development*, (London: Sage Publications), 1990.

such benefits. The potential for relocation, discussed above, could lead to areas located near enterprise zones losing businesses and economic vitality. For example, one study of British enterprise zones found that 86 percent of businesses which relocated into enterprise zones came from the same county as that which contained the enterprise zone.[58] A result could be that the social and economic problems which led to the establishment of an enterprise zone are shifted to neighboring areas. On the other hand, if the enterprise zone does experience economic growth, other taxpayers may find it advantageous to locate near the enterprise zone to either serve enterprise zone businesses or to live near their place of employment. If this occurs, some of the benefits of the enterprise zone spillover into neighboring areas that are not designated as a part of the enterprise zone.

In addition to providing incentives to locate existing businesses in particular geographical areas, the incentives could induce the creation of new businesses which would not otherwise have been initiated in any location. Such new businesses could produce taxable profits and incomes which might reduce the revenue cost of the incentives. On the other hand, the incentives could induce investments inside enterprise zones which would be uneconomic in the absence of the tax incentives. Such an outcome would reduce the efficiency of aggregate national investment.

Competition between communities for the location of business may reduce the efficiency of tax incentives and other inducements. Thus, even if enterprise zones provide sufficient incentives to affect the location decisions of firms, an additional question is whether these incentives are cost-effective. To be cost-effective, the tax subsidies should be the smallest subsidies needed to achieve the desired behavioral change. Moreover, the subsidies should be narrowly targeted so that the benefits go primarily to firms that change their economic behavior in the desired fashion. That is, a cost-effective tax incentive program would minimize the amount of subsidy going to investors who would have located in the enterprise zone even in the absence of the tax subsidy program. When communities compete with one another using financial incentives, the chosen community may spend, in tax and other benefits, more than is necessary to induce the business to locate in a particular location.[59]

One measure of the efficiency of tax incentives for enterprise zones is the cost, in terms of direct spending and foregone revenue, per job created. Several studies have attempted to calculate the cost per job created by enterprise zone programs. Such calculations are inherently difficult. It is difficult to determine how many jobs in an enterprise zone represent net additions to employment. To the extent that there are net additions to employment within the enterprise zone, there may be other jobs created or lost outside the enterprise zone. Such employment changes are equally difficult to

[58] Peter Hall, "The British Enterprise Zones."

[59] Kolesar, "Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development." Kolesar reports that before deciding to locate its new plant in Georgetown, Kentucky, Toyota, which had given early indication of preferring the Georgetown location, threatened Kentucky with the prospect of locating in another State. This strategy resulted in greater public assistance for Toyota than Kentucky had initially offered.

quantify. In addition, it may be important to distinguish all new jobs from those new jobs gained by residents of the enterprise zone.

A recent study has attempted to measure the cost to taxpayers of the new jobs created by the Indiana enterprise zone program. The study calculates the annual cost in 1988 per job created ranged across zones between $815 and $11,747 with a mean of $4,921. If, however, one looks at the cost per new job for an enterprise zone resident, the cost ranged between $1,722 and $173,539 with a mean of $33,543.[60] A study of New Jersey's enterprise zone program put the costs per job at between $8,000 and $13,000, but if the program costs per year remain at the levels experienced in 1987 and 1988, then the costs per job would be $40,000 to $60,000 over a decade and continue to grow.[61] Analysis of British enterprise zones concluded that the cost of each additional job created in an enterprise zone was 8,500 pounds sterling (approximately $15,300 at current exchange rates) and the cost of each additional job in the wider area was between 23,000 and 30,000 pounds sterling ($41,000 to $54,000 at current exchange rates).[62]

Tax incentives and the type of business formation

The choice of tax incentives granted to enterprise zone businesses may influence the type of business that will take place in an enterprise zone. For example, tax incentives for investment may induce more capital intensive businesses to locate in enterprise zones. Alternatively, if only employment subsidies are offered, more labor intensive businesses may be expected to locate in enterprise zones. Size limitations may induce small rather than large businesses to locate in enterprise zones. When a number of tax incentives are offered, the relative value of the different tax preferences may influence the type of businesses which locate within an enterprise zone.

Some argue that the need for enterprise zones grows out of the persistence of areas of pervasive unemployment and poverty, and therefore it is more appropriate to induce labor intensive businesses to locate in enterprise zones. It is argued that the resulting demand for labor simultaneously will attack both unemployment and poverty. Critics of this view note that there are no guarantees that the jobs created will be filled by residents of the enterprise zone. When jobs are filled by individuals from outside the enterprise zone, the objectives of reducing poverty and unemployment within the enterprise zone are not accomplished. Critics also observe that many labor intensive businesses are low wage employers which, by the nature of their business, offer little training to enhance the skills of employees. As a result, while employment might

[60] Leslie E. Papke, "Tax Policy and Urban Development: Evidence from an Enterprise Zone Program," photocopy, Michigan State University, December 1991.

[61] See Marilyn Marks Rubin, "Urban Enterprise Zones in New Jersey: Have They Made a Difference?," in Roy E. Green, editor, *Enterprise Zones: New Directions in Economic Development*, (London: sage Publications), 1990, and Franklin J. James, "The Evaluation of Enterprise Zone Programs," in Roy E. Green, editor, *Enterprise Zones: New Directions in Economic Development*, (London: Sage Publications), 1990. It is unclear whether these figures refer to jobs within an enterprise zone or jobs held by enterprise zone residents.

[62] Peter Hall, "The British Enterprise Zones." As with the study of the New Jersey enterprise zone program, it is unclear whether these figures refer to jobs within an enterprise zone or jobs held by enterprise zone residents.

increase, poverty may only be somewhat mitigated and individuals' further economic advancement may still be limited by a lack of marketable skills. Proponents counter that society gains by reducing government welfare payments and individuals gain by establishing positive employment histories.

Others argue that it may be more appropriate to induce capital intensive businesses to locate within enterprise zones. Capital intensive businesses often require skilled workers and pay higher wages. Proponents also argue that businesses which make large investments are less likely to move once available subsidies expire or when another community offers financial inducements. As a consequence, such businesses may provide a more stable economic base to area development. Critics of this view observe that the residents of many areas which might qualify as enterprise zones may not have the skills necessary to gain employment in many capital intensive businesses, and little employment gain among residents may result. They also note that often individuals do not choose to reside in close proximity to many capital intensive businesses (for example, a steel mill) and large capital intensive businesses may, by locating within an enterprise zone, displace current residents. Such displacement, if it occurs, may only disperse the problems of economic development which were manifest in the area's designation as an enterprise zone.

Some assert that only small businesses should be permitted to take advantage of the economic inducements offered within enterprise zones. They note that small businesses are responsible for many of the jobs created within the United States and that small businesses are often innovators. Critics of this view observe that small businesses frequently fail. Consequently, small business may provide an unstable employment base for an enterprise zone. They contend that large employers are more stable employers. They further note that many small businesses need large businesses to purchase their products and often find it most economical to locate near major customers. Proponents counter that fostering many small businesses rather than one or two large businesses creates a broad economic base which is not subject to the business fluctuations of a single industry.

Others would like to encourage venture capital investments and the location of high technology businesses within enterprise zones. They contend that such businesses are the source of future economic growth and it is appropriate to direct some of this growth to economically under-developed areas. As discussed regarding capital intensive businesses above, high technology businesses may require skills not possessed by residents of an enterprise zone. Such businesses may find non-tax factors such as the proximity of scientists at a research university more important to their location decisions. Venture capital investments generally are high risk investments. Because a high risk implies a higher probability of failure, such investments may not provide stable employment opportunities within the enterprise zones.

Neutrality

Tax incentives for employment and investment in enterprise zones are intended to affect employment and investment decisions.

However, these incentives can create an inefficient allocation of resources because the preferences can make it more profitable, on an after-tax basis, to locate property at site A rather than site B, even though site B would produce greater pre-tax profits. On the other hand, the incentives may be necessary to promote the social goal of more economic growth and opportunity in distressed areas. If the enterprise zone does help reduce crime and other social ills in an area, then an efficiency gain can result despite the non-neutral treatment of employment and investment decisions.

Targeting tax incentives within an enterprise zone can also reduce economic welfare below that which might be attainable under proposals with broad based incentives. For example, an employment tax credit may skew the allocation of resources within an enterprise zone to labor-intensive industries. Similarly, tax incentives for capital may skew the allocation of resources within an enterprise zone to capital-intensive industries. A proposal which provides incentives of similar magnitudes for all types of capital and all types of labor is likely to result in larger economic benefit per dollar of revenue cost than more narrowly targeted incentives.

Incidence of enterprise zone benefits

The tax benefits associated with enterprise zones are aimed at creating investment, employment, and business activity within the enterprise zones. However, as with any tax or subsidy, the ultimate division of these tax reductions among various classes of potential beneficiaries depends on demand and supply conditions in the affected markets and the particular characteristics of the proposals. In general, ~~the incidence~~ of a tax (or of a tax subsidy) falls most heavily on the factor of production that is least mobile, that is, the factor that is least able to escape the burden of the tax by changing behavior. Because enterprise zones distribute tax benefits according to geographic location, factors which are relatively immobile across geographic locations are more likely to receive the benefit of proposed tax incentives than are factors which are geographically mobile.

Among the groups that may benefit from the establishment of enterprise zones are those owning land in the zone, those who may gain employment in the zone, those who invest in the zone, and the entrepreneurs who organize businesses within the zone.[63] Land is an immobile factor. It may be expected that tax benefits granted for economic activity undertaken in enterprise zones will tend to result in higher prices for land in the enterprise zone. If other factors of production are to some extent immobile, some of the value of enterprise zone benefits may accrue to these factors. For example, if residents of other areas are unable to commute easily to jobs in enterprise zones, then residents of enterprise zones may receive some of the benefits granted for employment or investment in enterprise zones.[64] Likewise, if entrepreneurs possess specific knowl-

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[63] The discussion above suggested that some of the potential benefit of tax subsidies provided in enterprise zones may be lost due to non-neutralities.

[64] Some analysts have suggested a spatial mismatch exists between employers and potential employees and that this has helped create pockets of unemployment in inner cities. However see, David Ellwood, "The Spatial Mismatch Hypothesis: Are There Teenage Jobs Missing in the

Continued

edge that aids in the establishment of a business in the enterprise zone, they may also gain some of the tax benefits provided.

Analysis of the incidence of enterprise zone tax benefits is further complicated by several factors. First, many of the potential employees of the newly established enterprises may be hired at wages at or near the minimum wage. Second, the proposals vary in the extent to which they provide incentives for employment as opposed to investment. Third, some proposals would place a limitation on the total tax benefits available within any particular zone. Fourth, the proposals may vary in the magnitude of transactions costs (e.g., syndication or legal fees) required of the taxpayer to avail him or herself of the benefit.

A tax credit given to employers for wages paid for work within enterprise zones might benefit minimum wage workers more than other workers hired. Businesses locating within enterprise zones might find it profitable to hire workers at the minimum wage whom they would not hire at the minimum wage were it not for the credit they receive. The individuals hired receive a portion of the benefit of the credit in the form of employment at a wage at least equal to the minimum wage. However, for workers paid more than the minimum wage the credit may provide no benefit if the supply of such workers is great enough that businesses which may claim the credit can continue to hire these workers without having to bid up the wages they offer. In this case, all the benefit of the tax credit accrues to the employer.

If, on the other hand, the credit were to be claimed by the employee, the business would not hire at the minimum wage an individual who is currently unemployed because the employer would be unable to pay the individual less than the minimum wage. Such an individual would receive no benefit from the tax credit. Those employed at wages above the minimum wage may now face competition from individuals willing to work at a lower wage with the knowledge that a tax credit will make up at least a part of the difference. If such competition among workers occurs, the employer benefits from lower labor costs. An employee who is currently employed at the minimum wage would, by law, face no direct competition and thus might benefit from the wage credit. However, the employer might find it profitable to substitute more skilled (and more highly paid) workers for such an employee, if the credit causes the wages paid to more skilled workers to fall.

One might expect tax benefits directed at investment rather than wages to benefit investors primarily. However, as with wage subsidies that might accrue to labor, the benefits of investment incentives will accrue to suppliers of capital only to the extent that capital is available in restricted supply to the enterprise zones. In a relatively competitive capital market, the benefits of investment incentives, like wage subsidies, will be shifted to other, less mobile factors, such as land. Hence, the incidence of the two types of subsidies need not differ markedly.

Ghetto?" National Bureau of Economic Research, Working Paper No. 1188, August 1983. In analyzing black, teenage unemployment, Ellwood finds no effect on the employment rate of teenage blacks of the proximity of job opportunities or of spatial neighborhood effects.

The degree to which tax benefits shifted from labor and capital are divided among land and entrepreneurs depends in part on the restrictions put on zone development through tax benefit limitations. If limitations are not imposed, activity may proceed to the point where entrepreneurs receive nothing more than a normal return to their efforts, with the entire benefit being received by land owners in the form of higher land rents or dissipated through the establishment of relatively high cost businesses. However, limitations may restrict the extent of this shifting, providing entrepreneurs with a greater fraction of the tax benefits that are provided.

Deferral v. exemption

Enterprise zone tax incentive proposals generally provide certain forms of income deferral from tax or exemption from tax. The form in which the incentive is provided affects the magnitude of the incentive. Exempting income from taxation is always more valuable to the taxpayer than deferring taxation on the same income. For example, if $1,000 could be invested for 10 years to earn eight percent annually and those earnings were exempt from taxation, this investment would have accumulated $1,158.93 in interest by the end of the 10-year period. If the earnings instead were taxed annually to a taxpayer at a 28-percent marginal tax rate, the accumulated interest, net of taxes, would be $750.71 after 10 years. If the earnings were not taxed annually, but rather the tax was deferred for 10 years and assessed on the accumulated interest at the end of the 10-year period, the value of the taxpayer's net earnings would be $834.43. In this example, deferral increases the taxpayer's return by 11.2 percent over the 10-year period compared to annual taxation. Exemption is 38.9 percent more beneficial than deferral over the same period.

The benefit of tax exemption generally is greater to a higher-income taxpayer than a lower-income taxpayer, because the tax liability saved per dollar of tax-exempt income is greater for taxpayers in higher marginal tax rate brackets. The benefit of deferral depends not only on the taxpayer's current tax rate, but also on his or her future tax rate. The benefit of deferral is increased for a taxpayer who currently is taxed at a high marginal rate, but who can defer the tax liability until a lower marginal rate applies. The benefit of deferral is decreased if the taxpayer currently is taxed at a low marginal rate and defers the tax liability to a year when a higher marginal tax rate applies. In this circumstance, because of the taxpayer's low initial tax rate, the taxes deferred may actually be worth less, in present value, than the taxes owed at the later date when the taxpayer is in a higher tax bracket.

Equity considerations

Horizontal equity requires that taxpayers in similar economic situations be treated by the tax system in the same manner. To the extent taxpayers with identical economic incomes bear different income tax burdens as a result of the enterprise zone tax incentive programs, horizontal equity is not attained. This may be more of a concern in the short run than in the long run because such differential tax treatment may be capitalized in the price of assets leading to an equalization of after-tax incomes.[65] Vertical equity requires that taxes be assessed in accordance with the taxpayer's ability to pay. To the extent that the benefits of enterprise zone tax incentives accrue primarily to high-income taxpayers, vertical equity of the Federal tax system may be compromised.

Tax incentives may be structured as either deductions or credits. When taxpayers face different marginal tax rates, deductions yield different dollar amounts of tax benefit depending upon the taxpayer's marginal tax rate. As the taxpayer's income and marginal tax rate increase the tax subsidy increases. Credits yield the same dollar amount of tax benefit to all recipients.[66]

Limitations on benefits

A goal of enterprise zones is to foster economic development within specified geographic areas. The tax benefits made available to enterprise zones may, however, be used to satisfy policy goals other than the economic development of the designated geographic area. For example, one may want to limit the ability of higher-income persons to utilize the tax benefits; to limit the magnitude of Federal assistance to any one geographic region; or to foster certain forms of economic development, such as the creation of labor intensive businesses rather than capital intensive businesses. Limitations on tax benefits available in enterprise zones may be used to satisfy policy goals in addition to the goal of the economic development of the designated geographic area. Proponents of limitations on tax benefits believe it is appropriate to address these additional policy concerns within the context of geographic economic development programs. Opponents observe that imposing limitations on tax benefits may reduce the magnitude of the tax incentives for economic development and thereby make it more difficult to achieve desired levels of economic development.

Limitation of the tax benefits available in enterprise zones generally may take two forms: limitations on specific tax benefits and limitations on the aggregate level of benefits. In the former case, the amount of tax benefit available to any one taxpayer may be limited or the class of qualifying taxpayers may be limited, but there generally is no limitation on the number of qualifying taxpayers who may receive the tax benefit. Many such limitations exist under present law. For example, the amount of money a taxpayer may annually contribute to a qualified pension plan is limited, but there is no limitation on the number of taxpayers who can make qualifying contributions. Present law also provides limitations on the aggregate amount of tax benefits available in certain cases. For example, the low-income housing credit is subject to an annual State credit allocation ceiling.

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[65] For example, under present law the interest paid on State and local bonds generally is tax-exempt. However, the interest paid on such tax-exempt bonds is less than that paid on taxable bonds. For many taxpayers, after-tax income is approximately the same whether they purchase a taxable bond and pay tax or purchase a tax-exempt bond (with similar risk and maturity) and earn less explicit interest. To the extent that yield spreads do not completely reflect the effect of the tax, horizontal equity could be said to be violated.

[66] This is not strictly true if the taxpayer has an insufficient tax liability to utilize the credit and the credit is not refundable.

If a limitation on the aggregate level of benefits is utilized, it is necessary to create a method of allocating the available benefits among potentially competing taxpayers. For example, under present law, allocations of the low-income housing credit are made by State allocating agencies. Critics of this approach argue that the market system is impeded by introducing a government agency into the process. They argue that market allocation decisions generally are superior to other outcomes and agency involvement slows individuals' ability to react to market opportunities. They note that the concept of an enterprise zone is based on a philosophy of non-planning and private sector domination.[67] Proponents note that utilizing an allocating agency has the potential advantage of bringing State and local officials into the economic development process as partners whose participation may enhance the possibility of success because these officials have a stake in the success of the project. They observe that these officials may better know the needs of their jurisdictions and may be able to allocate the Federal benefits, or to combine the Federal tax benefits with State and local benefits, to achieve the economic development goals of their jurisdictions at least total cost. They further observe that such officials may provide oversight of the program to the benefit of taxpayers generally.

[67] Michael Allan Wolf, "Enterprise Zones: A Decade of Diversity," *Economic Development Quarterly*, vol. 4, February 1990.

B. Issues in the Design of Specific Enterprise Zone Tax Incentives

Tax credits for enterprise zone employment

The tax credits for enterprise zone employment in S. 2217, S. 1920, S. 1603, S. 1032, S. 686, S. 383, and H.R. 4210 consist of two separate types: a credit for increased employment and a credit for employee compensation. S. 686 creates a credit for increased employment, while the other bills create a credit for employee compensation. H.R. 4210, S. 686, and S. 383 would provide the credit to the employer. S. 2217, S. 1920, S. 1603, and S. 1032 would provide the credit to the employee.

Tax credit for increased employment expenditures

S. 686 would provide a 10-percent tax credit for increased employment expenditures. This credit is intended as an incentive for the expansion of employment and wages beyond a base period level of wage expenditures. Because only wages below the designated cap would be eligible for the credit, the credit would provide an incentive for part-time or modestly compensated labor. For example, if the wage cap were $17,000, an increase in wages paid for additional work performed by a current employee from $17,000 to $18,000 would not be eligible for the credit, but hiring a new part-time employee to do the same work for $1,000 would generate wages eligible for the credit.

The employer credit for increased employment expenditures is a marginal credit which for existing employers is determined by reference to the amount of qualified wages paid by the employer prior to designation as an enterprise zone. If in later years the amount of employment and qualified wages 'ecline from a previous higher level, the amount of wages paid in excess of the amount paid before the area was designated an enterprise zone would still qualify for the credit. In the case of a business that starts up after an area is designated as an enterprise zone, *all* qualified wages would be eligible for the credit *every* year.

Tax credit for compensation paid employees

H.R. 4210 would provide a 7.5-percent tax credit to employers for wages paid to qualifying employees. Qualifying employees must receive annual wages of less than $30,000, live in the enterprise zone, and work in the enterprise zone for an employer who does not employ more than 100 employees. S. 2217, S. 1920, S. 1603, and S.1032 would provide a 5-percent credit to employees for the first $10,500 of wages (based on the FUTA wage base) to employees who work in an enterprise zone. The credit is phased out for wages between $20,000 and $25,000.

Some argue that such credits would have the greatest effect on the distressed area if the employee were required to live and to work in the enterprise zone. Others claim, however, that incentives for businesses to establish operations within a zone and encourage more employment within a zone will benefit the distressed area regardless of where the employees reside. (A more general discussion of the incidence of the benefits of wage credits is presented in Part IV. A., above.)

Some question the need to provide a tax credit to individuals who would otherwise be well compensated and argue that it is prudent to reduce the credit amount for individuals with compensation above a certain level. Others maintain that new enterprise zone businesses require a mix of skill levels, and an incentive for individuals at all compensation levels is needed.

Investment tax credits and additional first-year depreciation allowances

Credit or allowance for general investment

S. 686 would provide a 10-percent credit for tangible personal property located and used in an enterprise zone, and newly constructed depreciable real property located in an enterprise zone. The credit, unlike the prior low investment tax credit, would include depreciable real estate in addition to equipment. H.R. 4210 would provide an additional first-year depreciation allowance equal to 25 percent of the adjusted basis of qualified zone property, including certain real property. This additional depreciation allowance is economically equivalent to an investment tax credit, where the credit percentage depends upon the depreciable life of the property.

Both proposals should be expected to lower the cost of capital for enterprise zone investments. If investment in certain geographic areas is inhibited because the perceived riskiness of the area increases the required cost of capital, proposals such as an investment tax credit may at least partially offset the high cost of funds. However, a high cost of capital to enterprise zone investments may not be the problem if investment is discouraged because of other deficiencies (e.g., poor public services or lack of a skilled work force), and an investment tax credit may do little to address these deficiencies.

A non-refundable investment tax credit or additional first year depreciation allowance may not have much affect on the cost of capital for firms with little or no tax liability. An investment tax credit or additional first year depreciation allowance may be a costly way to provide an investment subsidy as normal replacement investment qualifies for the tax preference as well as net new additions to the capital stock. While targeting the investment subsidy to incremental investment may be desirable, separating incremental investment from non-incremental investment may be problematic. However, to the extent that these proposals encourage more rapid replacement of the capital stock, they may encourage the more rapid adoption of equipment embodying new technology.

In the past, advocates of an investment tax credit have argued that it was necessary to encourage investment in equipment, rather than real property, as a means to encourage more productive business activities. Supporters of broader investment preferences for enterprise zones observe that it would be necessary to build up the capital stock in enterprise zones, including the stock of structures. Depreciable real estate, because it is not movable, would have long-term benefits for the enterprise zone area that could not be provided by increased investment in movable equipment. Similarly, a tax preference for tangible property used in the enterprise zone is likely to have more benefit to the enterprise zone than a preference granted to intangible property as it is difficult to ensure that intangible property is employed inside the designated enterprise zone.

Credit for child care facilities

To encourage the provision of child care facilities by businesses located in enterprise zones, S. 383 would provide a 25-percent income tax credit for the adjusted basis in a qualified child care facility. The intent of this provision is to reduce the after-tax cost to taxpayers located in an enterprise zone who provide child care facilities for their employees. If firms can provide cost-effective on-site child care for their employees, it may increase the retention rate of the firm's employees, or permit the employer to provide tax-favored compensation to the employee in the form of subsidized child care. Both effects may provide enterprise zone employers with an advantage over competitors located elsewhere.

While the intention of the credit for child care facilities is to induce taxpayers to build such facilities, this may not be the most effective use of the taxpayer's funds, in that profitable opportunities may be passed over and investment made in tax-favored child care facilities. Moreover, if taxpayers would ordinarily construct child care facilities on-site, then the tax subsidy through an investment credit may be inefficient, because it would have little effect on taxpayer behavior.

Treatment of capital gains and purchases of enterprise zone stock

In general

Other than H.R. 4210, all the bills would create preferential treatment for capital gains with respect to enterprise zone property. S. 686 and S. 383 would permit taxpayers to defer recognition of gain for up to ten years on any property sold if the proceeds were reinvested in enterprise zone property. S. 2217, S. 1920, S. 1603, and S.1032 would exclude from taxable income any gain on qualifying enterprise zone property accrued during the period of enterprise zone designation.

In addition, H.R. 4210, S. 2217, S. 1920, S. 1603, and S.1032 would create a deduction for the purchase of qualifying stock in a qualifying enterprise zone corporation. If the deduction were claimed, the taxpayer's basis in the stock would be reduced by the amount of deduction claimed, and any subsequent gain would be taxed as ordinary income. Such tax treatment is equivalent to exempting the gain on qualifying stock from tax. To illustrate, assume a taxpayer with a marginal tax rate of 28 percent purchases $1,000 of qualifying stock. The initial tax saving from deducting the cost of this stock is $280, the tax that would have been paid on the $1,000. For the purpose of this example, assume that the stock has appreciated at an annual rate of 10-percent and that the taxpayer sells the stock after one year.[68] The value of the stock upon sale will be

[68] H.R. 4210, S. 2217, S. 1920, S. 1603, and S.1032 would charge interest if a disposition occurs within five years. For the purpose of the example, no holding period requirement is assumed.

$1,100 which must be included in income, creating a tax liability of $308, and the taxpayer is left with $792. Notice that if the taxpayer had paid the initial tax of $280 and invested the remaining $720 in the qualifying stock, the stock would have been worth $792 after one year (assuming the same 10-percent rate of return). Upon sale the taxpayer would have to pay tax of $20.16 (.28 times $72) on the capital gain of $72 and would be left with $771.84 after payment of taxes. The value of the deduction for the purchase of qualifying stock is that the taxpayer does not have to pay the $20.16 in tax on the capital gain. Thus, the deduction for the purchase of qualifying stock effectively allows the taxpayer to obtain a tax-free return on an investment of $720.

Alternatively, the deductibility of the purchase of qualifying stock can be viewed as an investment that is jointly owned by the government and the taxpayer. The government's ownership share is equal to the tax rate (28 percent in the above example). When the stock is sold, the government receives its share of the funds. In the above example, when the funds are withdrawn after one year, the government receives 28 percent of $1,100 ($308), and the taxpayer receives 72 percent of $1,100 ($792). The taxpayer pays no tax on the earnings attributable to the taxpayer's share of the investment, and thus receives a tax-free return on the investment.

The taxpayer receives an additional advantage if the taxpayer's marginal tax rate in the year the stock is sold is lower than the marginal tax rate in the year the stock is purchased. Because the government's share of the investment is equal to the taxpayer's tax rate in the year the stock is sold, the lower the tax rate prevailing at that time, the smaller the government's share. On the other hand, the advantage of the deductibility of the purchase of qualifying stock is reduced if the taxpayer's marginal tax rate is higher at the time the stock is sold than at the time the stock is purchased.

Preferential treatment for capital gains realized outside an enterprise zone if the proceeds are invested in an enterprise zone may be expected to encourage an investor to roll over his or her equity into an enterprise zone investment. Limiting an investment incentive to the class of taxpayers with accrued capital gains rather than all potential investors may limit the effectiveness of the incentive in increasing total investment in an enterprise zone. On the other hand, taxpayers with funds to invest frequently have accrued capital gains.

Incentives for equity investments

Preferential capital gains tax rates for enterprise zone property and deductions for purchases of enterprise zone stock are intended to encourage investors to buy corporate stock in enterprise zone businesses, and especially to provide venture capital for new companies, thereby stimulating investment in productive business activities within the zone. Advocates of such preferences note that investment is necessary to create jobs and growth.

Opponents of preferential capital gains treatment for zone assets generally make three arguments. First, such preferences may create windfalls for owners of existing enterprise zone property. Demand for such property is increased by a tax preference which is available only to property within a specified geographic location, thereby driving up its price. Opponents argue that such windfalls would do little to create new employment opportunities. Moreover, to the extent that housing, and more generally, land are qualifying assets, the increased demand for these assets could drive up the cost of owner occupied housing in designated enterprise zones. However, by making investments in housing more attractive the stock of housing may expand and rents charged to tenants may fall.

Second, a preferential tax rate for capital gains, even if targeted geographically, encourages taxpayers to enter into transactions designed to convert ordinary income into capital gains. Proponents counter that such "conversion" opportunities are simply part of the overall tax incentive for investments in enterprise zones which the preference is intended to encourage. They further observe the Tax Reform Act of 1986 made several changes to limit conversion opportunities.

Third, preferential treatment of capital gains may be inefficient because the preference is available to investments which would have occurred without the preference as well as to net, new investments. Opponents also question the efficacy of a deduction for the purchase of stock in enterprise zone corporations. To the extent that investors make large contributions of capital, the deduction may provide no benefit to the marginal, or last, dollar contributed. This could result in potential large investors not altering their behavior while receiving a windfall reduction in tax liability. Proponents of the deduction for the purchase of zone stock respond that even when this occurs the deduction will have encouraged equity investments rather than debt, and that greater equity participation will create a more stable business.

Cost of capital

Proponents of preferential treatment for capital gains for enterprise zone property and deductions for the purchase of stock in enterprise zone corporations argue that the cost of capital is high for enterprise zone investments. They argue that a preferential tax rate on capital gains increases investors' expected after-tax returns on such assets and thereby will lower the cost of capital for such investments. In addition, proponents note, a deduction for the purchase of stock in an enterprise zone corporation makes such stock relatively more attractive than other assets and thereby lowers the cost of raising investment funds. With a relatively lower cost of capital, more investment capital would flow into designated areas.

Opponents argue that because the preference for capital gains accrues only to property located in the enterprise zone, gains in reduced capital costs may be offset by increases in land costs, as the demand for such land increases. In addition, opponents argue that because of the ability to defer gains, the ability of individual taxpayers to receive step-up of basis at death, and the substantial participation of tax-exempt institutions in the investment markets, the effective tax rate on gains, which helps determine the cost of capital, may already be substantially below the statutory rate. On the other hand, proponents of a capital gains tax reduction for enterprise zone property note that because nominal gains are taxed, that even accounting for deferral, the effective tax rate on real (inflation adjusted) gains can be high. They further contend that any reduction in a tax on capital reduces the cost of capital for these investments.

Incentives for risk-taking

Proponents of preferential treatment argue that a reduced tax rate on gains encourages risk-taking, and that investors generally would view investments in designated zones as particularly risky. As a consequence, a preferential capital gains tax rate for enterprise zone property is justified to overcome this outcome of the marketplace. In addition, it is argued, preferential treatment is important for the entrepreneur who often contributes more in time and effort than in financial capital. However, the financial gains from risk-taking and the creative process are the major rewards entrepreneurs seek. Providing a tax benefit may inefficiently subsidize such activity beyond the socially optimal level.

Opponents of preferential treatment argue that if risk-taking is to be encouraged, a more efficient method might be to reduce the current asymmetric treatment of gains and losses, by expanding the provisions for loss offset in a targeted manner. However, preferred treatment for capital losses within enterprise zones may attract more risky investments to enterprise zones than throughout the economy at large. Because high risk implies a higher probability of failure, such investment may not provide stable employment opportunities within the enterprise zone.

Length of preference period

Choosing the length of time during which preferential treatment for capital gains is to apply involves trade-offs. The choice of preference period may affect the efficiency of the tax incentive as well as the ease or difficulty incurred by the taxpayer in complying with, and the Internal Revenue Service in administering, the provision.

Creating a permanent preference for capital gains which accrue on property in enterprise zones could bestow benefits on owners of assets long after the economic development of an enterprise zone has progressed to the point that such benefits are unnecessary. Permitting preferential treatment on gains accrued prior to enterprise zone designation may reduce taxes without generating commensurate employment or productivity growth in return. On the other hand, a permanent preference could be relatively simple to administer.

Proposals which would grant preferential capital gains treatment only during a limited period, such as during the period of enterprise zone designation, would create incentives to sell the enterprise zone property before the end of such period. This could reduce the attractiveness of enterprise zone investments, thereby reducing the effectiveness of the preference. The incentive to realize gain prior to the expiration of the period of preferential treatment could depress prices for enterprise zone assets and create instability in the market for such assets. Some argue that a preference for a limited period does not promote investment with a long-term view, but rather creates a short-term, unstable investment environment. In addition, limiting the preference to gains which accrue during a specified period may require appraisals of enterprise zone assets at the beginning and end of the period. Such appraisals can be costly and create tax compliance difficulties.

Size of enterprise zones

An important consideration in designing a proposal intended to help spur development in economically depressed areas is the allowable size of an enterprise zone. To the extent the enterprise zone itself is geographically compact, the tax benefits provided may be more intensively targeted to a relatively small area. This may concentrate the impact of the valuable tax incentives provided through an enterprise zone program. Concentrating economic development may be a desirable strategy since the encouragement provided through an enterprise zone program may be greater than the sum of the various tax incentives provided, if neighboring businesses have beneficial effects on each other. Conversely, if the tax incentives provided through an enterprise zone program are geographically dispersed, the businesses involved may not be able to capture the operating economies that may exist when businesses are in close proximity.

It is possible that size constraints may operate to limit the types of areas that may qualify as enterprise zones. For example, rural or suburban areas tend to have low population density. In order to meet desired levels of economic development, public officials may believe that a minimum number of businesses must be affected. For the less densely populated areas of the United States, a tight size constraint for enterprise zones may preclude the possibility of these tax incentives affecting economic development to any significant extent.

To provide some perspective on the sizes of allowable enterprise zones under the legislative proposals under consideration, Table 1 lists the sizes of selected metropolitan areas. A 12-square mile enterprise zone is relatively large, compared to the size of many cities.[69] A 10,000-square mile enterprise zone is large compared to the size of some states (7 states have an area of less than 10,000 square miles, and 10,000 square miles is roughly the size of Maryland).

Enterprise zone proposals generally have some allowance for non-contiguous areas to be aggregated into a single enterprise zone. The rationale for this feature is to permit public officials to combine economically disadvantaged areas that may not neighbor each other into a single enterprise zone in order to take advantage of economies of scale in administering an enterprise zone. However, one potential pitfall in the allowance of non-contiguous areas to be part of a single enterprise zone is that areas with significantly different demographic or economic characteristics may be combined into a single zone and treated in similar fashion. This concern could be addressed with a requirement that an enterprise zone have a continuous perimeter no longer that X miles. In such a way, both the concern over size of an enterprise zone and the concern over non-contiguous areas being incorrectly aggregated would be mitigated.

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[69] For example, Jersey City, New Jersey has a land area of approximately 13 square miles.

Table 1.—Land Area and Population of Selected U.S. Cities

City	Area (sq. miles)	Population (1990)
Baltimore	80.3	736,000
Boston	47.2	574,000
Chicago	228.1	2,784,000
Cleveland	79.0	506,000
Dallas	333.0	1,007,000
Detroit	135.6	1,028,000
Honolulu	87.0	365,000
Indianapolis	351.9	731,000
Kansas City, MO	317.4	435,000
Las Vegas	79.2	258,000
Los Angeles	467.3	3,485,000
Memphis	264.1	610,000
Milwaukee	95.8	628,000
Minneapolis	55.1	368,000
New Orleans	199.4	497,000
New York	301.5	7,323,000
Oakland	53.9	372,000
Philadelphia	136.0	1,586,000
Pittsburgh	55.4	370,000
St. Louis	61.4	397,000
San Diego	328.6	1,111,000
San Francisco	46.4	724,000
Seattle	83.7	516,000
Washington, DC	62.7	607,000

Source: Bureau of the Census, *Statistical Abstract of the United States, 1991.*

Complexity

By design, enterprise zone proposals offer tax preferences based on geographical location. This may create complexity for both tax administrators and taxpayers. At a simple level, additional tax preferences create complexity as more forms are required, more recordkeeping is necessitated, and more, and perhaps complex, computations are needed. However, the design of such preferences may create complexities in addition to whatever burden the filing of additional forms may entail.

Many enterprise zone proposals distinguish taxpayers who may qualify for enterprise zone tax preferences by size or other characteristics. The proposals lay out potentially complex rules defining qualifying taxpayers. Satisfaction of these rules may necessitate more careful recordkeeping for taxpayers to insure their compliance and may cause taxpayers to incur additional expenses to collect and verify information that is not needed for ordinary business purposes. For example, proposals that limit preferences to small businesses, may necessitate more careful record keeping to verify that indeed the business meets the criteria for classification as small. Proposals that give wage credits only to enterprise zone residents may place a burden on the employer of verifying the residence of the employee. To the extent that the tax preferences are phased out as the taxpayer's circumstances change, computational complexity is created for taxpayers.

If one believes that most of the taxpayers affected by the proposals are small businesses and individual taxpayers, such computational complexity may impose a greater relative cost than for large businesses. Small businesses may be compelled to rely on professional tax preparation more than they currently do, increasing their costs. To the extent that these businesses forego professional help, both compliance and the utilization of the tax preferences may suffer. Complexity also would increase for taxpayers who conduct businesses both inside and outside of enterprise zones, as their activities outside of the enterprise zone would be governed by one set of tax rules, while their activities inside the enterprise zone would be governed by a different set of tax rules.

These potential complexities faced by taxpayers also increase the burden of tax administrators to verify that preferences are properly claimed. For example, tax administrators would be responsible for determining the location of businesses in addition to their current task of verifying the proper reporting of income and expense.

PREPARED STATEMENT OF GREGG J. BOURLAND

As the Chairman of the Cheyenne River Sioux Tribe, I have set reservation economic development as my highest priority. I have long recognized that Indian reservations have a unique set of problems regarding their inability to compete in the arena of national economics. The primary problems confronting Indian tribes is the difficulty in raising adequate capital to finance business enterprises. Closely related is the provision of incentives to attract private industry or enterprises to locate on reservations. Regardless of all of the planning, goal setting and reaffirmation of our economic development priorities, the fact remains that the private sector is not impressed much or motivated by a tribe's ability to manage, negotiate or operate business enterprises. What private sector industry needs before it will locate on an Indian reservation or other economically depressed areas are assurances that they have bonafide incentives backed by Congressional action. That action is the passage of a enterprise zone legislative package that will have some realistic and tangible incentives for reservation development. It is a sad day in America when civil unrest, rioting and looting becomes the method of getting the attention of the law makers of this land. It will be a sadder day yet if Indian tribes are not included in any legislation that is developed.

Since the inception of the Indian enterprise zone bills introduced in the last four years, our Tribe as well as other Indian tribes have supported and advocated the passage of H.R. 1747 and S. 383 the Indian Economic Development Act of 1991. We feel that the Indian Economic Development Act of 1991 contains appropriate language which can serve as a model for an inner city enterprise zone bill. Any proposed enterprise zone bill have to contain sufficient incentives to optimize successful business enterprise outcomes. Following are the primary components an enterprise zone should contain.

GOALS

1. To revitalize economically and physically distressed Indian reservations, primarily by encouraging the formation of new business and the retention of existing businesses.
2. To promote meaningful employment for Indians living on or near reservations.
3. To encourage self-determination by developing viable reservation economies; and
4. To raise Indian incomes, thereby reducing poverty levels and providing the means for achieving a satisfactory standard of living on reservations.

TAX INCENTIVES

1. Wage Credit

a. If an Enterprise Zone business has more than 60% Indian employees, the employer will be permitted to claim a credit equal to 25 percent of (a) wages paid by this business plus (b) the cost of health insurance provided to employees. No credit may be claimed with respect to employees earning wages in excess of $30,000 per year.

b. If an Enterprise Zone employer has a work force composed of fewer than 60% Indian employees, the wage and health insurance credit will be 10%.

2. Capital Gain Referral

Income taxes on capital gains will be deferred for up to 10 years, if the capital gain is reinvested within an Enterprise Zone. Eligible capital gains can be obtained on or off the reservation. The reinvestment must be maintained for at least five years to obtain this tax benefit.

3. Child Care Facility Investment Credit

A 25 percent credit will be provided to employers and others who make investments in child care facilities within an Enterprise Zone. The credit is limited to $400,000 in any year.

4. Corporate Income Tax Payment Credit

Enterprise Zone business will receive a tax credit equal to 50% of their tax payments on their earnings of corporate income within the Enterprise Zone (the practical effect is to provide a 50% corporate tax exemption for income earned within the Enterprise Zone). Tax credits under this provision cannot exceed $8,000 per year per Indian employee. This credit is patterned after the Puerto Rico tax exemption which has long excluded 100 percent of corporate income from taxation.

5. Other Enterprise Zone Provisions

Small Issue Bonds. Tribes will be permitted to continue to make use of small issue bonds, if the bond revenues are used in an Enterprise Zone. Under current law, after 1991 there will no longer be authority for the use of small issue bonds.

Foreign Trade Zones. Applications for foreign trade zones within an Enterprise Zone will receive priority in the review process for trade zone designation. Designation as a foreign trade zone will permit storage, exhibition, sale and general dealing (e.g., packaging, assembling, distribution, sorting) with respect to foreign goods entering and leaving the United States without subjecting it to United States customs duties.

6. Private Activity Bonds

Indian tribes will be permitted to make use of private activity bonds under the same terms and conditions as state and local governments. Prior to 1987 Indian tribes were treated as states for purposes of issuing tax exempt bonds for "essential governmental functions" but were not allowed to issue private activity bonds. Under the Omnibus Reconciliation Act of 1987, tribes were allowed to issue private activity bonds, but only under tightly restricted circumstances that have largely precluded use of these bonds by tribes and reservations and would not be limited to Enterprise Zone.

7. Volume Cap

A column cap will control the total annual revenue cost to the Treasury. Each Enterprise Zone will be subject to aggregate annual limits—on average $20 million per year per Enterprise Zone—on the amount of tax credits and other tax incentives that can be obtained. A set of operating rules will determine how much of the overall zone credit will be allocated to each Enterprise Zone business.

8. Tribal Incentives

Provisions to allow tribes to negotiate lowered power and water rates for industrial purposes with utility companies. Their credits could be based on consumption of power and water used in the Enterprise Zone.

Typically reservation statistics are distressingly similar. The highest rate of unemployment, the lowest rate of health care, the highest incidence of alcoholism, the lowest level of economic development. As an Indian it makes one feel like he's on a social roller coaster to hell. In many respects reservations closely resemble undeveloped third world nations with one exception and that exception is that Congress has not pumped billions of dollars into reservations for economic development like it has third world nations. The Bureau of Indian Affairs spends less than 1% of its total budget on economic development. In their 1993 appropriations request we can only identify about 5 million dollars for tribal economic development.

CONCLUSION

We can only conclude that the First Americans are always the last Americans in the eyes of Congress. Its been true throughout the history of national legislation that Indian people's concerns are generally addressed in these acts as an afterthought and often only after considerable lobbying on the part of the tribes. I believe we should have an enterprise zone bill like S. 2254 created just for Indian tribes. If not, then, I feel that there should be a minimum of five reservation enterprise zones designated out of the 50 proposed enterprise zones. Of these five or more enterprise zones on reservations, special language similar to S. 2254 needs to be inserted to accommodate the unique set of conditions imposed on tribes through treaties and other existing Congressional laws and acts that impact on the economic development of Indian tribes.

PREPARED STATEMENT OF TOM BRADLEY

Mr. Chairman, my name is Tom Bradley, and I am the mayor of the city of Los Angeles. I am pleased to be before you today and the members of the Senate Finance Committee to discuss how the economic enterprise zone legislation could assist the city of Los Angeles.

Just over one month ago, the city of Los Angeles experienced the most physically and emotionally devastating event in most recent memory. The Rodney King verdict was the spark that set our city on fire. Yet, in Los Angeles and other cities there was fertile ground for these events. The youth of American cities have lost hope. The problems of few jobs, poor education and no positive role models have left cities in the vulnerable position of having a young population full of despair and rage. The lack of programs and jobs in distressed communities has reached enormous proportions. For many, the civil disturbance in Los Angeles was a national wake-up call to the cries of cities all across this country.

Solving our urban ills will not be easy. But, let me tell you, as the mayor of one of the largest cities in this country, we need your help. We can no longer shoulder the burden alone and benign neglect is not acceptable.

Today, I am here to talk to you about the importance of Federal enterprise zone legislation in creating an environment which allows cities across the country an opportunity to bring our inner cities back to being thriving business centers.

Mr. Chairman, I must tell you that I am under no illusion that enterprise zones are the panacea for bringing jobs to the inner city. On the other hand, I can assure you that we are willing to invest in programs that have a chance of making a difference in the economic outlook of our distressed areas. I believe enterprise zones provide one important option in our battle against job flight that is afflicting our central cities and eroding the very essence of our communities.

Just over a week ago, the United State Senate passed H.R. 5132, the dire urgent supplemental bill, and in section 104 the senate outlined its position on federal enterprise zones. I support the findings and specifically four statements in the sense of senate report. These sections declare:

> (1) The crisis of poverty and high unemployment in America's inner cities and rural areas demands an appropriate and timely response from congress;
>
> (2) Manufacturing and industry has largely disappeared from many United States inner cities which, in turn, leads to the severe decline in good high-wage jobs, wholesale trade, retail businesses, and a large source of local tax revenues;
>
> (3) Encouraging small and medium-sized businesses, which create the majority of new jobs in the United States economy, to locate and invest in poor neighborhoods is one of the keys to revitalizing urban America;
>
> (4) Enterprise zones will help convince businesses to build and grow in poor neighborhoods; they will give people incentives to invest in such businesses and to hire and train both unemployed and economically disadvantaged individuals; they will create jobs and stimulate entrepreneurship; and they will help restore the local tax revenue base to these communities.

Accomplishing these worthy goals is a tall order, but I am willing and eager to join with the Senate, the House and the administration in testing the validity of the enterprise zone.

To bring new businesses to the city of Los Angeles I have approached businesses from every corner of the world. Los Angeles boasts of a truly global economy and, indeed, we have seen many important foreign investments in businesses. We are proud of the presence of a vital international business community in Los Angeles.

As mayor of all of the people, I still have a vision of flourishing businesses spread throughout all sections of the city. I am not convinced that mini-malls are an adequate substitute for manufacturing and wholesale operations. I want to see shopping malls with anchor stores such as the Baldwin Hills Crenshaw shopping plaza in Los Angeles. I want to see more recycling and refuse processing industries opening and flourishing in our city. I want to see electric vehicles manufactured near watts. I want to see new industries spring from the expertise developed in the defense industry and use the workers from south central and east Los Angeles.

If enterprise zones will help us to realize these dreams, then let's give it a chance to work.

For my dreams to be truly realized enterprise zones must be combined with entrepreneurship from within the community. We must provide capital resources necessary for entrepreneurs to start their own business in their own communities. This will take a commitment from banking institutions and community based banks to invest in our inner city.

I know it is not necessary to remind you, but cities across this country have been waiting for 11 years for the Federal Government to enact federal enterprise zone legislation. In Los Angeles, the State of California and cities and States across this country, we have taken the initiative and developed our own enterprise zone concepts.

Los Angeles has already designated five zone areas and we are ready to move ahead. We ask that these areas be allowed to compete for new industries and for the tax incentives that will help bring new industry into these zones. All are deserving and all are prepared to provide the "person-power" to new businesses.

In the city of Los Angeles, we have offered incentives to businesses locating in enterprise zones, including, but not limited to: Expediting sewer hook-ups, reducing local fees, reducing parking requirements, cutting electric rates, and increasing what can be built on lots. In addition, the State of California offers employee hiring credits, sales tax credits and business expense deductions.

For Federal enterprise zone legislation to make a significant dent in our economic recovery it must have the following elements:

- The size of the zones must be large enough to allow for the variation in urban situations. Current zone legislation limits the geographical boundaries for zone designation which would put a stranglehold on our efforts to address the most distressed areas.
- Further Federal assistance should be targeted to enterprise zone areas to guarantee coordinated programs which will support economic development and magnify their impact. For example, the weed and seed program identifies the necessity for a linkage between enterprise zones and the designated areas of this Federal program. Complementary Federal, State, and local resources should be encouraged to support enterprise zones.
- It is imperative that any enterprise zone legislation include specific requirements for businesses to employ local residents to receive tax incentives. It has been said over and over again that unless the community has a stake in the businesses and the development of their neighborhoods we have failed to make a change in the lives of the families living in our cities. *I cannot emphasize this point strongly or enough to you today.*
- Tax incentives must be aimed at both small and large business development. Small businesses continue to grow and flourish and make up a majority of the job creation opportunities in our country.
- Although I can understand the interest of placing an upper limit on the total value of subsidies that are available to any one city, I would argue that the Federal Government must be willing to allocate resources on a scale sufficient to have a significant impact on the economies of the inner cities.
- The speed in which this legislation is passed and enterprise zones are selected is critical for Los Angeles. Any legislation should require immediate action to ensure the business community knows we are serious about reversing the decline of our inner cities.
- Tax incentives should be simple, direct and immediate. We want to encourage the retention and expansion of businesses. Possible incentives would include: Investment tax credits, accelerated depreciation for equipment and buildings used in the zone area and wage credits for employers

Enterprise zone legislation should be seen as an investment in our communities, our families, and our future.

Last week, I testified before Senator Tom Harkin's Subcommittee for Labor, Health and Human Services and Education on the importance of investing in our children. I stated that:

> "To achieve our goals, we must recognize that our economy, health care, education, child care, crime drugs and gangs are all intertwined. Unless we invest in our children, we will have difficulty creating a skilled workforce, encouraging businesses to locate in cities across the country, stopping the scourge of gang violence, and creating a bright future for this country. Band-aid approaches will not work. A commitment to an urban agenda and our children is essential to address the crisis we are facing today."

As we discuss the future of our city, and the impact of the recent civil disturbance, I believe it is important to note that we must not forget about the majority of the people who live and work in these communities and who care about their neighborhoods and fellow human beings. They are hardworking individuals who take pride in their community. This was demonstrated by people stopping looters, helping innocent victims of violence and clean-up efforts throughout the devastated areas.

The private sector is also willing us to help us do the job. They are critical to a successful national commitment to our economic recovery. Peter Ueberroth epitomizes a businessman who has not given up on our future. Peter Ueberroth recently chaired the State Council on California Competitiveness. Within 48 hours after the riots began, I called Peter Ueberroth to ask him to once again show his commitment to Los Angeles by leading a partnership of the public, private and community sectors to rebuild our city. The next day, on the Saturday following the outbreak of violence, we announced the formation of the non-profit group known as rebuild L.A. The 10,000 calls from constituents and businesses offering assistance to rebuild L.A. has been heartwarming and encouraging. The true spirit of Los Angeles has been seen as all areas of our city have pitched in to help. But, for us to be successful, we need the support of all levels of government as well.

Economic recovery will require more than bricks and mortar. It will take an investment in the people of our great city. Jobs are an essential ingredient in providing dignity and self respect to those currently unemployed or underemployed. Rebuild L.A. acknowledges this challenge and is anxious to marry the public and private sector incentives to develop a package which will be appealing to businesses and the community alike.

A commitment to the establishment of Federal enterprise zones is an important step in our efforts to breathe new life into our communities. I call upon you today to take swift and diligent action to let cities across the country know that a true partnership has been forged between all levels of government and the private sector in an effort to address this crisis.

Thank you for giving me the time to speak with you today.

PREPARED STATEMENT OF JANET S. BURRESON

Mr. Chairman, Senator Packwood, distinguished members of the Senate Finance Committee. For the record, my name is Janet S. Burreson. I am the Director of Economic Development with the Portland Development Commission (PDC) in the City of Portland, Oregon. PDC is the City's Economic Development, Housing and Urban Renewal Agency.

As an economic development professional who has been in the trenches for the past 14 years, I must extend my appreciation to you for having this hearing today. Even though H.R. 4210, the Tax Fairness and Economic Development Act of 1991, was vetoed, your interest in the issues relating to a Federal enterprise zone program raises them to a level of importance and demonstrates that Congress is beginning to appreciate how this tool can stimulate economic development in America's cities.

I am here today to underline the importance of Federal Enterprise Zone legislation as an element in revitalizing inner-city neighborhoods of cities such as Portland, Oregon. I serve on the Federal Policies Working Group of the National Council for Urban and Economic Development and my colleagues in cities across the country also strongly support such legislation.

Portland currently operates an enterprise zone program authorized by the State of Oregon, providing three (3) year property tax abatement on new investment as long as significant hiring of Enterprise Zone residents occurs. While this program has been effective within its small scope, greater tools are needed to effect significant sustained change. This requires a team approach of business, local and state governments and the federal government.

We support the scope of H.R. 4210. We are concerned, however, that medium sized cities appear to have been overlooked in favor of large urban centers and rural districts.

Portland is a good example of a mid-sized city which, compared to the overwhelming urban decay of America's largest cities, would appear to have no serious urban issues to face. It is the general view that we are not affected by traditional urban ills; that we enjoy the growth and vitality of one of America's most livable cities. This is not true—and it has been extremely hard work scrambling for the few special grants and resources available to solve real inner urban problems.

Our inner Northeast neighborhoods have been left behind and excluded from the region's prosperity. N/NE Portland experiences more than twice the unemployment of other areas in the metropolitan region. This area has a soaring crime rate fueled by growing anger, bitterness and the frustration of the area's residents who see little opportunity for access to the region's prosperity. We also see increasing levels of gang activity spreading from Los Angeles. With the precipitous decline of the wood products industries, our state continues to lose large numbers of family wage jobs. Many of these people come to the City competing for the limited number of jobs available.

We have been particularly aggressive at finding and using resources to enhance the ongoing work of Portland's neighborhoods, police, government and business, all of which work closely together to address these problems. Portland has been the recipient of special federal grants to combat clandestine drug labs, enhance business retention and support low income home ownership (the Nehemiah Program). We have also used State resources in job training and enterprise zone programming. We have closely coordinated our economic development, housing, workforce development and public safety programs.

A Federal Enterprise Zone designation could add a significant tool to those efforts, enabling us to immediately expand the effectiveness of our comprehensive approach to Portland's urban challenges.

We believe that the Federal designation is a complementary partnership that brings the kind of clout to the table which local governments cannot provide.

It is vital that Congress provide mid-sized cities the opportunity to compete for designation under realistic criteria that write them *in*, not *out* of the Federal Enterprise Zone program. In order to include mid-sized cities in this legislation, we recommend that Congress *significantly* increase the number of zones designated, providing enough designations under "urban" criteria to assure that not only the obvious urban centers are designated, but also allowing a number of mid-sized cities to participate. We would like to see a minimum of 25 cities designated. At the same time, we recommend Congress shorten the period of designation to accommodate the larger number of zones. Alternatively, Congress could designate a specific number of zones to be allocated to mid-sized cities like Portland. In keeping with the recommendations of the National Council on Urban Economic Development, we encourage a federal program that truly targets urban districts in need of a comprehensive approach to resolving economic issues, rather than those that simply establish a marketing function using public incentives to make deals.

In particular, we support the incentives set forth in H.R. 4210:

- **Wage Credit**

In our cities over the years, we have demonstrated that proximity to jobs does not necessarily result in hiring of local residents. Therefore, we strongly support the provisions in H.R. 4210 for tax credits for wages of *zone residents only*. In Portland we have used this approach very successfully in the last two years. 55,000 people reside in our state-sanctioned enterprise zone. Through our targeted hiring program in the enterprise zone, we have seen approximately 60% of the new family wage jobs, that pay an average hourly wage of $7.50 plus benefits, go to zone residents.

While the President's proposal limits the tax credit to jobs which earn $20,000 or less per year, H.R. 4210 proposes a more realistic level of $30,000 which we support. We do not want to be in the business of encouraging principally low-wage, low-skill jobs.

- **Training Council**

While there has been much discussion of accelerated depreciation for equipment purchases in zone businesses, little consideration has been given to a tax benefit for businesses which invest in re-tooling the workforce whose skills are rapidly depreciating. We strongly urge you to consider including a limited tax credit for certain documentable training expenditures made in enterprise zones. Such training would occur after hiring and would include participation in recognized apprenticeship programs as well as customized training offered through local community colleges. In our experience, increasing the job skills of the enterprise zone population is the most long-term and transferable investment that we can promote.

- **Dedication for Purchase of Enterprise Zone Stock**

We have some reservations regarding the "dedication for purchase of Enterprise Zone Stock" in that it is difficult to see how this will stimulate investment in most small and medium sized businesses which are likely to be the main job generators in an enterprise zone. We would like to see a comparable incentive structured for alternate forms of financing which will benefit businesses fully owned by community residents.

It is our experience that minority and women owned firms, often found within the enterprise zone, struggle to attract capital for growth and sustenance. And, while they are the first to "re-take" our dis-invested commercial areas; the first to hire from the community without regard to incentives and leveraging; they are also the first to fail, often because of the scarcity of capital.

In closing, we would again like to applaud Congress on the scope and intent of the "Tax Fairness and Economic Growth Act of 1991" (H.R. 4210—Conference Version); it provides a remarkable opportunity to allow Federal, State and local governments to combine forces in targeted areas to combat the decay of the nation's cities.

Your remaining challenge is to identify teammates among the mid-sized, soon-to-be-large; urban areas and really solve problems before they become institutions. Thank you.

Prepared Statement of Senator Bob Dole

Mr. Chairman, I am pleased to see that the committee is starting to take action on this important initiative. I might add that the President has included enterprise zones on his agenda since 1989.

But, if we're actually going to do something other than create more political rhetoric, *we must move quickly*. I started from the beginning that we had 30 days before politics would take over the issue—this is after all an election year.

We have an opportunity to show the American public, and the world, that Congress and the administration can work together.

The President held a bipartisan leadership meeting on May 12. Everyone was encouraged that we would be able to work out a bipartisan proposal. Today is June 3, 22 day later, and we have yet to act. This hearing is a good sign. I hope we can take it to its logical conclusion—bipartisan legislation—and provide hope and opportunity for those trying to make a living in these desperate area.

I also hope we can *be realistic*. There is no need to state that this country faces serious fiscal problems. We have a $400 billion deficit and we pay over $200 billion in interest every year. However worthy this proposal or any proposal may be, it must be paid for. Simply adding to the deficit will only add to our problems.

We need to produce a bipartisan package with a realistic price tag. We should also proceed with some caution as Federal enterprise zones are yet untested. Why not a two year program? There are a significant number of rural concerns that must be considered and balanced with an urban initiative. Additionally, as noted earlier, although 38 States maintain enterprise zones, this is the first time a Federal program would be enacted. A two-year tryout would help curb the cost. It would also give the program time to prove itself and give the new Congress an opportunity to evaluate the program and make the decision as to whether or not to make it permanent.

I would also suggest that we combine a few of the other measures facing us—perhaps we should combine the repeal of the luxury tax, the extension of the emergency unemployment benefit, and the extenders with this package.

The luxury tax after all is also a jobs issue. As we have all witnessed, it is not a tax on the so-called rich, it's a job loss for the middle class.

An extension of Emergency Unemployment Benefits was agreed to in principle by President Bush almost a month ago. Based on the proposal announced by President Bush and the Republican leadership, I introduced legislation to extend the current program—now scheduled to expire July 4—through March 6. If we play politics with this issue as occurred on prior occasions, the unemployed lose while some politicians try to score a few points. The President will sign this legislation and it is time we put our partisan differences aside and act.

I, personally, don't care for all the extenders and frankly, I'm tired of having to renew them every year. But in the interest of quick action I would suggest that we provide a six month extension for all expiring provisions and then come back with a new Congress for ultimate disposition of these provisions.

So, the bottom line is that we need quick action on a short-term package- two years for the urban proposal, complete repeal of the luxury tax, extension of unemployment benefits and a six month extension of the expiring provisions.

Let's see if we can agree on the program and the payment—let's agree to get something done.

Prepared Statement of Senator Dave Durenberger

Mr. Chairman, in the wake of the recent riots in Los Angeles, the entire country has been concentrating on what we can do, and what we must do, to prevent this tragedy and travesty from happening again. I appreciate your holding these hearings on enterprise zones as a part of the solution to the desperate situation confronting many people in the nation's cities as well as in rural America.

In my judgment, enterprise zones are far from a panacea for economically depressed areas. Although I am not yet convinced that these types of tax incentives are the most effective use of scarce resources, I do look forward to exploring how tax incentives can be used to foster localized economic growth. My fear, Mr. Chairman, is that enterprise zones will be more effective at diverting growth from nearby areas than in fostering economic growth from the ground up.

My own state of Minnesota has experimented with border enterprise zones since 1983. Although I am pleased that these programs have kept jobs on the Minnesota side of the border, this success also serves to highlight my fears. The enterprise zones encouraged existing business to take advantage of the available tax incentives but were not as successful in prompting a flurry of new investment and job creation.

The 1988 report from the General Accounting Office also concluded that enterprise zones, such as those currently before the Congress, are better at shifting jobs rather than creating new ones. The transmittal from then-GAO Director Eleanor Chilemsky states that "Our evidence generally indicated that the Maryland program (which resembled the proposals before the Congress and served as a model) did not stimulate local economic growth as measured by employment or strongly influence most employers' decisions about business location."

While I do have reservations about the efficacy of enterprise zones, I appreciate this opportunity to explore the problems facing urban America. Mr. Chairman, I commend you for holding these hearings. I look forward to working with you and the rest of the Committee to address this critical situation.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF FRED T. GOLDBE[illegible], JR.

Mr. Chairman and Members of the Committee: I am pleased to be here today to discuss the Treasury Department's views regarding the Administration's enterprise zone proposal. America's urban centers are plagued by a number of daunting problems including poverty, crime, drug abuse, gang activity, and inadequate economic development and opportunity. These conditions have varied and complex causes. To be successful, any effort to cope with the root causes must have as its goal the creation of a stable and secure environment in which the cycle of poverty is broken and economic success and upward mobility become the norm. Realization of this goal requires a consistent, broad-based strategy that forges a partnership among Federal, State and local governments, industry and the local community. Secretary Kemp has described in some detail the wide range of initiatives that have been proposed by the Administration to foster development of the desired environment. My testimony will focus on the enterprise zone proposal, which is designed to attack the economic conditions that impede growth and opportunity.

The Administration's enterprise zone proposal is directed at creating for residents of distressed communities a dynamic local economy in which they can participate as entrepreneurs, customers, and employees. The current lack of economic growth and opportunity in these communities results in part from the breakdown of traditional capital markets. Because of the social and economic problems I noted earlier, capital investments in these areas are perceived to be very risky. As a result, aspiring entrepreneurs seeking equity capital cannot offer sufficient returns for investments in businesses that would be economically viable if located in a community perceived to be more stable. Moreover, given the high interest rates necessary to cover lender's perceived risks, practical constraints and, in some cases, legal barriers may preclude borrowing.

The Administration believes that access to capital and the development of entrepreneurship is the key to economic revitalization in troubled communities. The process of economic development in this country and abroad has demonstrated the importance of entrepreneurship for creating jobs and improving economic conditions. Given the fact that the normal operation of the capital markets in troubled areas has failed to provide the capital needed to stimulate growth, tax incentives are an appropriate means to increase the rewards of entrepreneurship and to reduce investors' required rates of return. The tax incentives we are proposing are targeted to encourage equity ownership by local residents, increase the availability of local goods and services, employ disadvantaged individuals, and stimulate meaningful entrepreneurial activity in the area. The targeting of the incentives is critical; the Administration wishes to promote the formation and success of local merchants, service providers and manufacturers, rather than warehouses and microwave transmission towers. Our program has been designed to deny benefits both to tax shelters built on uneconomic, tax-driven investments and to those who would exploit the tax incentives for their own economic gain but confer no benefits on the zone and its residents.

The enterprise zone proposal makes certain modifications that broaden and deepen the President's Fiscal Year 1993 Budget proposal. A summary of these modifications and a brief comparison of the original and modified proposals are attached to my testimony.

THE DESIGNATION PROCESS

Areas nominated by State or local governments are designated as Federal enterprise zones based on objective criteria evidencing economic distress. Any nominated area meeting the objective distress criteria is eligible for designation as an enterprise zone. Nominating governments are required to specify a course of action that they will undertake to enhance the effectiveness of the Federal incentives targeted to the zone.

QUALIFYING ENTERPRISE ZONE BUSINESS

Since the program's emphasis is on entrepreneurship, tax incentives are available to the investors, creditors and employees of qualifying enterprise zone businesses. An activity must have a significant business presence in the zone to qualify as an enterprise zone business. This requires that at least 80 percent of its annual gross income is derived from, and substantially all of its property and employees (at least one-third of whom must be zone residents) are directly involved with, the active conduct of the trade or business in the zone. The rental of commercial real property to other enterprise zone businesses and the rental of substantially improved residential real property are treated as the active conduct of a trade or business for this purpose.

Certain businesses are not treated as active zone businesses, including businesses holding collectibles or financial property (other than accounts receivable arising in the ordinary course of the business or financial instruments of a type and in an amount appropriate to reasonable working capital needs), businesses principally conducted for the benefit of a government, and businesses creating intangibles for sale or licensing intangibles to non-zone businesses. These businesses are excluded because the increase in value of their intangible property is not related to the economic activity of the business within the zone and does not contribute to community revitalization.

In addition to the foregoing, the "significant business presence" test requires that tax benefits flowing from treatment as an enterprise zone business be commensurate with the contribution of the business to enhancing employment, providing access to goods and services, and promoting entrepreneurial participation by zone residents. This additional requirement assures that a business receiving tax benefits advances the purposes of the Administration's enterprise zone proposal. Manufacturing facilities generally satisfy this test as they generally provide substantial local employment. Local retail and franchise businesses meet this test as they generally provide local employment and ownership, as well as goods and services to the community. However, businesses that contribute little to achieving the aforementioned purposes, such as broadcast towers, tank farms and "warehouses" holding title to intangibles, generally do not qualify.

BUSINESS TAX INCENTIVES

The tax incentives to encourage entrepreneurship in enterprise zones include investor level investment incentives, business level investment incentives, a financing incentive, and an employment incentive. The focus of the investment incentives is to increase the attractiveness of zone investments by eliminating Federal taxation of capital gains, allowing an immediate ordinary loss deduction for losses on investments in enterprise zone businesses, and encouraging investment in plant and equipment. These incentives should encourage risk-taking in enterprise zones and will improve the financing capacity of zone entrepreneurs.

At the business level, the proposal provides for a 100 percent exclusion (for both regular and alternative minimum tax purposes) of capital gains realized (during the period the enterprise zone designation is in effect) by a business on tangible property and zone-related intangible assets, such as goodwill, going concern value, or customer lists, that have been held and used for at least 2 years (5 years in the case of real property) in the enterprise zone business. The inclusion of zone-related intangibles is central to the program's focus on entrepreneurship. Intangible assets are the primary source of appreciation for local business and, accordingly, must be included to provide the necessary incentives for local entrepreneurship. Certain enterprise zone businesses will also enjoy increased expensing ($20,000 rather than the $10,000 available under current law) for investments in depreciable personal property, such as equipment and machinery.

At the investor level, the proposal provides for exclusion (for regular and alternative minimum tax purposes) of capital gains realized on the disposition of an equity interest in an enterprise zone business, regardless of the form in which the business is conducted. In addition, for each taxable year of the investor, the passive loss limitations of section 469 will not apply to the first $10,000 of losses resulting from an investment in an enterprise zone business.

As an alternative to capital gains exclusion/ordinary loss provisions, individual investors may elect instead to deduct their contributions to the capital of an enterprise zone business. Electing individuals may deduct capital contributions of up to $50,000 per year (not to exceed a $250,000 lifetime cap). To qualify, the business must be organized as a C corporation, have less than $5 million of total assets, and use the contributions to acquire tangible assets to be used in the enterprise zone business. Amounts deducted under the stock expensing provision are not treated as a preference for purposes of the alternative minimum tax. Gain recognized on the sale of stock that has been expensed is treated as ordinary income. Both the capital gain exclusion and the stock expensing incentives are available to investors who are zone owner-employees or zone residents.

At both the investor and enterprise levels, losses recognized on disposition of qualified assets, including an equity interest in an enterprise zone business, would be treated as ordinary losses. That is, these losses may offset earned income in addition to any capital gains.

The financing incentive is intended to enhance returns on investment in enterprise zone businesses by reducing the cost of borrowing. The proposal would authorize State and local governments to use the proceeds of tax-exempt bonds to make loans to an enterprise zone business for the acquisition of tangible property, up to a maximum of $250,000 per business. Tax-exempt bonds used for this purpose are authorized as exempt-facility bonds and would be subject to existing annual volume caps.

The Administration believes that, taken together, these incentives will increase the flow of needed equity and debt capital into the businesses most likely to produce sustained economic growth in the zones and provide the benefits of that growth to zone residents.

The employment incentive is designed to reduce employee costs associated with zone employment and encourage disadvantaged persons to seek employment in the zone. Employees of an enterprise zone business with qualifying earned income levels are eligible for the earned income tax credit (EITC) whether or not they have a qualifying child. This incentive replaces the employee wage credit that was included in the original proposal. We believe that the effect of this modification will be to target a more meaningful credit to that segment of the unemployed enterprise zone population most in need of employment.

PERSONAL TAX INCENTIVE

To attract homeowners to the zone and encourage home ownership by zone residents, the proposal also provides that a taxpayer may exclude capital gain (subject to an appropriate cap) recognized on the sale of a residence in a zone that has been the taxpayer's principal residence for the 5-year period immediately preceding the disposition. This exclusion will give homeowners a greater stake in the economic vitality of their neighborhood. As with business investments, excluded gain must be attributable to the period during which an enterprise zone designation is in effect for the area.

REVENUE EFFECT

The Treasury Department's preliminary estimate indicates that the Administration's proposal will reduce Federal revenues by approximately $2.3 billion over the 1992–1997 budget period. Additional revenues must be provided to offset this cost consistent with the pay-as-you-go requirements of the Omnibus Budget Reconciliation Act of 1990. The Administration's 1993 Budget included a number of revenue provisions that would be sufficient to offset the enterprise zone proposal. Three alternative "pay fors" are identified in the attachments to my testimony.

The Administration believes that the tax incentives described above are essential to the economic revitalization of enterprise zones. Although the incentives will not, by themselves, eliminate the conditions of poverty experienced by zone communities, they will play a crucial part in the broader program for economic development of these areas.

CHART I—FRAME OF REFERENCE

I. The objective: stable and secure environment where economic opportunity and upward mobility are the norms.
II. The strategies: eliminate barriers, invest in human capital, and stimulate economic growth through access to equity capital and entrepreneurial opportunities.
III. The programs: Weed and Seed; HOPE; America 2000; summer jobs and job training; enterprise zones.
IV. What's required: a comprehensive, long-term commitment by Federal, state, local governments and the affected community.

CHART II—SUMMARY OF MAJOR PROVISIONS, MODIFIED ENTERPRISE ZONE PROPOSAL

All distressed areas meeting objective criteria are eligible for EZ status.

Investor Level Incentives

- Capital gains exclusion for investments in EZ businesses (for regular and AMT purposes); no dollar limit, no limit on form of business, not limited to individuals.
- Ordinary loss deduction for losses from investments in EZ businesses (may be used to offset earned income).
- Passive loss limitations do not apply to first $10,000 per year of losses resulting from investment in EZ business.
- EZ residents and employees may expense up to $50,000 per year/$250,000 lifetime on C Corp stock investments in certain EZ businesses.
- Other investors may elect stock expensing in lieu of capital gains exclusion and ordinary loss treatment.

Business Level Incentives and Access to Capital

- Access to capital facilitated by investor level incentives.
- Capital gains exclusion for investments in tangible and intangible assets used in EZ businesses (for regular and AMT purposes).
- Ordinary loss deduction for losses from investments in EZ assets.
- Immediate deduction for purchases of depreciable personal property by certain EZ businesses (limit increased from $10,000 to $20,000).
- Access to tax-exempt financing (exempt facilities bonds, subject to volume cap).

Employee Incentives

- EZ employees without children eligible for Earned Income Tax Credit of up to $1,800.

Homeowners Incentive

- Exclude first $200,000 of gain on sale of EZ residence.

CHART III—COMPARISION OF ORIGINAL AND MODIFIED ENTERPRISE ZONE PROPOSALS

- All distressed areas meeting objective criteria are eligible for EZ status.
  —Original proposal imposed limit of 50 zones, subject to mandatory phase-in.
- All assets used in EZ businesses qualify for 100% capital gains exclusion (excludes passive intangibles, such as financial products and intellectual property, that are not used in an active EZ trade or business).
  —Original proposal limited to tangible assets; modified proposal covers intangibles used in EZ business.
  —Unlike original proposal, rental real estate must be leased to EZ business or be substantially renovated residential property.
  —Unlike original propcsal, rental real estate must be leased to a qualifying EZ business or constitute substantially improved residential property.
- All equity investments in EZ businesses qualify for 100% capital gains exclusion.
  —No similar provision in original proposal.
  —No limits on type of investor, amounts invested, or form of doing business.
- Losses on EZ investments are treated as ordinary losses, rather than capital losses.
  —No similar provision in original proposal.
- EZ residents and employees of EZ businesses entitled to expense certain stock investments (original stock expensing proposal).
- Individual investors may forego capital gains exclusion and elect original stock expensing proposal.
- Investors may use up to $10,000 per year of passive losses from investments in EZ businesses.
  —No similar provision in original proposal.
- Certain EZ businesses may expense up to $20,000 per year of investment in depreciable personal property.
  —No similar provision in original proposal.
- EZ businesses qualify for tax-exempt financing (exempt facility bonds).
  —No similar provision in original proposal.
- Qualifying EZ business must meet following criteria: 1/3 of its employees must be EZ residents; 80% of its annual gross income must be derived from EZ business activities; substantially all of its employees and property must be directly involved with the active conduct of a trade or business in the zone; tax benefits must be commensurate with benefits to EZ community.
  —Original proposal did not include the 1/3 of all employees and commensurate benefit requirements.

—Original proposal included related party and integraged business rules that have been deleted from modified proposal.

- Gain on sale of principal personal residence in an EZ is not subject to tax (subject to appropriate cap).
  —No similar provision in original proposal.
- EZ employees who are otherwise not eligible will qualify for the Earned Income Tax Credit (approximately $1,800 in 1994); current EITC beneficiaries unaffected.
  —Replaces wage credit of up to $525 available to all qualifying EZ employees.

CHART IV—REVENUE ESTIMATES, REVISED ENTERPRISE ZONE PROPOSAL

Following are Treasury's preliminary revenue estimates for the Administration's modified enterprise zone proposal (dollars in millions):

1992	1993	1994	1995	1996	1997	1992–1997
0	–(1)	–0.2	–0.5	–0.7	–0.9	–2.3

[1] Less than $50 million

By way of comparison, following are Treasury's revenue estimates for the original enterprise zone proposal (dollars in millions):

1992	1993	1994	1995	1996	1997	1992–1997
0	–(1)	–0 2	–0.3	–0.5	–0.8	–1.8

[1] Less than $50 million

CHART V

[In millions of dollars]

Proposal	1992	1993	1994	1995	1996	1997	1992–97
1 Conform book and tax accounting for securities inventories, modified 10-year 481 adjustment	0	532	586	667	806	929	3520
2 Enterprise zones	0	–32	–215	–466	–722	–878	–2313
Total:	0	500	371	201	84	51	1207

CHART VI

[In millions of dollars]

Proposal[1]	1992	1993	1994	1995	1996	1997	1992–97
1 Conform book and tax accounting for securities inventories (President's budget)	0	808	616	666	689	716	3495
2 Prohibit double dipping by thrifts receiving Federal financial assistance (President's budget)[2]	335	380	1	–40	–65	84	695
3 Individual estimated tax "safe harbor"[3]	600	0	0	0	100	4700	5400
4 Taxable years of partnerships, etc. (H.R. 4210)	440	–15	–255	5	4	3	182
Subtotal	1375	1173	362	631	728	5503	9772
5 Extension of unemployment benefits	–609	–1800	0	0	0	0	–2409
6 Enterprise zones	0	–32	–215	–466	–722	–878	–2313
Total	766	–659	147	165	6	4625	7363

[1] Proposals that raise revenues (or lower deficit) have positive signs; proposals that lower revenues (or raise deficit) have negative signs.
[2] Estimate includes OMB's estimate of the outlay effect.
[3] The individual tax safe-harbor proposal is to replace current temporary rule ($75,000/$40,000) with temporary 115% safe harbor with no AGI floor.

CHART VII

[In millions of dollars]

Proposal	1992	1993	1994	1995	1996	1997	1992-97
1 Place hospital update on calendar year basis (President's budget)	0	630	1050	1160	1210	1330	5380
2 Lower cap for laboratory services from 88% to 76% (President's budget)	0	310	560	770	1020	1320	3980
3 Raise deduction for self-employed health to 100%	–58	–246	–544	–885	–1292	–2022	–5047
4 Mine reclamation fee (President's budget)	0	0	0	0	228	251	479
5 Enterprise zones	0	–32	–215	–466	–722	–878	–2313
Total	–58	662	851	579	444	1	2479

RESPONSES OF SECRETARY GOLDBERG TO QUESTIONS SUBMITTED BY SENATOR DANFORTH

Question No. 1. We must ensure that the cost of any enterprise zone proposal remains manageable. My understanding is that the cost of various enterprise zone proposals runs from $1 billion to $2.75 billion. What incentives contribute to the higher cost of some of the proposals? Will these incentives provide benefits, i.e., jobs and new investment, commensurate with the additional cost?

Answer. The highest-cost tax incentives are generally the wage or employment credits and the stock expensing. However, these more costly tax incentives are also more likely to stimulate economic activity within the enterprise zones. The Administration's proposal is designed to limit tax incentives to activities which are expected to provide benefits commensurate with the cost of those incentives. For example, activities such as broadcast towers, tank farms or holding of collectibles would not provide sufficient benefits and would, therefore, not be subject to these incentives. Instead, the Administration's proposed tax incentives are targeted to promote the formation and success of local merchants, service providers and manufacturers, thus encouraging equity ownership by local residents, increasing the availability of local goods and services, employing disadvantaged individuals and stimulating meaningful entrepreneurial activity. Moreover, this program has been designed to deny benefits both to tax shelters built on uneconomic, tax-driven investments and to those who would exploit the tax incentives for their own economic gain but confer few or no benefits on the zone and its residents.

Question No. 2. We have many legislative objectives that need to be achieved this year—extending unemployment benefits and the expiring tax provisions. Both of these measures will also require funding. Do you have any ideas how we can pay for an enterprise zone proposal along with aid to the unemployed and the expiring tax provisions?

Answer. The Administration's 1993 Budget included a number of revenue provisions and spending reforms that would be sufficient to offset the enterprise zone proposal as well as other programs.

Question No. 3. Who would be responsible for the oversight and administration of the programs depicted in the various proposals? Most states have state enterprise zone programs. Would it be more efficient to allow states to administer the federal program, for example, like the state housing agencies administer the low income housing tax credit program?

Answer. One of the advantages of the Administration's enterprise zone proposal is that it is basically self-executing: the tax incentives are claimed by the individuals who invest in enterprise zone businesses, or by the businesses themselves, and do not have to be apportioned out by any administrators. Most other enterprise zone proposals, however, would require administrators to dole out some or all of the tax benefits among applicants. In that type of structure, we would have to consider the alternatives to determine the appropriate entity responsible for deciding which applicants could contribute most to the distressed communities in return for the tax incentives.

Question No. 4. We are concerned that we may need to provide additional incentives with respect to distressed areas in conjunction with the low-income housing tax credit program to assure that investment capital for affordable housing continues to flow into such areas. We want to make sure that investors using the LIHTC will find it attractive to invest funds in distressed areas despite the additional risks inherent with housing located in those areas. One way to provide this incentive would be to allow investors in housing located in an enterprise zone (or possibly additional defined areas such as "qualified census tracts" or "difficult development areas" under the LIHTC program) to utilize the LIHTC against a greater amount of tax on non-passive income and, in a limited manner, against alternative minimum tax liability. Specifically, please give us your position on a proposal which would (1) permit individuals investing in housing located in enterprise zones (or broader areas as suggested above) to utilize the LIHTC to offset $20,000 of regular tax on non-passive income (i.e., a $65,000 deduction equivalent) and (2) permit individuals to use the LIHTC to offset AMT liability to the extent of the lesser of (a) $20,000 or (b) 25 percent of AMT liability (determined before application of such credits).

Answer. The Administration believes that the tax incentives contained in its enterprise zone proposal will work to create sufficient capital flow into distressed areas designated as enterprise zones. Therefore, we do not believe it is necessary to the success of our enterprise zone proposal to provide additional benefits under the low-income housing tax credit provisions. Moreover, our revenue projections reflect only the tax incentives that have been outlined in the Administration's proposal.

Prepared Statement of Senator Charles E. Grassley

Mr. Chairman: I appreciate today's hearing on enterprise zones. We're all very aware of the need to address the problems of the inner cities in the narrow window of opportunity that exists. It's unfortunate that it took devastating public unrest to bring these problems to light.

Financial assistance to Los Angeles will be necessary, but merely signing a check over is not going to lead to any long-term solutions. We need to provide incentives for investment and job creation if we're going to make progress. enterprise zones can be an important component of an overall solution. I'm a cosponsor of such legislation, but there are other components that are needed as well.

I've introduced S. 1860 that would establish microenterprise programs for the poor. This legislation will encourage independence from public assistance through self-employment. By helping the poor start small businesses, we will get them off welfare and on to the tax rolls. Similar programs have been very successful on an international level in developing countries. There's no reason why they can't be successful in our own country.

In addition, beyond helping the inner cities, it's very important to point out that rural America needs our help at the same time. Rural America has always been the backbone of our Nation's economy, and as we consider solutions to the problems of our urban areas, we need to consider solutions to the overwhelming problems of our rural communities as well.

It's very troubling to me that there are some rural counties in my State of Iowa that have a per capita income very similar to the approximate $7,500 per capita income of south central L.A. Just because these communities haven't resorted to violence and unrest doesn't mean it's not an emergency situation.

So, as we discuss urban enterprise zones, we need to discuss rural enterprise zones. There has been bipartisan support for rural enterprise zones and they were included in the last tax bill. Unfortunately, at this time, the rural component seems to have been pushed into the background. But, when we talk about creating jobs in the cities through direct investment, whether it's through enterprise zones, microenterprise programs, or other methods, we also need to create jobs for the rural poor.

Last month, I wrote to President Bush regarding these concerns and also communicated them to you, Mr. Chairman. I hope these concerns will be seriously considered and addressed.

Prepared Statement of Orrin G. Hatch

Thank you Mr. Chairman. The need for increased economic opportunity in the urban areas of this country has been underscored by the recent unrest and violence in some of our cities. These incidents were more than just riots about racial inequity, they were symptoms of a larger problem. The people in these communities need help. They need jobs, food, education, and health care. We need to show them that the Federal government is aware of their situation and that we are going to do something about it.

Enterprise zones are one possible solution. They have the potential of targeting the resources of the Federal government to those areas where they will do the most good. I have long been a supporter of the investment incentives to spur economic growth and job creation contained in these proposals.

However, I am concerned that in our rush to solve the highly visible and emotional urban problems, we will forget the rural communities of America. Many of these communities are experiencing the same problems in housing, education, health care, and economic development. The citizens in these communities deserve the same help as those living in the urban areas of our nation.

I am also concerned that we will rush in and craft a solution consisting of short term fixes that will not help anyone. We must put into place a mechanism that will ensure long term growth in the economy1 education and health care of these enterprise zones.

The current economic and budget conditions put us into a difficult position of having to walk a tightrope. We need to designate enough programs to fill the needs of the country, but we must also put some limitations on the number of zones created. This is a very difficult task, and I do not have all of the answers.

I am looking forward to hearing the testimony of the witnesses today and am sure that they will help answer some of these questions. The hearing today is one more step in the process of developing a solution. However, we cannot stop here. There is still much more work to be done. I am confident that the members of Congress and the Administration can continue to work together and craft a legislative package to attack this problem.

Thank you, Mr. Chairman.

Prepared Statement of Terry Jones

Good morning, Mr. Chairman and members of the Senate Finance Committee. I am Terry Jones, President of SYNCOM Capital Corporation in Washington DC, and a director of the National Association of Investment Companies (NAIC). NAIC is the industry trade association for venture capital firms that dedicate their financial resources to investment in minority businesses. Today the approximately 150 NAIC members include privately-owned Specialized Small Business Investment Companies (SSBICs), licensed and regulated by the U.S. Small Business Administration; privately-owned venture capital firms; and a number of investment companies chartered by state and local governments to do focused investing, primarily in minority businesses.

Twenty years ago leaders in government and business engaged in a daring public-private sector experiment—creation of specialized investment companies with a mandate to invest only in minority-owned businesses. Black, Hispanic, Asian American and Native American—entrepreneurs from all minority groups who for the most part were shut off from access to venture capital from banks and other financial institutions—would for the first time have access to "patient," equity capital for minority business formation and growth.

NAIC has for two decades provided the vision and energy for growth from an experiment in minority business financing to a dynamic industry which has invested an estimated $1 billion in capital.

SYNCOM Capital Corporation was one such specialized small business investment company created in 1977 to increase the number of minority owned communications properties. SYNCOM is now acknowledged as a progressive leader in venture capital investing for minority individuals seeking capital for media acquisitions and start ups. Since 1978 we have financed over 60 minority owned companies involved in various areas of telecommunications which include, for example, the development of cable television franchises in Newark, New Jersey, East Los Angeles, Seattle, Columbus, Chicago and Washington, D.C. among others. In broadcasting, SYNCOM has financed network affiliated television stations owned by African American and Hispanic entrepreneurs, as well as AM–FM radio properties in most of the major markets in the U.S. SYNCOM's investees have also participated in the development and ownership of new communications technologies ranging from cellular telephones to mobile satellite delivered services. Each of these enterprises is managed, owned and controlled by successful minority entrepreneurs and contributes greatly to the economic vitality of their localities. Over 75% of these companies were start-ups.

I am pleased to have the opportunity to appear before the Senate Finance Committee to speak on behalf of the positive track record established by the minority venture capital industry and in support of H.R. 4221, the Minority Development Act of 1992, which was introduced earlier this year in the House of Representatives. We expect a companion bill to be introduced in the Senate this week. I have attached a summary of the key provisions of the bill.

The key challenge to minority business development is to accomplish the efficient aggregation and the prudent deployment of investment capital to under served entrepreneurs and enterprises. The problem is not that there is a shortage of capital per se, in fact, statistics dramatically demonstrate that adequate capital is—generally available for business creation and development. The problem, however, is that almost no incentives exist that cause capital to flow to enterprises and areas which help to save and stabilize our cities, our communities and our youth.

During the ten years from 1981–1990, venture capital industry resources have increased from $5.8 billion to $36.0 billion. Unfortunately, less than $10 million dollars, only 1/30 of 1%, of the capital raised found its way into minority-owned firms.

And, this is at a time when the gross of receipts of minority businesses are growing at a much higher rate than all U.S. firms. From 1982 to 1987, the number of businesses owned by minorities increased 64% compared to overall U.S. firms growth of 14%. From 1982 to 1987, total receipts of minority owned firms grew 126% compared to 79% for all U.S. firms. However, still only 7% of all U.S. businesses with paid employees are owned by minorities. Recently, minority entrepreneurs have been expanding their business focus to include high growth and profit opportunities in the areas of communications, finance, computer technology, environmental, and health related industries. But, many of these businesses have been unable to access traditional sources of equity capital to support that growth. Even the companies which comprise the only nationally available source of investment capital for these businesses, the specialized SBICs, are often not well suited or of adequate size to foster the growth and development of new ventures. For example, specialized SBICs and other organized sources of equity capital for minority owned businesses are relatively small, by majority venture capital standards, and usually require current income to be generated by the investments they make. The paradox is that the kind of companies that need financing often cannot provide current yields to their equity investors in their early years. There is, therefore, a desperate need to diversify the type of capital available which can then be provided in a broad mix of long term debt, equity, and mezzanine financing as well as to increase the total capital available for minority ventures.

However, in spite of its current limitations the SSBIC industry has managed to invest over $650 million in 6,182 small companies over the last five years. As financial intermediaries, the SSBICs have developed the ability to nationally aggregate capital, via investment syndicates, and direct that capital to worthwhile minority enterprises anywhere in the United States. (Examples of companies financed by the minority venture capital industry are attached). This positive impact has been accomplished with the limited capital resources available to SSBICs. But, just as the minority entrepreneur has encountered difficulties in raising capital, so to have the SSBICS and other sources of capital dedicated to financing minority enterprise faced similar challenges raising capital to invest in minority firms.

As stated throughout this presentation, the aggregation and targeted deployment of private capital is fundamental to the success of urban and rural economic initiatives. In order words, private capital must be incentivized to form investment pools, which are then prudently invested in for-profit enterprises and/or targeted enterprise zones.

The intent and essence of H.R. 4221, The Minority Enterprise Development Act of 1992, is to provide the incentives that cause the aggregation, or pooling of private capital for this purpose. Fortunately, there already exists an institutional network, the Specialized Small Business Investment Company industry which can efficiently and professionally direct, or invest, this capital into the most viable opportunities, provide support for the businesses in which the capital is invested, and maximize the return to the providers of private capital and thereby continue to attract new capital.

Thus, Mr. Chairman, we have arrived at a point in history where it is now possible to join together these two essential ingredients needed to dramatically spur minority business growth. And, it is the unique opportunity of this Congress to allow this economic development of our urban and rural areas by passing the essential provisions of the Minority Enterprise Development Act of 1992.

There are two main components of this legislation that work toward bridging the gap between the minority entrepreneur and the sources of private capital. The first provision provides targeted income tax deductions for individuals and institutions that provide capital to minority controlled companies. However, if the investor elects to take the deduction, the equity investment must be held for at least three years.

The second provision allows for investors to realize a tax deferral on long-term (three or more years) capital gains, if reinvested in qualified minority or small disadvantaged businesses.

Finally, a third provision stipulates that the benefits provided by the bill would not be treated as preference items for purposes of the alternative minimum tax.

Mr. Chairman, we appreciate the opportunity to have appeared before this Committee today to discuss legislative incentives for urban and rural business development, and how the public and private sector can work together to ensure their success.

We believe that there is a mechanism currently in place that does address the financial needs of the ethnic marketplace. The question remains, "How can we direct the needed capital to this under-served marketplace?" We feel the Minority Enterprise Development Act of 1992 is a step in the right direction and should be a part of any urban development strategy and program.

The government can be very proud of its role in the creation of the Specialized SBIC industry. From its beginnings twenty years ago, this industry has become a foundation and a crucial part of minority business development in this Country. This private-public sector partnership has developed a cadre of venture capital managers who are expert in investing in urban and rural based minority businesses. And, because there is a continuing and pressing need to raise new and larger pools of capital dedicated to minority financing, it is critical at this time to provide incentives that direct capital from individual and institutional investors into ethnic enterprises and communities.

Mr. Chairman, I appreciate the opportunity to testify before the Committee today. I would be pleased to answer any questions your might have.

Attachment.

MINORITY ENTERPRISE DEVELOPMENT ACT OF 1992

SUMMARY OF PROPOSAL SPECIFICATIONS

I. Targeted Tax Deductions

A. *Small Disadvantaged Business.* Non-corporate taxpayers could elect to deduct up to $50,000 for any taxable year, with a lifetime cap of $250,000 for existing investments. Election available for investments in companies owned by persons deemed "socially disadvantaged" by the SBA (for example, persons who are Asian American, African American or Hispanic American). Qualified companies may not own or lease more than $12 million of property and may not issue more than $5 million of stock for which the deduction is available.

B. *Venture Capital Companies.* Investors in venture capital companies could elect to deduct up to $300,000 per year of an equity investment provided (1) the company is a SBA licensed MESBIC; or (2) the company was formed exclusively for the purpose of acquiring equity interests in small disadvantaged businesses or for making loans to such businesses; and (3) in the case of a non-SBA licensee, at least a majority of its assets have been invested in small disadvantaged businesses.

C. *Holding Periods, Recapture and Basis Adjustments.* If the investor elects to take the deductions, the property must be held at least 3 years. Interest would be charged on the decrease in tax that resulted from the deduction for property held for less than 3 years. Tlle property's basis would be reduced by the amount of deduction(s) claimed.

II. Capital Gain and Deferral

A. *Long Term Capital Gain.* Fifty percent (50%) of the long term capital gain realized from the disposition of eligible property would be excluded from gross income. The property must have been held for at least three (3) years.

B. *Deferral of Capital Gain Reinvested.* Recognition of long term gain from the sale or exchange of the property could be deferred up to nine (9) years if the gain is used for reinvestment in "qualified replacement property." The amount of gain deferred is subject to a lifetime cap of $500,000 for individuals. "Qualified replacement property" refers to equity investments in small and disadvantaged businesses and in eligible venture capital companies.

III. Treatment of Losses; Alternative Minimum Tax

A. *Losses.* Loss in qualified investments would be treated as ordinary.

B. *Alternative Minimum Tax.* Deductions elected and capital gain excluded would not be treated as a preference item for purposes of the alternative minimum tax.

PORTFOLIO COMPANIES

Companies receiving investments from minority venture capital companies vary widely in size and type. Successful portfolio companies range from fast food franchises to communications properties to technology-based companies. As noted in the previous section, minority business investment trends have changed over the past two decades from traditional mom-and-pop operations to increasingly larger and more sophisticated deals.

The 14 portfolio companies described in the following section represent a range of companies in the portfolios of the investment companies tending toward deals with higher growth potential. They vary in terms of geographical location, racial/ethnic ownership, size, and type, reflecting the diversity of investments in the minority business investment industry.

Alamo Technologies

In 1981, four Hispanic engineers founded Alamo Technologies, a company that specializes in providing engineering services for the government. Alamo Technologies is based in San Antonio, Texas, a city which serves as home to five military bases. In 1987 MESBIC Ventures, Inc. and four other minority investment companies provided several rounds of financing to Alamo Technologies, which at the time had reached sales of approximately $3 million and had just won a $16 million contract with the government to design and manufacture a jet engine set. This test has received recognition for its overall efficiency. On most tests this set uses 50% less fuel and 50% less time and labor.

MESBIC Ventures and the four other investment companies provided over $1.5 million in financing to Alamo Technologies, which is currently doing $6 million annually in revenues, has substantial net worth and profitability, and is ranked by Hispanic Business as the sixth largest Hispanic-owned engineering company. The entrepreneurs and investors see Alamo Technologies as a leading candidate to grow to a $25 million company, providing capital can be secured to match the human talent already in place.

With the financing from the investment companies, Alamo Technologies has over the past three years brought the engine test sets into full production and is manufacturing 250 test sets per year. The company also built prototypes to conduct field test, two of which provided critical assistance during the Desert Storm operation. Given the success of the engine test sets, Alamo Technologies is currently developing plans for commercial applications and seeks additional venture capital to build a commercial test set by the mid-1990s. In addition, the company created a unique, totally automated software system in developing the engine test sets, and is developing software to provide services for other types of equipment.

Almic Broadcasting, Inc.

In 1980, SYNCOM Capital Corporation led the first in a series of investments in Almic Broadcasting, Inc. that are helping to build a highly successful broadcasting company based in Washington, DC. Owned by entrepreneurs Cathy Hughes and her son, Alfred Liggins, Almic Broadcasting in 1980 purchased WOL–AM, a premiere radio station in the Washington area's Black community. SYNCOM was the lead investor in a syndicated deal involving several other minority investment companies.

In 1987 SYNCOM served as lead investor for Almic's purchase of WMMJ–FM from The Outlet Company for $7.5 million. Almic paired the AM and FM stations, converted WMMJ's adult contemporary format to upscale urban, and turned the AM/FM combination into the number one station in Washington, DC for people aged 25–54, the most desirable demographics for advertisers. The company has gone from zero revenue, zero cash flow in 1987 to close to $7 million revenue and almost a $1 million cash flow.

Almic is currently in the process of buying an FM/AM combination in Baltimore, Maryland. The growth in the values of the Washington, DC properties has been instrumental in Almic being able to leverage the acquisition of the Baltimore stations, further enhancing the value of the company.

The investors are also realizing some return on investment at this point. Almic is repurchasing about 20% of SYNCOM'S warrants, and the investors are also realizing returns on debentures. The company is currently worth an estimated $17–20 million, despite today's down market.

Envirotest Systems Corporation

In December, 1990, Envirotest Systems Corporation acquired Hamilton Test Systems, a leading provider of motor vehicle emission testing systems and services, from United Technologies. The company designs, installs and operates centralized motor vehicle testing facilities on a contract basis in states and municipalities around the country. Envirotest Systems currently tests vehicles in Connecticut, Ohio, and Wisconsin, and in January 1991, shortly after the acquisition of Hamilton Test Systems, it won a contract through competitive bidding to conduct all motor vehicles emission testing in Vancouver, British Columbia.

Black entrepreneur Chester Davenport formed Envirotest Systems Corporation for the purpose of acquiring Hamilton Test Systems from United Technologies. The equity part of financing the $43 million deal was provided by Georgetown Partners, a buyout fund which Davenport created, and an investment group led by Equico Capital Corporation, a New York-based minority investment company. A major international bank provided the bank financing. Davenport, an attorney and former Deputy Assistant Secretary of the U.S. Department of Transportation, was a successful real estate entrepreneur in the Washington, DC metropolitan area prior to establishing his Bethesda, Maryland-based buyout fund.

Envirotest Systems Corporation is currently negotiating to acquire a significant competitor in the motor vehicles emission testing business. If the deal is consummated, the company will hold a superior position in the industry and the economies of combining the two companies will enhance its profitability.

Tennessee Double Drive Thru (Checkers of North America)

In November, 1991, the Combined Fund, Inc. closed a $1 million syndicated financing in Tennessee Double Drive Thru, a company formed by Black entrepreneur John Perry to develop five Checkers of North America franchise operations in Memphis, Tennessee. Checkers restaurants are double drive through fast food restaurants that sell hamburgers, French fries, fish and other fast foods. The franchisor, Checkers of North America, headquartered in Clearwater, Florida, just went public in order to raise funds for expanding franchise operations. The Combined Fund, Inc. provided $300,000 of the $1 million syndicated financing for Tennessee Double Drive Thru. The Combined Fund has 40% potential equity interest in the company, and entrepreneur John Perry has the balance.

A veteran in the fast food industry, Perry previously owned the 87th Street Corporation, which bought and sold three McDonald's restaurants over a period of a decade and a half and provided numerous jobs to inner city young people. All three McDonald's were profitable operations. The Combined Fund began investing in Perry in 1975, providing $250,000 in financing and bringing in an additional $500,000 from other sources. Perry determined that the growth potential of McDonald's was flat, especially compared to Checkers of North America which some analysts expect to be the number one double drive through restaurant in America within the next three years. Perry sold his last McDonald's property in May, 1991.

Education Alternatives, Inc.

In 1988, Education Alternatives, Inc. was founded to develop and operate proprietary private schools. Prior to the company's public offering (NASDAQ tracking symbol EAIC) in 1990, Capital Dimensions Venture Fund, Inc., another SBIC and a group of private investors provided $4.5 million of equity and an additional $1 million in other bank and public borrowing. The two minority investment companies put in $700,000 in preferred stock in 1988, and an additional $80,000 in debt guarantees in 1990. Hispanic entrepreneur Frank Martin was the founder of the company.

Education Alternatives, known nationally for its pioneering work with Tesseract Schools, built and operated two private schools in the suburbs of Minneapolis and Phoenix. Students in the preschool through sixth grade schools advanced an average of 1.7 grades within a year with the Tesseract model's emphasis on individual students' learning styles. The teacher-student ratio is 1 to 12, a ratio achieved with economic feasibility through an innovative system of master teachers, junior teachers, and assistants. The schools also make maximum use of technology, an approach which is facilitated through a relationship with IBM.

The original two schools' education performance was not matched by their financial performance, and the adaptive company is now contracting with school systems to operate schools using the Tesseract methodology. Education Alternatives is operating schools in Dade County (Miami) and Tallahassee, Florida. An agreement is currently in discussion with Johnson Controls and KPMG Peat Marwick that will allow the three companies to bid on and assume management of entire school systems. Given the number of school systems in the country and the size of their budgets, Education Alternatives will not require deep penetration of the market to achieve profitability. The company has received widespread publicity through media such as ABC's "Good Morning America," "CBS This Morning," the *Wall Street Journal,* and numerous other media for its innovative and highly successful approach to education.

TLC Group Inc.

In January of 1984, Equico Capital Corporation invested $500,000 in TLC Group Inc. ("TLC"), a newly formed company owned by Reginald Lewis. Equico's investment took the form of a $500,00013% subordinated debenture. The terms also included a warrant to purchase 10% of the common stock of TIC. An option to purchase 10% of the common stock of any company acquired by TIC within two years of Equico's investment was also a part of the terms.

Equico's investment provided part of the equity for TIC's acquisition of the McCall Pattern Company ("McCall") in a leveraged buyout valued at $22.5 million. McCall was the second largest producer of home sewing patterns. In the fiscal year prior to the acquisition, McCall reported sales of $51.9 million and operating income of $7.1 million.

TIC prepaid the $500,000 subordinated debenture in December 1985 and in June 1986 agreed to repurchase its warrant and option for $2.4 million. Equico received $700,000 cash and a one-year note for $1.7 million. TIle note was paid in December 1987. This transaction produced an internal rate of return of 128%

Subsequent to the acquisition and sale of TIC, entrepreneur Reginald Lewis acquired Beatrice International in a $1 billion leveraged buyout, the largest LBO ever conducted by a minority investor group. Lewis' McCall Pattern Company deal, which secured half of its equity from Equico Capital Corporation, served as the springboard for the Beatrice transaction.

Emerge Communications, Inc.

In 1987, SYNCOM Capital Corporation began putting together a deal to invest in a start-up communications company that would own a news magazine targeted to the Black middle class. The concept for EMERGE Magazine was developed by Black entrepreneur/journalist Wilmer Ames, who was on the staff of Time Inc. when he conceived the idea and submitted it to Time Inc. in 1986. Time Inc. approached SYNCOM, the minority investment company which has financed the majority of minority-owned communications properties in the United States, as a potential partner in developing the magazine. SYNCOM agreed to conduct the analysis, structure the deal, and bring in investors.

In April, 1989 SYNCOM closed the deal, along with an investors group which includes Time Warner, Black Entertainment Television, Tower Ventures, Incorporated of Chicago, Opportunity Capital Corporation of Fremont, California, and Future Value Ventures, Inc. of Milwaukee, Wisconsin.

EMERGE Magazine is a monthly news magazine which is positioned to promote thought among the most influential members of the Black community. All EMERGE writers are Black freelance writers who cover issues and opinion makers that affect the Black community. Entrepreneur/journalist Wilmer Ames is Editor-in-Chief of EMERGE, and is also part owner. Bob Johnson of Black Entertainment Television (BET) is the publisher. BET recently bought out Time Warner's share of EMERGE, and now owns 51% of the magazine. EMERGE published its first issue in October, 1989, and currently has a circulation of 120,000. It expects to achieve break-even by the end of 1992.

Ninfa's

Between 1981 and 1991, MESBIC Ventures, Inc. of Dallas, Texas and several other minority investment companies have provided four rounds of financing for the expansion of Ninfa's, a restaurant chain based in Houston. Entrepreneur Ninfa Lorenzo began Ninfa's 25 years ago when customers of her popular flour tortilla stand urged her to open a restaurant. She started Ninfa's with a tortilla restaurant in the front of a Houston factory.

Today Ninfa's enterprise owns 30 stores and will do close to $35 million in sales in 1991. Ninfa Lorenzo serves as chairman of the company, and the oldest of her four children, Naval Academy graduate and Vietnam War veteran Roland Lorenzo, is the president. The company operates three restaurant concepts. Ninfa's is a Mexican restaurant. Bambalino's, a restaurant with an Italian concept which was created by Ninfa and her children to honor her late husband (who was Italian) serves pizza and lasagna. Acchafalia's, named for a Louisiana waterway, has a Cajun theme.

Ninfa's, and the owner Ninfa Lorenzo herself, have become a legend in Houston. In fact, a local play was based upon the enterprising family, two of whose children are restaurant operators independent of the Ninfa's complex.

Following the original MESBIC Ventures financing in 1981, Ninfa's grew from $18 million in sales to 1991's $35 million. Three minority investment companies have provided close to $1 million through four rounds of financing, including one in 1991 to create Bambalino's. The first round of financing was paid off in six years with a solid capital gain. The company is financially sound and profitable. It hopes to expand throughout Texas in the 1990's, providing at least $2 million in venture capital can be secured.

HR Industries

HR Industries, the largest Hispanic-owned company in the Southwest, is a turnaround company that grew from sales of near zero in 1983 and 1984 to sales today of $12 million and 280 employees, most of whom are Hispanic. Hispanic entrepreneurs Paul Dickenson and Sam Moren, who founded HR Industries in the early 1970's, owned an oil company when they acquired a manufacturer of printed circuit boards in 1980. When the oil market fell apart in 1981 and the local economy crumbled in 1982–1983, the company was on the verge of failure. MESBIC Ventures, Inc. and three other minority investment companies provided financing to Dickenson and Moren to restart and restructure the company.

HR Industries has an automated state-of-the-art manufacturing process, and for the last five years has had substantial profitability. One of the largest printed circuit board companies in the industry, it is the largest Hispanic-owned electrical company in the country. Given the capital intensive requirements of the company's automated equipment, HR industries anticipates a need for $3–$5 million to continue its growth path in the 1990's.

Micronics Computers Inc.

Founded in 1986, Micronics Computers, Inc. is a leading designer, manufacturer and marketer of high performance, industry-standard microcomputer products. Micronics products include 80386 and 80486 system boards, portable computers and X-Terminals, based on the highest level of technology available. The company's product mix moved markedly toward the Intel 486SX–20 Mhz based product introduced in May, 1991. Micronics' products are marketed through two primary channels: (1) large PC manufacturers who use OEM Micronics' system boards in their brand name personal computers and (2) smaller VARs and System Integrators who use Micronics' boards as the basis of IBM PC/AT compatible systems.

With financing which includes Equitable Capital Corporation, a Chinese American-owned minority investment company based in San Francisco, Micronics has grown into a company that has been profitable every year since the company was founded. Under the management of Micronic's President, Frank Lin, dynamic growth and creative marketing strategies in 1988 resulted in a 525% increase in revenue to $25 million from $4 million the previous year. Micronics went public in July, 1991, and in its first quarterly report as a public company it reported that sales reached $34,977,000 in the third quarter, up 64% from $21,317,000 of sales in the previous year's third quarter. For the nine-month period, sales increased 66% to $96,155,000 from the previous year, while net income was up 131%. The third quarter result represented the company's nineteenth consecutive profitable quarter.

Pueblo Broadcasting Corporation

In May, 1987, SYNCOM Capital Corporation and six other minority investment companies closed on a $3.5 million deal to finance Pueblo Broadcasting Corporation's start-up of a Spanish language television station in the Houston, Texas market. The group of Hispanic entrepreneurs who had approached SYNCOM approximately four years earlier about structuring such a deal included a pharmacist, who became president of the company; a sales account manager from a Spanish language station in Los Angeles, who initially was the chief operating officer; a doctor; a shop owner; and other primarily professional Hispanic people. Upon SYNCOM's advice, the group sought a broadcast license for the station through the Federal Communications Commission's "comparative hearings" process, a lengthy and expensive process through which the FCC decides among multiple applicants for free licenses which best serves the public interest.

Upon receiving its license, the group returned to SYNCOM for assistance in structuring the deal. SYNCOM was joined in the syndicated financing by MESBIC Venture Capital, Inc. of Dallas; Intercontinental Capital Funding Corporation of New York; Venture Opportunities Corporation of New York; Fulcrum Venture Capital Corporation of Washington, D.C.; Opportunity Capital Corporation of Fremont, California; Associated Southwest Investors, Inc. of New Mexico; and Capital Dimensions

Venture Fund, Inc. of Minneapolis. The group financed $1.5 million in preferred stock for Pueblo Broadcasting: In addition, Capital Dimensions Venture Fund provided $2 million senior debt financing, bringing total financing to $3.5 million.

Station KX, Channel 45, went to a full power UHF Television station by 1988, and was the first Spanish language station to service the Houston community of one million documented Hispanic people. Its program services use Univision programming, as well as locally originated programming. The station was profitable from day one, earning $250,000 in its first year as a low power station, and reaching nearly $6 million in revenue in 1988 when it went to a full power UHF station. At the end of 1988 Hispanic Business named Pueblo Broadcasting the "Fastest Growing Hispanic Business in the United States." From a value of around $6 million when it was financed, Pueblo Broadcasting grew within a year to a value of $26 million. With two additional Spanish language stations now in the Houston market, Channel 45 remains the leading Spanish language station in Houston.

The minority investment company group in November, 1991 provided a substantial buyout of the entrepreneurs, resulting in a gain to the investors of $3 million. The investor group retained 1% of equity at the request of the entrepreneurs, who wanted the investors to remain involved with the company.

Cybernetics Systems International Corporation

This Coral Gables, Florida corporation designs and markets automated workforce management systems. It structures and administers workplace schedules, for example, for companies such as airlines and hotels with large employee bases.

Cybernetics System International Corporation ("Cybernetics") develops and markets automated workforce management systems and software that control and administer intricate workplace schedules. The company was founded in 1980 by Claudio Mendoza and Gustavo Agusti, two Hispanic industrial engineers.

In March 1990, Equico invested $400,000 of a total $1.6 million in equity provided by three venture capital companies. The financing recapitalized the company and provided much needed capital for growth and new product development. During 1991 the venture group invested an additional $500,000. Equico's share was $145,000.

After a period of slow sales and unprofitability in late 1990 and early 1991, the company has signed major stew contracts with Pacific Bell and the Florida State Department of Transportation. Other significant customers include American Airlines, Northwest Airlines and American Express.

The recent market acceptance of the company's proprietary software should signal rapid growth. For 1992 Cybernetics is forecasting sales in excess of $7.0 million and significantly increased profits.

Citywide Broadcasting Corporation

In 1990, the Combined Fund, Inc., a minority investment company located in Chicago, began a series of investments in Citywide Broadcasting Corporation, a Louisiana-based broadcast company owned and operated by two Black entrepreneurs. Citywide Broadcasting Corporation currently owns three radio stations in Louisiana, including KQXL–FM and WXOK–FM in Baton Rouge and KFXZ–FM in Lafayette. The FM/AM combination is number one in the Baton Rouge market, with the combined audience base of the FM urban format and the AM news, rhythm and blues, and gospel format commanding 20% of the listener audience. KFXZ–FM is the number two station in Lafayette, commanding over 13% of the listening audience in its market.

The total investment in Citywide Broadcasting since 1990 totals $2 million. The Combined Fund recently led an investment of nearly $1 million, and has itself provided close to $1 million in financing overall. The Combined Fund holds stock warrants in an amount of about 20–25% of the company. The funds have been used So refinance the Baton Rouge station and to acquire the Lafayette station. The Baton Rouge station has grown from a small Class A FM station, acquired by Citywide Broadcasting eight years ago with a value of $500,000, to the AM/FM combination valued at close to $8 million. Three years ago the station was upgraded to 50,000 watts. The three stations generate revenues of $3.5 million, and are consistently profitable. The return on investment in Citywide Broadcasting is expected to exceed 40%

Peter Moncrieffe, President and General Manager of Citywide Broadcasting Corporation, and Bill Tucker, the two entrepreneurs who are building the company, were successful entrepreneurs in the construction and real estate businesses in Baton Rouge prior to entering the broadcast field. Their objective is to build Citywide Broadcasting into the number one broadcast company in Louisiana, building value through the growth of currently-owned stations and acquiring additional stations.

MultiRestaurants, Ltd.

In 1989, MESBIC Ventures, Inc. and six other minority investment companies syndicated over $4 million in equity financing for MultiRestaurants, Ltd. to acquire Key West Grill from Steak&Ale. Key West Grill, a restaurant concept described as "a seafood version of Bennigan's," currently has three restaurants in Texas and plans to expand in Texas and Florida. Key West Grill has an operating profit of 20%.

Hispanic entrepreneur Gilbert Aranza, President of MFVS, Inc., the managing general partner of MultiRestaurants, Ltd., created the concept for another of MultiRestaurant's holdings, a restaurant chain called J. Pepe's. Aranza founded J. Pepe's in 1982, and the upscale Mexican restaurant chain now has three stores. The Key West Grill and J. Pepe's operations have a combined $9 million in sales.

Aranza, who worked his way through the University of Texas by working at the Dobbs House, Inc., a major airport restaurant operation, has a law degree from Harvard Law School and maintains a partnership role in the Dallas Law firm of Cohan, Simpson, Cowlishaw, Aranza & Wulff. Aranza and the investors have the objective of opening an additional 10 stores over the next five years in Texas and Florida, with emphasis on the profitable Key West Grill concept.

Prepared Statement of Jack Kemp

Chairman Bentsen and members of the Committee, thank you for this opportunity to appear on behalf of the Administration and a bipartisan coalition to discuss how passage of our Enterprise Zone legislation will enable people in our inner cities, rural areas and Native American communities to get jobs, private property ownership and economic opportunity. President Bush believes that the creation of Enterprise Zones will instantaneously expand minority entrepreneurship and bring prosperity and ownership to people who are today locked into poverty and despair.

Accordingly, he has decided to dramatically expand the Administration's Enterprise Zone proposal by ensuring that ALL distressed areas meeting defined criteria can qualify as Enterprise Zones. In Los Angeles last week, the President said: " . . . here's an open invitation to the mayors of America's cities and a challenge to the Congress: If you meet the criteria, instead of 50 Enterprise Zones for America, every deserving neighborhood will become one."

As a nation we can all take pride that America has encouraged the movement to freedom and democracy around the world. we can do no less for Americans here at home who are today caught in a web of joblessness and hopelessness, bureaucracy and a system of top-down government paternalism.

We must move to change the rules of the tax system and overhaul the welfare system in ways that will help encourage work and let low income families regain control of their lives and liberate themselves from poverty.

Mr. Chairman, you and I and the members of this Committee have it within our power to make these changes to help allow opportunity to take root in America's most distressed areas by passing bipartisan Enterprise Zone legislation.

This is the fourth different Congressional committee before which I have testified on Enterprise Zones in the last three years. Mr. Chairman, please let this be the last. As the President pointed out in Los Angeles last week, the time is past due to enact an Enterprise Zone law that will greenline for growth and opportunity the impoverished communities and neighborhoods around this country that today are being redlined because they have no access to credit, capital and private property.

Only six months ago, I appeared before this Committee to discuss a broad range of economic and tax policy initiatives to help stimulate growth and create jobs and opportunity for all Americans.

I told the Committee then that we have effectively created two economies in this country. One economy, the mainstream economy, is democratic capitalist, market oriented, entrepreneurial, and based on private property. Indeed, incentives abound for working, saving, investing, getting an education, starting a family and starting a business.

But there is a second economy in this country that predominates in the pockets of poverty throughout urban and rural America. This economy has incredible barriers to productive economic activity, and a virtual lack of economic incentives, rewards or private property. It stresses dependency over independence; subsistence over self-sufficiency; and literally has shattered the link between effort and reward.

Over the past 25 years, government has spent $3.2 trillion on social welfare programs, with the best of intentions. Many people have been helped by these programs. But we must also admit that for many, the problems of poverty, joblessness, crime, drug abuse, violence and despair which these programs were meant to address are, by most measures, worse today than before.

The President, and indeed all men and women of civility and good will on both sides of the aisle, absolutely agree that there must be a "safety net" for the poor. But there is an emerging consensus that while we cannot forget the safety net, we must also build a ladder of opportunity to help poor people escape poverty. Today's welfare rules encourage family breakup and discourage people from getting jobs; and, believe it or not, it is against the law to save and accumulate assets to own a home, start a business or send one's children to college. The rules of our tax system have locked in place and out of reach the source of seed corn and capital for the next generation of entrepreneurs.

Mr. Chairman, this is wrong. These rules must be changed. Mr. Chairman, we have the power together to change the rules.

President Bush and I heard Governor Pete Wilson, Mayor Tom Bradley, and Peter Ueberroth of Rebuild L.A. tell a bipartisan leadership meeting at the White House yesterday that the unemployment rate in South Central Lost Angeles is close to 70 percent. In addition, the Los Angeles Times has pointed out that the 30.5 percent poverty rate of South Central Los Angeles is twice that of the City of Los Angeles and higher than it was in 1965. The homeownership rate in Los Angeles among families at or near poverty is about 25 percent. And while blacks in Los Angeles County represent more than 10 percent of the population, they own fewer than 5 percent of the businesses.

When people have nothing to lose but the shirt off their backs, when they lack jobs, opportunity and ownership of property, they have little or no stake in their communities and in my view, this is precisely what undermines respect for other peoples' property. There are not enough Federal troops and police in America to bring stability to areas where people have no stake in their communities.

On the contrary, according to news reports, in those area of Los Angeles where people had a stake in the community, pride in their neighborhoods, and high degrees of homeownership and resident management in public housing, there was very little or no rioting and violence.

I appreciate the bipartisan support of members of Congress who have sponsored Enterprise Zone legislation that reflects the President's and my views on how to produce economic opportunity for those Americans that are trapped in poverty.

The President has asked me to testify today to urge the Senate to enact Enterprise Zone legislation by July 4th in order to make sure that this year all Americans can truly join in to celebrate Independence Day.

The Administration's new Enterprise Zone proposal will provide unprecedented opportunities for entrepreneurship and job creation in our cities. The Administration introduced its first Enterprise Zone proposal three years ago. Three years have passed, and it has not been enacted. We cannot rewrite history—but we can adopt Enterprise Zones legislation now, and as the President said, we can deepen and broaden our incentives.

Mr. Chairman, there is no one answer that will cure the problems of urban America. We need a broad-based and bipartisan program that begins with the President's entire urban agenda—"Weed and Seed," increased low income homeownership opportunity, radical reform of the welfare system, greater educational choice, and expanded job training opportunities.

This time, we must focus on incentives to empower the poor, not social welfare bureaucracies. We don't need "trickle down" government, we need incentives for entrepreneurship, job Creation and economic growth.

In America, the ladder of opportunity climbs high enough, but it doesn't reach deep enough. The creation of Enterprise Zones will extend the ladder of opportunity to those that live or work in the most depressed areas of our country, from East Harlem to South Central Los Angeles. The Bush Administration's proposal will provide unprecedented opportunities for people to create businesses and jobs in our inner cities, rural areas and Native American communities.

The first and essential step in freeing people from the rules that now prevent prosperity from appearing in urban and rural areas of poverty is the complete elimination of the capital gains tax on investing, working and living in Enterprise Zones. The President's proposal expands the Administration's previous initiative by extending the capital gains tax exclusion to most intangible, as well as tangible, assets. These capital gains in Enterprise Zones would not be subject to the alternative minimum tax. In addition, any losses in an Enterprise Zone business may be treated as an ordinary income loss as opposed to a capital loss.

Second—as Congressman Charlie Rangel has proposed and as the major Senate Enterprise Zone bills provide—we should *allow expensing of investment in stock in Enterprise Zone businesses.*

The Administration proposal provides for expensing in three different ways:

- Individual investors in an Enterprise Zone business can elect either to expense their stock investment or to receive the capital gains exclusion. Up to 50,000 per year may be expensed, with a lifetime cap of $250,000.
- Individual investors in an Enterprise Zone business who live or work in the Zone will receive the stock expensing in addition to the capital gains exclusion. That includes entrepreneurs in the Zone.
- Small businesses in Enterprise Zones will be able to expense up to $20,000 a year in equipment investment as long as the area retains its Enterprise Zone designation.

Permitting an up-front tax deduction will encourage individuals to risk their own money by providing the all important seed capital to inner city and rural entrepreneurs. Just as important, with their own money at stake, we can expect that these investors will also bring to these community-based businesses their business and marketing skills, and their networks of potential customers.

The Administration's proposal has also been expanded to permit passive loss relief up to $10,000 per year of any kind of passive loss on Enterprise Zone investment, not just real estate. In addition, the proposal will permit the use of tax exempt (IDB) financing for loans to almost any Enterprise Zone businesses, such a retail stores.

When the President and I visited the Cochran Gardens Tenant Management Corporation a year ago, the President was applauded when he called for a reduction in the capital gains rate and the elimination of capital gains taxes in Enterprise Zones. That surprised some people, but the people of Cochran Gardens have a better understanding of what it takes to succeed in the free market than those who have never known what it's like to be locked out, kept down and held hostage by the second economy. They understood the President's message, because they know who will benefit from lower capital gains taxes. Minority entrepreneurs have most of their capital gains in front of them.

When most people look at one of America's inner cities, they see poverty. When the President and I tour South Central Los Angeles and other American cities, we see a shortage of wealth and opportunity.

Therefore, our first priority is to eliminate wherever possible obstacles to the creation of wealth. One of the most gratuitous obstacles for the inner cities is the capital gains tax. The capital gains tax is not a tax on wealth, it is a tax on people who want to create wealth.

Today, this tax depresses the creation of business and jobs in our inner cities. Capital gains can only be realized after wealth has been created, producing an increase in the value of an asset. To tax the creation of wealth in economically depressed areas is wrong.

The homeowners, apartment house owners and business people who increase the value of their assets through their savings, hard work or management skill must not be taxed on the realization of the capital gains they produce. The benefits to the community of their hard work far outweigh any revenue the government might otherwise collect.

Recent studies by the Federal Reserve show that minorities are twice as likely to be turned down for mortgage loans as whites with the same income level. For businesses located in depressed areas, access to capital is all but impossible. Eliminating the gains tax also addresses this disadvantage by drawing risk capital to those areas where it is most lacking.

John Jacob's "State of Black America" shows there were only about 425,000 Black entrepreneurs in 1989, about two percent of the total of 14.7 million small businesses. Today, Blacks represent more than 12 percent of the U.S. population, yet own only one-half of one percent of the nation's $29 trillion of capital stock. And although the number of Hispanic-owned businesses has grown sharply in recent years, Hispanic entrepreneurship is also still far too low.

Mr. Chairman, what these numbers tell us is that people don't permanently escape poverty by cashing a government welfare check. An essential part of any program to rebuild our distressed inner cities is to help create ownership, entrepreneurship and jobs. Taxing away any increase in the wealth of those that live or work in the inner cities via the capital gains tax perpetuates divisions in our society and prolongs the legacy of Jim Crowism and racial discrimination.

The capital gains tax perpetuates poverty and despair. This Committee can act to erase the "redline" that now surrounds depressed economic areas and replace it with a "greenline" of opportunity.

Mr. Chairman, as I said at the outset, we should assure that ALL distressed areas meeting defined criteria can qualify as Enterprise Zones.

Mr. Chairman, Enterprise Zones will not only benefit urban areas. They can also can help greenline distressed rural communities in the Mississippi Delta and the Colonias along the Rio Grande, and provide unprecedented economic opportunities in our Native American communities.

The Administration will work with Congress to designate appropriate criteria. Any area with pervasive poverty and distress, high unemployment, and high numbers of people on welfare should be eligible. The Enterprise Zone selection process should not be a zero-sum game pitting mayor against mayor, city against city, community against community.

There is one more rule that must be changed to give people on welfare the opportunity to escape their poverty. Today, the immediate loss of welfare benefits offsets more than 90 percent of the income earned by those on welfare. This robs the poor of she benefits of their work, including not only the financial rewards, but also the dignity and the possibility of advancement and self reliance that a job provides. This interaction between our tax codes and the welfare system traps people in poverty.

Providing an earned income tax credit to all low-income workers in an Enterprise Zone is an immediate and direct step to offset the disincentives of the high payroll tax rate. This tax credit complements the elimination of the capital gains tax and the deduction for equity investments in the Enterprise Zone. Currently, workers without children are not eligible for the $1,800 earned income tax credit. Allowing these workers to realize more of the benefits of their hard work will also give them the economic security they need to begin to raise stable families.

The Administration is anxious to work with Congress to develop a bipartisan Enterprise Zone bill, and we welcome all suggestions that meet the standard of helping the poor regain control of their lives and liberate themselves from poverty.

But we will not tolerate a defense of the status quo nor accept efforts to undermine this program by hobbling it with requirements that put the well-being of the welfare bureaucracy ahead of the betterment of the poor.

Let me state candidly that the Enterprise Zone proposal passed by Congress and vetoed by the President last Spring because it also included a large tax increase package was wholly unacceptable.

Good intentions aside, that bill would have created only 35 enterprise zones, 10 urban and 25 rural.

The bill centered on the concept of a "zone czar" who picks winners and losers of Federal tax benefits. This concept is completely incompatible with the Administration proposal, because it would empower the bureaucracy rather than the entrepreneur. Government officials are not the people who should be making decisions about risk taking, creating new businesses, and directing capital: Entrepreneurs are.

Virtually every study on business in America, including studies by MIT's David Birch, the National Federation of Independent Business and the Small Business Administration convincingly demonstrate that small businesses create most of the net new jobs—and virtually all of the new jobs in inner cities and for minorities. These same studies demonstrate that these firms tend to be fragile and many fail within the first four years. In short, they are exactly the same type of firm that would be bypassed by government officials as too risky and unstable. As Professor Birch's landmark study concluded: "The very spirit that gives them (small business) their volatility and job creating powers is the same spirit that makes them unpromising partners for the development administrator."

Mr. Chairman, the bill passed earlier this year by Congress was also flawed because it failed to eliminate the capital gains tax on successful Enterprise Zone investments. The Administration also considers alternative proposals to defer capital gains taxes to be inadequate. Such proposals are merely halfway measures that fail to ensure that capital is brought into the zone and used productively by inner city entrepreneurs. The Administration's proposals offer the entrepreneur the best package of incentives as well as the freedom to choose the tax incentive that will best ensure his or her success.

The benefits and risks outlined in our Enterprise Zone program are available to all that meet the predetermined criteria. Individuals who are willing to take the risks and investing their own money will benefit from these programs by increasing the wealth of their communities.

There are people who say that Enterprise Zones will not work because they believe some poor people prefer welfare to work.

On the other hand, there are others that attack Enterprise Zones by saying that people on welfare lack the proper values and are incapable of improving their lives.

Mr. Chairman, I am here today to say that both are wrong.

The people that I have met in every urban and rural pocket of poverty in this country are both willing and able to achieve a better life, if we are willing to give them the tools with which they can escape poverty.

Many agree with me. I am confident that every member of this Committee agrees with me.

Mr. Chairman, during the time we have been debating Enterprise Zone legislation, 36 States and the District of Columbia have taken leadership on their own. State zones have saved or created an estimated total of 180,000 jobs and spurred about $9 billion in private investment in poor areas.

These State zones have worked quite well despite the fact that they lack the most powerful ingredient of Federal tax incentives, including the ability to reduce such large barriers as the Federal income tax, capital gains taxes, payroll taxes, and the corporate income tax, which together impose a far higher tax burden than State taxes.

It is in your power to help turn the modest success of State Enterprise Zones into one of the most effective weapons our nation can muster on the side of empowerment, against poverty and dependency.

With America's inner cities crying out for our help, enterprise zones offer a solution. They extend to people in distressed communities the same system of economic incentives and benefits enjoyed by the rest of society—the ladder of opportunity and social mobility. They reward risk taking, saving and investment, and help people move from welfare to jobs. They free the poor from barriers to opportunity and unleash the potential of the individual. They offer the possibility of advancement, self-reliance, independence from the welfare bureaucracy, and dignity.

Robert Kennedy once said, "To fight poverty without the power of free enterprise is to wage war with a single platoon while great armies are left to stand on the side." Bobby Kennedy was right that the war on poverty cannot seek only government solutions to the exclusion and diminishment of the private sector. By failing to involve the private sector, he said, "we have not only ignored the potential contributions of millions of talented and energetic Americans in thousands of productive enterprises. More dangerously, we have created for the poor a separate economy, a second-rate system of government agencies keeping the poor apart from the rest of us."

Mr. Chairman, on behalf of the Administration, and many Members on both sides of the aisle, I urge Congress to do what the Administration has proposed, what Los Angeles Mayor Tom Bradley has recommended, what Mayor Henry Espy of Clarksdale, Mississippi and the National Conference of Black Mayors and the U.S. Hispanic Chamber of Commerce have endorsed: Pass an effective Enterprise Zone proposal without delay. Don't let another Fourth of July pass without giving the poor the opportunity to achieve the independence that we take for granted.

I look forward to working with this Committee to produce an enterprise zone bill that is truly bipartisan; that will unleash the boundless source of energy that drives people to better themselves, and that will restore to America's poor the chance to participate in the American dream. They deserve no less.

RESPONSE OF SECRETARY KEMP TO A QUESTION SUBMITTED BY SENATOR DANFORTH

Question. Rural poverty is as widespread as urban poverty. The unemployment rate for several rural counties in Missouri was over 10% last year. It is important to include rural areas in any legislative proposal. Will rural areas be included in the Administration's new proposal? What criteria would these areas have to meet in order to qualify for an enterprise zone designation?

Answer. The Administration's Enterprise Zones proposal would address the low rates of investment, job creation and economic growth in rural, as well as urban areas. Our proposal would specifically designate 50 rural areas to be designated as zones from the total 150 in the program.

Like urban areas, rural areas would need to satisfy eligibility requirements. Under the Administration's proposal an area could qualify by satisfying one of a number of different measures. A nominated area would qualify under one of the following designations: Base area; adjoining area; connecting area; rural population loss area or a special rural poverty area.

A Base Area has a population not more than 1,000 using the 1990 census and has a minimum unemployment rate of 10%, a poverty rate of at least 50% and a public assistance rate of at least 10%.

An adjoining area is an area which consists of a base area and one or more adjoining census tracts which posses a minimum 40% poverty rate and if treated as a single census tract has an average 45% poverty rate.

A connecting area is an area consisting of two or more connected census tracts, coupled to a base area, with each connecting tract having a minimum of 20% poverty rate, and each connecting tract is geographically situated on a straight line with the base area; and if treated as a single census tract, the overall minimum poverty rate is 45%.

A rural population loss area is located within a state which does not have an area that could qualify as a base, adjoining, connecting or high public assistance area, but has a high population loss (exceeding 10%) between 1980 and 1990.

A special rural poverty area is a an area located within a state that does not have an area which would qualify as a rural enterprise zone under any of the preceding measures, but has a census tract of 500 or more which possesses the highest unemployment in that state exceeding 20% unemployment.

Prepared Statement of Senator Joseph I. Lieberman

Mr. Chairman, members of the committee, thank you for this opportunity to appear before you on the topic of enterprise zones. If there is any good news—or silver lining—to bring from the recent riots in Los Angeles, they have focused this Administration and this Congress on the desperate conditions which exist in many of America's inner cities—the urban decline, the crime, the poverty, the drugs, the unemployment, and the homelessness have gone untreated for far too long.

Mr. Chairman, as we attempt to craft a solution to the economic problems faced in America's inner cities I believe it is necessary to first identify some of the causes. They are really no great mystery. Manufacturing and industry, which used to be the centerpiece of economic activity and employment in our inner cities, have largely disappeared. With the loss of manufacturing went—in this order—good jobs, wholesale trade, retail businesses and a large source of local tax revenues. At the same time we saw a rise in poverty, crime, drug use, homelessness, and illiteracy. With a shrinking tax base, cities needed to provide more services with less revenue. As a result, cities were forced to raise revenue from sources such as residential property taxes, which added to the outward migration of many middle-class residents and homeowners. Finally, infrastructure continued to decline, and crime rates rose, making cities even less attractive to businesses and residents.

In many regards, the Federal government has ignored this cycle of decay for most of the decade of the 1980's. Indeed what happened in Los Angeles is a symptom of that inaction. I believe that enterprise zones offer us an opportunity to break this cycle.

Mr. Chairman, at the state level, 36 states plus the District of Columbia have adopted enterprise zone programs. I am proud to say that the State of Connecticut led the nation in establishing enterprise zones in 1982, offering a wide range of state and local incentives, as well as administrative support to help develop distressed urban areas.

In total, state enterprise zones have created more than 250,000 jobs and have attracted more than $28 billion in capital investments. This has all been obtained without Federal incentives, which are critical to the maximum possible enterprise zone success. It is true that some zones have not been as effective as others, but overall there is a strong pattern of success. In general, the state experience suggests that there is a strong correlation between the strength of the incentives and the success of the zone.

The state experience provides evidence that, if properly designed, enterprise zones will help convince businesses to build and grow in poor neighborhoods. They will give people incentives to invest in such businesses and to hire and train both unemployed and economically disadvantaged individuals. They will create jobs and stimulate entrepreneurship. Perhaps most importantly they will help restore the tax base to communities that have been forced to provide *increasing* social services with *decreasing* sources of revenue.

Mr. Chairman, if I may, I would like to offer the committee some observations drawn from the experience of the state programs on how to design an effective enterprise zone program:

- First, in my opinion, the objective of the enterprise zone program is to use tax—and other forms of public policy—to direct investment and employment opportunities to distressed urban and rural areas that would otherwise not occur. The increased investment and employment, spurred by the package of incentives should result in the revitalization, over time, of these distressed areas. Therefore in order for the program to achieve its desired results, the package of incentives, including state and local incentives, must be of a strong enough and practical enough nature to attract the necessary business and investment activity. The package of incentives must also reduce *both labor and capital costs* to a sufficient level that a firm would be willing to forgo other factors that impact location decisions including access to markets, quality infrastructure, efficient transportation, a skilled labor force, quality of life, and security.

- There must be a Federal, state, and local partnership. It is clear that no one level of government can provide the incentives necessary to be effective. Rather, the three levels of government should strive to provide complementary incentives. The goal should be the net effect of the entire package, not of the individual incentives.
- There should be a process for maximizing state and local non-financial incentives. The best way to achieve this would be through a competitive designation process where states and localities compete for designation of the basis of their contribution to the package, taking into account fiscal ability. This would have the result of creating the strongest possible package of incentives.
- The program must focus on newer and smaller businesses. Small businesses have been and continue to be the primary source of job creation and economic growth in this country. They are more agile and more likely to respond to well crafted incentives. It is also clear that "smokestack chasing"—the process of using incentives to attract a major employers—is indeed a zero sum game.
- Capital incentives must be a component of any program and should be targeted towards small businesses. They should encourage equity over debt. And, they should be focused on seed capital and cash flow—two of the most common barriers to small business creation. Labor incentives alone will not be sufficient to attract business investment.
- The program must focus on providing jobs and opportunities for zone residents and economically disadvantaged individuals. Many opponents of enterprise zones also argue that firms are not likely to hire residents of impoverished zones. There are ways to target the tax incentives to encourage resident hiring. I believe any enterprise zone proposal must include wage credits to encourage the hiring of economically disadvantaged individuals and targeted programs for job training.
- Finally, this program can not be viewed in isolation. It must be part of a larger economic development and social strategy including job training, education, health care, housing, and transportation.

Mr. Chairman, to conclude, enterprise zones are designed to directly counter the most important cause of urban decline—namely the reduction of business activity, and therefore, investment and jobs.

Among others, enterprise zones have been endorsed by the National Governors Association, the National Council of State Legislators, the Council of Black State Legislators, the Conference of Mayors, and the Conference of Black Mayors.

It is clear that enterprise zones are not the whole cure for the social and economic ills plaguing our inner cities. We must provide access to education, break the cycle of welfare, supply housing for the homeless, and rid our cities of crime and drugs. But, Mr. Chairman, as we develop a longer-term response to the tragedy in Los Angeles, we must recognize that any response that does not include a mechanism to attract jobs, businesses and investment back into our inner cities is a response destined for failure.

Mr. Chairman, it is time to do something substantial on a national scale about urban decay and chronic unemployment. Unemployment and decay that not only encompasses whole sections of every one of our inner cities but also, in too many cases, spans generations. It is a cloud over our nation's future. The unemployed and the poverty stricken, whether they are in the South Bronx, East St. Louis, New Orleans, Chicago, Bridgeport, or Watts are in need of our help. I believe enterprise zones can offer help in a long-term, meaningful way.

Prepared Statement of Frank O'Bannon

Mr. Chairman, members of the Committee, it is a privilege and honor to be here with you today. I am Frank O'Bannon, Lieutenant Governor of the State of Indiana and director of the Indiana Department of Commerce, which oversees our state's enterprise zone program.

At the outset, let me express my appreciation that this committee is conducting this hearing on the subject of enterprise zones. This country's distressed areas—both urban and rural—sorely need a sustained effort to revitalize and rebuild themselves. We should not delude ourselves to believe that enterprise zones can themselves solve this vexing and complex challenge. They are not a panacea. But government can and should play a significant role—in partnership with private enterprise and the not-for-profit sector. And the federal government can play a helpful role by establishing federal enterprise zones, if they are done right.

I appreciate the opportunity to share with you some of Indiana's experience with enterprise zones, to outline what we think has and has not worked, and to suggest some ways a federal zone program could most effectively join with state and local efforts. In that spirit I would like briefly to outline enterprise zones as developed in Indiana, and to summarize the costs and benefits of the program. With the bulk of my comments I want to consider two basic issues. First, what components are critical to the success of an enterprise zone program? And second, how best can a federal enterprise zone program work in partnership with existing state and local efforts?

1. Development of Indiana Enterprise zones. Allow me to give a brief description of Indiana's program. Indiana's Urban Enterprise Zone program developed in the early 1980s as interest in enterprise zones at the federal level and throughout the nation evolved. While the federal government deliberated the advantages and disadvantages of federal enterprise zones, in 1984 Indiana established six zones across the state. To date, nine more communities have established enterprise zones, bringing the total number of zones to fifteen.

Indiana's zone program encourages reinvestment and job creation in an enterprise zone, to bring new life to blighted urban areas struggling from the effects of high unemployment and financial disinvestment. Please recall that in 1983 and 1984, Indiana, like much of the nation, was faced with double-digit unemployment, double-digit interest rates, and double-digit inflation. Indiana's program provided tax incentives and benefits for community and economic development efforts in targeted zones. Initial efforts were directed more toward business development and jobs than the development of human capacity and potential. As the program has matured, our efforts have now been directed toward balancing the scales in building human capacity and potential to ensure long term and sustained success.

The nuts and bolts of Indiana's program are as follows. To establish an enterprise zone, a community must develop a detailed application and plan for development, and gain approval of the state enterprise zone board. By law, zones may not be larger then three squares miles and must have a population between 2,000 and 8,000 residents. Zone businesses are exempted from state gross income tax on the increase in their receipts, pay no property tax on business inventory, and receive income tax credits for 10% of the first $15,000 of wages paid to residents of the zones. Zone residents working for a zone business are themselves eligible for state income tax deductions of 50% on the first $15,000 of gross income. Finally, individuals who purchase an ownership interest in a zone business may qualify for state income tax credit of up to 30%, and lenders who make loans in the zone or improvements to property or business development may qualify for a 5% credit on the interest of the loans made.

These tax incentives are important. But two additional factors set Indiana's program apart, and we feel have been fundamental to its success. I will discuss these in more detail below, but must emphasize them here at the outset as well.

First, every dollar of tax incentives earned through the zone program oust be reinvested in the zone itself. And second, every zone program is overseen by a local board made up of zone residents, business persons, and elected officials. This combination—requiring every dollar of tax saving to be invested in the zone, and establishing a local board whose purpose is to foster the growth of a healthy community—has been critical to the success of Indiana's program.

2. Costs and Benefits of Indiana's Program. As you might expect, we have quite a bit of data concerning the costs and benefits of the zone program. One thing to keep in mind about Indiana's program is that the local community provides the lion's share, 85% on average, of the tax benefits of the program. Since 1986, when detailed data was first collected, approximately $66 million in actual tax incentives have been earned by businesses located in and residents living in the 15 zones.

While we have fairly clear data about the costs of the program, clearly determining the benefits is much more difficult. We can never be certain that these benefits have been caused directly by the zone program. Nonetheless, let me provide you with a conservative listing of some of the benefits:

(1) From 1986 to 1990, approximately 17,400 now jobs were created in 13 zones. These are jobs that were not in the communities when the program begun. The figure does not include jobs that were retained as a result of some of the tax incentives earned by the businesses in the zone.

(2) From 1986 to 1990, zone residents employed by zone businesses earned approximately $177 million in wages and salaries. Community and zone residents, some of whom were costs to the state, now are productive contributors to the state and local economies.

(3) In the two year period from 1989 to 1990, Zone businesses made new capital investments of approximately $400 million. Remember, we are not saying that all these benefits were caused entirely by the zone program. Zone businesses and residents, however, tell us anecdotal that those investments would not have taken place had the zone not been there to provide these incentives and opportunities.

Allow me to provide a more specific example, of an enterprise zone in Fort Wayne, Indiana. One steel-processing company in the Fort Wayne zone has invested $50 million in new capital improvements and increased employment from 425 to 765 employees since the zone was established. A Fort Wayne zone resident who graduated from the local UEA-funded program began and operates a day care business in the zone that is operating at capacity. An aluminum extrusion firm in the zone expanded from monthly sales of $15,000 in 1990 to $3 million this year, and employment from 3 to 30 in the same period. Another pump-manufacturing company in the zone opted to expand operations in the zone rather than relocate, Increasing employment from 352 to 536 and investing $5 million for 3 new buildings. The local zone board supports two full-time positions at the local Urban League and Jobworks offices, specifically to assist zone residents with job training and placement. The board has also funded other zone initiatives, including road and curb improvements in the zone, and crime prevention programs.

3. Lessons Learned from Indiana's Program. The State of Indiana and fifteen communities have benefited from our enterprise zone program. But, as I mentioned above, two aspects of our program have been critical to our succe6s. And, perhaps more important for today's purpose, these two components have not been included in several enterprise zone programs apparently being considered at the federal level.

They are simple concepts. First, any tax benefit earned through an enterprise zone must be reinvested in the zone. If taxpayers are subsidizing businesses and employees in a zone, then the tax expenditures should be reinvested in the zone. Second, zones are overseen by a local board. This is *not* a so-called "zone czar" that allocates benefits. This *is* an empowered group of zone leaders—residents, business owners, and elected officials—who function as a community development corporation.

As to reinvestment of benefits. In Indiana, the law is plain and simple: all tax savings realized under the program must be reinvested in the zone. For a business, the options are many, including: expanding operations with more investment or more employees, cutting production costs with modernized equipment, providing additional training to employees, or contributing to the local zone board. Tax savings cannot be used for purposes such as: passing through gains to outside owners, transferring to a subsidiary or parent located outside the zone, or paying additional dividends to stockholders.

We have found that this simple reinvestment requirement does work. Four hundred million dollars of investment was achieved in just two years. And compliance is not difficult to handle—local boards track the progress. Perhaps most important, we see the benefits going into the zone, not being passed through a collection of syndicators, accountants, bankers and lawyers with complex financial schemes.

In addition, a portion of the tax savings goes to administer the program. One percent goes to the state for administrative costs. A larger percentage—an average of 20 to 254—goes to the local urban Enterprise Association for community development. This board administers the local program, not as a zone czar, but as community development corporation—building partnerships with private and not-for-profit groups, accessing other support from local, state and federal programs, assisting businesses in the zone to grow and prosper, and strengthening local leadership in the community. One specific function of the local board is its oversight of the program benefits. The local board recommends to the state board that specific businesses that do not reinvest their benefits in the zone be decertified. Subject to an appeal to the state board, a local business will lose tax benefits altogether if it fails to comply with reinvestment requirements.

As You can imagine, it does give citizens of zones and of the state some comfort to know that the $66 million in tax benefits has been reinvested in the zones, rather than distributed across the state, country, or overseas to investors seeking tax shelters, or to non-resident owners seeking a competitive advantage and bearing no particular interest in that community's overall development.

Let me propose the second critical factor: local board control, The state approves and provides some monitoring of the zone program, but each zone is initiated at the local community level and driven by a local administrative body. The local board is composed of zone residents, zone business representatives, and local government representatives. This structure, which we refer to as an Urban Enterprise Association (UEA), ensures that the people closest to and most affected by the zone have a direct say in the programmatic and administrative directions of the zone.

This is a critical point. In our program, a portion of the tax benefits must go to the support of local leadership, to provide resources to community members to direct the development of their neighborhood. On average 20 to 25% of the tax benefits support the local board. As we all know enterprise zones cannot themselves work miracles. They cannot save a neighborhood. They are not a panacea. In our program, we try to strike a balance. Yes, the state and local jurisdictions will provide tax benefits to private employers and employees, but we're also going to make certain that a portion of the benefits go to support local community development organizations. A portion of the benefits will give a local group enough resources to plan for the neighborhood's rejuvenation, to access other government and private resources, to market the neighborhood to new businesses, to build partnerships with existing businesses, to catalyze the many varied forces that can build a healthy community.

Several studies have concluded that Indiana's tone program works well, perhaps as well as any in the country. And those same studies have emphasized that the holistic approach, the locally driven, community development approach, is the key to this success. Indeed, a major philanthropic institution, the Lilly Endowment, has committed several million dollars to further Indiana's program, specifically to help the local boards continue to deal with the zone neighborhoods as a whole: each local zone board is receiving additional funds to do long-term strategic planning, and for implementation grants, emphasizing human investment and community development—in housing job training, public safety, child care, education, and similar efforts.

I should mention that some specific components of some potential federal enterprise zone legislation appear to be pointed in this direction. For example, providing greater tax incentives for zone businesses that offer training to zone residents makes a great deal of sense; or requiring that zone businesses support a community development corporation in some manner; or providing greater incentive for hiring zone residents rather than nonresidents. Many such individual program elements can be important. And many might be usefully included in whatever legislation finally may be passed by Congress.

But I cannot emphasize strongly enough: give the local leadership the tools to chart their own course. Use the enterprise zone program to build local leadership, in the neighborhood, among its residents, among its business owners, among its elected officials. A very simple way exists to do this: require a percentage of the tax benefits to go to support a local zone board. And let them work. Let the people whose neighborhood it is, whose streets they walk, whose lives depend on its success, let them run this program. Those forces can work miracles.

4. Coordinating a Federal Program with Existing Efforts. As a final point, let me presume to suggest come concerns about how a federal program should and should not be established, in connection with existing local and state efforts.

A well-designed federal zone program can accomplish much. But it must not conflict with existing local and state efforts. It would be disastrous, in my view, for new federal zones to be established that would compete or conflict with existing programs. I would respectfully suggest the following components of any federal program:

First, I believe an application process should be used. Demand that local and state governments come to you with their proposals, their plans, and their resources, to show how they would leverage federal dollars to build successful communities. Take advantage of successful local programs, and elicit cooperative applications from organizations that care about their community's health.

Second, establish a federal program that complements the strengths of existing programs. Do not establish a federal zone that competes or conflicts, either geographically or programmatically, with existing efforts. I can venture that no community in Indiana would want to deal with the complexity of a federal zone that is not joined with its own local zone.

Third, do not try to solve all of a community's challenges with an enterprise zone program. Realize it is just one tool among many that can help build a healthy neighborhood. Treat it as such, and ensure that it adds to local leadership's ability to improve their community. Do not create a complicated program that will require lawyers, syndicators, accountants and consultants. Create a simple program that will spark investment and job growth, and deliver much-needed resources to local leadership to chart their own path.

In conclusion, let me express my appreciation that the federal government is rolling up its sleeves to help communities help themselves. But let us please keep our eye on the ball: our role, as government leaders both state and federal, is to provide resources to let the people help themselves. I bring two simple requests in that spirit. First, please mandate that any tax benefits provided must stay in the zone. Do not let them slosh through a network of investors, syndicators, bankers and layers across the country and overseas to distant parties. Keep the benefits in the zone, working on behalf of residents. And second, please designate a reasonable portion of the benefits to build local capacity, to support local leadership, so the enterprise zone program serves as an engine for overall community development and empowerment.

Thank you very much for the chance to appear before you.

PREPARED STATEMENT OF SENATOR DAVID PRYOR

I want to commend Chairman Bentsen for holding this hearing on the subject of enterprise zones.

In these times of growing unemployment, shrinking opportunity, and a general lack of confidence in the economy, it is imperative that we explore every conceivable tool to stimulate entrepreneurship and create jobs.

No one knows for sure whether "enterprise zones" will work. However, the absence of absolute knowledge is a poor reason for inaction.

The American people are demanding action. Washington gridlock has never been as hurtful as now.

The concept of enterprise zones to assist economically depressed urban areas has come to the forefront of the President's agenda only because of the crisis in Los Angeles. It is the typical reactive rather than proactive approach that the American people have come to expect.

But what about the crisis in rural America? And what about the crisis in areas affected by cuts in U.S. defense spending?

Just two months ago, majority leader Mitchell named me chairman of a 21 member Democratic Task Force whose mission was to develop a plan for the transition from massive cold war defense spending to policies which focus on jobs for Americans and a climate of competitiveness for American business in a worldwide market.

Defense cuts have already begun to take place with no plan to fill the void left by military downsizing and shrinking defense companies. As of today, 34 military bases will be closed, 48 will be aligned, and more will be announced in 1993. Up to 350,000 defense workers will lose their jobs each year through 1997—that's roughly 1,000 workers a day. Clearly, the Federal Government has the responcibility to provide a plan of transition.

On May 21, 1992, the Senate Task Force on Defense Transition submitted a report which recommended the use of tax incentive programs similar to Federal enterprise zones to stimulate business and create jobs.

One week later on May 28th, the President unveiled his program for assistance to defense-dependent workers and communities. Notably, it did not mention enterprise zones or tax incentives of any kind for communities hit by defense cuts.

Today, I will be interested in hearing from our witnesses on whether the administration plans to address the problems of defense-dependent workers and communities through the enterprise zone concept; and if so, what type of tax incentives will best encourage economic growth in these particular economically depressed areas.

Our country is clearly on the doorstep of a new era. We may view our current dilemma as an immovable obstacle or a challenge to create new opportunities. I look forward to the challenge and to hearing from our witnesses here today.

PREPARED STATEMENT OF EDWARD G. RENDELL

Good morning Chairman Bentsen and members of the Committee on Finance. My name is Edward G. Rendell. I am Mayor of the City of Philadelphia. Thank you for giving me the opportunity to present my views on the creation of federal enterprise zones.

We are all here today because we all recognize one certain fact:

Our cities are in trouble.

They need help.

But one other fact is clear today, as well, and it is this: The solution to these problems is not going to come exclusively from the federal government. The federal budget dilemmas dwarf even the celebrated fiscal short-falls of Philadelphia.

In Philadelphia, moreover, we have concluded that salvation is not coming—at least, in the form of direct cash infusions—from the fiscally stricken state government, either. A state fiscal oversight authority, known as "PICA"—the Pennsylvania Intergovernmental Cooperation Authority—has been established to buy us time. But it will *not* buy us *answers*. PICA is helping our City obtain short-term relief in the capital markets, but only after we developed a long-term plan to balance our budget ourselves.

This lesson is applicable across the country. There is no doubt that in large measure, our great cities find themselves in dire straits today because of the neglect and abandonment they have suffered at the hands of the federal government. In the past twelve years, programs like Urban Development Action Grants, the Economic Development Administration, and General Revenue Sharing have simply disappeared—compounding the problems that cities face due to the recession and tightening budgets. But a large part of the problem has been the profligacy and irresponsibility of the cities themselves.

We will not heal the scars of our urban landscapes until the cities begin to mend their own ways. We will not be able to enforce law and order if city officials cannot impose self-discipline. We will not solve the problems of sheltering our people unless city governments get their own houses in order.

This is not to say that there is no direct federal role in fighting the war to save our cities: The federal government *can* and *must* lend tremendous tactical support with *targeted* aid to help us solve *specific* problems.

The most important thing the federal government can do for American cities is to help us help ourselves by creating incentives that will produce **growth**—more jobs, more businesses and an expanded tax base. The fight for Philadelphia's future depends on how well we do this. To do it well we need your help to create the condition that will let private investment and incentives bloom.

That is why I support plans to generate growth by lifting the cap on passive loss deductions, increasing incentives and tax credits for investment, and reducing the tax on capital gains. But I believe that these incentives must be provided in a manner targeted to produce jobs, spur real estate development, and aid America's deeply distressed urban areas. They cannot be created without any restrictions because in this form they will not provide the help to those areas of America that need it the most—cities like Detroit, New York, Houston, Newark, Los Angeles and Philadelphia. That is why I favor a permanent extension of the tax credit for investment in low-income housing—which has already produced significant results. And it is why I strongly support the most successful and comprehensive example of how the federal government can help cities help themselves through private initiatives, and that is: *enterprise zones.*

The tragic events in Los Angeles last month have brought the crisis facing urban America to the forefront of our national debate, and with it has reinvigorated the debate over enterprise zones. I was encouraged by the President's call yesterday for an expanded enterprise zone plan and hope that we can see an enterprise zone bill move through Congress in the next few weeks.

I do want to take this opportunity to share with you some of our experiences with enterprise zones—as well as some specific provisions that I would like to see included in the enterprise zone plan. In Philadelphia, a number of state and local incentives are already available for such zones, including corporate tax credits, security rebates, low interest loans, and technical assistance. I am committed to increasing the City's efforts in these zones, including a commitment for increased police and sanitation services to the zones. Philadelphia currently provides a five-year real estate tax abatement for improvements to real estate. This city-wide incentive's success has been most visible in our central business district and in middle-class areas, but it is scheduled to decrease this year from five years to three. I intend to explore the feasibility of maintaining the tax abatement program at the five-year level for real estate improvements in the designated enterprise zones only.

The three state-designated enterprise zones, with the City's assistance, stimulated investment and created jobs in these areas. But there is no doubt that the program would be infinitely more effective with the support of federal tax incentives.

That is why I strongly endorse the federal enterprise zone proposal originally advanced by Representative Charles Rangel. In particular, I call on the Congress to enact legislation providing for a total of *fifty* federal enterprise zones—35 in urban communities, and 15 in rural areas—and for the immediate implementation of all 50 zones. I support a $2.5 billion cap on this effort—allowing up to $50 million in tax incentives per zone. This level of incentives will create real and meaningful investment.

To provide maximum benefits, these efforts should be targeted to small and mid-sized businesses. Although there are some larger businesses in Philadelphia's enterprise zones which serve as anchors for further development, the businesses which have been attracted to our City's zones have, for the most part, been firms employing no more than 50 people. Small businesses, of course, tend to create the most new jobs. To encourage this process, I also support a 10 percent tax credit for wages, up to the first $30,000 per worker, for enterprise zones with up to 100 employees.

As we discussed earlier, access to health care is also an acute problem in Philadelphia: At least 40,000 children of the working poor lack health insurance, and infant mortality in some areas of our City rival those of the Third World. I, therefore, wholeheartedly support the inclusion of employer tax credits for health care benefits in enterprise zones, as well.

Further benefits must be encouraged in order to truly benefit the zones' residents and improve the local economy: We must provide incentives to businesses to offer employees advanced training, and to enhance the school-to-work transition of zone residents; enterprise zones must offer not only job *creation* and retention, but also the hope for job *advancement*. I, therefore, urge you to also support a targeted tax credit for work-based education contributions by employers.

We also need accessible day care to enable many needy workers to obtain and hold these jobs. Currently, 50 percent of the workers in our enterprise zones live within the zone. I support expansion of the low-income housing credit for buildings in enterprise zones in which a portion is used as a qualified child care center.

Extension of the rehabilitation tax credits to include buildings that are at least 30 years old would also greatly benefit this and other older cities. In the past, the rehabilitation and historic tax credits have been helpful in revitalizing depressed areas, providing a strong core to generate a ripple of economic improvement in the surrounding areas. Between 1983 and 1986, Philadelphia was a leader in such projects. I believe that similar efforts in enterprise zones can achieve an even greater effect.

Finally, favorable tax treatment of capital gains if the proceeds are reinvested in a qualified enterprise zone will serve the greatest need of these areas: expanding the pool of available capital. I, therefore, strongly support provisions totally *excluding* from gross income any qualifying long-term capital gains realized from the disposition of enterprise zone property.

These initiatives can and will work.

However, enterprise zones, as helpful as they can be, will not work in the absence of a coordinated program, including social and infrastructure programs targeted to the cities.

For instance, the "Healthy Start" program is a proven and cost-effective means of bringing badly needed prenatal and infant health care to poor families. Philadelphia was one of 16 cities to be chosen from 58 applicants for a federal "Healthy Start" grant. But our grant covers only about one-quarter of the City. This successful program must be expanded to cover all areas of all needy cities.

We similarly need federal help in another critical and cost-effective preventive health care effort establishing school-based clinics in poverty areas in our cities.

And of overriding importance in insuring basic health care for Americans is our desperate need for national health insurance. Not only would such a system aid tens of thousands of Philadelphians, but it would also save the City between ten and twenty million dollars that it currently expends on providing unreimbursed health care.

Still another "early start" program—*Head* Start—must be made available to *every* poor child. It is time for the federal government to fully fund Head Start and all-day kindergarten—and then *add* to that funding, to extend our school year to eleven months. We will never effectively compete with the Japanese if our kids go to school for only 180 days while theirs attend for 240.

Older cities like Philadelphia depend heavily on mass transit. We are a highly-transit dependent city, with 80 percent of Center City workers commuting by mass transit. The recent six year transportation authorization was a major step forward in narrowing the gap between our national investment in mass transit and our funding of highways. But the Congress must fully fund the nation's demonstrated mass transit needs. It must revise the President's ill-advised decision to reduce the original allocation for mass transit contained in the ISTEA formula. And it *should* enact President Bush's proposal to raise the business expense deduction for employer-paid commuter benefits from $15 to $60 a month.

The most important short-term help the federal government can provide in the housing area, as well, is to extend the tax credit for low-income housing. In the long run, we must continue to increase Community Development Block Grant funds, as the President did this year after a decade of cuts. And the McKinney Act, which supports remarkably cost-effective efforts to prevent homelessness, must be better funded so that cities need no longer compete against each other for funding.

Solving the problems facing our cities will take time and sacrifice on everybody's part. We are not asking for a handout from the federal government—we just want the tools to begin building a more productive and vital urban core. I hope that you will immediately enact federal enterprise zone legislation so that cities like Philadelphia can continue on the road to fiscal recovery.

Thank you.

PREPARED STATEMENT OF C. EUGENE STEUERLE [1]

Mr. Chairman and Members of the Committee: The task to which this committee addresses itself is an extremely difficult one. In dealing with many social problems such as poverty, crime, disadvantage, and discrimination, no one knows for sure what government program "will work." If we knew with assurance, we probably would have tried it already. In a time of dissatisfaction with many of the government's social welfare programs, enterprise zones have succeeded in latching onto the label of "something new." Our limited knowledge, however, should warn us to proceed with caution, to avoid past mistakes, and, in particular, not to undertake actions that could actually worsen, rather than better, the well-being of the poorest of our citizens.

By the same token, the lack of absolute knowledge cannot be used as an excuse for continual inaction. As parents, we spend time and effort to raise our children even knowing that we are going to make mistakes along the way. As guardians of the young of our society, our obligations to them and all posterity are similarly great, if daunting.

BASIC PRINCIPLES

What is an enterprise zone? Even here our understanding is weak. Is it a zone with special tax breaks? With particular societal problems? With subsidies? Which ones and in what combinations? The definition can be totally arbitrary: an enterprise zone essentially will be what legislators define it to be. Now the very name, enterprise zone, implies that within a limited geographic area something good or "enterprising" is happening that is not happening elsewhere. If one thinks about it for a moment, however, the momentum for the creation of enterprise zones in the United States is just the opposite: that certain areas have problems, not advantages, that cannot be found in such abundance elsewhere.

This simple definitional exercise gives us our first clues as to how enterprise zone proposals might be designed best. If I live in an area with inferior phone service, would it make sense to subsidize my purchases of food so that I pay a lower price than others? Or if I were threatened unusually by forest fires, would this justify granting me an extra tax break for investing in real estate?

These examples may appear far-fetched, but consider why one is so easily offended by the programmatic solutions to the problems posed in the examples. The solutions not only don't address the problems at hand, they create new sources of inefficiency and inequity.

Now change the examples slightly to deal with the problems presumably addressed by enterprise zone proposals. Suppose that individual A, simply by living in a particular area, has less of a job opportunity than individual B. Or that A's educational opportunities are less because she must tolerate more disruption in the classroom. Would granting individual C—but not other individuals—a capital gains tax break for locating near individual A be the best way to solve A's problems? The answer is probably "No."

As a general principle, the well-being of society can be increased, and people can be treated more fairly, when public policies are designed to treat similarly those in similar situations. Creating new sources of inequity and inefficiency not only may fail to eliminate the old ones, but additionally may exacerbate the grievances among different members of society.

Suppose that Congress and the President agree that the first principle of enterprise zone legislation should be to try to eliminate disadvantages rather than to create new discrimination through government-designed advantages that are applied

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[1] Any opinions expressed herein are solely the authors and should not be attributed to The Urban Institute, its officers or funders.

unevenly. What should be done if funding is limited? In most cases, it is still more efficient to spread that funding equally among individuals with equal disadvantage than to spend it only on a few. Enterprise zone proposals, however, are almost all confined to limited geographic areas. In 1989, Bret Birdsong, then at the Urban Institute, showed how a program encompassing 50 enterprise zones might only reach about 1.5 percent of the poor. Are there any conditions under which these limits can be justified?

As best I can tell, there are two—but the requirements are fairly strict. First, experimentation may warrant limited efforts until more is known about what will succeed. Second, certain problems are more amenable to defeat if they are attacked in mass. An army in battle almost never attacks all of the enemy at once, but will attempt to gain the advantage of mass over the enemy at the point of attack. In an idealized flanking maneuver, for instance, an army attains preponderance of force by sweeping down the line of the enemy from the side and by beating back the opponents one-by-one. It seems that in the war against crime, drugs, and disruption in the classroom we often let small, petty, gangs and cliques apply the principle of "mass" against those who obey the rules of society rather than the reverse.

Note that experimentation and the attainment of mass require a plan that allows resources to be increased or shifted over time. Experiments, if successful, should be repeated on a more universal basis or, else, they aren't really experiments. The advantages of mass, in turn, should be applied consecutively to the problem in different locations or wherever it is most amenable to attack.

These latter considerations help us decide what types of programs should not be contained in enterprise zone legislation. If a particular tax subsidy could not possibly be applied more universally or be shifted from one problem zone to another, for instance, then it probably should not be adopted. Dissipation of resources among too many experiments, moreover, should be avoided if it reduces the likelihood of attaining critical mass in any one area.

In sum, almost no program is going to be effective if it creates new sources of inequity, discrimination, and inefficiency. A program should attack sources of disadvantage directly. In general, those who are equally disadvantaged should have equal access to government assistance to overcome that disadvantage. Geographical targeting might be justified on the grounds of experimentation or to gain temporary advantages of mass. Both exceptions require that any resulting discrimination be removed quickly either by adoption of more universal rules or by allowing resources to move in a sweeping operation from one geographical area to the next.

PROGRAMS LIKELY TO FAIL

By turning to efficiency and equity principles and by delineating when selective policy might be justified, we now have at least some criteria by which to examine enterprise zone proposals. Let me begin by examining programs that are likely to fail.

Limiting the Mobility of the Poor

Among the types of proposals that may even be harmful are those that tend to restrict the mobility of those living in poor areas. Remember that the ghettos of poverty within the United States are formed partly by the inability to the poor to move at the same rate and into the same areas as those who are better off. When the United States has responded to this problem by such programs as public housing located in the same areas, it effectively has paid beneficiaries to restrict their mobility. That is, the person who moves to take a job or acquire better education for his children usually gives up, temporarily or permanently, the right to subsidized housing benefits. Society effectively pays him to stay put. Relative to vouchers, which at least in theory should be portable, public housing is quite inefficient and costly relative to what could have been achieved with the same amount of money.

Jobs and training programs for individuals should not suffer from the same problems as public housing. If a job or training subsidy is to be created through an enterprise zone proposal, for instance, it should not be confined to those who work in an enterprise zone area, but should allow individuals to pursue the best opportunities available anywhere.

Subsidizing Providers and Current Owners of Assets

Another danger is that subsidies intended for particular beneficiaries are spent mainly on others. Government programs often end up raising the salaries of providers or increasing the number of providers. The gains from other subsidies—in particular, those to capital—often are capitalized in the value of existing assets.

For example, a blanket capital gains tax cut for investment in enterprise zone areas would be likely to increase the value of land held by existing owners. This increase in price reduces the net amount of incentive for new businesses to establish themselves in the area.

Another example is given by private purpose tax-exempt bonds. These have been proven generally to be inefficient relative to other forms of subsidy because much of the subsidy accrues to holders of the bonds without being passed forward to intended beneficiaries. Partly because such bonds are limited in supply, significant amounts of the subsidy are also floated out to consultants, planners, and others who get involved in trying to determine how to gain some share of the subsidy. When housing projects are supported by tax-exempt bonds, for instance, it is common for the effective interest rate to be increased simply to cover these additional overhead costs.

In housing, part of the cost is also attributable to the myriad ways in which the government provides housing subsidies: tax exempt bonds, credits for low-income housing, mortgage insurance, and so forth. An enterprise zone proposal should not add to the confusion and cost already in the system.

Subsidizing Intangibles

Subsidizing intangibles seems to be a clear means of insuring that only a small portion of the revenues spent on enterprise zones inures to the benefit of the poor or of zone residents. Intangibles such as good will and invention are difficult to locate geographically. Firms can follow the letter of the law in insuring that certain minimum standards are met: the cardboard offices within tax haven countries demonstrates that the ability to claim residence can easily be met regardless of how little productive activity takes place within the "legal" residence.

Allocating Benefits Through Pork Barrel Politics

Although enterprise zone initiatives claim to be trying something new and different, some types of tax incentives would merely repeat experiments that have had mixed, if not failing, reviews. Experience with the Economic Development Administration (EDA) and Urban Development Action Grants (UDAG), which themselves involved spatially targeted programs, indicates that political battles over site designation can dissipate funds, shift funds to areas of less need, and create significant cynicism within areas that fail to get their "share" of grant money. Simply shifting the source of the grant from the expenditure to the tax side of the budget will in no way alleviate these dangers.

Creating a Dependency Relationship

If enterprise zone incentives are to be tried, they should not be open-ended in time or money. Grants need to be limited and recipients need to understand these limits from the start. Dependency relations upon the program should be avoided, for such relations prevent the shifting of resources over time to those with greater need and to communities with better prospects for success.

In addition, except for experimental reasons, it becomes very difficult to continue to justify subsidies given to the person or business on one side of a street boundary, but not to persons or businesses on the other side. Equally difficult is the continual exclusion of other worthy locations. Enterprise zone legislation at its best must be to "seed" the foundation of initiatives that will be carried on, and improved, by local governments, firms, and individuals.

Financing Through Hidden or Deferred Budget Costs

The budgetary cost of money spent for some current activity in an enterprise zone should be recognized currently. When costs are deferred, it becomes difficult to shift future moneys toward those types of programs that might succeed or, for that matter, to back out of failing programs.

Many of our expenditure and tax programs have been designed in a way that determines future expenditures and uses of revenues long in advance. Both by hiding long-term costs in low initial-year costs and by predetermining the structure of programs for the future, past legislators have prevented current legislators from responding to today's crises and needs. Today's enterprise zone proposals should not impose similar constraints on future legislators.

Adding a Little of This and a Little of That

Some enterprise zone proposals tend to be a smorgasbord of selective tax options, many of which could not be justified easily if standing on their own. It will become virtually impossible later to assess the impact of a bill that provides a wage credit, capital gains relief, special treatment of losses, low-income housing tax credits, special tax amortization rules, and so forth. Without assessment, the experimental nature of enterprise zones becomes almost worthless.

It is well to remember also that one of the themes of some enterprise zone legislation is to reduce regulations that tend to raise costs and limit the ability of businesses and nonprofit institutions to provide housing and other services that are appropriate to the needs of residents. While deregulation might simplify, a bill with a smorgasbord of tax options moves in the opposite direction: creating a host of special laws, rules, and regulations that can only be understood by high-priced lawyers and local bureaucrats. Given the limited amount of money being considered for enterprise zone legislation, the cost of complexity per dollar spent is quite high.

EFFORTS THAT MIGHT WORK

Today we find ourselves at the beginning stage of a fundamental shift in the way that society thinks about and adopts programs to improve social welfare. In the early part of this century perhaps the largest social welfare program in the United States was the school. The emphasis of education is on investment in human capital and on the creation of opportunity. In more recent decades, social welfare concerns shifted—in many cases, appropriately—toward greater emphasis on what people are, not what they do. People are poor; therefore they need money; people are sick, therefore, they need health care. And so forth.

Recent years, it seems to me, are witnessing an attempt to shift the balance back toward worrying about what people "do," rather than simply what they "are." There is a re-emphasis on investing in people, not merely caring for them, on equality of opportunity rather than of result, and on provision of preventive care rather than acute care after problems have festered.

This shift can be detected only slightly in the budget, but there are some telling signs. The movement toward increased wage subsidies, as in the Earned Income Tax Credit (EITC), as opposed to increased welfare grants, provides one example. Other examples are provided by work requirements in welfare, the targeted jobs tax credit, and attempts to set up reward and penalty structures around educational standards. Renewed concern at the state and local level has been expressed about disincentive effects of social welfare programs, although changes here have been quite modest. The notion of empowerment of people, and the more narrow attempt to apply that notion in something called "enterprise zones," might be considered in this light. Simply throwing money at a need is considered inadequate. The notion is that people learn by doing; by working and maintaining their own property, by building up their own community.

In many ways, I am excited about the potential contained within this shifting of emphasis. When I put on my research hat, however, I am compelled to admit that what we know is quite limited. Even among existing programs such as EITCs, targeted jobs credits, and work requirements in welfare, there are a number of significant difficulties that have not been ironed out, and the jury is still out on the success of these efforts.

The push for enterprise zone legislation comes from the notion that something more must be done now to help those who are disadvantaged, and that this help should be in a form that increases opportunity for work and ownership.

On the expenditure side of the budget, it seems to me that several efforts do offer some promise. Among those worth strong consideration are the President's proposal for "weed and seed" programs, summer youth jobs programs, some aspects of educational choice; as well as Head Start increases and additional money for training that may or may not be directed to particular "zones."

On the tax side of the budget, the choices are more difficult, in part because many of the tax proposals are not targeted well at the problems confronting the disadvantaged in our nation.

If one is willing seriously to consider change, however, there are tax provisions—including the implicit taxes in most welfare programs—that deserve examination. The following are some types of changes that are consistent with the goals that I believe are implicit in the drive for enterprise zones, but do not create new sources of inefficiency or inequity.

Expanding Opportunities for Home Ownership by Low-Income Individuals

In the middle part of this century, mortgages for homeownerhip were about one-half the size of residential construction. In recent years, the net increase in mortgages has grown to well in excess of the size of the net amount of residential construction. In effect, a larger and larger percentage of the mortgage interest deduction has been subsidizing various forms of consumption, but not home ownership. Most individuals, moreover, are non-itemizers and not eligible for federal subsidies for deductions of property taxes and mortgage interest write-offs. Even when low and moderate income individuals do itemize, they are likely to be paying income tax at a rate of 15 percent or zero percent, so that the value of the deduction is fairly low or non-existent.

A number of years ago, new government assistance and mortgage guarantees also expanded housing opportunity considerably. Like the mortgage interest deduction, these programs today have matured. In effect, the nation no longer has a housing policy that is succeeding in expanding homeownership.

A strong case can be made, therefore, that subsidies for homeownership, if they are to be available at all, ought to be allocated more evenly among income groups. Low income individuals, for instance, could be made eligible for a tax credit for homeownership in exchange for not taking interest and property tax deductions for a number of years. Without these types of changes, it is difficult to believe that any enterprise zone initiative is going to succeed in doing much to encourage ownership of property.

Removal of Penalties on Marriage

If the growth in single parent families is one of the concerns in many of our urban areas, then some attention should be given to welfare and tax systems that together impose enormous penalties on welfare recipients who marry. When a typical single parent on welfare with two children marries a minimum wage worker, for instance, their combined income will be reduced by about $4,700 or close to 30 percent.

Removing these huge marriage penalties is not easy. The research literature, moreover, gives us mixed evidence as to the ultimate effect of these penalties on marital patterns, and long-term consequences are difficult to determine. The signals and symbols established by the tax and welfare laws under the jurisdiction of the tax-writing committees, nonetheless, are quite clear: If you're poor and have children, don't marry. The bottom line is that no amount of tinkering is going to change the basic message sent out by a policy that discourages low-income parents to join in or remain in households with two parents. The policy is also quite unfair.

Removal of Extraordinary Penalties on Work

The welfare and tax systems also impose significant penalties on work by welfare recipients. Again, the literature offers mixed evidence as to whether simply changing these incentives would lead to significant increases in labor supply. We do know that there is a significant amount of work that is off-the-books—in tax parlance, illegally tax sheltered. If values have meaning—and if the young are influenced by the value system that says that work should have little or no reward, except when it is accompanied by illegal underreporting—then there is a strong case for correcting this situation even if the ultimate effect on labor supply remains uncertain.

Jobs Credits

While I do not believe that we have solved the issue of how to design jobs credits, it still appears to me that such credits have the potential of working better than pure guarantees of public sector jobs and better than many forms of welfare. Such credits, of course, could be easily designed as expenditures rather than tax credits.

One of the major reasons that this nation does not undertake a significant jobs program is that their cost to the budget tend to be even larger than simple welfare subsidies. Where jobs programs succeed both in increasing output and training individuals to be more productive, however, their cost to the economy is often less than welfare. As an experiment, therefore, enterprise zone legislation might attempt to provide the credits in sufficient size and quantity as to guarantee the availability of a job to those currently living within a limited geographic area. The jobs program ought also to be allowed to displace other forms of welfare, so that a true test of an alternative system can be made. The confinement to a limited area would allow some testing of how or whether jobs programs could be designed as eventual substitutes for existing welfare programs.

Targeting of Benefits

No matter what the design of particular expenditure and tax provisions, the designation of target communities should be based both upon a standard of need and upon the responsiveness of the local community in putting up their own resources to support a renewal effort.

In determining standards of need, Isabel Sawhill and others at the Urban Institute have developed definitions that involve a high incidence of behaviors that are often associated with poverty. School dropout rates among the high school age population, proportion of working age males not attached to the labor force, the proportion of households headed by a woman with children, and the proportion of households receiving welfare are all criteria that can be determined, at least within Census tracts.

Determining responsiveness is much more difficult. Obviously, if Congress puts forth a small amount of money for limited experiments, it will receive many more applicants for the money than can be served. In this type of situation, the community with the best public relations effort or the most political pull may be the one to garner the resources.

In an analysis of promising local innovations to increase opportunities in urban areas, Bruce Ferguson of the Urban Institute found that practically all involved public/private partnerships and the involvement of local citizens, community leaders, and businesses. This combined personal effort is far more important to the success of a project than small amounts of tax incentives ever will be. These local efforts are also uniquely capable of centering attention on the problems that are special to the community and taking advantage of the skills and ideas of its people.

Many types of efforts and plans are necessary: to provide safety on the street and classrooms without disruption. A strong case can be built that businesses locating in enterprise zones should face no higher costs of insurance against theft, fire, and riot. If this is not to be provided in federal legislation, then some local effort needs to be put together to achieve this goal. Jobs programs probably work best when there is some intermediary, private or public, that serves to assist firms seeking information and helps to screen applicants.

Therefore, there needs to be some assurance that any enterprise zone tax benefits be supplemented by the more important local and private efforts. An added benefit from a combined effort is a lower probability that the monies will simply be eaten up by intermediaries: local governments, businesses, and individuals will have some of their own money and time at stake. In the end, these local and private efforts must displace federal efforts that, because of special targeting, could come to be viewed as discriminating against individuals or firms in areas not selected as enterprise zones.

Evaluation

Finally, some money should be made available for evaluation. Evaluation is a tool not only for determining whether particular efforts might work elsewhere, it also tends to increase the accountability of those in charge of existing programs. Evaluation, however, should not be self-serving, as when agencies simply list numbers served or fail to account for costs on jobs displaced. Mandating studies by Treasury or the General Accounting Office, but not providing the necessary funds, may merely add to the backlog of mandated studies than increase the amount of information by which to make future choices.

SUMMARY

To deal with the types of problems prevalent in many poor areas of this country, a renewed emphasis has come to be placed on investment in people and in providing further equality of opportunity. These types of efforts offer much promise, but we should not pretend that they can be done cheaply.

Enterprise zone legislation attempts to attack problems on a spatial or geographical basis. Such legislation should be aimed at eliminating disadvantages rather than creating new sources of discrimination or distinction in the expenditure and tax law. Even then, spatial distinctions can probably only be justified on the basis of experimentation or of trying to achieve sufficient mass in attacking a problem.

Especially troublesome would be enterprise zone legislation that tends to limit the mobility of the poor, subsidizes providers and current owners of assets, subsidizes intangibles, allocates benefits through pork barrel politics, creates a dependency relationship, finances through hidden or deferred budget costs, or is merely a smorgasbord of tax breaks that have only loose relationship to the problems supposedly being addressed.

Some efforts, such as Head Start, "weed and seed" programs, summer youth jobs programs are worthy of strong consideration. With respect to the taxes, both explicit and implicit, difficult choices are required to expand opportunities for home ownership for low-income individuals and to remove the enormous penalties on work and marriage in the tax and welfare laws.

Perhaps the most important experiment that could be performed with enterprise zones would be to try to create a significant jobs program that might even displace much welfare—although I do not want to pretend that designing jobs subsidies is easy.

In the end, the successful local initiative will be one where local residents, community leaders, and civic officials combine to conduct massive attacks on a variety of related problems. The amount of resources—effort, time, money, and commitment—they will require are quite large, so that the modest amount of revenues being considered for federal enterprise zone legislation can at best serve as a catalyst for those more important local efforts.

Prepared Statement of Senator Steve Symms

I am very pleased to be here this morning. In the aftermath of the Los Angeles riots, I believe this hearing is not only timely but also desperately needed. I think it is time that we pass the President's domestic agenda. Contrary to popular belief the President does have a domestic agenda, however the Congress is unwilling to pass it.

I believe enterprise zones move in the right direction. We need to be finding alternatives to improve this nation's crumbling cities and depressed rural areas that incorporate private investment and involvement.

Clearly, there are major structural changes occurring in the country as we speak. With the end of the cold war, new industries must take the place of our past focus on defense.

It is up to us in the Congress to ensure that new businesses are able to find the capital they need and that government does not hinder their creation. The major structural changes will ultimately result in a shift in demographics.

In my State of Idaho for example, we have seen a significant increase in people moving there. From 1980 to 1990 Idaho has seen an increase of 6% in its population.

I am looking forward to hearing the testimony of all the distinguished guests this morning. I know this will be an interesting and informative hearing. I hope that this hearing marks the start of working toward passing the President's domestic agenda that is so needed today.

COMMUNICATIONS

STATEMENT OF THE AMERICAN ASSOCIATION OF ENTERPRISE ZONES

Congress may be on the verge of doing the right thing under the wrong circumstances. After putting off the adoption of a federal policy on its cities for more than a decade, recent events have riveted Washington's attention on the need to address critical problems of the inner cities. Clearly, Congress is under pressure to enact urban legislation quickly. But it should not and it need not act out of panic.

It should be encouraged to know that it has been making progress in the direction of a true urban policy, which it approved as part of last winter's economic stimulus package. The major elements are contained in Housing Secretary Jack Kemp's enterprise zone proposal, in new initiatives like the "Weed and Seed" program and in the notable experiences of state-designated zones, which provide a framework for a national inner city policy.

In the coming days Congress should act to approve legislation that draws from Secretary Jack Kemp's original proposal and that builds on the work of the states. This would for the first time form a linkage among local, state and federal responses to the needs of low-income areas.

It would have effects far beyond any federal investment incentives in the law because it also would establish a way to reward cities and states that work harder to address problems in their most distressed neighborhoods. At this level of integration, the enterprise zone concept distinguishes itself from the array of individual programmatic measures that lawmakers might recommend. It becomes a true policy.

As they approach this task, both parties in Congress should agree that developing a policy itself is more important than any given feature it comprises. The participants should work for an optimal mix of programs to implement through the policy, but they should anticipate revisiting the legislation as we learn more about its effects and as new ideas emerge.

Congress should regard its work this summer as the beginning of a process, rather than a culmination. It should build a sense of flexibility into enterprise zone legislation that encourages compromise. Secretary Kemp and Rep. Charles Rangel serve as good examples of this spirit. They have had contrasting views of an ideal urban policy, but they have come a long way toward working out their differences on this matter. Mr. Kemp and the administration favor a series of tax incentives to stimulate business activity in the zones, but they are willing to accommodate Mr. Rangel's concern for the areas' immediate needs.

Mr. Rangel has introduced legislation that would expand a Justice Department demonstration program, Weed and Seed. It would set aside $500 million in funds from the departments of Justice, Transportation, Labor, Housing, Education, Agriculture and Commerce to address local crime-prevention problems and to support redevelopment. Of this amount, 80 percent would be earmarked for federally designated enterprise zones.

The zones might serve as an economical means to help target other components of any assistance package the democratic process generates. This could include HUD's home ownership initiatives or even training and jobs provisions that have been suggested.

As Congress develops enterprise zone legislation, it should take into account the experiences of the states to date. It is useful to note that many states established their zone statutes in the early to mid 1980s in anticipation of a federal initiative. Twelve years after Mr. Kemp introduced the first federal zone legislation, 36 states have designated more than 600 zones.

Although all would prefer to have a federal zone law in place by now, many agree that the delay of federal participation has netted at least one significant benefit. As they have awaited congressional action on zones the states have had the latitude to experiment with a far wider variety of implementation models than would have been likely otherwise.

The first several state/local zones relied almost entirely on tax incentives, as suggested in Kemp's federal legislation. Later, states learned to augment tax abatements for business investment and job creation with many other measures designed to set the stage for reinvestment. Today, many states simply use the zones as a mechanism to focus redevelopment programs that meet their particular needs and circumstances. The best state-designated enterprise zones combine incentives with a strategy to upgrade streets, sidewalks, bridges and to nurture enterprise start-ups with small business incubators or improvised business parks.

In some states, the primary incentives for attracting investment to the zones are low-interest loan pools. Others have made creative use of industrial development bonds. The State of New York offers the zones preference in allocating all forms of economic development assistance that it has at its disposal.

Cities have been equally innovative. Some have established challenge grants to encourage shopkeepers to brighten store fronts. Housing rehabilitation programs and paint donation programs are becoming common zone-related activities. Zone officials have worked with volunteer organizations to conduct fix-up/clean-up campaigns and block watches. One-stop permitting centers in zones are cutting red tape for large and small businesses.

More and more utilities are working successfully with cities and states as partners in the redevelopment process. In several cases they have offered discounted rates and other benefits to new customers in zones.

In recent months charitable foundations have discovered enterprise zones. The Lilly Endowment, which has long a history of promoting development in Indiana, has begun a program of supporting activities in each of that state's 14 enterprise zones.

Individually, none of these measures represents a dramatic change for a city with an enterprise zone. What is significant, however, is that they indicate zone officials are learning from their own experiences and from those in other cities and states. The expansion in activity of this nature is the most important trend in enterprise zones around the United States since the mid 1980s. And yet most of these kinds of benefits and improvements are not reflected in cost/benefit analyses that have been conducted on the states' zones.

Indeed, how do we quantify a gradual change in the perception of security in a neighborhood? How do we account for the long-term job creation and investment impact of trees planted on a once-blighted street, or of a sidewalk made less hazardous to pedestrians? We all understand intuitively that these are the steps cities must take to revitalize decaying neighborhoods. We all realize that cities whose tax bases have been eroded should receive help from the states in making these improvements. This is what redevelopment planning should be about.

Yet critics fixate only on the issue of how many jobs have enterprise zone tax incentives created. Many then use this increasingly irrelevant data to project the effects of a federal zone policy. In our view, this line of inquiry serves little purpose because it focuses on what state-designated zones might have been when they were first created rather than on what they have become today. It is somewhat analogous to evaluating modern automotive safety performance by testing a Corvair.

Our association has been actively encouraging cities and states that are using enterprise zone techniques to regard their programs as co-extensive with the goals of their overall planning strategies. They should incorporate whatever measures into the policy that are appropriate to their needs and capabilities. As an organization, we believe it is time to move the concept of urban redevelopment a step further.

For this reason, one of the items in our attached set of recommendations to Congress suggests a relatively simple change in the legislative language relating to the designation of enterprise zones in S. 1032. As it reads now, the bill instructs cities and states competing for federal zone designation to include in their "course of action" statements any of 10 items. The first of these in all past iterations of the proposal has been, "The reduction or elimination of tax rates or fees applying within the enterprise zone."

Perhaps simply by moving this item down the list, Congress could send a different signal to cities than has been sent in the past. Whether it is done in this manner or through some other means, the federal enterprise zone policy should reward cities and states that foster new investment by improving infrastructure and conditions in their targeted areas.

However elementary such a departure may seem, it could alter the way communities think about enterprise zones even before they submit their applications to Washington under a prospective new law. Congress should make this change in order to move away from the simplistic way enterprise zones have been regarded.

If we do not do so before the legislation passes, we may argue forever about the efficacy of state and local tax incentives instead of concentrating on ways to rebuild cities.

Finally, almost every witness that has ever testified on this matter over the years has addressed his or her comments exclusively to the effect the federal incentives will have on inner city investment. Our organization has always maintained that the federal program will have a dual impact. In addition to whatever effect federal incentives may have on the location decisions of business or on stimulating entrepreneurship, it will play a far more important role in influencing the actions of cities and states.

We believe that the key to an effective urban policy is in the interactions it sets into motion with the private sector and among the participating levels of government. Or work with cities and states indicates that they are willing to put a far greater effort into their redevelopment programs if only Washington will agree to support them.

Seen in this light, it is not so important that Congress adopt an enterprise zone program that includes the perfect incentive or combination of benefits. Whatever the law provides, people will find reason to criticize.

It is much more important that the federal government get started with a policy that compels communities to identify areas of need, to set priorities and to work deliberately toward their objectives. As fundamental as this may seem, it is true to say that until now, this country has never had a policy that would accomplish these ends.

Statement of the American Federation of Labor and Congress of Industrial Organizations

The AFL–CIO welcomes this opportunity to testify about the effectiveness of Enterprise Zones as a spur to investment in economically distressed areas.

The AFL–CIO has over the years consistently opposed federal Enterprise Zone tax incentives. They are a tax giveaway that will not work. The elimination of the capital gains loophole, for example, was one of the important accomplishments of the 1986 tax reform law; an agreement was made to tax capital gains as "ordinary" income in exchange for reduced tax rates on upper income taxpayers. The capital gains provisions of Enterprise Zone bills would represent a rollback of this agreement.

Tax based Enterprise Zones would just squander resources in rearranging the location of businesses or "pirate" firms to zones without a net increase in firms or jobs; the Enterprise Zones regulatory rollbacks could be counterproductive; state and local zone tax reductions encouraged under Enterprise Zone proposals would reduce the ability of jurisdictions to pay for city services, both inside and outside the zones. Tax revenues lost by Enterprise Zone could be better spent directly through existing programs for job training, urban redevelopment, housing and other needs.

Last November the Nineteenth AFL–CIO Convention reaffirmed this view in a statement on State and Local Needs which said, in part, "The Bush proposal for Enterprise Zones is similar to other tax schemes previously studied and rejected by Congress. Such tax 'incentives' would encourage existing firms to move from place to place and federal tax dollars would be squandered paying firms for doing what they would be doing anyway."

DEBATE ON URBAN CRISIS TOO NARROW

Enterprise Zones have not worked and the long overdue public debate on the urban crisis has become too narrowly focused on Enterprise Zones as the solution.

The AFL–CIO has backed a broader "urban agenda," backed up with funding, that would respond both to recessionary economic conditions as well as the neglect of the cities. This is the $60 billion recovery and reinvestment program proposed by the AFL–CIO months before the recent troubles in Los Angeles.

The AFL–CIO recovery program includes needed investments in infrastructure, housing, direct countercyclical assistance to cities, along with greater attention to education, training, trade and tax equity. In addition, the AFL–CIO has called for increased unemployment insurance assistance, local public works, community development aid on an emergency basis, increased spending on infrastructure, waiving local matches and so forth.

These ideas are outlined in a detailed proposal, *It Takes Jobs to End Recessions: A Program for Quick Recovery and Long-Term Growth,* a one-page summary of which is attached to this testimony.

CONGRESSIONAL PROPOSALS ONLY FIRST STEPS

If the Committee decides to go ahead with Enterprise Zone tax legislation, we would suggest that the breadth and depth of inner city problems—those outside the boundaries of specially designated urban zones—be recognized. The federal budgets of the 1980s have cut back on programs which directly and effectively address problems of the cities. The 1993 budget offered by the Administration only a few months ago called for a number of further reductions in relevant programs for housing and community development, as described later in this testimony.

The programs that should be considered as part of the urban package, include summer jobs, childhood immunization, WIC, Head Start, Chapter I education assistance and other measures. But these proposals are not in and of themselves adequate. More needs to be done.

We also recommend that, if adopted, the federal Enterprise Zone program be restricted to a few sites as a demonstration only so that the results of the program over several years can be studied before any wider national program is adopted. We would also suggest the inclusion of a realistic sunset provision.

These restrictions are necessary in view of the huge tax expenditures which would attach to an unlimited Enterprise Zone program and because a number of studies cast extreme doubt on the success of the Enterprise Zones.

THE COST OF ENTERPRISE ZONES AND THE BUSH PROPOSAL

The President's fiscal 1993 budget, for example, proposed designating up to 50 Enterprise Zones over a four-year period and of providing a number of tax incentives: elimination of capital gains for tangible and intangible property located in zones and used for at least 2 years; expensing of equity investments in zone firms with assets of less than $5 million; a refundable 5 percent wage credit on the first $10,500 earned by low-income workers of businesses in zones (up to $525 per worker, with the credit phasing out when the worker earns between $20,000 and $25,000 of total annual wages).

This would be on top of the Targeted Jobs Tax Credit (TJTC) under present law. TJTC provides an income tax credit to employers for a portion of the wages paid to certain employees, who generally are either economically disadvantaged or participating in a specific education or rehabilitation program. A few years ago, the General Accounting Office found that employers had claimed an estimated $4.5 billion in tax credits, but that half of them took advantage of the credit without making special efforts to hire members of targeted groups. They simply claimed the credit if they found they had hired an eligible person.

What about the cost? The Joint Committee on Taxation estimated that the revenue loss from tax incentives in zones would amount to $3.3 billion from 1992 through 1997. The Administration estimated a revenue loss of $1.8 billion over the same period. Obviously, a much larger program covering perhaps hundreds of zones would cost some multiple of the $3.3 billion estimated for 50 small zones. The Administration, for example, has more recently proposed expanding the program to 125 zones or making it unlimited to areas qualifying under certain criteria.

THE RIOTS AND THE FEDERAL BUDGET

The L.A. riots raise larger issues of the federal budget.

During the decade of the 1980s the federal budget for the cities was deeply cut. General revenue sharing is gone. Funding for training and employment services was cut by two-thirds. Community Development Block Grants were cut by 40 percent. Subsidized housing from the Department of Housing and Urban Development was cut by 80 percent.

The Bush Administration is proposing "weed and seed" initiatives and the sell-off of public housing as well as other proposals in addition to Enterprise Zones. It is funding some of these ideas by cutting or eliminating worthwhile ongoing programs that directly or indirectly help the urban underclass.

The fiscal 1993 budget, proposed earlier this year, cuts many of the programs that are beneficial to the cities, such as Community Development Block Grants (cut by $500 million), HOME state-local housing block grants (cut in half from $1.5 billion to $0.7 billion), public housing construction (zero new units, compared with 7,500 units in 1992), public housing operating assistance and modernization funding (by several hundred millions). Overall, the HUD budget envisioned by President Bush is $1 billion less than enacted by Congress for fiscal 1992.

Also, the Administration proposed a total rescission of public housing construction funds already approved for fiscal 1992, despite the existence of long waiting lists for public housing in cities across the country.

The Enterprise Zones proposal, considered alone, is at once both too little and too much. It is too little because it ignores or goes along with the budget cuts for other relevant programs that bear on inner city problems. It is too much because it is the beginning of a big tax giveaway if Enterprise Zones are adopted as national policy. Further, if Enterprise Zones don't work, the money is wasted.

STUDIF OF ENTERPRISE ZONES

Recent studies have been critical of Enterprise Zones and emphasize the complexity and inter-related nature of social problems in areas that might be designated as such zones. All agreed that Enterprise Zones are no panacea.

For example, a 1988 study by the General Accounting Office looked at three state Enterprise Zones in Maryland which had a number of years of activity, surveying numerous employers in the process. GAO found that employment increases could not be attributed to Enterprise Zones incentives and that factors such as market access and community characteristics were more important than Enterprise Zones incentives.

An Indiana study showed that jobs created in Enterprise Zones often did not pay workers very much, but cost taxpayers.

A fact sheet summary of selected studies is attached to this testimony for the reference of the committee.

OTHER ISSUES

While opposed to enterprise zones, the AFL–CIO believes that even supporters should ask additional questions about the Administration's latest proposal.

The application of a zero capital gains rate while violating the 1986 agreement also raises technical questions on its own. The extension of a zero capital gains rate for capital, as well as homeownership appears to provide basis for "tax havens" within the U.S. Further, it is unclear how a zero capital gains rate would be applied to intangible property as proposed. Finally, by an increased focus on zero capital gains the proposal could shift to investment in capital at the expense of providing jobs in the Enterprise Zone which would contradict supporter's chief goal -the creation of new jobs in these zones.

Therefore the Committee should look carefully at the tax incentives which is proposed as a part of the Enterprise Zone concept.

CONCLUSION

Proposals to restore and give new life to the cities take on urgency and significance in the wake of T.V. images of looted liquor stores, out-of-control street thugs, a flaming nighttime L.A. skyline, and casualties more reminiscent of the urban conflict of the Middle East than of the U.S. west coast.

Enterprise Zone proposals should not be adopted. However, if they are adopted, they should be restricted as to the number of zones and there should be an appropriate sunset to the demonstration. Enterprise Zones are no panacea to the problems of the cities. Part of their appeal is that they are funded through the tax system. Thus hiding their true cost. The amounts of tax expenditures could be very high if Enterprise Zones were adopted as national policy. And during this time of budget stringency, we can ill afford big tax expenditures to pay for investments that would occur anyway.

The cities do need help, including adequate federal funding. The place to start, however, is by reviewing the rollbacks in effective programs which have occurred over the Reagan-Bush era in programs for urban development, training, housing and other areas. In addition, the U.S. needs to make the kind of long-term investments cited in the AFL–CIO program for recovery and economic growth to ensure economic growth and job creation in the future.

Mr. Chairman, the AFL–CIO appreciates this opportunity to provide the Committee with our views.

FACT SHEET—AFL–CIO PROGRAM FOR RECOVERY AND LONG-TERM GROWTH

The AFL–CIO recommends an immediate overall job-creating fiscal stimulus program to be spent on (1) ready-to-go projects for infrastructure, (2) housing, and (3) aid to state and local governments to maintain services.

To get these projects started quickly, state and local matching requirements should be waived. There has never been a robust recovery from any modern recession that was not helped along by a strong dose of fiscal stimulus. Therefore, the 1990 budget agreement should be set aside.

In addition, a comprehensive recovery program should include:

- A tax cut for the middle class paid for by raising rates on the wealthiest 1 percent of Americans.
- Education and training investment in people to promote long-term economic growth.
- A realistic trade policy that supports American jobs and industries.
- Industrial policies and economic conversion to stop the further erosion of the nation's industrial base and to strengthen the U.S. economy.
- Reform of the nation's health care system, including cost control and guaranteed access to basic health services for all Americans.
- Unemployment benefits should be re-authorized and expanded until the recession is over. A complete overhaul of the entire unemployment insurance system is needed. Protection for workers should be increased by eliminating many eligibility criteria now used to disqualify workers.

The fiscal stimulus should be in the neighborhood of 1 percent of Gross National Product—about $60 billion.

FACT SHEET—SUMMARY OF RECENT STUDIES OF ENTERPRISE ZONES

- A 1988 study by the General Accounting Office looked at three state Enterprise Zones in Maryland which had a number of years of activity, surveying almost 500 employers in the process. GAO found that employment increases could not be attributed to Enterprise Zones incentives and that factors such as market access and community characteristics were more important than Enterprise Zone incentives.

"In the cases GAO examined, employment increases were found but they could not be attributed to the Enterprise Zone program . . . Employers who responded to a GAO survey were less likely to cite Enterprise Zone incentives as important to business location decisions than to cite as important other factors that are not part of an Enterprise Zone program . . ." such as market access and community characteristics. (p. 3) The study also states that "Our findings suggest that many employers in the Maryland program may have legally won financial windfalls from program credits for behavior that they had already made or would have made in the absence of a program." (p. 61) (Enterprise Zones: Lessons from the Maryland Experience. December 1988.)

- The Congressional Budget Office, commenting on the Administration's Enterprise Zone proposal for this year: "Some states have established Enterprise Zones and have reported consequent gains in investment and employment. It is unclear, however, how much employment in the zones is new instead of relocated employment. Enterprise Zones are much more likely to affect the location of investment than to contribute to net new investment or employment. (p. 52) An Analysis of the President's Budgetary Proposals for Fiscal Year 1993. March 1992.
- Sar Levitan, director of George Washington University's Center for Social Policy Studies testified before the House Banking Committee earlier this year on a new study co-authored by him titled, "Enterprise Zones: A Promise Based on Rhetoric."

According to Levitan, tax expenditures are likely to offer more benefit to potential investors than to residents of the designated areas. He concludes that instead of Enterprise Zones, depressed communities should be rehabilitated with direct investments in human and physical infrastructure. "Many of the residents lack the skills needed for most jobs. They are in need of basic education and training which requires direct expenditures, not tax subsidies to businesses."

Levitan noted the high cost of the Enterprise Zone tax subsidies and argued that, "It seems unlikely that the majority of both Houses will be willing to shift scarce funds from the established and proven social programs to experiment with an initiative grounded in supply-side economics . . . " (George Washington University Press Release February 13, 1992.)

- A 1989 Urban Institute study was critical of Enterprise Zones, concluding that "Careful evaluations of state Enterprise Zone programs have found no evidence that incentives have contributed to employment or investment growth in designated areas." The Urban Institute states that assessments of federal tax breaks designed to increase overall business fixed investment or to create or redistribute jobs are mixed. The study also found a number of "distinct drawbacks" to Enterprise Zones: "First, they are costly. Second, they reach only a tiny fraction of poor people in the U.S. Third, they are poorly targeted. Finally, like other spatially targeted policies, they face well known political pitfalls." (p.

21) The study warns against "significant windfall costs" (p. 21) and argues that Enterprise Zones should be "evaluated as a means of redistributing investment and employment, not as a means of achieving more of each." *Federal Enterprise Zones: A Poverty Program for the 1990s?* Bret C. Birdsong. October 1989.

- A May 15, 1992 USA Today editorial cites the experience in Indiana. "The zones can waste huge sums. Jobs created by Indiana's programs paid an average of $11,746, according to a Purdue study. But the taxpayer's cost for each job created averaged $32,112, with some costs soaring as high as $185,000."

STATEMENT OF STEVE BARTLETT, MAYOR, CITY OF DALLAS

As the Mayor of a city having a population exceeding 1,000,000 residents, I want to take the opportunity to submit written comments to the Senate Finance Committee on proposed federal enterprise zone legislation. As a former Congressman from the Dallas area and in my current official capacity, I have had the opportunity to examine closely the positive impact of such zones and I offer these comments based upon the experience and observations obtained in my federal and municipal capacities.

Two major issues are common to the various bills: (a) the designation process for proposed enterprise zones and (b) federal income tax incentives. The following comments on such issues have not been formally adopted by the Dallas City Council; they are my own. Once Senator Bentsen's bill is introduced, the Dallas City Council may consider and adopt a resolution addressing specific points in the proposed legislation.

(A) DESIGNATION OF ZONES

It is important that any legislation be simple, straight-forward and immediately applicable. Enterprise zones which are (1) designated by local governments and the state in which they are located at the time of passage of the federal legislation and (2) are located in large urban areas having a population of at least 500,000 should automatically qualify for federal designation. Automatic designation would expedite the positive impacts the zones are designed to create. For any newly designated or expanded zones, the review process should be expeditious, preferably ninety days or less.

Enterprise zones in large urban areas of the minimum population may be initially designated or expanded pursuant to the following suggested modifications of the eligibility requirements of 42 U.S.C. 11501(c)(3):

(3) Eligibility Requirements

For purposes of paragraph (1), a nominated area meets the requirements of this paragraph if the State and local governments in which it is located certify that four of the six following criteria apply to the area and the Secretary, upon review of such supporting data as he deems appropriate, accepts such certification.

(A) The area is one of pervasive poverty, unemployment and general distress; or

(B) the area is located wholly within the jurisdiction of a local government that is eligible for Federal assistance under section 119 of the Housing and Community Development Act of 1974, as in effect upon the date of enactment of the enterprise zone legislation; or

(C) the unemployment rate, as determined by the appropriate available data, was not less than 1.5 times the national unemployment rate for that period; or

(D) the poverty rate (as determined by the most recent census data available) for each populous census tract (or where not tracted, the equivalent county division as defined by the Bureau of the Census for the purpose of defining poverty areas) within the area was not less than 20 percent for the period to which such data relate; or

(E) the area meets at least one of the following criteria:

(i) not less than 70 percent of the households living in the area have incomes below 80 percent of the median income of households of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974);

(ii) the population of the area decreased by 20 percent or more between 1980 and 1990 (as determined from the most recent census available).

(F) the area meets at least two of the following location requirements:

(i) be within one and one-half mile of a locally designated Central Business District; or

(ii) be within 5,000 feet of a federally assisted housing project of not less than 300 units; or

(iii) be within 2,750 feet of an existing or proposed Rapid Transit Station.

(B) FEDERAL INCOME TAX INCENTIVES

It is in the best interests of the nation's cities to encourage capital influx and business and job development in the blighted areas targeted by this legislation. Large and small businesses each offer intrinsic benefits which should be considered and addressed. Large companies provide the ability to train and hire large numbers of employees, particularly critical to enterprise zone or other residents who lack education or job skills. Small companies can provide a rich and diverse foundation, offering, as experienced in the economic growth of the last decade, tremendous opportunities for job creation and capital growth, which should inure to the benefit of the residents of such enterprise zones.

In discussions with members of the private sector, we sought to identify specific federal taxation strategies in which enterprise zone legislation would serve as a economic catalyst and engine for the distressed communities. The following proposals are offered as a starting point:

1. *Revised Job Credit.* An annual credit, (in addition to the credit provided by I.R.C. Section 51) of approximately $700 granted to employers for each eligible employee utilized in an active trade or business located within an enterprise zone. Issues that will require consideration include types of business qualified for the credit, extension of the credit based upon the residence of the employee within the boundaries of the enterprise zone, credit carryovers, alternative minimum tax effects and expiration of the credit.
2. *Investment Tax Credit.* A credit for the acquisition of tangible personal property used in an active trade or business located in an enterprise zone. Qualifying property would include assets used to either (i) enhance security for property/employers (e.g. high intensity lighting) or (ii) reduce insurance costs (e.g. security systems). In effect, these provisions would resurrect the pre-1986 investment tax credit and target it to enterprise zones.
3. *Share deductions.* Deductibility of shares owned by investors of enterprise zone businesses.
4. *Capital gains tax.* Institution of capital gains tax reduction on qualifying gains realized by businesses located in an enterprise zones.
5. *Tax Exempt Financing.* Resurrect (without state caps) small issue "industrial" development bonds in order to finance (i) acquisition of business facilities, and (ii) the purchase, by zone residents, of housing located in the zone.
6. *Capital Gains Exclusion.* Exclusion from taxation of capital gains realized from the sale of a primary residence within an enterprise zone.
7. *Childcare Tax Credits.* Tax credits to encourage businesses which operate in the zones to offer childcare. Such an approach should encourage and enhance the employment prospects of single parents with small children.

I would appreciate the opportunity to testify at any hearing and offer testimony which would provide specific proposals designed to enhance the impact of enterprise zones. If no hearings are planned, I would be happy to meet with you or members of your staff to further discuss these topics.

We appreciate your hard work on this very important piece of legislation. If my staff or I may be of assistance or answer any questions, please contact me or my assistant, Kristi Sherrill at (214) 670–0773 or Scott Carlson, City of Dallas federal Liaison, at (214) 670–3519.

STATEMENT OF THE INTERNATIONAL LADIES' GARMENT WORKERS' UNION

This testimony on enterprise zones is submitted in behalf of the 175,000 members of the International Ladies' Garment Workers' Union. Our members are employed in producing women's and children's apparel, accessories and related products. They live and work in more than two-thirds of the nation's fifty states.

The present proposal to create enterprise zones is similar to those that have been made over and over in the course of the last ten years. We, too, want to deal with the problems of our inner cities. However, we remain unconvinced that tax and other incentives, including a cut in the capital gains tax, will put new vigor into the depressed areas of our country and lead to the creation of new jobs.

We have testified to this effect three times—once before this Committee in 1982, again before a subcommittee of this Committee in 1983 and lastly on July 18, 1991 before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee.

However enterprise zones are dressed up, their inherent inability to deal with poverty has not changed. This is the case despite the almost mystical belief about how jobs are created in general and especially by small business. I know small business well; it characterizes the industry in which the members of our union work. I assure you that business does not operate in accordance with a mystical faith, but on the basis of hard profits.

It is elementary that firms do not invest and create jobs because it is worth doing. They do so to make a profit by selling what they produce at a price which provides for a profit. Expansion of production occurs when demand is greater than the capacity to supply the market, again in the expectation that sales and, therefore, profits will increase.

The worsening of the nation's urban crisis results from a lack of concern on the part of the federal government and the severe cutbacks in federal assistance to urban America. These policies have intensified poverty, homelessness and crime, have contributed to the increasing breakdown of our nation's infrastructure, have deprived millions of Americans of health care or allowed for insufficient health care and have permitted an increasingly inadequate educational system.

There can be little question that one of the major factors in the disturbances that occurred in Los Angeles, and could take place in other cities, is the lack of jobs and job opportunities in our inner cities. Limited education is not the only reason for this unemployment. Government trade policy, which gives away both labor-intensive and capital-intensive jobs in the name of free trade has also contributed to this problem.

In our industry, apparel, more than 400,000 jobs have been lost because of rapidly increasing imports, which now represent more than 60 percent of domestic apparel consumption. Current trade negotiations will further intensify the problem as U.S. apparel (and other) companies are encouraged to move production to Mexico, where .bor costs are low.

By their very nature, labor-intensive industries are not tied to a given area, nor are raw materials and power supplies major factors in the determination of locations. The crucial requirement in such industries is an abundant labor supply that, with relatively brief training, can perform the work required. Small scale and low capitalization make these industries extremely mobile.

Yet, they provide a key source of employment for members of minority groups, for women and for recent immigrants. Large numbers of small-scale labor-intensive industries, including apparel plants, already exist in the distressed urban areas that enterprise zones are supposed to aid. They are there because the labor supply is there.

Enterprise zones will not create new jobs. They will simply shift existing jobs from one depressed area to another and from one minority group to another. Workers in such areas are also under constant threat on the part of employers who seek to lower the workers' incomes in order to be able to compete with wages in Asian and Latin American countries or with undocumented workers in our own country. Such employers will now threaten to move to enterprise zones to further depress standards. The proposed zones will not solve the problems of urban blight nor the desperate need for employment that their proponents suggest.

The enterprise zone proposals, including the most recent one, ignore basic urban needs, among them improved sanitation, health care facilities, crime, drug and alcohol prevention and housing. These needs will not be filled by some magic if enterprise zone legislation is enacted.

Each impoverished or disadvantaged community that might seek assistance under the enterprise zone program would be competing with a similarly deprived community. Free enterprise could, in the process, come to mean destructive competition for giveaways. This has occurred in many parts of the world where "enterprising" employers have moved into areas of widespread unemployment, set up operations and, after gaining as much as they could, gone on to greener pastures.

There are many examples in which labor-intensive industries have made use of a large labor pool to play off workers against each other for the limited available employment. Workers are forced to compete for wages and working conditions. Such labor pools exist in distressed areas.

Nor can it be anticipated that General Motors or other huge capital-intensive companies would move into enterprise zones. On the other hand, the lure of quick profits, minimal investment and tax abatement would encourage fly-by-night and speculative employers. Such footloose firms, which could take advantage of the tax breaks offered, would be the principal beneficiaries of tax giveaways.

A firm outside a zone which employed workers living in a zone would receive no benefits. Tax abatement provisions would, on the other hand, provide incentives to shut down plants outside the zones and relocate them in the zones.

And, as I have said, the concept of creating new jobs, presumably mainly labor-intensive jobs, in the inner city comes into obvious conflict with the Administration's trade policy which seeks to export, among others, the very kinds of jobs they say they expect to create.

It is of some interest that, despite the fact that the Administration is proposing creation of enterprise zones, the U.S. Department of the Treasury, as reported in the press, shares our view that jobs would merely be shifted from one area to another if the zones were created. It is also worth noting that *The New York Times* (June 4, 1992) editorially voiced the same doubts as I have about the efficacy of Enterprise Zones.

There is certainly a need to rebuild our inner cities and to create new jobs in our nation. Growth in economic activity has always depended upon an adequate and expanding stock of private and public capital facilities that complement each other. Highways and ports, streets and bridges are necessary to move industry's products. Mass transit systems are critical in moving people in our age of growing energy scarcity. Water supply and sewage collection systems are needed for everyday living.

In testimony on Enterprise Zones before a House Committee last year, the American Federation of Labor-Congress of Industrial Organizations observed in a statement that is worth repeating:

"No evidence has been presented by advocates of enterprise zones that positive consequences will follow from their establishment, or that negative consequences will be averted. Evaluations of many state enterprise zone experiments undertaken since federal enterprise zones were first proposed in 1981 have not found significant employment or economic development benefits. . . . It is difficult to understand why a program deserves to be implemented at a federal level when it has been tried in various forms for up to a decade in nearly 40 states without demonstrable positive results."

There is a need to tackle the problems of our inner cities and to lower the poverty level in our country.

A recent study prepared for the National Bureau of Economic Research observes that the key element in the continued high level of poverty and our inability to lower it is due to the "slower income growth among families at the bottom of the income distribution. . . . [S]even years of sustained economic expansion did little to significantly lower the poverty rate or increase incomes among low income families. . . ."

Enterprise Zones will not solve or contribute to the solution of the problems of our inner cities. What is needed is a comprehensive program, including education, training, the rebuilding of our infrastructure and a basic change in our trade policy. Good jobs will not be created so long as we continue to ignore the real needs of our people. Nor can we continue to export labor-intensive jobs and try to substitute additional negative policies that clearly cannot work.

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