URBAN ENTERPRISE ZONES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 1310

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE CERTAIN COMMUNITY DEVELOPMENT, EMPLOYMENT, AND TAX INCENTIVES FOR INDIVIDUALS AND BUSINESSES IN DEPRESSED AREAS

JULY 13 AND 16, 1981

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URBAN JOBS AND ENTERPRISE ZONE ACT

MONDAY, JULY 13, 1981

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS,
AND INVESTMENT POLICY
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senators Chafee, Dole, Durenberger, and Grassley.

[The press release, the bill S. 1310, the "joint committee print" (description of S. 1310), and Senator Chafee's opening statement follow:]

[Press Release No. 81-147; July 2, 1981]

U.S. SENATE, COMMITTEE ON FINANCE,
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY,
Dirksen Senate Office Building.

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY SETS HEARINGS ON URBAN ENTERPRISE ZONES

Senator Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy of the Senate Committee on Finance, announced today that the Subcommittee will hold hearings on July 13, 1981, and July 16, 1981, on proposed legislation to establish Urban Enterprise Zones.

The hearings will begin at 9:30 a.m. on July 13, 1981 and July 16, 1981 in Room 2221 of the Dirksen Senate Office Building.

The following legislative proposal will be considered at the hearing: S. 1310—The Urban Jobs and Enterprise Zone Act, introduced by Senators Boschwitz and Chafee. The bill would provide community development, employment, and tax incentives for individuals and businesses in depressed areas.

In announcing the hearings, Senator Chafee noted that "The Urban Enterprise Zone offers our nation's most distressed cities and towns an opportunity for economic rebirth. The concept is founded on the belief that true economic revitalization can only be achieved through job creation in the private sector."

The Urban Jobs and Enterprise Zone Act would authorize the Federal Government to designate certain areas as economically distressed. Local governments would apply for such designation, and areas so designated would be eligible for certain Federal tax incentives to encourage the creation of new jobs and business enterprises. In order to qualify for designation as a zone, the local community would have to demonstrate a strong commitment to the revitalization effort. It is anticipated that this commitment could be demonstrated in various ways, including reduction of regulations within the designated areas, upgrading of municipal services, or support to the local business community.

Requests to testify.—Witnesses who desire to testify at the hearing must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than noon on Wednesday, July 8, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such a case, a witness should notify the Committee of his inability to appear as soon as possible.

Consolidated testimony.—Senator Chafee urges all witnesses who have a common position or who have the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Chafee urges that all witnesses exert a maximum effort to consolidate and coordinate their statements.

Legislative Reorganization Act.—Senator Chafee stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statement must be typed on letter-size paper (not legal size) and at least 100 copies must be delivered not later than noon on Friday, July 10, 1981.

(4) Witnesses should not read their written statements to be Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

(5) Not more than five minutes will be allowed for the oral summary.

Written statements.—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Monday, August 3, 1981. On the first page of your written statement please indicate the date and subject of the hearing.

II

97TH CONGRESS
1ST SESSION

S. 1310

To amend the Internal Revenue Code of 1954 to provide certain community development, employment, and tax incentives for individuals and businesses in depressed areas.

IN THE SENATE OF THE UNITED STATES

JUNE 3 (legislative day, JUNE 1), 1981

Mr. BOSCHWITZ (for himself, Mr. CHAFEE, Mr. BURDICK, Mr. GORTON, Mr. HATCH, Mr. HAYAKAWA, Mr. HUMPHREY, Mr. JEPSEN, Mr. PERCY, Mr. TOWER, Mr. QUAYLE, Mr. ARMSTRONG, and Mr. KASTEN) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to provide certain community development, employment, and tax incentives for individuals and businesses in depressed areas.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Urban Jobs and Enterprise Zone Act of 1981".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—DESIGNATION OF ENTERPRISE ZONES

SEC. 101. DESIGNATION OF ZONES.

(a) GENERAL RULE.—Chapter 80 (relating to general rules) is amended by adding at the end thereof the following new subchapter:

"Subchapter C—Designation of Enterprise Zones

"SEC. 7871. DESIGNATION.

"(a) DESIGNATION OF ZONES.—

"(1) ENTERPRISE ZONES DEFINED.—For purposes of this title, the term 'enterprise zone' means any area in the United States or its possessions which is designated by one or more local governments for purposes of this section if—

"(A) the Secretary, after consultation with the Secretaries of Commerce, Labor, and Treasury, and the Administrator of the Small Business Administration, approves such designation, and

"(B) the government making such designation has authority to make the local commitments under subsection (d) and provides assurances satisfactory to the Secretary that such commitments will be made in such area.

"(2) LIMITATIONS ON DESIGNATIONS.—The Secretary may not approve any designation under paragraph (1)—

"(A) unless an application therefor is submitted in such manner and in such form, and contains such information, as the Secretary shall by regulations prescribe,

"(B) if any portion of the area to be designated is already included in an area designated and approved as an enterprise zone, or

"(C) if the chief executive officer of the State or possession in which the area to be designated is located files an objection with the Secretary within 21 days of the filing of the application.

"(3) DESIGNATION BY STATES.—A designation under this subsection may be made by a State government on behalf of a local government with the consent of such local government.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

"(1) IN GENERAL.—Any designation of an area as an enterprise zone shall remain in effect during the period beginning on the date of the designation and ending on December 31, 2001, unless the Secretary revokes such designation under paragraph (2).

"(2) REVOCATION OF DESIGNATION.—The Secretary, after consultation with the officials described in subsection (a)(1)(A), may revoke any designation of an area only if the Secretary determines that the government which designated such area is not substantially complying with the local commitments described in subsection (d). Any such revocation shall take effect under rules similar to the rules of subsection (a).

"(c) AREA REQUIREMENTS.—

"(1) IN GENERAL.—The Secretary may approve the designation of any area under subsection (a) only if—

"(A) the area is within the jurisdiction of the government designating such area,

"(B) the boundary of the area is continuous and includes, if feasible, proximately located vacant or underutilized lands or buildings which are conveniently accessible to residents of the area,

"(C) the area—

"(i) has a population which, as determined under the most recent census, is at least—

"(I) 4,000 if any portion of such area is located within a standard metropolitan statistical area (within the meaning of section 103A(l)(4)(B)) with a population of 50,000 or greater, or

"(II) 2,500 in any other case, or

"(ii) is an Indian reservation (as determined by the Secretary of the Interior), and

"(D) the area meets the requirements of paragraphs (2) and (3).

"(2) ELIGIBILITY REQUIREMENTS.—For purposes of paragraph (1), an area meets the requirements of this paragraph if the Secretary determines that—

"(A) the area is one of pervasive poverty, unemployment, and general distress, and

"(B) the area is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974.

"(3) UNEMPLOYMENT, POVERTY, ETC. REQUIREMENTS.—An area meets the requirements of this paragraph if—

"(A) the average rate of unemployment in such area for the most recent 18-month period for which data are available was at least 1½ times the average national rate of unemployment for such 18-month period;

"(B) such area was a low-income poverty area (as determined by the Bureau of the Census during its most recent census);

"(C) at least 70 percent of the residents living in the area have incomes below 80 percent of the median income of the residents of the government designating such area (determined in the same manner as under section 119(b) of the Housing and Community Development Act of 1974); or

"(D) with respect to such area—

"(i) the population of all census tracts in the area decreased by 10 percent or more between 1970 and 1980, and

"(ii) the government seeking designation of the area establishes to the satisfaction of the Secretary that—

"(I) chronic abandonment or demolition of commercial or residential structures exists in the area, or

"(II) substantial tax arrearages of commercial or residential structures exist in the area.

"(4) DETERMINATIONS MADE BY SECRETARY.— Determinations under this subsection shall be made by the Secretary on the basis of data submitted by or on behalf of the government designating the area (or persons designated by the government) if the Secretary determines that such data is reasonably accurate.

"(d) REQUIRED LOCAL COMMITMENT.—

"(1) IN GENERAL.—No area shall be designated as an enterprise zone unless the government seeking such designation agrees in writing that during any period during which the area is an enterprise zone such government will follow a course of action designed to reduce the various burdens borne by employers or employees in such area.

"(2) COURSE OF ACTION.—A course of action under paragraph (1) may be implemented by the government, private entities, or both, may be funded from the proceeds of any Federal program, and may include, but is not limited to—

"(A) a reduction of tax rates or fees,

"(B) an increase in the level or efficiency of local services, "(C) a simplification or streamlining of governmental requirements on employers or employees, or

"(D) a commitment from private entities in the area to provide jobs and job training for, and technical, financial, or other assistance to, employees and residents of the area.

"(e) LIMITATIONS ON DESIGNATIONS.—

"(1) IN GENERAL.—The Secretary may only designate areas as enterprise zones during the period beginning on the date of the enactment of this subchapter and ending on December 31, 1996.

"(2) MINIMUM NUMBER OF DESIGNATIONS.—During each of the 3 calendar years following the calendar year in which the date of the enactment of this subchapter occurs, the Secretary of Housing and Urban Development shall designate at least 10 but not more than 25 areas as enterprise zones.

"(f) PRIORITY OF DESIGNATION.—In deciding which areas should be designated as enterprise zones, the Secretary shall give preference to—

"(1) areas with the highest levels of poverty, unemployment, and general distress,

"(2) areas with respect to which the government seeking or approving the designation has made (or will make) the greatest effort to examine and remove impediments to job creation, taking into account the resources available to such government to make such efforts,

"(3) areas which have the widest support from the government seeking designation, the community, residents, local businesses, and private organizations, especially in meeting the local commitment described in subsection (d), and

"(4) areas with respect to which the government of the State or possession in which the area is located has made commitments similar to the local commitments described in subsection (d).

"(g) DEFINITIONS AND SPECIAL RULE.—For purposes of this section—

"(1) SECRETARY.—The term 'Secretary' means the Secretary of Housing and Urban Development or his delegate.

"(2) GOVERNMENTS.—If more than one government seeks the designation of an area as an enterprise zone, any reference to, or requirement of, this section shall apply to all such governments.".

(b) CONFORMING AMENDMENT.—The table of subchapters for chapter 80 is amended by adding at the end thereof the following new item:

"SUBCHAPTER C. Designation of enterprise zones.".

SEC. 102. COORDINATION WITH OTHER FEDERAL PROGRAMS.

(a) IN GENERAL.—The Secretary of Housing and Urban Development shall—

(1) promote the coordination of all Federal housing, community and economic development, banking, financial assistance, and employment training programs which are carried on within an enterprise zone (within the meaning of subchapter C of chapter 80 of the Internal Revenue Code of 1954),

(2) expedite, to the greatest extent possible, the consideration of applications for programs described in paragraph (1) through the consolidation of forms or otherwise, and

(3) provide, whenever possible, for the consolidation of periodic reports required under programs described in paragraph (1) into one summary report submitted at such intervals as may be designated by the Secretary.

(b) PROPERTY TAX REDUCTIONS.—Any reduction of taxes under any required program of local commitment under section 7871(d) of the Internal Revenue Code of 1954 shall be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

SEC. 103. SENSE OF CONGRESS WITH RESPECT TO DESIGNATIONS OF FOREIGN TRADE ZONES.

It is the sense of the Congress that—

(1) whenever possible foreign trade zones shall be established within enterprise zones (within the meaning of subchapter C of chapter 80 of the Internal Revenue Code of 1954), and

(2) in the case of any application for designation of an area in an enterprise zone as a foreign-trade zone—

(A) the Foreign-Trade Zone Board should expedite the application process as much as possible;

(B) in evaluating such application, the Board should take into account not only current economic development within the enterprise zone but also future development to be expected from the incentives offered by this Act; and

(C) the Board should provide technical assistance to the applicants.

TITLE II—TAXATION

Subtitle A—Refundable Credits for Employers and Employees

SEC. 201. REFUNDABLE EMPLOYERS' CREDIT.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable) is amended by inserting immediately before section 45 the following new section:

"SEC. 44F. EMPLOYMENT OF CERTAIN EMPLOYEES IN ENTERPRISE ZONES.

"(a) IN GENERAL.—At the election of the taxpayer, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the qualified wages of the taxpayer for the taxable year.

"(b) QUALIFIED WAGES DEFINED.—For purposes of this section, the term 'qualified wages' means the wages paid or incurred by the employer during the taxable year to qualified employees.

"(c) WAGES DEFINED.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'wages' has the meaning given to such term by subsection (b) of section 3306 (determined without regard to any dollar limitation contained in such section).

"(2) EXCLUSION OF CERTAIN AMOUNTS FOR EMPLOYERS RECEIVING ON-THE-JOB TRAINING PAYMENTS.—The term 'wages' shall not include that portion of any amount paid or incurred by an employer for any period to any individual which is equal to the amount of any federally funded payments the employer receives for on-the-job training of such individual for such period.

"(3) INDIVIDUALS FOR WHOM WIN OR EMPLOYMENT CREDIT CLAIMED.—The term 'wages' does not include any amount paid or incurred by the employer to an individual with respect to whom the employer claims credit under section 40 or 44B.

"(4) TERMINATION.—The term 'wages' shall not include any amount paid or incurred after December 31, 2001.

"(d) QUALIFIED EMPLOYEE.—For purposes of this section, the term 'qualified employee' means an individual—

"(1) who is certified by the designated local agency as having been (during the preemployment period) an eligible applicant or otherwise eligible—

"(A) under part B or part D of title II of the Comprehensive Employment and Training Act, or

"(B) under part A or part B of title IV of such Act, and

"(2) who performs at least 50 percent of his services during any period for which any computation is being made under this section within an enterprise zone.

For purposes of paragraph (1), the terms 'designated local agency' and 'preemployment period' have the same meanings given such terms by paragraphs (10) and (12) of section 51(d).

"(e) OTHER DEFINITIONS AND SPECIAL RULES.—

"(1) CONTROLLED GROUPS, ETC.—Under regulations prescribed by the Secretary, rules similar to the rules of section 52 and of subsections (f), (g), and (h) of section 51 shall apply to the credit allowable by this section, except that subsection (h) of section 51 shall be applied without regard to any dollar limitation.

"(2) ENTERPRISE ZONE.—The term 'enterprise zone' means an area for which a designation as an enterprise zone is in effect under section 7871.".

(b) CREDIT TO BE REFUNDABLE.—

(1) Subsection (b) of section 6401 (relating to amounts treated as overpayments) is amended—

(A) by striking out "and 43 (relating to earned income credit)," and inserting in lieu thereof "43 (relating to earned income credit), and 44F (relating to employment of certain employees in enterprise zones)", and

(B) by striking out "and 43" and inserting in lieu thereof ", 43, and 44F".

(2) Sections 44C(b)(5), 44D(b)(5), 44E(e)(1), 55(b)(2), 55(b)(4), and 56(c) are each amended by

striking out "and 43" and inserting in lieu thereof "43, and 44F".

(3) Paragraph (4) of section 6201(a) (relating to assessment authority) is amended—

(A) by striking out "or section 43 (relating to earned income)," and inserting in lieu thereof "section 43 (relating to earned income), or section 44F (relating to employment of certain employees in enterprise zones),", and

(B) by striking out "under section 39 or 43" in the heading thereof.

(c) NO DEDUCTION ALLOWED.—

(1) IN GENERAL.—Section 280C (relating to disallowance of deduction for portion of wages for which credit is claimed under section 40 or 44B) is amended—

(A) by adding at the end thereof the following new subsection:

"(c) RULE FOR SECTION 44F CREDIT.—No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the amount of the credit allowable under section 44F (relating to credit for employment of certain employees in enterprise zones). This subsection shall be applied under a rule similar to the rule under the last sentence of subsection (b)."; and

(B) by striking out "or 44B" in the heading and inserting in lieu thereof ", 44B, or 44F".

(2) CONFORMING AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by striking out "or 44B" in the item relating to section 280C and inserting in lieu thereof ", 44B, or 44F".

(d) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting before the item relating to section 45 the following new item:

"Sec. 44F. Employment of certain employees in enterprise zones.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to wages paid after the date of the enactment of this Act in taxable years ending after such date.

SEC. 202. REFUNDABLE EMPLOYEES' CREDIT.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable), as amended by section 201, is amended by inserting immediately before section 45 the following new section:

"SEC. 44G. EARNED INCOME OF EMPLOYEES IN ENTERPRISE ZONES.

"(a) IN GENERAL.—In the case of a qualified employee, there is allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to 5 percent of the qualified earned income for the taxable year.

"(b) LIMITATION.—The amount of the credit allowable to a taxpayer under subsection (a) for any taxable year shall not exceed $1,500.

"(c) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EMPLOYEE.—The term 'qualified employee' means an individual—

"(A) who is employed by a qualified business during the taxable year, and

"(B) with respect to whom at least 50 percent of the services performed by the individual for the qualified business during the taxable year are services performed in an enterprise zone.

"(2) QUALIFIED EARNED INCOME.—

"(A) IN GENERAL.—The term 'qualified earned income' means earned income attributable to services which were performed—

"(i) for a qualified business,

"(ii) in an enterprise zone, and

"(iii) during the 36-month period beginning on the date the qualified employee first performed services for any qualified business in any enterprise zone.

"(B) EARNED INCOME.—The term 'earned income' has the meaning given such term by section 43(c)(2).

"(3) ENTERPRISE ZONE.—The term 'enterprise zone' means any area with respect to which a designation as an enterprise zone is in effect under section 7871.

"(4) QUALIFIED BUSINESS.—The term 'qualified business' has the meaning given such term by section 1201(b)(2).

"(d) CREDIT TO BE REFUNDABLE; ADVANCE PAYMENTS.—For purposes of this title (other than this section, this subpart and chapter 63), any credit allowable under this section shall be treated as if it were allowed by section 43 and not by this section.

"(e) TERMINATION.—This section shall not apply to qualified earned income attributable to services performed after December 31, 2001.".

(b) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44G. Earned income of employees in enterprise zones.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

Subtitle B—Reduction in Capital Gain Tax Rates

SEC. 211. CORPORATIONS.

(a) GENERAL RULE.—Subsection (a) of section 1201 (relating to alternative tax for corporations) is amended by striking out paragraphs (1) and (2) and inserting in lieu thereof the following:

"(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

"(2) a tax of 28 percent of the excess (if any) of—

"(A) the net capital gain for the taxable year, over

"(B) the net capital gain determined only by taking into account sales or exchanges of qualified property.".

(b) DEFINITION OF QUALIFIED PROPERTY.—Section 1201 is amended by redesignating subsections (b) and (c) as subsections (c) and (d) and by inserting after subsection (a) the following new subsection:

"(b) DEFINITION OF QUALIFIED PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified property' means—

"(A) any tangible personal property which was acquired by the taxpayer after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in such enterprise zone in the active conduct of a trade or business,

"(B) any real property located in an enterprise zone which was acquired by the taxpayer after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in the active conduct of a trade or business, and

"(C) any interest in a corporation, partnership, or other entity if, for the most recent taxable year of such entity ending before the date of acquisition of such interest, such entity was a qualified business.

"(2) QUALIFIED BUSINESS.—

"(A) IN GENERAL.—The term 'qualified business' means any person—

"(i) which is actively engaged in the conduct of a trade or business during such taxable year,

"(ii) with respect to which at least 50 percent of such person's gross receipts for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone, and

"(iii) with respect to which at least 40 percent of any employees hired by such person after the later of the date on which—

"(I) such person begins the active conduct of a trade or business within an enterprise zone, or

"(II) any area in which such person is actively engaged in the conduct of a trade or business is designated as an enterprise zone,

are qualified employees.

"(B) EXISTING BUSINESS.—Any person which—

"(i) was actively engaged in the conduct of a trade or business in an area immediately before such area is designated as an enterprise zone, and "(ii) otherwise meets the requirements of this paragraph,

shall not be treated as a qualified business unless the average number of employees (determined on a full-time basis) during the taxable year is at least 10 percent greater than the average number of such employees during the taxable year preceding the designation of such area as an enterprise zone.

"(3) QUALIFIED EMPLOYEES.—The term 'qualified employee' has the same meaning given such term by section 44F(d).

"(4) SPECIAL RULES FOR LOW INCOME RENTAL PROPERTY.—

"(A) IN GENERAL.—In the case of property described in subparagraph (B)—

"(i) such property shall, for purposes of section 1201(a)(2)(B), be treated as qualified property, and

"(ii) ownership of such property shall, for purposes of section 128, be treated as the active conduct of a trade or business within an enterprise zone.

"(B) PROPERTY TO WHICH PARAGRAPH APPLIES.—Property is described in this subparagraph if such property—

"(i) is section 1250 property described in clauses (i)–(iv) of section 1250(a)(1)(B), or similar property designated by the Secretary of Housing and Urban Development,

"(ii) is located in an enterprise zone, and

"(iii) was—

"(I) constructed after the area's designation as an enterprise zone, or

"(II) rehabilitated after such designation and the cost of such rehabilitation was at least $10,000 per unit with respect to each project (or $3,000 per unit if such project was financed from a State or local agency and such agency certifies that no person is in default with respect to such financing at the time of the rehabilitation).

"(5) PROPERTY REMAINS QUALIFIED AFTER ZONE DESIGNATION CEASES TO APPLY.—

"(A) IN GENERAL.—The treatment of property as qualified property under paragraph (1) shall not terminate when the designation of the enterprise zone in which the property is located or used ceases to apply.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply after the first sale or exchange of property occurring after the designation ceases to apply to the zone.

"(6) ENTERPRISE ZONE.—The term 'enterprise zone' means an area with respect to which a designation as an enterprise zone is in effect under section 7871.".

SEC. 212. TAXPAYERS OTHER THAN CORPORATIONS.

Subsection (a) of section 1202 (relating to deduction for capital gains) is amended to read as follows:

"(a) DEDUCTION ALLOWED.—

"(1) IN GENERAL.—If for any taxable year a taxpayer other than a corporation has a net capital gain, there shall be allowed as a deduction from gross income an amount equal to the sum of—

"(A) 100 percent of the lesser of—

"(i) the net capital gain, or

"(ii) the net capital gain determined by only taking into account sales or exchanges of qualified property (as defined in section 1201(b)), plus

"(B) 60 percent of the excess (if any) of—

"(i) the net capital gain, over

"(ii) the amount of the net capital gain taken into account under subparagraph (A).

"(2) PROPERTY REMAINS QUALIFIED AFTER ZONE DESIGNATION CEASES TO APPLY.—

"(A) IN GENERAL.—The treatment of property as qualified property under paragraph (1) shall not terminate when the designation of the enterprise zone in which the property is located or used ceases to apply.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply after the first sale or exchange of property occurring after the designation ceases to apply to the zone.".

SEC. 213. MINIMUM TAX.

(a) CAPITAL GAINS.—Paragraph (9) of section 57(a) (relating to tax preference for capital gains) is amended by adding at the end thereof the following new subparagraph:

"(E) SALES OF CERTAIN PROPERTY NOT TAKEN INTO ACCOUNT.—For purposes of this paragraph, sales or exchanges of qualified property (as defined in section 1201(b)) shall not be taken into account.".

(b) ACCELERATED DEPRECIATION.—Paragraph (2) of section 57(a) (relating to accelerated depreciation on real property) is amended by adding at the end thereof the following: "The preceding sentence shall not apply to any section 1250 property which is qualified property (within the meaning of section 1201(b)).".

SEC. 214. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to sales or exchanges after December 31, 1981, in taxable years ending after such date.

Subtitle C—Reduction in Gross Income of Trades or Businesses Operating in Zone

SEC. 221. EXCLUSION FROM GROSS INCOME.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 128 as section 129 and by inserting after section 127 the following new section:

"SEC. 128. CERTAIN INCOME ATTRIBUTABLE TO ENTERPRISE ZONES.

"(a) GENERAL RULE.—There shall be excluded from the taxable income of a taxpayer (whether or not incorporated) for the taxable year an amount equal to the applicable percentage of the sum of—

"(1) any amount received by a qualified business from the active conduct of a trade or business within an enterprise zone, or

"(2) any amount received as interest on any mortgage, loan, or other financing (other than refinancing) provided by the taxpayer to any qualified business in connection with the conduct of a trade or business within an enterprise zone.

"(b) APPLICABLE PERCENTAGE.—For purposes of subsection (a), the applicable percentage shall be determined in accordance with the following table:

"If the taxable year begins in:	The applicable percentage is:
1981-1997	50
1998	40
1999	30
2000	20
2001	10.

"(c) DEFINITIONS.—For purposes of this section—

"(1) ENTERPRISE ZONE.—The term 'enterprise zone' means an area with respect to which a designation as an enterprise zone is in effect under section 7871.

"(2) QUALIFIED BUSINESS.—The term 'qualified business' has the same meaning given such term by section 1201(b)(2).

"(3) TAXABLE INCOME.—The term 'taxable income' means the excess of the income received from the active conduct of a trade or business within an enterprise zone, less the deductions allowable under this chapter which are allocable to such income.

"(d) APPLICATION OF SECTION.—The provisions of this section shall apply to—

"(1) amounts described in subsection (a) which are received after the date of the enactment of this section and before January 1, 2002, and

"(2) amounts described in subsection (a)(2) which are received during the period described in paragraph (1) and which are attributable to financing provided during such period.".

(b) CONFORMING AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 128 and inserting in lieu thereof the following new items:

"Sec. 128. Certain income attributable to enterprise zones.
"Sec. 129. Cross references to other Acts.".

Subtitle D—Other Incentives

SEC. 231. OPTIONAL CASH METHOD OF ACCOUNTING FOR CERTAIN SMALL BUSINESSES.

Section 446 (relating to general rule for methods of accounting) is amended by adding at the end thereof the following new subsection:

"(f) OPTIONAL CASH METHOD.—

"(1) IN GENERAL.—Any taxpayer which is a qualified business (as defined in section 1201(b)(2)) for any taxable year may elect to compute taxable income—

"(A) under the cash receipts and disbursements method of accounting, and

"(B) without any requirement to use inventories under section 471.

"(2) GROSS RECEIPTS LIMITATION.—Paragraph (1) shall not apply for any taxable year with respect to any taxpayer if for any prior taxable year the gross receipts of such taxpayer exceeded $2,000,000.

"(3) ELECTION.—An election under paragraph (1) may be made by any taxpayer without the consent of the Secretary for the taxpayer's first taxable year for which the taxpayer is a qualified business.".

SEC. 232. EXTENSION OF NET OPERATING LOSS CARRYOVERS.

(a) GENERAL RULE.—Paragraph (1) of section 172(b) (relating to net operating loss carrybacks and carryovers) is amended by adding at the end thereof the following new subparagraph:

"(J) In the case of any taxpayer which is a qualified business (as defined in section 1201(b)(2)) for any taxable year, any net operating loss for such taxable year shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of such loss.".

(b) TECHNICAL AMENDMENT.—Subparagraph (B) of section 172(b)(1) is amended by striking out "and (F)" and inserting in lieu thereof "(F), and (J)".

SEC. 233. INVESTMENT CREDIT FOR CERTAIN LOW INCOME RENTAL HOUSING.

(a) DEFINITION OF SECTION 38 PROPERTY.—Paragraph (1) of section 48(a) (defining section 38 property) is amended by striking out the period at the end of subparagraph (F) and inserting in lieu thereof ", or" and by adding immediately after subparagraph (F) the following new subparagraph:

"(G) property described in section 1201(b)(4)(B).".

(b) LODGING EXCEPTION.—Paragraph (3) of section 48(o) (relating to property used for lodging) is amended—

(1) by striking out "and" at the end of subparagraph (B),

(2) by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and

(3) by adding at the end thereof the following new subparagraph:

"(D) property described in section 1201(b)(4)(B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to periods beginning after the date of the enactment of this Act under rules similar to the rules contained in section 48(m) of the Internal Revenue Code of 1954.

Subtitle E—Sense of the Congress With Respect to Tax Simplification

SEC. 241. TAX SIMPLIFICATION.

It is the sense of the Congress that the Internal Revenue Service should in every way possible simplify the administration and enforcement of any provision of the Internal Revenue Code of 1954 added to, or amended by, this title.

TITLE III—REGULATORY FLEXIBILITY

SEC. 301. DEFINITION OF SMALL ENTITY FOR PURPOSES OF ANALYSIS OF REGULATORY FUNCTIONS.

Paragraph (6) of section 601 of title 5, United States Code, defining small entity, is amended to read as follows:

"(6) the term 'small entity' means—

"(A) a small business, small organization or small governmental jurisdiction (within the meaning of paragraphs (3), (4), and (5), respectively), and

"(B) any qualified business (within the meaning of section 1201(b)(2) of the Internal Revenue

Code of 1954), any government designating an area as an enterprise zone (within the meaning of section 7871 of such Code) to the extent any rule will affect such zone, and any not-for-profit enterprise operating within such zone.".

[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 1310 URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981

SCHEDULED FOR HEARINGS

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE

ON JULY 13 AND 16, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JULY 10, 1981

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INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled public hearings on July 13 and 16, 1981, on S. 1310, the Urban Jobs and Enterprise Zone Act of 1981 (introduced by Senators Boschwitz, Chafee, Armstrong, Grassley and others).

This pamphlet, prepared in connection with the hearings, contains descriptions of the various provisions of the bill. Accompanying each description is a summary of the related provisions of present law.

I. SUMMARY

A. Present Law

Targeted area

The Internal Revenue Code generally does not contain rules for targeting areas. However, the provision relating to mortgage subsidy bonds defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of the employees. However, there are two provisions, the targeted jobs tax credit and the WIN tax credit, which provide credits against tax for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education program, or economic status.

Tax credit for employees and self-employed

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of the employment. However, the earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Capital gains taxation

Noncorporate taxpayers deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital loss) for the taxable year. Corporate taxpayers compute their tax liability using a 28 percent alternative rate applied to net capital gain, if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Reduction in taxation of income derived from certain areas

Under present law, the Federal income tax liability of individuals and businesses located in the United States generally does not vary according to the location of the business within the United States. However, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income.

Cash accounting

Taxpayers generally must use the accrual method of accounting for inventories, and thus may deduct for a taxable year only the cost of goods sold in that year.

Net operating loss carryovers

Under present law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 7 years and thus may be deducted from income attributable to other taxable years within this period.

Investment credit

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. In addition, the credit applies to expenditures to rehabilitate industrial and commercial buildings which are at least 20 years old. Low-income housing is allowed special treatment for recapture of depreciation and for rapid amortization of rehabilitation expenditures.

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to lighten the regulatory burden of small businesses, small nonprofit organizations, or small governmental jurisdictions.

B. Summary of the Bill

Business and employers located in an enterprise zone would be entitled to various tax incentives and regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated after approval of a local government and the Secretary of Housing and Urban Development. The zone would have to satisfy various requirements concerning physical and economic characteristics. The local government seeking designation would be required to commit itself to specific actions to enhance the development of the area. The Secretary would be required to designate 10 to 25 areas as enterprise zones in each of the 3 years after enactment of the bill.

A designation would remain in effect through 2001. Whenever possible, foreign trade zones would be established within enterprise zones.

Title II. Tax incentive provisions

Tax credit for zone employers

Employers would be allowed a refundable tax credit of 5 percent of wages paid to qualified employees. Qualified employees would be individuals who perform at least 50 percent of their services within an enterprise zone and who are eligible for various programs under the Comprehensive Employment and Training Act (CETA).

Tax credit for zone employees

Qualified employees would be allowed a refundable tax credit equal to 5 percent of wages, salaries, and self-employment earnings. Qualified employees would be those who performed at least 50 percent of their services for a qualified business. A qualified business would be a person at least 50 percent of whose gross receipts were attributable to the active conduct of a trade or business within an enterprise zone and at least 40 percent of whose employees were qualified employees for purposes of the credit described above.

Elimination of capital gains taxation

Taxpayers would be allowed to deduct from gross income all net capital gains on property used in an enterprise zone in the active conduct of a trade or business or gains on an interest in a qualified business, including low-income rental property. Conforming changes would be made in the minimum tax provisions.

Reduction in taxation of zone income

A percentage of gross receipts attributable to a qualified business or of interest received from financing for a qualified business would be excluded from the taxable income attributable to that business. The percentage would be 50 percent through 1997 and would phase down to zero by 2002.

Cash accounting for zone businesses

Any qualified business with gross receipts for any prior year of $2 million or less could elect the cash method of accounting for inventories.

Extension of net operating loss carryover

Any qualified business could extend to 20 years the period that net operating losses could be carried forward.

Investment credit for low-income housing

Low-income housing located in the enterprise zone would be made eligible for the investment credit.

Simplified IRS administration

The Internal Revenue Service would be required to simplify the administration of the tax provisions added by this bill.

Title III. Regulatory flexibility

Qualified businesses, any government designating an area as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as is now given to certain small entities.

II. DESCRIPTION OF S. 1310

(THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981)

A. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting economic development within these areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96-499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Under present law, each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, a company may receive dutiable goods free of duty. These goods may be stored, sold, assembled, distributed, or manufactured, and exported, or sent into customs territory of the United States. When goods are sent from a foreign trade zone into the customs territory of the United States, they are subject to the laws affecting imported merchandise.

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

Explanation of Provision

1. Definition of enterprise zones

An enterprise zone would be any area in the United States or its possessions which is designated as an enterprise zone by one or more local governments (or by a State government on behalf of a local government) if the Secretary of Housing and Urban Development approves the designation. The Secretary could approve the designation only after consultation with the Secretaries of Commerce, Labor, and Treasury and the Administrator of the Small Business Administration, after assurance that the local governments which seek the enterprise zone designation have authority to make local commitments (see item 4 below) and after the Secretary is satisfied that various other requirements are satisfied.

The bill specifies limits on the Secretary's authority to make a designation. No designation may be approved if (1) the application is not submitted in accordance with regulations relating to the manner, form and information of the submission; (2) any part of the area is included in an already approved zone; or (3) the chief executive officer of the State or possession files an objection with the Secretary to designation of any area within 21 days of the application.

2. Period of designation

Under the bill, any designation of an area as an enterprise zone would remain in effect through December 31, 2001. The Secretary could revoke a designation, if he determines that the local government is not substantially complying with the requirement for local commitments.

3. Area requirements

The Secretary could designate an area as an enterprise zone, if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. The designation would be made on the basis of information submitted by the local government which the Secretary determines is reasonably accurate. A description of these requirements follows:

a. The area would be required to be within the jurisdiction of the government seeking the designation, to have a continuous boundary and to include, if feasible, vacant or underutilized land or buildings conveniently accessible to residents of the area.

b. The most recent census would have to show that area population is at least 4,000 if the area is included within a standard metropolitan statistical area with 50,000 or more people or at least 2,500 in areas of smaller population, or the area would have to be an Indian reservation (as determined by the Secretary of the Interior).

c. The Secretary would have to determine that the area is one of pervasive poverty, unemployment, and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974.[1]

d. At least one of four additional requirements would have to be satisfied: (1) For the most recent 18-month period, the average rate of unemployment would have to be at least 1½ times the average national unemployment rate; or (2) according to its most recent census, the Bureau of the Census would have to determine that the area was a low-income poverty area; or (3) at least 70 percent of the residents living in the area would have to have income below 80 percent of

[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods.

the median income of the residents of the government designating the area (determined in the same manner as under section 119(b) of the Housing and Community Development Act of 1974); or (4) the population of all census tracts in the area would have to decrease by 10 percent or more between 1970 and 1980 and the government seeking designation would have to establish with respect to the area that chronic abandonment or demolition of commercial or residential structures exists, or substantial tax arrearages of commercial or residential structures exist.

4. Required local commitment

Under the bill, a local government seeking designation of one of its areas as an enterprise zone would have to agree in writing that it would follow a course of action designed to reduce the various burdens borne by employers or employees in the area to be designated.

A course of action under the commitment could be implemented by the local government, private entities or both, could be funded from the proceeds of any Federal program, and could include (but would not be limited to) (1) reduction of tax rates or fees, (2) increase in the level or efficiency of local services, (3) simplification of governmental requirements on employers or employees, or (4) commitment from private entities in the area to provide technical, financial, or other assistance to, and jobs or job training for, employees and residents of the area.

5. Number and period of zone designations

Under the bill, the Secretary could designate areas as enterprise zones only during the period from the date of enactment through December 31, 1996. During each of the three years following the calendar year in which the bill was enacted the Secretary would be required to designate 10 to 25 areas as enterprise zones.

6. Priority of designation

In determining which areas to designate as enterprise zones, the bill provides that the Secretary would give preference to areas (1) with the highest levels of poverty, unemployment, and economic distress, (2) for which the applying local government has made (or will make) the greatest effort possible with its resources to examine and remove impediments to job creation, (3) with the widest support in meeting local commitments from the applying government, the community, residents, local business, and private organizations, and (4) where the State or possession government has made commitments similar to the commitments that would be required of local governments.

7. Coordination with other Federal programs

The coordination of Federal programs within enterprise zones would be the responsibility of the Secretary of Housing and Urban Development. Under the bill, he would promote the coordination of all Federal housing, community and economic development, banking, financial assistance and employment training programs carried on in the enterprise zone. He would expedite consideration of applications for Federal programs and consolidate reporting requirements.

Tax reductions made in fulfillment of the required local commitment would be disregarded in determining State or local government eligibility for any other assistance under any Federal law.

8. Sense of Congress with respect to designation of foreign trade zones

The bill provides that, whenever possible, foreign trade zones would be established within the enterprise zone. With respect to applications for designation of an enterprise zone as a foreign trade zone, the Foreign Trade Zone Board would expedite the application process, in which it would consider current economic development within the zone and the development anticipated as a result of the incentives in the bill.

B. Tax Incentive Provisions (Title II of the Bill)

1. Refundable tax credit for employers

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of the employees. There are two provisions, the targeted jobs tax credit and the WIN tax credit which allow credits against tax for a portion of wage payments made to certain types of employees.

Targeted jobs tax credit

The targeted jobs tax credit, which applies to eligible wages paid before January 1, 1982, is available on an elective basis for hiring individuals from one or more of seven target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 to 25; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income recipients; (5) general assistance recipients; (6) cooperative education students; and (7) economically disadvantaged former convicts.

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages is reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program. Moreover, an employer may not claim credit for wages paid to an individual for whom a WIN tax credit is claimed. Finally, qualified first-year wages for all targeted employees may not exceed 30 percent of FUTA wages for all employees.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward seven years.

WIN tax credit

Taxpayers are allowed, in the case of trade or business employment, a WIN tax credit equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages paid to WIN (Work Incentive Program) registrants and AFDC recipients. For non-trade on business employment, the credit is 35 percent of up to $12,000 per employer of qualified first-year wages.

No more than $6,000 of wages during either the first or second year of employment may be taken into account with respect to any individual. Thus, the maximum credit per individual employed in a trade or business is $3,000 in the first year of employment and $1,500 in the second year of employment. The employer's deduction for wages is reduced by the amount of the credit.

The credit may not exceed 100 percent of tax liability. Excess credits may be carried back three years and carried forward seven years.

Explanation of Provision

Under the bill, employers would be permitted to claim, on an elective basis, a refundable tax credit (i.e., not limited to tax liability) that is equal to 5 percent of qualified wages paid during the taxable year. This credit would be available with respect to qualified wages paid or incurred prior to January 1, 2002. The credit claimed by an employer would reduce the employer's deduction for wages.

In general, qualified wages would be all remuneration for employment of "qualified employees", including the cash value of all remuneration paid in any medium other than cash treated as wages for employment tax purposes. Amounts excluded from the FUTA wage base generally would not be creditable. However, there would be no dollar limitation on wages eligible for the credit. Moreover, wages for purposes of the credit would not include amounts paid to an individual that are equal to payments received by the employer for on-the-job training of that individual under a Federally-funded program. Also, the credit would not be available for wages paid to an individual with respect to whom the employer has claimed a WIN tax credit or targeted jobs tax credit.

To be a "qualified employee", for purposes of the credit, an individual would have to meet two requirements. First, the individual would have to be eligible under the Comprehensive Employment and Training Act (specifically, under parts B or D of title II of CETA, dealing with general training programs and public service employment programs, respectively, or under parts A or B of title IV of CETA, dealing with youth employment programs and the job corps, respectively). Second, the individual would have to perform at least 50 percent of his services within an "enterprise zone." (See definition of an enterprise zone in part II.A., above.)

The Treasury Department would be given the authority to issue regulations dealing with special problems, such as allocation of the credit among controlled groups of corporations, in a manner similar to the way in which those problems are dealt with under the targeted jobs tax credit.

Effective Date

The provision would be effective for wages paid after the date of enactment in taxable years ending after such date.

2. Refundable credit for employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of the employment. However, a refundable credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit, taxpayers living with children in the United States are eligible for a refundable tax credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The credit phases out at a rate of 12.5 percent (*i.e.*, a reduction of 12½ cents for each additional dollar of income) as income (earned income or adjusted gross income, whichever is greater) rises above $6,000. Thus, no credit is available for families with incomes of $10,000 or more.

The earned income credit may be received in the form of advance payments added to employees' paychecks.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a refundable tax credit equal to 5 percent of qualified earned income. The maximum credit for any taxable year would be $1,500.

For purposes of the credit, a qualified employee would be an individual who is employed by a qualified business and who performed at least 50 percent of his services for that business in an enterprise zone. (See item 3 below for definition of a qualified business.)

Earned income, for purposes of this credit, would be the same as earned income for purposes of the earned income credit. That is, generally, it would be wages, salaries, tips, and other employee compensation, plus net earnings from self-employment. Earned income qualifying for the credit ("qualified earned income") would be earned income attributable to services performed for a qualified business, in an enterprise zone, during the 36-month period beginning on the date the qualified employee first performed services for any qualified business in any enterprise zone.

Qualified employees would be able to elect advance payment of the credit. The credit would not apply to qualified earned income attributable to services performed after December 31, 2001.

Effective Date

The provision would be effective for taxable years ending after the date of enactment.

3. Elimination of capital gains taxation

Present Law

Overview

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means property held by the taxpayer. However, capital assets do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) short-term government obligations, or (6) certain U.S. publications.

In addition, gains from sales or exchanges of certain depreciable or real property used in the taxpayer's trade or business may be treated as capital gains under certain circumstances.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used.[1] In specific instances, however, present law allows nonrecognition, or rollover, of gain or loss from certain property, such as owner-occupied housing, to the extent that the proceeds are reinvested in an approved manner. In addition, present law treats some capital gain as ordinary income to the extent of certain previously taken deductions, e.g., depreciation recapture.

Capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a taxpayer's entire net capital gain is 28 percent, i.e., 70 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in gross income.[2]

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the

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[1] UP to $50,000 ($100,000 in the case of a joint return) of losses on certain small business stock is treated as ordinary, rather than a captial, losses (Code sec. 1244).

[2] The Senate Finance Committee amendment to H.J. Res. 266 would reduce the highest individual income tax rate to 50 percent. As a result, the highest capital gains tax rate for individuals would be 20 percent, i.e., 50 percent (the highest individual tax rate under the amendment) times the 40 percent of the entire net capital gain includible in gross income.

corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax on certain specified tax preference items. Accelerated depreciation on real property is a tax preference item for all taxpayers. Accelerated depreciation on leased personal property is a tax preference item for noncorporate taxpayers, and 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that it exceeds their regular income tax, including the "add-on" minimum tax. The alternative minimum tax is based on the sum of the taxpayer's gross income, reduced by allowed deductions, and increased by two tax preference items: (1) "excess" itemized deductions and (2) the capital gains deduction. The alternative minimum tax rate is 10 percent for amounts from $20,000 to $60,000; 20 percent for amounts from $60,000 to $100,000; and 25 percent for amounts over $100,000.[3]

Explanation of Provision

Qualified property and qualified business

The bill would provide special tax treatment for gains and losses from sales or exchanges of "qualified property." For this purpose, the term "qualified property" would mean (1) tangible personal property acquired after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in such a zone in the active conduct of a trade or business, (2) real property acquired after the designation of an area as an enterprise zone and which was used predominantly by the taxpayer in the active conduct of a trade or business, and (3) any interest in a corporation, partnership, or other entity if, for the most recent taxable year of the entity ending before the date of acquisition of the interest, the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) which is actively engaged in the conduct of a trade or business during the taxable year, (2) with respect to which at least 50 percent of such person's gross receipts for the taxable year will be attributable to the active conduct of a trade or business within an enterprise zone, and (3) with respect to which at least 40 percent of any employees hired by such person after the date on which either the person begins the active conduct of a trade or business, or any area in which the person is actively engaged in the conduct of a trade or a business is designated as an enterprise zone, are qualified employees. (See part item 1, above, for definition of a qualified employee.)

The provisions of the bill generally would not allow an already established business to be eligible for classification as a qualified business simply because it was located in an area which subsequently was des-

[3] The Senate Finance Committee amendment to H.J. Res. 266 would reduce the highest alternative minimum tax rate to 20 percent for amounts over $60,000.

ignated as an enterprise zone. However, an exception would be provided for such active trades or businesses if their average number of employees (determined on a full-time basis) during the taxable year is at least 10 percent greater than the average number of such employees during the taxable year preceding the designation of an area as an enterprise zone.

Certain low-income rental property located within an enterprise zone would also be qualified property, and the ownership of such property would be treated as the active conduct of a trade or business for purposes of the enterprise zone income exclusion (described in item 4, below). These special rules would apply to property which is described in the depreciation recapture provisions of present law relating to low-income housing (sec. 1250(a)(1)(B)(i)-(iv)), or similar property designated by the Secretary of Housing and Urban Development, and would be restricted to such property that is located in an enterprise zone, and either was constructed subsequent to the area's designation as an enterprise zone or was rehabilitated after such a designation at a cost of at least $10,000 per unit with respect to each project. If the project was financed from a State or local agency, and such agency certifies that no person is in default with respect to such financing at the time of the rehabilitation, the $10,000 per unit rehabilitation cost requirement would be reduced to $3,000.

Under the bill, the special tax treatment for gains and losses from sales or exchanges of "qualified property" would not cease to be available subsequent to the termination of an area's designation as an enterprise zone. However, the special tax rules would not apply after the first sale or exchange of any item of "qualified property" after the designation of an area as an enterprise zone ceases to apply.

Capital gains deduction

The bill would provide a special rule for a noncorporate taxpayer's gains and losses from sales or exchanges of qualified property. Under this rule, a noncorporate taxpayer could deduct from gross income an amount equal to the sum of (1) 100 percent of the lesser of: the taxpayer's net capital gain, or the net capital gain taking into account only sales or exchanges of qualified property, plus (2) 60 percent of the excess (in any) of the net capital gain over the amount of the net capital gain subject to the 100 percent deduction. This rule, in effect, would allow a noncorporate taxpayer to deduct from gross income 100 percent of any net capital gain from qualified property.

Corporate capital gains tax

The bill, in effect, would allow a corporation to exclude from taxation net capital gains from qualified property.

Minimum taxes

The bill would eliminate the minimum tax and alternative minimum tax classification of net capital gains from qualified property as a tax preference item. It also would eliminate the tax preference classification of accelerated depreciation on real property that is qualified property.

Effective Date

The capital gain changes would apply to sales or exchanges after December 31, 1981, in taxable years ending after that date.

4. Reduction in taxation of gross income of business

Present Law

Under present law, the Federal income tax liability of individuals and businesses located in the United States generally does not vary according to the location of the business within the United States. However, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 50 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puerto Rico or the possession.

Explanation of Provision

The bill would provide an exclusion of a portion of certain gross receipts from that part of a taxpayer's taxable income which is attributable to the taxpayer's active conduct of a trade or business within an enterprise zone. This exclusion would apply to taxable years beginning after 1980 and before 2002.

The amount excluded would be determined by multiplying the applicable percentage times the sum of—

(1) receipts of a taxpayer's qualified business that are attributable to the active conduct of a trade or business within an enterprise zone, and

(2) interest received on financing (other than refinancing) that is provided by a taxpayer to a qualified business for conduct of a trade or business within an enterprise zone.

The applicable percentage for a taxable year would be as follows:

If the taxable year begins in:	*The applicable percentage is:*
1981–1997	50
1998	40
1999	30
2000	20
2001	10

For purposes of determining the amount of gross receipts excluded and the amount of taxable income from which such gross receipts would be excluded, the terms "enterprise zone" and "qualified business" have the same meanings as they do elsewhere in the bill. (See parts II.A. and II.B.3., respectively.)

Effective Date

This provision would apply to taxable years beginning after 1980 and before 2002.

5. Cash accounting for small business

Present Law

Under the cash method of accounting, taxpayers generally must deduct all expenditures other than those for capital assets. However, if a taxpayer other than a farmer has inventories, he may not use the cash method but must use the accrual method of accounting for those inventories. Under the accrual method, the taxpayer may deduct only the cost of those goods that were actually sold in the year. Thus, taxpayers may not take a deduction for goods that were purchased but not sold during the year.

Explanation of Provision

The provision would allow any qualified business (as defined in item 3, above) which has not had gross receipts in any prior taxable year of more than $2 million to elect to use the cash method of accounting for its inventories. Thus, it could deduct goods purchased, but not sold, in that year.

Effective Date

This provision would be effective for any taxable year beginning after the date of enactment.

6. Extension of net operating loss carryovers

Present Law

Under existing law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 7 years and thus may be deducted from income attributable to the other taxable years within this period.[1]

[1] The carryforward period generally would be extended to 10 years under an amendment to current law included in the Economic Recovery Tax Act of 1981, as reported by the Senate Finance Committee (H.J. Res. 266).

Explanation of Provision

For any taxable year during which a taxpayer satisfies the definition of a "qualified business" (see item 3, above), the bill would extend to 20 years the period that a net operating loss could be carried forward.

Effective Date

The provision would apply to taxable years beginning after the date of enactment.

7. Investment tax cerdit for low-income rental housing

Present Law

Under present law, a 10-percent regular investment tax credit applies to eligible property used in a trade or business or for the production of income. Certain energy property is entitled to an additional credit. Further, up to an additional one and one-half percent credit is available if certain requirements concerning employee stock ownership plans are met.

Property eligible for investment credits includes (1) tangible personal property, and (2) other tangible property used as an integral part of certain activities, such as manufacturing and production. In general, buildings and their structural components are ineligible. However, certain single purpose agricultural structures and the cost of rehabilitating a building that is at least 20 years old (rehabilitation expenditures) are eligible for investment credits. In general, property is not eligible if it is used for furnishing lodging or used in connection with furnishing lodging.

Under present law, rehabilitation expenditures for low-income rental housing may be amortized over a 60-month period, in place of the depreciation deductions which are otherwise applicable. Also, for subsidized low-income rental housing, the amount of depreciation subject to recapture as ordinary income when the property is sold is phased out by one percentage point for each month after the property has been held for 100 months.[1]

Explanation of Provision

The bill would extend eligibility for the regular 10-percent investment tax credit to certain low-income rental housing, thus creating an exception from the general rule denying the investment credit for real property and property used for lodging. Eligible low-income housing would have to be located in an enterprise zone and constructed after the area has been designated an enterprise zone. If the property were rehabilitated, rehabilitation costs would qualify for the credit if incurred after designation of the area as an enterprise zone and if the cost of rehabilitation were at least $10,000 per unit with respect to each project (or $3,000 per unit for certain property financed by a State or local agency).

Effective Date

The provision would apply to property acquired, constructed, or reconstructed after the date of enactment.

[1] Under the Economic Recovery Tax Act of 1981, as reported by the Senate Finance Committee on July 6, 1981, as an amendment to H.J. Res. 266, these special benefits would remain available for low-income housing. That bill also revises the rules relating to rehabilitation tax credits. Under that bill, credits would be available, at varying percentages, for buildings that are at least 30 years old or are certified historic structures.

8. Simplified IRS administration

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

Effective Date

The provision would be effective upon enactment.

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[1] Sec. 507 of P.L. 94-455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95-600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simplification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD-78-74; July 5, 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

C. Regulatory Flexibility (Title III of the Bill)

Present Law

Chapter 6, Title 5, United States Code (popularly referred to as the Regulatory Flexibility Act) relates to the analysis of regulatory functions. In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexibile regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provision

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within the zone.

For the purposes of this provision, a qualified business would be defined as it would be for other purposes of the bill.

Effective Date

The provision would be effective upon enactment.

OPENING STATEMENT OF SENATOR JOHN H. CHAFEE (REPUBLICAN, RHODE ISLAND), CHAIRMAN, SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

HEARING ON PROPOSED URBAN JOBS AND ENTERPRISE ZONE ACT, MONDAY, JULY 13, 1981

Good morning and welcome to the first Senate Finance committee hearing on S. 1310, the Urban Jobs and Enterprise Zone Act of 1981. This legislation offers our nation's most distressed cities and towns a long-awaited opportunity for economic rebirth.

Let me emphasize the concept of "opportunity" because it is just that. It is not the answer; it is not the miracle cure; it is not a massive, new spending program masquerading as salvation from Washington, D.C.

The enterprise zone idea and the support it has from President Reagan signal a new direction in American urban policy. It is founded on our belief that job creation in declining urban and rural areas can only be achieved by removing obstacles to economic growth and providing tangible incentives for people to live and work in these places. Given the limited resources of our federal government, it is imperative that the energy and creativity of private sector enterprise be harnessed for this monumental task.

This is the goal of the Urban Jobs and Enterprise Zone Act of 1981. Having worked on this legislation for more than a year with Senator Boschwitz, Congressman Kemp and Congressman Garcia, I believe we have made significant improvements over the original 1980 draft of the bill. We have also had the input and support of dozens of economic development experts from around the United States in producing this new bill.

The Act allows between 10 and 25 zones to be established in each of the next three years. Applications for zone designation will be considered from areas which meet tests of high unemployment and widespread poverty, and show a strong commitment on the part of local business, government and civic leaders to work together to enhance economic opportunities. The Department of Housing and Urban Development (HUD) will be the administering agency.

The primary benefits under the Enterprise Zone Act are federal tax reductions designed to increase new jobs and business investment in zone areas. These tax breaks will increase the rate of return on productive economic activity, helping to overcome the high costs associated with locating in distressed areas. Such costs might include training an unskilled workforce, protecting against crime and vandalism, and compensating for poor city services.

Zone employers will be given a 5 percent refundable tax credit for wages paid to CETA-eligible employees, that is, people who are considered long-term unemployed from economically disadvantaged families. The capital gains tax will also be eliminated on all new zone investments.

For zone businesses hiring at least 40 percent CETA-eligible workers, there are additional tax incentives. Income tax on half their profits will be eliminated. And, for those who lend capital to such zone enterprises, taxes will be eliminated on half the income from their loans.

For all workers in businesses with at least 40 percent CETA-eligible employees, there is a 5 percent refundable tax credit for wages earned, up to a $1,500 credit per year. This relief is provided in view of the fact that, in many cases, leaving welfare rolls also means leaving behind tax-free income and health benefits which can far exceed minimum or low wage salaries in many entry-level jobs.

The Act also recognizes that many federal program enacted in past years have been useful tools in economic development projects. Therefore, special consideration will be given to applications from zone areas for assistance under programs such as the Urban Development Action Grant (UDAG), Section 8 low-income housing, and CETA private sector job training.

I believe that this legislation offers a fresh and effective approach to the perplexing problems of economic decline—an approach that can be used in the South Bronxes and South Providences of our Nation, as well as in depressed rural areas.

Thank you all for coming this morning to the opening session on the Urban Jobs and Enterprise Zone Act of 1981.

Senator CHAFEE. Good morning and welcome to this first Senate Finance Committee hearing on S. 1310, which is the Urban Jobs and Enterprise Zone Act of 1981.

This legislation offers our Nation's most distressed cities and towns a long awaited opportunity for economic rebirth. Let me emphasize the word "opportunity." It is not a miracle cure. It is not a massive new spending program, masquerading as salvation from Washington, D.C., and it is not in any way a replacement for existing programs which deal with job training or urban development.

Many of those who are concerned about our inner cities have the fear that this program is going to be a substitute for existing programs. It is not looked on as such by myself and the cosponsors of this act.

The enterprise zone idea and the support it has from President Reagan signals a new direction for American urban policy. It is founded on our belief that job creation in declining urban and rural areas can only be achieved by removing obstacles to economic growth and providing tangible incentives for people to live and work in these areas.

Given the limited resources of our Federal Government, it is imperative that the energy and creativity of private sector enterprise be harnessed for this monumental task.

This is the goal of the Urban Jobs and Enterprise Zone Act 1981.

Having worked on this legislation for more than a year with Senator Boschwitz, Congressman Kemp, and Congressman Garcia, who will testify here shortly, I believe we have made significant improvements over the act that we submitted a year ago. We have also had the input and support of dozens of economic development experts, mayors, and others concerned with inner cities.

Now, what does it do? This act allows between 10 and 25 zones to be established in each of the next 3 years.

Applications for zone designation will be considered from areas which meet tests of high unemployment and widespread poverty. These applicants must show a strong commitment on the part of local business, local government, and civic leaders to work together to enhance economic opportunity. The Department of HUD will be the administering agency.

The primary benefits under the Enterprise Zone Act are Federal tax reductions designed to increase new jobs and business investments in the area. These tax breaks will increase the rate of return on productive economic activity and help to overcome the high costs which are associated with locating in distressed areas. Such costs might include the training of an unskilled work force and protection against crime and vandalism.

The zone employers will be given a 5-percent refundable tax credit for wages paid to CETA eligible employees; people who are considered long-term unemployed and from economically disadvantaged families. The capital gains tax will also be eliminated for all new zone investments.

For zone businesses hiring at least 40 percent CETA eligible workers—that is 40 percent of their work force—there are additional tax incentives. Income taxes on half their profits will be eliminated. And for those who lend capital to such zone businesses, taxes will be eliminated on half the income from their loans. In the hearings that I have held around the country so far, in Boston and Atlanta, the principal stumbling block that all new businesses seem to find in locating in the inner city, is obtaining capital.

This provision is an incentive for those who lend capital to such zone enterprises.

Also, for all workers in businesses with at least 40 percent CETA eligible employees there is a 5-percent refundable tax credit for wages earned up to a $1,500 tax credit per year.

This relief is provided in view of the fact that many of these CETA eligible employees who leave the welfare roles, also leave tax-free income, health care, and other benefits which far exceed minimum- or low-wage salaries in many entry-level jobs.

This act also recognizes that many Federal programs enacted in past years have been useful tools in economic development projects. Therefore, special consideration will be given to applications from zone areas for assistance under programs such as UDAG, section 8, low-income housing, and CETA private sector job training.

I believe this legislation offers a fresh and effective approach to the perplexing problems of economic decline. An approach that can be used in the South Bronxes, in the South Providences of our Nation, as well as in depressed rural areas.

I want to thank everyone for coming this morning. We look forward to the testimony and to obtaining ideas of how we can improve this legislation. That is what these hearings are all about.

I am very pleased that Senator Dole, chairman of our full committee, who has had long interest in improving the situation for our urban and our rural poor, is here. So, Senator, if you have a statement, we would be delighted to hear it.

Senator DOLE. I'll not read my entire statement. You have some outstanding witnesses who have been waiting.

I would indicate first my thanks to you, Senator Chafee, for having these hearings. It seems to me that this is our first opportunity in Congress—at least on this side, the Senate side—to take a look at some of the benefits of such a program, and consider some of the problems.

It would seem to me that we should in these hearings, and in later hearings, determine first of all if we could reduce some of the known administrative complexities, and whether we can tie this to the President's economic recovery package. This is a concept supported by the President. It is one that I think has some merit.

I recall that President Ford in 1976 had a similar approach to this problem. He didn't call it the enterprise zone, but it was a way to help distressed areas in urban centers around the country.

So, it is my hope that we can proceed in an orderly fashion to work with State and local officials to come up with a program that would really provide opportunities without just setting aside an enclave somewhere that benefits from certain incentives, so that everyone in the surrounding area would have disincentives.

So, it's a very complicated question. But it is one that I think we can address, and hopefully this hearing will be the start.

[The prepared statement of Senator Dole follows:]

PREPARED STATEMENT OF SENATOR ROBERT DOLE

Mr. Chairman, by scheduling these hearings on enterprise zones you have provided Congress and the public with their first opportunity formally to examine the concept of tax and regulatory relief directed to certain depressed areas. The notion of an enterprise zone is to lift burdens imposed by Government that tend to inhibit economic growth, and to do so in areas where the public sector involvement has failed to arrest or reverse an economic decline. Enterprise zones have the potential for demonstrating, by eliminating disincentives caused by the failure to accurately evaluate costs and benefits in implementing public policy, that the private sector remains the key to steady growth and job-creation.

The enterprise zone concept is beginning to be tested in Great Britain, and we may be able to learn from the experience of that nation. The idea certainly merits careful and detailed attention from this committee and this Congress; it has also been strongly supported by the President. I hope the witnesses will be able to give us some idea of the best way to structure a system of relief from Government burdens that will make a real difference to our depressed inner cities and rural communities. It would also be helpful, I think, to hear how the witnesses feel the enterprise zone concept fits in with the Reagan administration economic recovery program.

Mr. Chairman, no doubt there are many complicated technical questions that would have to be resolved before we could implement legislation authorizing enterprise zones. You have considered many of these problems in formulating the legislation before the subcommittee, S. 1310. Other problems will no doubt surface. But if we are committed to an even-handed approach to economic development, as I believe we are, we ought to make our best effort to find a way to make enterprise zones work, without excessive administrative complexity that would defeat the purpose of minimizing Government involvement. The task will not be easy, and it will require a cooperative and common-sense approach on the part of State and local governments as well as from Federal policymakers and the private sector. The goal is to lift restrictions that inhibit development, not to subsidize special projects that merely shift the patterns of economic growth. It is a difficult task, and I appreciate your setting these hearings to begin grappling with the problem.

I look forward to hearing the testimony of Representative Garcia and the other witnesses, and I hope this process can lead to a proposal that the Congress and the administration can agree to, in cooperation with State and local officials.

Senator DOLE. Thank you, Mr. Chairman.

Senator CHAFEE. Thank you, Senator Dole, we are glad that you are here. We know you have a busy schedule as you prepare for the reconciliation measures conference. So, any time that you can spend with us, we appreciate, but we certainly recognize that you have other claims on your time.

We have a letter from Secretary Baldrige which I would like to read. As Senator Dole mentioned, the President is supportive of this legislation. I think the Secretary Baldrige's letter will be helpful. It is addressed to me as Chairman of the Subcommittee on Savings, Pensions and Related Investment Policy.

[Senator Chafee reads letter from Secretary Baldrige:]

I regret that I am unable to appear personally before your Subcommittee as it considers legislation establishing enterprise zones.

As I have stated on previous occasions, the Administration supports the establishment of enterprise zones in order to create new jobs and enterprises in our Nation's poorest community.

Many of our Nation's depressed areas can be revitalized by new economic activities. Particularly the development of new small businesses which create opportunity and jobs for the residents.

Currently the new economic activity which these areas so vitally need is being discouraged by regulatory obstacles and tax burdens, which are especially burdensome to such ventures.

These two obstacles, more than others, discourage would-be entrepreneurs, who might otherwise go into business in these areas, and create much needed job opportunity.

It is my view that significant roll backs in taxation, and in counter-productive regulations in our poorest areas, could create new opportunity for economic activity. I firmly believe that local residents will respond to that opportunity.

As a result, new jobs would be created and these distressed would again become centers of economic strength and vitality—making a real contribution to the Nation's economy as a whole.

As a consequence, I would favor legislation which implements the enterprise zone concept, is tightly drafted and precisely targeted, and establishes unambiguously, the substantial role which the states, local communities, and the private sector must play in making the concept a reality.

Senate Bill 1310, the Urban Jobs and Enterprise Zone Act of 1981 seeks to address the economic problems of our poorest areas by amending the Internal Revenue Code of 1954 in two major ways.

First, it would authorize the Secretary of Housing and Urban Development to approve the designation of areas meeting certain distress criteria as enterprise zones.

Second, it would provide certain tax incentives to encourage economic activity in these zones.

The Administration supports the thrust of S. 1310, but we have not taken a position on the details of the bill yet.

I will be pleased to discuss that with you when our review is completed.

Sincerely,

MALCOLM BALDRIGE, *Secretary of Commerce.*

Senator CHAFEE. It would be my intention, as soon as the administration has come to its conclusion as to what exactly it wishes in connection with this effort, to call the Secretary of Commerce to schedule hearings, and have him testify at that time. Obviously, having the imprimatur of the administration is extremely helpful in getting any legislation passed. We do want to work with them.

The point that Senator Dole made during his brief remarks is important. There are problems with this bill. Any time you set up a zone, somebody will be living on the boundary and will not receive the benefits that their neighbors do. That raises difficulties. Another problem area concerns residence requirements. If you have 40 percent of your work force who are CETA eligible, do they have to be CETA eligible from within the zone, or doesn't that make any difference? And if they are from the zone, suppose they move out, then what happens?

These are some of the problems we will expect to find answers to today.

I am delighted to have here today as our first witness, Representative Robert Garcia from the Bronx, N.Y., who has long worked on this legislation. He introduced it last year along with Representative Kemp in the House and has done the same this year while both years Senator Boschwitz and I have been cosponsors in the Senate.

I don't think anybody has been more deeply involved with this matter than you, Representative Garcia, and we are delighted that you are here this morning.

STATEMENT OF HON. ROBERT GARCIA, U.S. REPRESENTATIVE FROM THE STATE OF NEW YORK

Mr. GARCIA. Thank you very much, Senator Chafee, Senator Dole.

I am pleased to discuss with you my thoughts and what I believe is a new and exciting concept in inner city revitalization.

The Enterprise Jobs—the Urban Jobs and Enterprise Zone Act of 1981 introduced by myself and Jack Kemp, H.R. 3824, is the bill that we will discuss.

In July of 1967, Senator Robert F. Kennedy introduced a bill to encourage investment in urban poverty areas with these words:

> The specific purpose of the bill is to stimulate investment—the creation of new jobs and income—in poverty areas. The Federal Government provides only a system of tax incentives, carefully designed to enable private enterprise to make its investments in the urban poverty areas.

A decade later as part of the first comprehensive approach to urban development undertaken in our Nation's history, President

Jimmy Carter urged Congress to enact a targeted fiscal assistance program, a targeted jobs tax credit, and a tax credit to target investment to distressed communities. These were to form the basis, the President said, of "a new partnership to conserve America's communities."

I have hereby introduced similar legislation to accomplish exactly the same purposes.

This is not to say that Bob Kennedy or Jimmy Carter, or myself ever intended our respective efforts to replace existing programs. Far from it. My predecessors understood, and I too understand, that targeted job economic development policy is most effective when used in conjunction with existing programs to ease the plight of our inner city residents—the poor, the elderly, and the unemployed. Section 102 of my bill provides for such coordination.

It is estimated, that 1 out of every 5 persons in New York City is poor, and that 1 out of every 3 who live in my district, the South Bronx, is below the poverty level. Approximately 1 out of 12 residents of New York City is unemployed, but in my part of the city, that number is closer to 1 out of 3. Blacks across the Nation have a poverty level of 33 percent and an unemployment rate of 17 percent. While 1 out of every 5 Hispanics is poor, and 1 out of every 10 is out of work, it is disgraceful that any elected official, much less the majority of those in Congress would contend that now is the time to eliminate the programs which would help these people.

I have voted consistently on the side of the poor since elected to Congress, and I will continue to do so despite the loss of social consciousness so very fashionable today in our Nation's Capital.

I have done so because I understand that the problem of urban decay is very complex, and that many different factors contribute to it. Grants, loans and subsidies are critically significant in helping out, but as Bob Kennedy and President Carter knew, that's not enough. Tax policy alone is not absolutely significant, much less relevant. The things which cause poverty and unemployment in one portion of the city differ from the things that cause poverty and unemployment in another.

The heart of my proposal is section 101 which offers a method in which community interest and support is mobilized so that a zone may be established. Under my proposal, it is only when a business has already made a commitment actually to hire the poor and unemployed that it may receive the tax benefits that I offer. Bob Kennedy stated almost exactly 14 years ago when he introduced his bill to promote investment within our Nation's slums:

> This Nation faces many problems. Some are outside our borders, some are almost beyond our comprehension. The awful potential of nuclear weapons; the technical complexities of air and water pollution; the meaning of learning in an age of computers. But of all of our problems, none is more immediate, none is more pressing, none is more omnipresent than the crisis of unemployment in every major city in the Nation.

It is for that purpose that I have introduced this legislation to answer these long-festering problems that we have had in America.

I thank you very much.

Senator CHAFEE. Thank you very much, Representative Garcia. I would like to touch on a couple of points.

We've made some changes in this legislation that I think are big steps ahead from last year. For instance, last year, as you will recall, we dealt with reducing social security taxes for those in the zone. I don't think we could achieve that in this climate today. This year we have gone to the refundable tax credit. Also this year, we do not have a residency requirement. The 40 percent CETA eligible can come from any CETA eligible area. In other words, they don't have to be within the zone.

Mr. GARCIA. Let's just take the city of New York for example, where we are bordered by the States of both Connecticut and New Jersey. I think that we would have to make every effort, because of the specific problems within to make sure that those jobs are earmarked for the people in that community.

There are many people who can come from various parts of the country and say they have an address in the South Bronx and then be qualified to work there, and also to qualify the employer for the tax credits and the various incentives that this bill offers. We must solve this problem.

In the city of New York, we have approximately 30 community planning boards, and I hope the community planning boards will play a major role. No one knows those communities better than those local community planning boards, in this case the city of New York.

So in answer to your question, I hope that local authority will enter through vehicles such as community planning boards.

Senator CHAFEE. I suppose as a practical matter no CETA eligible employee is going to come from Pittsburgh. The people you are going to get are the people who are going to be in the neighborhood.

Mr. GARCIA. I would agree.

Senator CHAFEE. I think it is well to get away from that residency problem that we wrestled with last year because what do you do if the person moves out of the zone. Does he lose his job then?

Mr. GARCIA. I think the best example that I can give you is in the Bed-Sty section of Brooklyn. The IBM Corp. opened what they called a cable lacing plant, and that was after Senator Kennedy and his wife Ethel toured the Bed-Sty section of Brooklyn. They were in a position to pick up the phone and call the chairman of the board of IBM, and several of the members of the board of directors of the IBM Corp., and almost immediately have the plant installed in Brooklyn.

The IBM philosophy is one of upward mobility. So we can see that there have been cases where people who have done well, with the IBM Corp. as in this particular case, have picked themselves up and left.

I don't see how you can avoid that. It seems to me that what we are trying to do is create an environment. Hopefully, many of those people will stay. That is how you start the long process of rebuilding roots within a community to make it viable over the long stretch. I imagine that there will be some cases where people leave, but hope that the majority of those people would be people who will stay within that community.

Senator, I was born and raised in the South Bronx and I still live there today.

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I had an aunt, who for close to 20 years lived on 139th Street, between St. Ann's and Cypress Avenue. She worked for that same period of time in a factory on the other side of Buckner Boulevard on 138th Street. The shopping center in our community was on 138th Street, but further east.

The fact is, is that she worked there, she lived there, her children went to school there, and she shopped there.

What happened was that the $20 or $30 that they earned was recycled at least two or three or four times.

That is my dream of what the enterprise zone bill is all about. I don't know if we will be able to achieve it it that same form, but you are not going to have a community without roots, without people living and working there.

There will be a spinoff and some people will leave, but I would hope that the vast majority would stay.

Senator CHAFEE. Thank you very much for coming, Representative Garcia, and we look forward to working more with you.

Would you like to join us up here? I know you have a busy schedule, but if you would like to sit up here, it is entirely up to you.

[The statement follows:]

STATEMENT OF CONGRESSMAN ROBERT GARCIA

I am very pleased to be here today to discuss with you my thoughts on what I believe is a new and exciting concept in inner-city revitalization; the Urban Jobs and Enterprise Zone Act of 1981 (H.R. 3824). For the record, I would like to submit a copy of my proposal, cosponsored by Representative Jack Kemp (R-N.Y.) along with a section-by-section analysis.

In July 1967, Senator Robert F. Kennedy introduced a bill to encourage investment in urban poverty areas with these words: "The specific purpose of the bill is to stimulate investment—the creation of new jobs and income—in poverty areas. The Federal Government provides only a system of tax incentives, carefully designed to enable private enterprise to make its investments in the urban poverty areas."

A decade later, as part of the first comprehennsive approach to urban development undertaken in our Nation's history, President Jimmy Carter urged Congress to enact a targeted fiscal assistance program, a targeted jobs tax credit, and a tax credit to target investment to distressed communities. These were to form the basis, the President said of "A new partnership to conserve America's communities."

And thus it is that I have introduced similar legislation to accomplish exactly the same purpose.

This is not to say that Robert Kennedy, Jimmy Carter, or Bob Garcia ever intended their respective efforts to replace existing programs. Far from it, Rather, my predecessors understood—as I too understand—that targeted economic development policy is most effective when used in conjunction with existing programs to ease the plight of our inner city residents; the poor, the elderly, and the unemployed. And section 102 of my bill provides for just such coordination.

It is estimated that one out of every five persons in New York City is poor and that one our of every three who live in my South Bronx congressional district is below the poverty line. Approximately 1 out of 12 residents of this city is unemployed, but in my part of the city that number is closer to one out of three. Blacks across the Nation have a poverty level of one third and an unemployment rate of one-sixth, while one out of every five Hispanics is poor and one out of every 10 is out of work. It is disgraceful that any elected official, much less a majority of those in Washington, would contend that now is the time to eliminate the programs which would help these people. I have voted consistently on the side of the poor since elected to Congress and I will continue to do so—despite the loss of social consciousness so very fashionable today in our Nation's Capital.

I have done so because I understand that the problem of urban decay is very complex and that many different factors contribute to it. Grants, loans, and subsidies are critically significant in helping out—but as Robert Kennedy and Jimmy Carter knew, they are not enough.

Nor is tax policy alone significant, much less relevant. The things which cause poverty and unemployment in one portion of a city differ from the things that cause poverty and unemployment in another. Thus, the heart of my proposal is not the package of tax incentives but rather section 101 which offers a method in which community interest and support is mobilized so that a zone may be established. And under my proposal, it is only when a business has made a commitment actually to hire the poor and unemployed that it may receive the tax benefits I offer. For as Senator Robert F. Kennedy stated almost exactly 14 years ago today when he introduced his bill to promote investment within our Nation's slums:

"This Nation faces many problems. Some are outside our borders . . . some are almost beyond our comprehension: the awful potential of the nuclear weapon, the technical complexities of air and water pollution, the meaning of learning in an age of computers. But of all our problems none is more immediate—none is more pressing—none is more omnipresent—than the crisis of unemployment in every major city in the Nation."

And it is for the purpose of addressing that long-festering crisis that I have introduce my bill.

Hearings held in New York City this past Wednesday by House Banking Committee. Broad consensus was bill still needs strengthening:

(1) Should be job training;

(2) Legislation should specifically set up a local public and private combined local entity to monitor and select the zones and the kinds of business activity going on within them;

(3) That the legislation should specifically offer a means for active citizen input and participation within the local zone administration;

(4) Minority and other kinds of small business assistance should be targeted to the zones;

(5) The bill should provide for targeted accelerated depreciation.

Senator CHAFEE. Now we have a panel of Maudine Cooper, vice president of the National Urban League; M. Carl Holman, National Urban Coalition, and Nesby Moore, president of the Union-Sarah Economic Development Corp., St. Louis, and Bob Zdenek, president of the National Congress for Community Economic Development.

A PANEL OF MAUDINE COOPER, VICE PRESIDENT, NATIONAL URBAN LEAGUE, WASHINGTON OPERATIONS; M. CARL HOLMAN, PRESIDENT, THE NATIONAL URBAN COALITION, WASHINGTON, D.C.; NESBY MOORE, PRESIDENT, UNION-SARAH ECONOMIC DEVELOPMENT CORP., ST. LOUIS, MO.; AND ROBERT ZDENEK, PRESIDENT, NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT, WASHINGTON, D.C.

Senator CHAFEE. Ms. Cooper, if you would start right off.

Ms. COOPER. Good morning.

Senator CHAFEE. Your statement will be entered in the record.

Ms. COOPER. Thank you. I will try to be very brief.

First of all, we welcome the opportunity to discuss the Urban Jobs and Enterprise Zone Act, S. 1310, with you this morning.

To begin with, we do in fact want to see the revitalization of our inner cities. That almost goes without saying. For that is the home of many of our constituents—the Urban League's constituents.

We want to see the residents of the inner city participate in this revitalization. We think that the enterprise zone concept has the potential for helping to do both.

Statistics show quite clearly why we are so concerned with life in the inner city. These are the areas that have suffered most from the flight of businesses to suburban cites. The areas where poverty continues to stifle economic and human growth. The areas where unemployment is indeed the highest.

We also see enterprise zones as a possible complement to the struggle for survival among many small inner city minority businesses.

In 1977, we saw that black businesses total aggregate receipts came to roughly $8.7 billion, which could only rank it as the 37th largest company in the United States. The aggregate figure that is.

The devastating effect of the 1974-75 recession on black businesses is reflected in the sharp decline in auto dealerships and service stations, in hotels and other lodging facilities, in food and eating establishments, and in inner city transporting firms.

In our annual publication, "State of Black America 1981," the National Urban League described the urban jobs and enterprise zone concept as one promising much. At the same time, we took the position that the legislation embodying the concept should be formulated so that it would be effective in stimulating economic and job development activities that would significantly enhance the economic well-being of minority residents in the affected areas.

The enterprise zone concept takes stock of some of our concerns and represents an intelligent and working approach to the problem of business development in our cities. But tax policies designed to encourage building new plants, such as the incentive offered by the administration for the private sector to invest in productive capacity, could make it cheaper and easier for industries to abandon their older installations and build elsewhere.

Older cities have already witnessed the erosion of their industrial base with the consequent loss of jobs.

The proposed new round of incentives to build new facilities could accidentally wipe out the local economies of major parts of the Nation.

So incentives, could be, should be narrowly targeted to create jobs where they are needed most.

Tax breaks for the rehabilitation of aging plants should be more favorable than building new ones. Or the system could be designed to favor replacing present facilities in the same areas.

Senator CHAFEE. I would point out that in the tax bill that this committee reported out, as perhaps you know, we have some very, very substantial incentives for rehabilitation of older, nonresidential building.

Ms. COOPER. But our key concern is that existing incentives within the tax code for building new structures could outweigh a determination by a corporation to move into the inner city. I think those possibilities ought to be balanced.

The fact that the enterprise zone concept encourages the maintenance of job-creating businesses in inner city areas, is certainly a step in the right direction. But we are cognizant of the potential failure of such a proposal should businesses be granted even greater concessions for moving away from the urban area.

And that, Senator, is our key point.

Certain provisions of the Urban Jobs and Enterprise Zone Act do reflect a sensitivity to the needs of the urban poor. Those provisions, we feel, appropriately seek to benefit poor zone residents by encouraging employment and job creation. While addressing the potential displacement caused by increased business activity.

But there are still some additional concerns which we feel ought to be addressed prior to enactment.

Presently the act encourages the hiring of poor and unskilled. But there is no stable mechanism for the institution of job training programs at any level of government.

Second, as to the designations of enterprise zones per se, there should be some provision whereby local governments guarantee the opportunity for input from local residents and community-based organizations.

Third, the revised legislation should, but still does not, answer our previous concern relative to the development of new businesses that might be provided with startup capital.

At any rate, the League would be remiss in its responsibilities to its constituents if it did not clearly indicate that while we support the concept, we do not—just as you, Senator Chafee, have indicated earlier—we do not regard it as a panacea.

We remember well the massive oversell that accompanied other Government programs in the past years.

The Urban Jobs and Enterprise Zone Act must be seen as a complement to—not a substitute for—other means of Federal assistance to our distressed cities. Amidst the current budget-cutting policies, the use of the Urban Jobs and Enterprise Zone Act as the sole urban policy is untenable.

The National Urban League sincerely hopes that these hearings will provide you with the information necessary to make the Urban Jobs and Enterprise Zone Act a truly effective program for the urban poor and minority.

The National Urban League will be preparing, in detail, a draft and an analysis of this bill, incorporating the comments that you are now receiving from your witnesses during the next 2 days.

We certainly welcome the opportunity to work with you toward that end.

Thank you very much, Senator.

Senator CHAFEE. Thank you Ms. Cooper. And I hope you would send on that analysis. When do you think that will be ready?

Ms. COOPER. Well, when you conclude your hearings, and we conclude our conference, we will begin.

That should be within the next 2 or 3 weeks.

Senator CHAFEE. All right.

Mr. Holman, please. National Urban Coalition.

Mr. HOLMAN. Thank you Senator.

The Urban Coalition has had a long interest in this kind of legislation and we were fortunate enough to have both Congressman Jack Kemp and Congressman Garcia, along with business and community representatives, and representatives of financial institutions and local government, discuss at our national conferences, enterprise zone concept. We regard this concept as offering an opportunity to revitalize business development and job creation for area residents; and for others in some of these deprived areas.

We realize at the same time that this occurs in a context in which unemployment is rising in many of our inner cities, outmigration is continuing, and the amount of Federal aid is declining.

Local governments confronted with severe economic hardships will find it necessary to increase tax and user fees, and public services may be curtailed.

We think that the 1981 Kemp-Garcia, Chafee-Boschwitz legislation has shown marked improvement since its introduction last year.

We speak particularly of the fact that there are more targeted incentives directed toward small businesses and labor-intensive businesses.

We feel that the employee wage tax credit on which I'll say a word in a moment, the operating loss carryover, the optional cash method accounting, and the interest credit for investors will help stimulate small businesses. And, we focus on small businesses because of their importance in this particular context; and, also because they provide three to four of the needed jobs which are created.

The earned income tax credit, and the capital gains tax breaks—while less of an incentive to small enterprises—may also prove beneficial if they bring in labor-intensive industries.

We would like to call attention to some other points which we will be looking further at, and would urge the drafters of the legislation to look at.

Some 2,500 areas may qualify for designation as zones. While only 30 to 75 zones, 3 percent are expected to be designated in the first 3 years after passage.

This means that there will be some competition for that. And we feel that those areas most in need of assistance should be given priority for selection. Especially those already standing to lose large amounts of Federal funding.

As you already noted, intracity location by businesses in nondesignated areas may create a situation which there would be no net gain for a city. That is somebody may move from one part of town into the zone, and the net job gain and economic gain will be small or negligible. And we think that the enterprise zone boards ought to look carefully into that at the local level.

Since small businesses provide two-thirds of all new jobs, we are hoping that you will add to the incentives needed to induce investors and financial lending institutions to provide startup capital for small businesses.

I don't know what to anticipate, but Paul Pryde of Janus Associates, a consultant to our economic development task force, will be testifying before you, and we would like to endorse some of his suggestions about trying to see that you do two things: That stronger incentives than now are provided will be given to workers, especially since they will have to pay for training—much of which we hope will be provided by a community based organization. And, also we think that it is important that the smaller businesses be able to anticipate their tax credits so that they will get the immediate benefit of the cash flow. But, Paul is not only much better able to deal with these things than I am, but I also don't want to poach on his territory. We would like to say that I would recommend to you looking closely at that.

Many zone residents now lack the necessary skills for employment in certain types of work. Job skills and training programs will be essential and we would urge again that specific efforts are made to see to it that community-based organizations are allowed to aid local governments in determining not only this, but zone designation, incentives and the types of businesses the zone needs to attract.

Reduction of Federal assistance will force many local governments to seek alternative means, as I have said, of funding their government.

Unless some outside assistance is provided, a great many seriously strapped local governments may find it hard to provide the initiatives and services necessary.

Your concept, the administration's concept, of federalism calls for an increase in the role of local and State governments. I don't know exactly how you encourage this, but the State of Connecticut has shown unusual initiative in passing its own enabling enterprise zone legislation.

The question is whether other States, less supportive of cities historically, are limited by their own revenue caps, will provide urban areas with adequate levels of financial support, technical and planning assistance, program supports, and greater flexibility in local tax matters.

Our last concern centers around the time frame for enterprise zones. We hope we are wrong. And it is clear that you have a firm grasp of your tax legislation. You will probably rip through this rather rapidly.

However, in case you don't, implementation of enterprise zones wouldn't occur then until fiscal 1983. Some people believe that the development growth and stabilization of enterprise zones will take 3 to 5 years. And, I hope people will stay with this, rather than trying to be, to have a quick in and a quick out.

If there is a rebound in economic vitality, this might not be so dangerous. But, if there is not, it seems to me that your admonition and ours is very important, that it will be bad policy, and worse practice to rely upon the zones as the sole source for urban revitalization and economic development.

Thank you.

Senator CHAFEE. Thank you very much, Mr. Holman.

Mr. Moore.

Mr. MOORE. Thank you.

Mr. Chairman, we want to thank you for the opportunity to testify before the committee to present our views of the National Congress for Community Economic Development, pertaining to S. 1310, the Urban Jobs and Enterprise Zone Act of 1981.

NCCED is a national membership association for community corporations and other community-based economic development organizations.

We believe that the enterprise zone concept embodied in S. 1310, can reduce labor and capital barriers affecting business formation and location of other business in distressed communities.

We also believe there has been significant improvement in the S. 1310 over the enterprise zone legislation introduced last year.

In targeting the tax incentives to areas and residents, I always feel that a key ingredient—the critical role the community-based development organization and enterprise zone, has not been adequately addressed.

The purpose of our testimony is to outline a rationale and discuss the role of community development corporations in the enterprise zone.

At the outset, we should discuss briefly the development policy framework in which the enterprise zone should be viewed.

The enterprise zone concept offers a potential valuable targeting tool for enhancing business participation; and ultimate job creation in distressed communities.

However, enterprise zone should not be viewed as more than a tool or resource for economic revitalization. It should be thought of in the context how they will stimulate development, lead to economic growth. And, how they can complement other economic development tools and mechanisms through revisions in the Federal Tax Code.

Enterprise zones cannot be thought of, of replacing existing Federal development programs or resources, such as programs operated by the Economic Development Administration (EDA), the Department of Labor (DOL), Department of Housing and Urban Development (HUD), and the Community Service Administration (CSA).

One of the underlying assumptions of the enterprise zone concept is that community residents will have a significant role in designing the centers and the benefit accrued through creation and improved services.

Community-based organizations ranges from block clubs to CDC's are representatives of local enterprise, local interests can assure that the enterprise zone activity will benefit residents, and that the infrastructure needed for enterprise zone will be in place.

Congressman Robert Garcia, Democrat of New York, in his opening remarks on June 3, 1981, introducing the Enterprise Zone Act, stated that community group would have a significant role in enterprise zone, and should be a major beneficiary of enterprise zone activities.

Community development organizations such as CDC's are particularly well suited to work with enterprise zones. CDC's are private, usually not for profit development institutions, create to revitalize some of the most distressed communities.

CDC's are owned and controlled by the community through a board of directors which is composed of at least 51 percent low-income residents and/or representative of other low-income organizations.

They engage in comprehensive development activities ranging from assisting small businesses to job placement to construction, commercial, and industrial facilities.

CDC's are able to coordinate and link various development activities, such as small business expansion and employment training, making both activities more effective in meeting long-term needs.

CDC's provide the missing resource that prevent private sector marketing forces from bringing jobs and facilities to these areas. A case in point is Union-Sarah Economic Development Corp. located in the city of St. Louis.

USCDC is located in a low-income community, characterized by high unemployment, abandoned housing, lack of commercial and industrial facilities.

This community is defined as an impact area in title 7 of the Economic Opportunity Act.

Title 7, where USCDC receives substantial support. Title 7 provides for the designation support of approximately 40 CDC's located in distressed urban and rural areas.

The special impact area, geographically featured, make them a natural enterprise zone.

USCDC has concentrated on a physical development strategy as a means of economically rebuilding a sound community. In the past few years USCDC has implemented 231 subsidized housing units to date; 78 market-rate apartment units, total rehab; approximately 50 properties formerly a city burden return to productive use on the city's tax role.

Some minority hiring practice put into place 60 to 80 percent minority subcontract participate on every construction project.

To date 142,000 square feet commercial and office space provided; 83,000 square feet additional on the way in which 40,000 square feet supermarket.

Joint venture partnership initiated bringing private sector development into the area.

In 1980, $96,000 in property payroll and businesses taxes paid by our corporation. A figure which increases every year.

Created; 313 permanent jobs; 230 part-time construction jobs as a result of USCDC's activities.

Private sector contributions from Monsanto City Bank and additional $14 million loan from lending institutions.

The example demonstrated that USCDC and other CDC's gain substantial development capacity that can be utilized in enterprise zones.

There are over 250 CDC's in the United States, and many of the most severely distressed urban and rural communities—such as Bedford-Stuyvesant, Harlem, South Bronx in New York, New York City, Hough in Cleveland, Roxbury in Boston, Anacostia in Washington, and Chicago, East Los Angeles, Kentucky, Delta in Mississippi, and Nevada.

While we know that S. 1310 is predominantly a tax bill, we know that the bill can be strengthened significantly by increasing the role of community-based organizations.

Community based and development organizations, such as CDC's can perform a variety of activities in enterprise zone areas. These activities can be divided into three broad categories: Small business assistance; job development; and management service.

A brief discussion of these activities are included, and I won't read all of that, I will just go down the list here.

Small business assistance, CDC's have those kinds of staff persons on their staff and could naturally plug into the enterprise concept.

Small business technical assistance, the same.

Small business financing, and et cetera.

Incubator facility, job development, job placement, management and other services, public service and enterprise zone, monitoring enterprise zone for pharmacies.

Mr. Chairman, Bob Zdenek will talk about the legislation in a little more detail.

Senator CHAFEE. All right, why don't you go ahead Mr. Zdenek.

Mr. ZDENEK. Thank you Mr. Chairman.

Consistent with Mr. Moore's discussion, we would like to propose the following minor changes to S. 1310.

They include: First, adding a new subsection (c) to title 1, section 101(c)(2) which is unemployment poverty requirements.

The new subsection would state that special impact areas currently designated under title 7 of the Economic Opportunity Act of 1964 would be eligible as enterprise zone areas.

Title 7 community development corporations which have accomplished significant economic development projects in their communities are natural mechanisms for providing services and activities in enterprise zone areas.

This amendment will also enable 15 severely distressed rural areas to potentially qualify for enterprise zone area designation.

This program was originally introduced by Senators Kennedy and Javits, based on their visits to Bedford-Stuyvesant, which Congressman Garcia referred to earlier.

Second amendment would be to title 1, section 101(d)(2)(d), which is required local commitment.

This defines the course of action required by the local government seeking designation of an area as an enterprise zone.

Our amendment would read:

> A commitment from private entities, including community-based development organizations in the area to provide jobs and job training for, and technical, financial or other assistance to employees and residents in the area.

This would insure better coordination.

The third amendment we recommend to title 1, section 101(f)(3) which is priority of designation.

The amendment would read:

> Areas which have the widest support from the government seeking designation, the community residents, local businesses, private organizations, and community-based development organizations, especially in meeting the local commitment described in subsection (d).

We would also, under that same section, we add a new amendment number (5):

> Areas with a strong viable community based development organizations to carry out the local commitment described in subsection (d).

Our fourth amendment, we would suggest add a section to title 2 of S. 1310. The amendment would read:

> The Internal Revenue Code would be amended to permit Federal tax credits of up to $250,000 for corporations that make contributions to non-profit organizations in enterprise zone areas that would provide services and activities designated to enhance the overall goals of this enterprise zone.

This is an amendment very similar to State tax credit program called The Neighborhood Assistance Act which is in Pennsylvania, Missouri, and in several other States.

Corporations would be able to receive tax credits for making financial and other inservice contributions to nonprofit organizations that provide services. The services would have to enhance the business climate of the enterprise zone.

The tax credits would be on a voluntary basis and will provide financial and technical support to nonprofit organizations.

As mentioned earlier, these amendments require minor changes in the legislation. But, they will better clarify the role of community-based organizations and enterprise zones.

We would like to propose several other suggestions that will strengthen the intent of the urban jobs and enterprise zone legislation.

They are: One, allow for leasing of abandoned or HUD owned property by community-based organizations. In distressed communities there is considerable amount of abandoned property that is in the possession of the local jurisdiction or HUD. By transferring this property in enterprise zones to community organizations, the organizations will have a strong incentive to upgrade the property and its existing facilities.

Community-based organizations should then be able to lease the property to businesses that will locate in an enterprise zone area and use the income from the lease to provide additional services and benefits to the enterprise zone area.

Second one is voucher or refundable tax credit for human capital skills.

A major benefit of an enterprise zone should be the opportunity for area residents to enhance their human capital skills that will lead to more productive jobs. We recommend that a voucher or refundable tax credit of up to $2,000 be given to unemployed or underemployed individuals so that they can receive job training that would help land them a permanent job.

The individuals would choose the type of training and organization to provide it.

The individuals will choose in their best interests the kind of training that will land them permanent jobs.

Organizations that are successful in undertaking job training efforts will be those that increase the individual's skill level and place the individual in private sector jobs.

CDC's are natural conduits for operating job training programs since they work with private sector firms and know their needs. As well as the CDC's capacity to link training and placement to job creation.

Mr. Chairman, in concluding, we want to reiterate that the role of community-based development organizations is critical to the success of enterprise zones since they serve often as the catalyst and bridge between individuals and businesses in distressed communities.

We think that enterprise zones can creatively utilize the tax code to further economic development in distressed communities.

There is a danger that policymakers and legislators will try to strictly rely on the tax code for undertaking economic development and, ultimately, economic growth.

Based on our experiences in revitalizing distressed communities, that would be a serious mistake.

Enterprise zones offer a flexible opportunity only if there is the participation and collaboration of business, community, and Government leaders. And, S. 1310 must reflect that dynamism.

Mr. Chairman, thank you again for the opportunity to testify before the subcommittee.

Senator CHAFEE. Well, thank you very much, Mr. Zdenek. We appreciate your testimony. I have a couple of comments I would like to make.

First, to Mr. Holman. On page 2 of your testimony, you talked about the number of designations, and you are quite right; this is going to be a slow process. HUD will only be able to designate between 10 and 25 zones per year for the first 3 years. Although this will take awhile, the objective is to try and have something that really will work. I think you indicated some concern that it would be 1985 before this really got rolling. This means that by 1986, there may be as few as 30 zones in operation.

I just hope it won't take too long to get these going, but the reason we have kept it down is to see how it works rather than plunging in and having everybody try one and having it fail.

I think the points that Mr. Moore and Mr. Zdenek made about bringing in the community-based organizations are well made. And we certainly will take your recommendations under consideration.

Do you have any comments, Senator Dole?

Senator DOLE. I have no questions.

I have been sitting here thinking about what this would cost. But maybe it is not appropriate to raise anything like that. [Laughter.]

When I hear the string of amendments suggested I am certain there are some costs attached to them, but I think it is rather difficult to pinpoint the cost. Because, as you have indicated, Mr. Holman, we are not certain how quickly we are going to move. It would depend how much activity there was.

But it would seem to me that there should certainly be cost estimates. I have heard the figure $1.4 billion, but again I don't think the Joint Committee on Taxation is yet ready to put a price tag even on the initial version of this proposal.

But we are going to have additional tax legislation, at least on the Senate side, later this year. I hope that we would have an opportunity to move rather quickly to see if we can put together an effective program. And we may be able to at least start the ball rolling once we know the cost, once we know the parameters, once we know whether or not it will be effective. No one is ever certain. Certainly some of the amendments Mr. Moore and Mr. Zdenek indicated would be helpful.

Other than that, have you thought about the cost of the program?

Mr. HOLMAN. No, I have talked to some of the people in London in terms of having heard, as did Congressman Garcia, a great deal about learning from the British model, and I found there was no British model since all that they have done so far is to designate the places.

I only say that I think that the term "patient money" is used a great deal. It seems to me that what you are looking for here is multiple benefits coming back. Many of them financial benefits come back to the Governments themselves. And whatever the first estimated cost may be, it seems to me that if the program does work succesfully, that same recycling of money within the areas that Bob Garcia talked about, will more than mitigate what the costs would be.

But, again, I think a great deal of patience is required. And this should not be a stop goal thing in which you look at two or three that didn't work too well and say, let's scrap it and start all over again.

Senator DOLE. In the economic package, the tax package referred to earlier by Senator Chafee, there are already very generous benefits to business. Maybe we should have figured out some way to tie in some modified version of this concept. But, hopefully that tax bill will be enough of a stimulus at least some in some areas to promote some activity. But, we certainly have an interest in this and an interest in testimony of Ms. Cooper and every other panel member.

Thank you very much.

Senator CHAFEE. Thank you. Those are helpful points.

[The prepared statements of the preceding panel follow:]

PREPARED TESTIMONY OF MAUDINE R. COOPER, VICE PRESIDENT FOR WASHINGTON OPERATIONS, NATIONAL URBAN LEAGUE, INC.

Mr. Chairman and members of the Subcommittee, I am Maudine R. Cooper, Vice President for Washington Operations of the National Urban League. The National Urban League, found 1910, is a nonprofit, community service organization committed to securing equal opportunities and the full participation of blacks, the poor and members of other minority groups in American life. The Urban League seeks to bring about changes in government and social systems that produce disparities among groups in America.

Working through 117 affiliates in 37 states and the District of Columbia, four Regional Offices and the Office of Washington Operations, the League has a multiracial staff of more than 3,000 individuals who are trained in organizational management as well as the social and behavioral sciences. The Urban League Movement is reinforced by a cadre of more than 32,000 volunteers.

We welcome the opportunity to discuss the Urban Jobs and Enterprise Zone Act (S. 1310)—an initiative that proposes employment, business development, and tax incentives for individuals and businesses in distressed inner-city areas.

Such a proposal piques the interest of the National Urban League Movement because we want to see the revitalization of our inner-cities, the home of many of our constituents. And just as importantly, we want to see the residents of the inner-city participate in this revitalization. We think that the Enterprise Zone concept has the potential for helping to do both.

Statistics show why we are so concerned with life in the inner-city. These are the areas that have suffered most from the flight of businesses to suburban sites, the areas where poverty continues to stifle economic and human growth, the areas where unemployment is highest.

Over three-fourths of the black working age population live in the metropolitan areas of the country: over half in the central cities and 26 percent in urban proverty areas.

Not only are blacks urban dwellers, but they are disproportionately among the cities' poorest residents. According to Labor Department figures, in 1980, 78 percent of unemployed blacks lived in central city areas and nearly half of these in urban poverty pockets. In some inner-cities, the unemployment rate for black teenagers is more than 70 percent. When you realize how recent economic downturns have affected the black population as a whole you can better understand the adverse effect they've had on inner-city residents.

Based on the rate of unemployment, blacks were more severely affected by the seven-month 1980 slump than they were by the 17-month 1974-75 recession—which all analysts agree was the most devastating decline since the Great Depression of the 1930's. While the number of unemployed white workers declined by 562,000 between 1975 and 1980, there were 200,000 more blacks unemployed in 1980 (at 1.7

million) than there were at the peak of the 1974-75 recession (at 1.5 million).[1] The unemployment rate for black adults continues to double the comparable rate for whites.

Minority business development, too, continues to suffer. Based on the latest (1977) government survey of minority-owned businesses, there are about 231,000 black firms which comprise about 3 percent of all the establishments in the country. About two thirds (68 percent) of the black firms are in retail trade or selected services. However, most alarming of all, is that only 17 percent (or 40,000) of all black firms have any paid employees, and only 113 businesses have 100 or more employees. Yet that 17 percent accounts for 74 percent of all the gross receipts of black businesses and those 113 firms account for 16 percent of all gross receipts. In 1977, black businesses total aggregate receipts came to $8.7 billion dollars, which would only rank it as the 37th largest company in the U.S.

The devastating effect of the 1974-75 recession on black businesses is reflected in the sharp declines in the following businesses between 1972 and 1977:

a. The number of auto dealerships and service stations fell by 24 percent—from 6,597 to 5,002.

b. The number of hotels and other lodging facilities declined by 21 percent—from 2,196 to 1,733.

c. The number of food and eating establishments fell by 10 percent—from 26,000 to 24,000.

d. The number of intercity transporting firms fell by 9 percent—from 8,881 to 8,088.[2]

That is the picture of the problems we are up against. Now, for the potential we see in the Enterprise Zone concept. In our annual publication "The State of Black America, 1981," the National Urban League described the Urban Jobs and Enterprise Zone concept as one offering many promising possibilities. At the same time, it took the position that legislation embodying the concept should be formulated so that it would be effective in stimulating economic and job development activities that would significantly enhance the economic well-being of minority residents in the affected areas.

The Enterprise Zone concept takes stock of some of our concerns and represents a more intelligent and workable approach to the problem of business development in our cities. Tax policies designed to encourage building new plants—such as the incentives offered by the Administration for the private sector to invest in productive capacity—could make it cheaper and easier for industries to abandon their older installations and build elsewhere. Older cities have already witnessed the erosion of their industrial base, with the consequent loss of jobs. The proposed new round of incentives to build new facilities could wipe out the local economies of major parts of the nation. So incentives should be narrowly targeted to create jobs where they are needed most. Tax breaks for the rehabilitation of aging plants should be more favorable than building new ones. Or the system could be designed to favor replacing present facilities in the same areas.

The fact that the Enterprise Zone concept encourages the maintenance of job creating businesses in inner-cities areas is certainly a step in the right direction. But we are cognizant of the potential failure of such a proposal should businesses be granted even greater concessions for moving away from the same urban area.

Certain provisions of the Urban Jobs and Enterprise Zone Act do reflect a sensitivity to the needs of the urban poor. For example, several provisions are geared entirely toward encouraging employers to hire low income workers: a refundable business income tax, a 50 percent exclusion on taxable income, and a 50 percent tax exclusion on interest received from mortgages and loans. Also the provision of low income housing qualifies, in the act, as a zone enterprise for the purpose of receiving tax incentives. These elements are all tied together by a targeting mechanism that requires the establishment of an enterprise zone only in a high unemployment, low income area and by the elimination of the capital gains tax to spirit investment into these zones where help is most needed.

Such provisions, we feel, appropriately seek to benefit poor zone residents by encouraging employment and job creation, while addressing the potential displacement caused by increased business activity. We are also pleased that existing businesses are required to increase their workforces by 10 percent over the year prior to zone designation in order to receive the benefit of the 100 percent capital gains tax credit.

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[1] "The State of Black America, 1981," 5-6.

[2] Ibid. 1981, 38-39.

The act encourages the hiring of the poor and unskilled, but there is no stable mechanism for the institution of job training programs at any level of government.

As to the designations of Enterprise Zone per se, there should be some provison whereby local governments guarantee the opportunity for input from local residents and community-based organizations.

The revised legislation still does not answer our previous concern relative to the development of new businesses that must be provided with start-up capital.

At any rate, the League would be remiss in its responsibilities to its constituents if it did not clearly indicate that while we support the concept, we do not regard it as a panacea. The Urban Jobs and Enterprise Zone Act must be seen as a complement to, not a substitute for, other means of Federal assistance to our distressed cities. Amidst the current budget-cutting policies, the use of the Urban Jobs and Enterprise Zone Act as the sole urban policy is untenable.

The National Urban League sincerely hopes that these hearings will provide you with the additional intelligent and sensitive input necessary to make the Urban Jobs and Enterprise Zone Act a truly effective program for the urban poor and minorities. We certainly welcome the opportunity to work with you toward that end.

Thank you.

Executive Summary of M. Carl Holman on the Urban Jobs and Enterprise Zone Act

Urban areas in the center of our cities will continue to undergo drastic changes in the next several years. Unemployment is rising, outmigration is continuing, and the amount of federal aid is declining. Local governments will be confronted with severe economic hardship. Tax rates and user fees may be increased, while public services may be curtailed. Enterpirse zones offer a potentially fruitful new approach to revitalizing distressed urban areas—especially in regard to economic and business development, job creation for area residents and housing. It would be a serious mistake, however, to regard enterprise zones as a comprehensive urban policy or a panacea capable of lasting success in the absence of other vital support vehicles.

The 1981 Kemp/Garcia-Chafee/Boschwitz legislation has shown marked improvement since its introduction last year. The bill now provides for more targeted incentives directed toward small businesses and labor intensive industries. We feel the employee wage tax credit, the operating loss carryover, the optional cash method accounting, and the interest credit for investors will help stimulate small businesses. The earned income credit and the capital gains tax breaks, while less of an incentive to small enterprises, may also prove beneficial if used by labor intensive industries.

Because we would like to see optimal results for this legislation aimed at populations and areas already too familiar with disappointments, the National Urban Coalition would like to raise the following points for particular consideration:

Some 2,500 areas may qualify for designation as zones, while only 30–75 zones (3 percent) are expected to be designated in the first three years after passage. We feel that those areas most in need of assistance should be given priority for selection, especially those areas that already stand to lose large amounts of federal funding.

Intracity relocation by businesses in non-designated areas to enterprise zones could lead to a destablization of employment security in those areas, would probably not result in any net employment gains, and would reduce tax revenues.

Small businesses (which now provide two-thirds of all new jobs) offer the strongest hope for meeting revitalizaiton and job creation goals. Substanial incentives will be needed to induce investors and financial lending institutions to provide start-up capital for small businesses.

Many zone residents may lack the necessary skills for employment. Job and skill training programs will be essential. Community-based organizaitons would provide a valuable service by making a portion of this training available. In addition, CBOs can also provide needed input to local governments in determining zone designation, incentives and types of business the zones need to attact.

Reduction of federal assistance will force many local governments to seek alternative means of financing the rising costs of essential city services. Increases in local taxes and user fees, along with reductions in public services are occurring or being considered in a number of urban centers. Unless some outside assistance is provided, a great many seriously strapped local governments may find it hard to provide the initiatives and services necessary to fulfill the requirements of the legislation.

The Administration's concept of Federalism calls for an increase in the role of local and state governments. The state of Connecticut has shown unusual initiative in passing its own enabling Enterprise Zone legislation. The question is whether other states historically less supportive of cities—or limited by their own revenue caps—will provide urban areas with adequate levels of financial support, technical and planning assistance, program support, and greater flexibility in local tax matters.

Our last concern centers around the time frame for enterprise zones. Though we hope we are wrong, it seems doubtful the Congress will move swiftly to enact the legislation this year. Implementation of enterprise zones probably wouldn't occur then until fiscal year 1983. Some experts believe the development, growth, and stabilization of enterprise zones will take 3-5 years. That means by 1986 there may be as few as 30 zones in operation. This may not be disasterous if there has been a considerable rebound in economic vitality throughout the cities where the zones are located. Which is why we support a strengthened version of the proposed enterprise zone legislation, while cautioning that it will almost certainly prove to be bad policy and worse practice to rely upon the zones as a sole source for urban revitalization and economic development.

PREPARED TESTIMONY SUBMITTED BY NESBY MOORE, JR., PRESIDENT, UNION SARAH ECONOMIC DEVELOPMENT CORP., AND BOARD DIRECTOR, NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT; AND ROBERT ZDENEK, PRESIDENT, NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT

Mr. Chairman, we want to thank you for the opportunity to testify before the subcommittee to present the views of the National Congress for Community Economic Development (NCCED) pertaining to S. 1310, the Urban Jobs and Enterprise Zone Act of 1981. NCCED is the national membership association for community development corporations (CDCs) and other community-based economic development organizations.

We believe that the Urban Job Enterprise Zone concept, embodied in S. 1310, can reduce labor and capital barriers, affect business formation and location of other businesses in distressed communities. We also believe that there has been significant improvement in S. 1310 over the enterprise zone legislation introduced last year, in targeting the tax incentives to area businesses and residents. However, we feel that a key ingredient—the critical role of community-based economic development organizations in enterprise zone—has not been adequately addressed. The purpose of our testimony is to outline the rationale and discuss the role of community development corporations in enterprise zones.

At the outset, we should discuss briefly the development policy framework in which enterprise zones should be viewed. The enterprise zone concept offers a potentially valuable targetted tool for enhancing business participation, and ultimately job creation, in distressed communities. However, enterprise zones should not be viewed as more than one tool or resource for economic revitalization. They should be thought of in the context of how they will stimulate development that leads to economic growth, and how they can complement other economic development tools and mechanisms through revisions in the federal tax code. Enterprise zones cannot be thought of as replacements for existing federal development programs or resources, such as programs operated by the Economic Development Administration (EDA), the Department of Labor (DOL), Department of Housing and Urban Development (HUD), and the Community Services Administration (CSA).

One of the underlying assumptions of the enterprise zone concept is that community residents will have a significant role in the designing of incentives and benefits accrued through job creation and improved services. Community-based organizations ranging from block clubs to CDCs that are representative of local interests can insure that enterprise zone activities will benefit area residents and that the so called "infrastructure" needed for enterprise zones will be in place.

Congressman Robert Garcia (D-N.Y.) in his opening remarks on June 3, 1981, on reintroducing the Urban Jobs and Enterprise Zone Act stated that community groups will have to play a significant role in enterprise zones and should be major beneficiaries of enterprise zone activity. Community development organizations such as CDCs are particularly well suited to working within enterprise zones. CDCs are private, usually non-profit, devlopment institutions created to revitalize some of the nation's most distressed communities. CDC's are owned and controlled by the community through a board of directors which is composed of at least 51 per cent low-income residents and/or representatives of other low-income organizations. They engage incomprehensive development activities ranging from assisting small businesses to job placement to constructing commercial and industrial facilities. CDCs are able to coordinate and to link various development activities, such as small business expansion and employment training, making both activities more effective in meeting long-term needs.

CDCs provide the missing resources that prevent private sector market forces from bringing jobs and facilities to these areas. A case in point is the Union Sarah Economic Development Corporation (USEDC) located in St. Louis, Missouri. USEDC is located in a black low-income community characterized by high unemployment, abandoned housing, and lack of commercial and industrial facilities. This community is defined as an "Impact Area" in title VII of the Economic Opportunity Act. Title VII where USEDC receives substantial support. Title VII provides for the designation and support of approximately 40 CDCs located in severely distressed urban and rural areas. The special impact areas geographical features make them a natural enterprise zone area.

USEDC has concentrated on a physical development strategy as a means of economically rebuilding a sound community. In the past few years, USEDC has implemented:

231 subsidized housing units produced to date;

78 market-rate apartment units totally rehabilitated;

Approximately 50 properties, formerly a city burden, returned to productive uses on the city tax rolls;

Sound minority hiring practices put into place; 60-80 percent minority subcontractor participation on every construction project;

142,000 square feet of commercial/office space provided to date, 83,000 square feet additional underway of which 40,000 square feet is for a supermarket;

Joint venture partnerships initiated, bringing private sector developers into the area;

$96,028 in property, payroll and business taxes paid by our corporation for 1980, a figure which increases every year;

313 permanent jobs created and 230 part-time construction jobs as a result of USEDC activity;

Private sector contributions from Monsanto Corporation and Citibank in addition to $14 million in loans from lending institutions.

These examples demonstrate that USEDC and other CDCs have gained substantial development capacity that can be utilized in enterprise zones. There are over 250 CDCs in the United States in many of the most severely distressed urban and rural communities such as Bedford-Stuyvesant, Harlem, and South Bronx in New York City; Hough in Cleveland; Roxbury in Boston; Anacostia in Washington, D.C.; the southside of Chicago; East Los Angeles; Southeastern Kentucky; the Delta area of Mississippi; and the Navaho reservation to name a few.

While we know that S. 1310 is predominantly a tax bill, we know that the bill can be strengthened significantly by increasing the role of community-based organizations. Community-based development organizations such as CDCs can perform a variety of activities in enterprise zone areas. These activities can be divided into three broad categories: small business assistance; job development; and management services. A brief discussion of the activities includes:

I. SMALL BUSINESS ASSISTANCE

Packaging small business deals.—Many CDCs have packaged small business deals for entrepreneurs that receive financing from lending institutions. One of the major problems that potential small businesses face is the difficulty in putting together a financial package that a lending institution will fund. CDCs could provide this assistance in enterprise zone areas through the formation of business development centers (BDCs).

Small business technical assistance.—CDCs have been providing a range of services to small businesses ranging from doing feasibility studies to structuring management plans. Few mechanisms have the capacity to provide this type of assistance to businesses in distressed communities. Enterprise zones could contract with CDCs to provide either general or specific assistance to indigenuous businesses.

Small business financing.—Distressed communities suffer from a lack of capital (both equity and debt). There are few lending institutions in these communities. CDCs provide a line of guarantee, such as a revolving loan guarantee fund, to small businesses. SBA programs often do not reach entrepreneurs in severely distressed communities. A line of guarantee will enhance the likelihood of lending institutions making "risky" loans to small businesses.

Finders fee.—CDCs and other entities could receive finders fees from the enterprise zone for inducing businesses to locate branch plants or relocate in enterprise zone areas. An enterprise zone must encourage both indigenous business formation and the locating of existing businesses in the zone.

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Incubator facilities.—An incubator facility would provide low cost space for start-up business until the businesses are able to generate enough revenues to rent or own a facility. CDCs could construct these incubator facilities since many CDCs have built or renovated commercial and industrial facilities.

II. JOB DEVELOPMENT

Job training.—CDCs have operated a variety of job training programs focused on strengthening attitudinal and job skills of unemployed people. Many residents in distressed communities lack basic job skills, and it will be crucial in enterprise zones to provide tartgeted job training program for these individuals.

Job placement.—CDCs have had considerable success in placing CETA eligible individuals into private sector jobs. The ultimate success of many businesses in enterprise zones will be based on employee output. CDCs could be contracted with to provide a job placement service linking individuals with the applicable business.

III. MANAGEMENT AND OTHER SERVICES

Mangement of enterprise zones.—Successful enterprise zones should operate on principles similar to industrial parks, that are well managed with specific goals, i.e., locating growth firms in a community. CDCs could contract for a variety of general management services ranging from managing an enterprise zone to providing management services for commercial centers in enterprise zones.

Public services in enterprise zones.—CDCs could contract to provide public services such as crime prevention, construction of public facilities (lights, curbs, etc.) or day care services in enterprise zones.

Monitor enterprise zone performance.—CDCs that have a broader community base would be excellent mechanisms for assessing the impact of enterprise zones benefits on community residents. CDCs could be contracted with to monitor enterprise zones several years after the zones have been established.

Consistent with this rationale, we would like to propose the following changes to S. 1310. They include: adding a new subsection (c) to Title I, Section 101 (c) 2 which would state that special impact areas currently designated under Title VII of the Economic Opportunity Act of 1964 would be eligible as enterprise zone area.

Title VII CDCs, which have accomplished significant economic development projects in their communities are natural mechanisms for providing services and activities in enterprise zone areas. This amendment will also enable 15 severely distressed rural areas to potentially qualify for enterprise zone area designation.

Title I, Section 101(d)(2)(D), which defines the course of action required by the local government seeking designation of an area as an enterprise zone:

"(D) a commitment from private entities, including community-based development organizations, in the area to provide jobs and job training for, and technical, financial or other assistance, to, employees and residents in the area."

A third amendment we recommend is to Title I, Section 101(f)(3) Priority of Designation.—The amendment would read, "areas which have the widest support from the government seeking, designation, the community, residents, local businesses, private organizations, and community-based development organizations, especially in meeting the local commitment described in subsection (d).

(5) areas with a strong, viable community-based development organizations to carry out the local commitment described in subsection (d).

The fourth amendment we would suggest would add a section to Title II of S. 1310. The amendment would read:

"the Internal Revenue Code would be amended to permit federal tax credits of up to $250,000 for corporations that make contributions to non-profit organizations in enterprise zones that provide services and activities designated to enhance the overall goals of the enterprise zones."

Corporations would be able to receive tax credits for making financial and other in service contributions to non-profit organizations that provide services. The services would have to enhance business climate of the enterprise zone. The tax credits will be on a voluntary basis and will provide financial and technical support to non-profit organizations.

As mentioned earlier, these four amendments require minor changes in the legislation, but they will better clarify the role of community-based organizations in enterprise zones. We would like to propose several other suggestions that will strengthen the intent of the legislation. They are:

Allow for the leasing of abandoned or HUD owned property by community-based organizations. In distressed communities, there is a considerable amount of abandoned property that is in the possession of the local jurisdiction or HUD. By transferring this property in enterprise zones to community organizations, the organizations will have a strong incentive to upgrade the property and its existing facilities. Community-based organizations should then be able to lease the property to businesses that will locate in an enterprise zone area, and use the income from the lease to provide additional services and benefits to the enterprise zone area. This will enhance the businesses and social climate of the enterprise zone area, and help ensure that some revenues (ease income) is circulated within the community.

Voucher or refundable tax credit for human capital skills. A major benefit of an enterprise zone should be the opportunity for area residents to enhance their human capital skills that will lead to more productive jobs. We recommend that a voucher or refundable tax credit of up to $2,000 be given to unemployed or underemployed individuals so that they could receive job training that would help them land a permanent job. The individual will choose the type of training and organization to provide it. Individuals choose in their best interest the kind of training that will land them permanent jobs. Organizations that are successful in undertaking job training efforts will be those that increase the individuals' skills level and place the individual in private sector jobs such as the information and word processing field. CDCs are natural conduits for operating job training programs since they work with private sector firms and know their needs, as well as the CDCs capacity to link training and placement to job creation.

As can be gleaned from the testimony, there are a variety of activities that CDCs can undertake in enterprise zone areas. We would like to suggest several of the obvious activities that CDCs can provide in enterprise zones, for the benefit of the Senate Finance Committee. They can be broadly divided into three components: small business assistance; job development; and management services.

Mr. Chairman, in concluding, we want to reiterate that the role of community-based development organizations is critical to the success of enterprise zones, since they serve often as the catalyst and bridge between individuals and businesses in distressed communities. We think that enterprise zones can creatively utilize the tax code to further economic development in distressed communities. There is a danger that policymakers and legislators will try to strictly rely on the tax code for undertaking economic development and ultimately economic growth. Based on our experiences in revitalizing distressed communities, that would be a serious mistake. Enterprise zones offer a flexible opportunity only if there is the participation and collaboration of business, community, and government leaders, and S. 1310 must reflect that dynamism.

Mr. Chairman, thank you again for the opportunity to testify before the subcommittee. We will be pleased to answer any questions.

Senator CHAFEE. We are delighted to have Mayor Fraser of the City of Minneapolis, representing the U.S. Conference of Mayors, here. I think it would be appropriate if your Senator from your home State said a few words of introduction for you.

Senator DURENBERGER. I really, Mr. Chairman, don't have to introduce Don Fraser. I think it has been part of this process a lot longer than most of us.

He has been before this committee and some of its subcommittees on other occasions, and I probably don't have to say that he represents both the community and a State that has addressed itself, over a long period of time, to the particular problems of community development and the role that various levels of the government play in dealing with the problems of community development, and jobs, and rebuilding infrastructures, so I am pleased that the conference has seen fit to ask Don to come here today to testify on your legislation.

Senator CHAFEE. Well, he looks relatively unharried, no gray hairs, straight from the front lines. He must have everything in control in Minneapolis.

STATEMENT OF HON. DONALD FRASER, MAYOR, CITY OF MINNEAPOLIS, MINN.

Mr. FRASER. Mr. Chairman, I have found in local government you can say that only up until the point that you've left what may have happened since that time is always uncertain. [Laughter.]

Senator CHAFEE. Well, you haven't received any telephone calls since you have been in the room, so I guess everything is all right back there. Why don't you proceed?

Mr. FRASER. Thank you Mr. Chairman. I would like to first submit my statement for the record if I may, and then I will simply touch on the main points.

Senator CHAFEE. Fine.

Mr. FRASER. And, I would also like to introduce Barry Zegas, who is with the staff of the U.S. Conference of Mayors. And I am testifying on their behalf, although at the end I want to make a couple of points that have been raised by our own city staff and city council.

First, Mr. Chairman, thanks for the opportunity to testify on this legislation. And, I particularly want to compliment you and Senator Boschwitz, from our State, for the changes that have been made in the initial legislation.

The U.S. Conference of Mayors is supportive of the concept which underlies this proposed measure.

At the annual meeting in June in Louisville, the Conference of Mayors adopted a resolution which urges the enactment of enterprise zone legislation with the following characteristics:

Flexibility with respect to the designation of zones and the commitment of resources to the zone bi-local government;

Rougher quality between investment and employment tax incentives;

The equal treatment for small and large business and special help for new ventures;

And development of linkages between enterprise zones and other economic development and training activities.

During this meeting, Mr. Chairman, there were three concerns raised about this bill which I would like to share with the committee.

First, the fact that the program is intended to be a small demonstration program for the first 3 years is a disappointment. While I understand the merits of a demonstration program, it does change the nature of the program from an automatic tax program to a categorical program with the resultant need for applications, and reports, and bureaucratic negotiations.

Moreover, in the time when the administration is emphasizing the devolvement of responsibilities on local governments, we are concerned that HUD may not resist the temptation to impose its own values and priorities on local governments in terms of the commitments if they are going to be awarded one of relatively few zone designations.

So the result may be a bidding war among local governments which may not foster the kind of responsible action which is needed to revitalize these areas.

A related point, Mr. Chairman, is that the relatively small number provided for in this bill is unlikely to lead to widespread support by mayors across the country since most mayors will perceive they will be unlikely to ever have a zone designation in their city.

And so, for these reasons, I think it would make a lot more sense to enact a full-fledged automatic tax program. Or at the very least, a much larger demonstration program of perhaps 100 zones each year.

The second concern has to do with the linkages which have to be developed between an enterprise zone program and other Federal programs. The bill does encourage the Secretary of HUD to forge those linkages. Many of the programs, however, that are supposed to be linked, are disappearing—employment and training programs and economic development activities.

In other words, there may not be much for the Secretary of HUD to try to tie into these zone designations.

One of the major worries of the mayors, when we first talked about the enterprise zone concept last year, was that this bill might be seen as a substitute for ongoing programs such as CETA and economic development programs. And yet, that's very close to what has happened.

I would urge that this committee not view enterprise zones in this fashion. Especially in view of the unproven efficacy of tax incentives in revitalizing distressed neighborhoods.

The third point, Mr. Chairman, is that the definition in the bill of "pervasive poverty, unemployment, and general distress" is such a general characterization that it may leave too much discretion to HUD to define eligibility. Moreover, the necessary Federal data on income tax arrearages and abandonment may not be readily available.

Mr. Chairman, our local—in Minneapolis we looked at this bill, and we had two further observations that we wanted to bring to your attention.

First, we would urge that credit be given for cities' past efforts in improving a potential zone area in the zone application process. In other words, the city has already taken steps to improve the infrastructure in order to encourage industrial development in an area; it seems to me it ought to be permitted to count that and not be limited to counting what may happen after what is proposed to happen after the application is accepted.

Second, the council has urged that conservation of energy and alternative forms of energy should be an explicit factor which would be counted as a plus if there were some innovative energy proposals contained in the application.

Let me just reiterate probably the most important point, though, that I want to make on behalf of the Conference of Mayors; namely, the importance of attempting to expand the program considerably. Not just limiting it to 13 to 25 zones annually.

Finally, in view of the many changes in depreciation allowance in the corporate tax structure which are being made this year—the changes which we fear will work to the detriment of the central cities—I hope this committee will move quickly to enact an enterprise zone bill.

The Conference of Mayors looks forward to working with this committee and the Congress on this and other tax legislation to encourage investment and job creation in distressed areas.

Mr. Chairman, thank you for the opportunity to appear. And, a special thanks to Senator Durenberger for his very kind introduction.

Senator CHAFEE. Thank you, Mayor, for your thoughtful words. As far as getting credit for activities already having been done in your application process, that makes a lot of sense. That was certainly not meant to be excluded and we will try and straighten that out.

I agree with you that conservation of energy should be a factor to be considered,

One of the concerns we have is that in going all out and letting there be an unlimited number of designations does make it a major piece of tax legislation, which we would have some problems getting in this year. I think given some experience under this, it can work. There is nothing magic about 10 to 25. Maybe it should be 100. But I personally would like to see it held down.

Mr. FRASER. Mr. Chairman, if I could comment on that. There is, in a way, a building protection here because if a zone is designated, and it doesn't work, it doesn't cost anything. What it will mean is that no new industry has been drawn in or no new employees, CETA-eligible employees have been added to the work force. So the error is in favor of the Treasury. It won't cost the Treasury.

But I can understand your reluctance to open it up to just any number, but if you had something like 100, that would mean that on the average—and I know that it wouldn't work this way—but on the average, there might be two in each State. The larger States probably will get three and maybe most States would only get one.

But, at least each State would have the possibility of being able to add this to the efforts that almost every central city in the United States is making today. Which is to try to not only create job growth in the city, but to link it to the hard-to-employ.

I have a major task force that is hard at work on this problem today. I would like to be able to tell them that there is some prospect that our city might get a designation. Because it would add to the things they could consider in trying to fashion the linkage which they hope will work.

At a figure of 13 to 25, our prospects would not be very good, I suspect.

Senator CHAFEE. You have had a rather dynamic effort out there between your two cities and your business community, Honeywell, Control Data, and so forth. I assume that that is essential, to make one of these things work.

Mr. FRASER. That's our experience. We have in our community what is known as a 5-percent club, in which corporations agree to use 5 percent of their pretax earnings and reinvest it in the community. That's been enormously useful in too many ways to try to describe this morning.

But the corporations have also made a very strong commitment to the central city. They are investing in it; they are helping in it; they are working in the neighborhoods; and they are now involved in this effort that we have undertaken to try and build the linkage between the hard-to-employ and the economic growth.

The key to that very honestly is likely to be manpower funds, because our experience is that we can get companies to agree to hire the hard-to-employ, but they are not specially equipped to find them or to deal with them. And we have to deliver warm bodies that are trained to their doorstep.

The only way I think we are going to be able to do that is by having an adequate flow of manpower funds that will enable us to do the outreach job training, the kind of job training that Control Data provides through their fair break program.

The job bank, which allows us to keep track of them and then to deliver them when we get the industry with the commitment—they'll take them provided that there is an intermediary.

We think——

Senator CHAFEE. Would that be the CETA program? By the way, the CETA program, as you know, hasn't been cut except for the municipal employment for CETA.

Mr. FRASER. It is continuing, but apparently being cut—we understand the public service part, and we had anticipated that and had gotten them off our city roles some time ago. So that part hasn't troubled us, but we have some training programs underway today.

We have what's called a "Partners for Stronger Neighborhoods," which involves the construction trade unions, the hard to employ in a program in which these people get training on the job and some classroom training. And when they are through they can become journeymen. The building trades are deeply involved and this is unusual, because often they have been resistent to this problem of bringing the hard-to-employ into their ranks.

But that funding is in jeopardy today.

So, we worry that the manpower funds will be cut.

That goes back to the point, we think that this zone thing will be helpful but that it cannot be a substitute for the other programs. The other programs disappear, if not this year, then the next in subsequent cuts, then we are fearful that all of our efforts will collapse.

Senator CHAFEE. Let me place added emphasis that this is not meant to be a substitute for those programs.

Mr. FRASER. Sure, I understand that.

Senator CHAFEE. Now, it is true that some of the other programs are going. But they are going to go regardless of whether this bill passes or not. But, we hope that UDAG and CETA, except for the municipal employees, the other urban programs will survive.

Senator Durenberger?

Senator Durenberger. Thank you, Mr. Chairman.

Don, you have been, either as a national policymaker or mayor through much of the National Government's efforts to make policy that would benefit the cities of this country. And, you know whether it starts with urban renewal and works its way through various types of revenue sharing to CDBG, and now UDAG, and all the housing programs, and the mass transit programs, and the whole variety of things.

One could take your testimony to say, in effect, this bill is not a substitute for what's left of all of these other programs; we want to hang onto what we got and to add to it.

If one were to cynically put that interpretation on your statement on behalf of all the mayors, it would probably devalue the worth of this particular proposal.

I am sympathetic to your point on the demonstration business. In other words, if this is worth doing as a different approach to community development and job creation, then why restrict it to 15 cities unless you set up something specific that you want to accomplish in each of these cities so that there is some guidance to determine what kind of a city, or what kind of an environment within a city, is suited to the demonstration.

I would be more inclined to say, if it is worth doing, I would agree with you. Why not let it apply to everybody?

So, what I am searching for in my question, is what it is of particular value in the urban enterprise concept that is essential to the mayor's role in community development and job creation.

Mr. FRASER. Well, I would just have to give you my own personal view on this. If I had to—if I were asked to make a choice, between a continuation of manpower training programs, for example, and this. I would pick the manpower training programs.

Senator DURENBERGER. And, why would you do that?

Mr. FRASER. Because of the difficulty that many companies experience in taking on board the disadvantaged worker. No matter how good intentions. We have a program under NAB, the National Alliance for Business, in which we go around and interview the businesses every year and say "How many people will you take on?" We get all kinds of commitments from people.

But, it is the followup where the thing fails.

The problem is to find the underemployed female head of household, who is barely making it, and find a way to put her into a training program so that she has marketable skills. But, if you can do that, and then present her to a company, they'll take her. They are willing to make the commitment, but they want some assurance that this employee knows how to get to work on time, has demonstrated some skill level that meets their requirements.

While we might get companies interested in moving into these zones, that still doesn't fill that basic gap. That's what we refer to as the linkage. It is referred to here as the linkage.

We have the people in the inner city neighborhoods. They do need training, and they need all kinds of training, not just skill training. We have to be able to produce them to the employer.

Our city is involved in helping a number of enterprises. Tax increment financing, redevelopment land acquisition and write down. We impose on these companies these affirmative action requirements, but we don't have adequate mechanism for producing the worker.

So, I see these as going in tandem. This offers added inducements to a company to locate in a distressed area. But I think it will only work if it is complemented then by a way of reaching the workers that we are really trying to help.

That is why I stress the duality here.

Senator DURENBERGER. In your written statement, you commented, I think near the end of the statement, on changes in the economic recovery act, the so-called tax bill that we passed out of here that we will be dealing with on the floor that might be detrimental to the cities. Could you be specific? Either specific with regard to Minneapolis or cities in general, where you think the detrimental features are in the tax bill?

Mr. FRASER. Well, let me make this general observation. Over the last decade, we have seen an exodus from our city of industry. When they have built, they have built in the suburbs. They go out there because land is more available. They can get the larger tracts of land they like. The expansion room. And we think, our general fear is that if going out and rebuilding the capital plant and putting in new machinery is made more financially attractive; and I am much in sympathy with that general prospect. I think renewal of our capital plant is one of the needs to increase productivity in the United States.

Nonetheless, the victim may be the inner, or the central city. Because it is not easy for us to provide the kinds of cites that they can find in the suburbs.

So our fear is that this will simply accelerate a trend that we have seen.

Now, fortunately our city has been blessed with growth in other kinds of enterprise. Service enterprises—finance, insurance, in our central city, so that we have been able to recoup some.

But, the kinds of jobs that we are looking at that are interesting, are the industrial jobs. I mean, they are important to help us reach the inner city resident.

Now, what I would like to do though Senator, if it would be agreeable, is perhaps submit a further statement for the record on that point because I think it is a very important point, and I would like to research it a little bit more.

Senator DURENBERGER. I think it would be helpful. If there are incentives in the ACR portion of the tax bill to move to the South, or to move to the suburbs, or whatever, then, the objectives of this bill become to hold those now more productive businesses in the core of the city. So, your thoughts would be helpful.

Mr. FRASER. Yes, we agree with that and that is one reason that we are urging that this committee do enact, or pass out a measure that would help us in that effort.

Senator CHAFEE. Mayor, let me ask you this. We held a hearing in Boston on this bill. We had many representatives from businesses testify. Mayor Schaeffer from Baltimore was also there. The concensus that arose from that gathering was that small businesses are not going to take advantage of this legislation. The small businesses problems are deeply involved in capital formation and in the need for a few very highly skilled people.

I am talking of the electronics, of the small business of the future. I am not talking of the automobile glass installation plant. But I am talking of electronics and the type of businesses that you foster out there in Minneapolis. They are not going to go into the inner city.

So, all this business about fancy tax credits and the 5-percent tax credit for employees and so forth, just isn't going to make a small creative business that has 5, 10, or 20 employees move from outside Wysetta, or wherever, to some garage in downtown Minneapolis where they have a host of problems that are going to confront them.

Mr. FRASER. I would judge that for a very small business that is trying to get established, that they have got so many problems, that they are not going to be able to focus on these kinds of questions. I mean this simply adds a whole lot of additional complexities.

But, I think it's worth considering that in many cities, and in many areas, there are in existance many small businesses that are successful. But which want to expand. I suppose by small business, I would take your bottom point, anybody hiring few employees, maybe up to 100 or 200 employees.

We have an illustration. We were working with City Venture, which Control Data is involved in, and they have been very innovative. They were able to identify a number of what I would call smaller businesses. I mean they weren't Honeywells, or General Mills, who wanted to go into an area which we were going to try and clear and redevelop. Put some new industrial construction on, and they saw some benefits. They liked the location. And, they liked the fact that City Venture was going to provide this linkage. City Venture was going to commit itself to go out to find the hard to employ and provide employees for them.

That particular project didn't work, because the economics didn't work out on it.

But, what it taught me, was that there are smaller enterprises that are successful. I think it's a smaller enterprise that's successful that we want to think about. They are looking for expansion room.

We have found that smaller businesses are a place for the hard to employ if we can build that linkage.

We don't have to just think of the very large corporations as the place for the hard to employ to find an opportunity to work.

So, I would differentiate. I think a new enterprise struggling to make it in the first instance. I just figure they do have their hands full. But, a smaller business is successful, but is expanding, there I think we have a real market.

Senator CHAFEE. As a mayor, would you hustle to qualify under this plan?

Mr. FRASER. Yes, sir. No matter what you give us, we will go for it. [Laughter.]

Mr. FRASER. We see no harm in whatever you do. And possibly some very real good.

Senator CHAFEE. We would like somewhat more of a positive view than that. [Laughter.]

Mr. FRASER. Well, we would like to see how you finally write it and know whether we have even a possibility of qualifying.

I think the bill, as written, if we could be designated, we would see that as an important additional incentive to enterprises in and around our city to locate. And then we would work with them and try to make it work.

Senator CHAFEE. What magic figure do you think we should choose if we start with the assumption we are not just going to have an open gate; that anybody can apply? What number should we take?

Mr. FRASER. Well, I would like to think that every State would at least have a shot at it. Assuming that they can meet the criteria. Now some States that are heavily impacted with economic distress, they probably ought to be able to get more than one. That's why I would think 100 is sort of a minimum.

I don't know how the regulations should be written, but I hope an effort would be made for every State.

In our State, we would sure love to have three because we have got three major cities, all of which I think without question could qualify.

Ours is an average State. We come right in the median almost every test—income, size, population. So I would think 100 would be a minimum. There may be some other way of establishing a limit.

Senator CHAFEE. Thank you very much Mayor.

Senator DURENBERGER. Mr. Chairman, could I add a point there? It seems to me the answer to your question is when it quits being of value. Either that or it is just another goodie tree on which a whole variety of mayors and a whole variety of cities can hang things. That is why I am concerned about what it is we are trying to accomplish here.

One of the nice things that the District of Columbia does for us every year, beside providing us with police protection and snow removal occasionally, it puts out a compilation of tax data on 30 major cities in the country. And I see from New York down to Nashville, we've got a combination State and local tax burden here running from $6,285 per person all the way down to $1,377.

It just calls to my mind the need as part of this process to clearly state what it is we are trying to accomplish for what kinds of cities and what role State and local taxes play in this whole effort. That is why I suggest that the concept of a definition—unless you want to take the top 15 off of a list like this—the concept of a definition of what purposes are to be served needs to be very closely looked at.

If, as the mayor suggested early in his statement, devolution under the Reagan federalism is where we start out by telling the cities that they have all of the problems and all of the responsibilities, and we end up by withdrawing financing and the second part says we are also now going to start turning back taxable resources or other forms of tax financing to State and local government, then this is an excellent concept. Because, as the chairman of the Finance Committee pointed out to us, we are creating more jobs, more income which can be taxed at whatever rate by the Minneapolises, or the Bostons or the Massachusetts or the Minnesotas.

And so that in the overall context of freeing up some taxable resources for State and local government, this seems to have a lot of merit and at that time, then it seems to me why not let everybody in on the act, rather than just 15 a year, or 12 a year.

Senator CHAFEE. Everybody in on the act, presuming that they meet the qualifications.

Senator DURENBERGER. Right.

Senator CHAFEE. Additional problems arise when wealthy cities such as Houston vie for designations that could go to poorer cities. Monitoring the program is also troublesome.

Somebody's got to monitor this and people might complain that wicked Uncle Sam is coming in to regulate once again. On the other hand, it is Federal taxes that are being reduced. Monitoring is critical particularly when you get into refundable tax credits which means somebody sends them a check.

Senator DURENBERGER. My concern is that you could find a portion of Houston that would qualify under this definition.

Senator CHAFEE. Oh, yes.

Senator DURENBERGER. When you look at Houston as a city in a larger context, there is a tremendous capacity in that city to meet the problems of that small area.

This is one of the things that our community has done through the Fiscal Disparities Act and property sharing. We have gone out without incentives from the Federal Government and taken from some areas to give to others and I would hate to see this be a disincentive to some of those kinds of local efforts.

So, you are absolutely correct. What you want to accomplish has to be definitely spelled out in this so that everybody does not qualify but also so that we don't have to pick magic numbers and say 15 or 100 or something like that. The criteria ought to set the number.

Mr. FRASER. I think, Mr. Chairman, your point about monitoring is an important one. But you do have the fact that you'll in a sense get an automatic set of reporting as companies claim that they have qualified, or that their income qualifies.

Moreover to the extent that there are refundable tax credits, there will have to be an appropriation which will be an opportunity to make an assessment of exactly what is going on.

That, in addition to any reporting that comes from the cities themselves. I mean, you get it automatically through the IRS.

So I think your ability to measure the efficacy of this program will turn out to be quite good. You will be able to measure quite accurately.

Senator CHAFEE. I think the points you made about the training of the CETA eligible employees is a darn good one. I think that this has got to be very closely tied in with CETA training.

Mr. FRASER. I think so. Training, and the Job Bank, the outreach, the whole cluster of activities that are needed to make that work.

Senator CHAFEE. We appreciate your coming mayor.

Mr. Fraser. Thank you, Mr. Chairman.

[The statement follows:]

PREPARED TESTIMONY OF HON. DONALD FRASER, MAYOR, MINNEAPOLIS, ON BEHALF OF THE U.S. CONFERENCE OF MAYORS

Mr. Chairman and Members of the Finance Committee, thank you for this opportunity for the U.S. Conference of Mayors to testify on enterprise zones, a subject of considerable interest to Mayors around the country.

First, let me compliment you, Senator Chafee, and my own Senator Rudy Boschwitz on your revisions in S. 1310, the Urban Jobs and Enterprise Zone Act. Mayors are especially relieved that the requirement of real property tax rate decreases has been dropped from the bill. It is important, as the bill recognizes, to give local governments substantial flexibility in designing their commitment to an enterprise zone. After all, local officials and citizens know best what incentives are most needed in their community to attract business investment—whether regulatory changes, service increases, infrastructure improvements, or tax cuts.

In addition, the Conference of Mayors commends you for your inclusion in the bill of a tax incentive for interest income on loans to businesses in enterprise zones. This reduction in taxable income could be a significant way to stimulate the creation of new ventures and to help small business.

I also consider three other revisions in the bill to be major improvements of potential benefit to businesses and citizens in enterprise zones. (1) The refundable nature of the employment tax credit, which will help small businesses and new ventures; (2) the targetting of tax-incentives to firms that hire CETA-eligible employees; and (3) the coordination of the new tax incentives with other federal programs in the zone, including housing, community and economic development, banking, financial assistance, and employment and training programs and foreign trade zones.

The eligibility requirements for an enterprise zone have also been improved, in our view, especially the requirement that enterprise zones must be located in UDAG-eligible areas. However, I am also concerned that the definition of "pervasive poverty, unemployment and general distress" may be too general, leaving too much discretion to HUD to define eligibility. Moreover, the necessary federal data on income, tax arrearages and abandonment may not be readily available.

The U.S. Conference of Mayors is supportive of the concept which underlies the Urban Jobs and Enterprise Zone Act—the use of the federal tax code to encourage investment in distressed areas. At our annual meeting in June, the Conference of Mayors adopted a comprehensive resolution on tax policy which urges the enactment of enterprise zone legislation with the following characteristics:

Flexibility with respect to the designation of zones and the commitment of resources to the zone by local governments;

Rough equality between investment and employment tax incentives;

Equal treatment for small and large business and special help for new ventures; and

Development of linkages between enterprise zones and other economic development and training activities.

A copy of the full resolution adopted by the Mayors is attached to my statement.

During our recent meeting Mayors raised three concerns about the Urban Jobs and Enterprize Zone bill which I would like to share with you.

First, the fact that the program is intended to be a small demonstration program for the first three years of its life is a disappointment. While I understand the merits of a demonstration program in this case, it changes the nature of the program for an automatic tax program to a categorical program with the need for applications, reports, and bureaucratic negotiations. Moreover, I am concerned that HUD will not resist the temptation to impose its own values and priorities on local governments, in terms of the commitments they must make if they are awarded one of the 13-25 zone designations. The result may well be a "bidding war" among local governments, which is not likely to foster the type of responsible action needed to revitalize distressed areas of cities.

The small demonstration program which the bill proposes is unlikely to lead to widespread active support by Mayors across the country, since most Mayors will perceive that they are unlikely to ever have a zone designated in their city.

For these reasons, I believe it would make much more sense to enact a full-fledged automatic tax program or at the very least, a much larger demonstration program, of perhaps 100 zones each year.

My second concern has to do with the linkages which should be developed between an enterprise zone program and other federal programs. While S. 1310 encourages the Secretary of HUD to forge such linkages, many of the programs to be coordinated are to be eliminated in the fiscal year 1982 budget—including most employment and training programs and economic development activities. Thus, there is little left to be coordinated.

One of the major worries of Mayors when the enterprise zone concept was first discussed last year was that the bill not be viewed as a substitute for proven ongoing federal programs. Yet, that is close to what has happened. I am very worried that this Committee not view enterprise zones in this fashion, especially in view of the unproven efficacy of tax incentives in revitalizing distressed neighborhoods.

Mr. Chairman, I thank you for the opportunity to present the views of the U.S. Conference of Mayors on the Urban Jobs and Enterprise Zone legislation. We fully support and sympathize with your goal of creating new investment and jobs in distressed urban areas. We are encouraged by the many improvements which have been made in the legislation, although we would urge that the program be expanded considerably and not just limited to 13-25 zones annually.

In view of the many changes in depreciation allowances and the corporate tax structure which are being made this year—changes which will work to the detriment of cities—I hope this Committee will move quickly to enact an enterprise zone bill. The Conference of Mayors looks forward to working with this Committee and the Congress on this and other tax legislation to encourage investment and job creation in distressed areas. Thank you.

Senator CHAFEE. Now we will have Mr. Arnold Cantor, assistant director of economic research at AFL-CIO, accompanied by Steve Koplan.

STATEMENT OF ARNOLD CANTOR, ASSISTANT DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AFL-CIO, WASHINGTON, D.C., ACCOMPANIED BY STEPHEN KOPLAN, LEGISLATIVE REPRESENTATIVE, AFL-CIO, WASHINGTON, D.C.

Mr. CANTOR. Sir, I will summarize a bit. There are a few more specific tax points in this statement that I would like brought out.

My name is Arnold Cantor, assistant director of research of the AFL-CIO. Accompanied by Stephen Koplan, legislative representative of the AFL-CIO.

We are pleased to have this opportunity to present our views on S. 1310.

Before commenting on some of the specifics of this proposal, we should like to note that last February the AFL-CIO Executive Council addressed itself to an earlier version of this measure, and characterized it as "based on a false notion that local economic problems will disappear if Government would spend less, tax less, and protect less." And the council stated that the proposal was, and again I quote, "a tax cut package, and not a program to correct urban problems." I have appended the full text of this statement and would like it included in the record.

S. 1310 specific provisions differ from the 1980 enterprise zone bills. But the essential premise is the same. The tools are similar. And its potential of creating additional jobs or forwarding other urban revitalization goals is just as limited.

Thus, the measure adds up to an array of tax reductions and other devices which directly, or indirectly, encourage a diminution of Government revenues, programs, standards, and safeguards.

Like its predecessor, it would not create additional jobs, nor help solve urban problems.

As we understand it, the concept is to designate certain areas for special economic aid to residents and businesses.

The AFL-CIO has no quarrel with the concept of targeted assistance, but we believe it should be done directly and not in a fashion which has so much potential for inequity, waste and abuse.

The major tax provision of the bill would allow an enterprise zone business to deduct 50 percent of its gross receipts from its taxable income until 1997. This could have the effect of wiping out any Federal income tax liability on income earned in the zone for many, if not most, qualified businesses.

In addition, this could generate artificial losses which could be washed out against other income.

Other provisions of the bill would eliminate capital gains taxes, provide a refundable tax credit for employers equal to 5 percent of the wage paid to CETA eligible employees, provide a refundable employee tax credit of 5 percent of wages for all employees of the business, so long as at least 50 percent of their services are performed within the zone.

Moreover, this tax credit would be retroactive for 3 years.

Among the inequities and flaws we see in these measures, are:

One, the major tax breaks provide no upfront money and the principal beneficiaries would be profitable firms that can take full advantage of the opportunity to reduce or eliminate tax liability by deducting half their gross receipts from taxable income.

As we see this provision's impact, there would be a substantial inducement to establish relatively high volume, low employment ventures, such as sales office, warehousing and distribution operations, professional offices, and the like as opposed to firms engaged in more labor intensive activities.

In addition, this could trigger a good deal of manipulation and imaginative bookkeeping to avoid taxes through shifting reported income into the zone.

The major tax benefit is in effect, a function of the firms gross receipts, rather than its employment, payroll, or investment in productive plant machinery or equipment.

The tax benefits are limited to firms within the designated zone. However, in many urban areas, existing and potential employment is outside the zone. Thus a firm outside the zone employing many zone residents would get no benefit. This, of course, would lead to extremely inequitable situations and a powerful incentive for shutdowns and relocations and counterproductive competition for footloose firms that adds nothing; and could, in fact, detract from economic development and job creation.

It is also likely that many stable existing firms in the zone that are, and have been providing employment, may not be able to meet the bills qualifying criteria for financial or other reasons and would be unable to compete with a new firm that is heavily subsidized by the tax benefits.

A resident of the zone, working within the zone, would receive the 5-percent wage credit. Yet his or her neighbor, whose job is outside the zone, would get no such benefit.

And, someone performing 50 percent of their "services" in the zone, but residing elsewhere would get up to the $1,500 tax break.

Also, the existing 50 percent of wages, targeted jobs tax credit has been a widely acknowledged failure in generating new jobs. I would ask therefore, how could a 5 percent of wages, employer credit, be expected to accomplish much or anything?

The interest income exclusion would raise the effective yields to lenders which would heighten the competition for available funds; and raise the cost of money to other borrowers, including municipalities. And would provide windfall benefits to banks and wealthy lenders.

It would also be impossible for the IRS to effectively monitor this provision.

The 100 percent capital gains exclusion is of no benefit to ongoing firms and could serve as a powerful inducement to sell out and leave the zone since there would be no tax liability on the profit of selling a business.

We would also like to question how this measure would interact with the tax bill just completed by the full committee?

It seems to us that the business tax provisions proposed in the economic recovery act would overshadow and negate any impact this measure could have on channeling business investment.

The section of the bill pertaining to local commitment and "course of action" requirements is equally disturbing. Specifically, the bill requires that as a condition of enterprise zone designation the local government follow a course of action which, and I quote:

> May be funded from the proceeds of any Federal program, and may include a reduction in tax rates or fees, and increase in the level of efficiency of government local services, simplification or streamlining of governmental requirements on employers or employees.

We feel these criteria are vague, unenforceable, and loaded with potential for confusion, political manipulation, and an undermining of programs, standards and protections.

We see this first of all as a clear inducement to cut local taxes, despite the fact that the enterprise zone areas are most likely to be in dire need of revenue. Does funding from the proceeds of any Federal program mean that Federal aid, for example, from urban mass transit, community development block grants, or revenue sharing programs, could be used to reduce business taxes.

Increasing the level of efficiency of local services is a phrase that could be interpreted in many ways. Consolidation of police and fire stations are, for example, frequently justified in the name of increased efficiency.

What does simplification or streamlining of Government requirements on employers and employees encompass?

Does this mean local building codes, safety, health, sanitation, and environmental standards, State or local wage, hour and child protection laws?

Mr. Chairman, it seems to us that these criteria would either be the subject of continuing controversy and potential abuse, or would require a level of administrative decisionmaking, regulation and enforcement that is not provided in the bill and I suspect, not intended by its sponsors.

We do not wish to be negative. And, we do not take any proposal which could help solve the Nation's urban problems lightly.

We have long been concerned about the special development needs of inner cities. We have been constant advocates of public and private efforts to meet these problems.

The attached resolution adopted by the last AFL-CIO convention fully outlines our position and our recommendations.

In addition, we do feel that tax incentives, if effectively targeted, could be a useful economic and job development tool. To that effect, we have supported a reindustrialization business tax cut, which could affectively target funds to the industries, areas and people where the needs are greatest, at minimal cost and risk.

That concept incorporated in a bill sponsored by Representatives Guarini, Brodhead and others, H.R. 3218, would represent a major beginning toward the revitalization and rehabilitation of the Nation's basic industries and economically distressed areas.

That measure was outlined in detail before the full Senate Finance Committee on May 20 by AFL-CIO President Kirkland.

We have attached an excerpt from that part of President Kirkland's testimony, and would appreciate if it be made part of the record of these hearings.

In view of the major basic flaws we have outlined, Mr. Chairman, the AFL-CIO cannot support S. 1310.

Thank you.

Senator CHAFEE. Thank you Mr. Cantor.

You are the heavy in this act this morning, and we are glad to have your thoughtful comments. Many of the points you have raised have concerned me, such as the example of the zone boundary. The boundary is a street, presumably.

It seems to me it would behoove businesses on the nonzone side to move into the zone. The hope would be that when they moved in the zone that they then would try to meet the criteria and begin employing CETA eligible people and proceed along that course. This would be a beneficial course for the Nation if they are hiring additional people, even though part of the costs of hiring these people was through a refundable tax credit.

I suppose that you have given the best argument against the argument previously made that we should go all out and have these zones. There is one thing I would note. The statement made by the AFL-CIO in February of this year raised justifiable concern about the 90 percent reduction in the employees' social security-employee-employer social security tax. As you are aware, that was in the former bill and is not encompassed in this act. I am glad that we got away from that. I was always skittish about that provision dealing with social security, and I thought it was improper.

Now, I don't think that this 1310 has any provision dealing with reductions of Federal regulation, so the concerns you voiced about wage and hour limitations would not apply. At the bottom of page 5 you talk of State or local wage hour and protection laws. Most of those would be Federal anyway.

Mr. CANTOR. My understanding, sir, is that many States and localities have such laws—building codes are an example.

Senator CHAFEE. Building codes, no question.

Mr. CANTOR. There are many States and a number of localities where the minimum wage and hour protections are at times more stringent than the Federal, or from my vantage point, more liberal than the Federal, and so forth.

But, I think the point is that quite frankly you may be correct, Senator, I'm not sure. Our point here is that these are very, very vague commitments, and yet the bill does require a local government to make this commitment and do it in writing. Yet I think they are extremely vague and unenforceable.

Senator CHAFEE. They are vague because we got away from the provisions in the 1980 bill which dealt with the 20 percent real property local tax reduction, which presented State constitutional problems. We are thinking along the lines of a more determined fire protection effort, for example, in the area.

Now you say if they are not giving proper fire protection in the area, they ought to be giving it anyway without an urban jobs enterprise zone bill. But, we both know that in certain areas of the inner city, the services aren't provided on the level they ought to be.

Here is a way of the local mayor saying, "We're going to make a more determined effort. We'll locate a police station there. We will increase our patrols. We will provide the city with better bus transportation and improved garbage collection."

Now, to me this represents an effort which, as you noted, is proposed on a rather modest scale. The maximum of 25 is perhaps too few. Even if you make it 100 a year, that's not very many. Yet, it is enough that can be supervised to some degree by HUD and it presents an opportunity to see if this works.

Now, you referred us to Mr. Kirkland's May 20 statement.

Mr. CANTOR. Yes. Yes, sir.

Senator CHAFEE. This talk about a reindustrialization board and a new reconstruction finance corporation troubles me. I just feel that with the mood of the Congress today, the chances of something of that nature passing are very, very slim.

Mr. CANTOR. Well, sir, you are certainly in a much better position to judge the mood of Congress today.

The only thing I can say in this is, No. 1, I honestly and truly, and the organization honestly and truly, feels that this bill would be counterproductive.

I really think there is more potential for harm in this than there is for good.

Senator CHAFEE. Primarily, because of what? Because of fly-by-nighters coming into the zone?

Mr. CANTOR. Well, there is a whole host of opportunities. The situation that you raised right off the bat about the inequity of a firm on one side of the street versus a firm on the other side of the street.

Mayor Fraser, I think very appropriately said, "Well, if the concept is good, let's extend it." But at the same time, the other side of that is, it's a big unknown. I understand neither the Treasury nor the Joint Committee on Taxation has been able to make any revenue estimates on the impact of this, certainly as yet. I can think of situations where, in New York City, Eighth Avenue, is a tremendous employment center for the garment district. And, I suspect very, very many of the workers on Eighth Avenue live in the south Bronx.

Now, I can't see how this could help. And, it could possibly hinder.

In addition, we all know situations where local communities are very legitimately and realistically subject to a lot of tax whipsawing.

And, I can see where a business can say to a particular local community that's not an enterprise zone, saying, "Look if we go into the enterprise zone, they are going to give us this whole smorgasbord of goodies. What are you going to do for us?"

And, I see again, an opportunity for a counterproductive competition for industry as a result of the basic tax inequities we outlined in our statement.

So, I can't support it. I believe I'm departing a bit from some of the points made by Mayor Fraser. I—the point is—I think it would be a counterproductive experiment.

I can't accept this notion of, "it's the only game in town, so why not do it on an experimental basis." I think it would not work, and I think it would be counterproductive. And again, you are a much better judge of this, but, I think in the future, just by having this on the books, would be considered as the urban program and would preclude efforts to rebuild cities through use of the kinds of programs that we think could work.

Senator CHAFEE. Well, I appreciate your coming and having the warning signals hoisted, and you have done that very effectively. I have been concerned that any time you talk refundable tax credits, you are talking something of tremendous potential.

You have heard the testimony of a successful mayor who has struggled with these problems. He wants to try it. He thinks it gives him another arrow in his quiver. That's the way I look on it. It may not be perfect and it may require some careful monitoring, but I think that the pluses outweigh the potential cons.

Mr. CANTOR. I would, if I may, and my colleague also wants to make a statement. Too little attention seems to have been put on the actual tax reduction proposal. It is not a 50 percent of tax liability credit, it is a provision which allows a firm to take its gross sales—its total sales—and use 50 percent of its sales to wash out against its income.

Now, I think in many cases, if not most every case, this would be tantamount to complete and total and absolute income tax freedom for the firm.

Senator CHAFEE. Well, that wasn't the intention. It was to reduce the tax burden on its net income.

Did Mr. Koplan have a statement that you would like to make?

Mr. KOPLAN. Just a couple of brief comments, Senator.

First, with respect to H.R. 3218, putting aside for a moment, the part of the bill that refers to a reconstruction finance board. A major difference between that proposal and the Senate bill, is that in H.R. 3218 there is a dollar cap—it's a 1-year bill, and there is a dollar cap on the total amount of moneys available to be used by the RFC in that year. The total would be $10 billion.

The amount of money to be available would be used not only for tax subsidies. Half of it would be available for tax subsidies, and the other half for nontax subsidies.

But one problem that we had when the current version of the urban enterprise bill was in drafting stages was the provision dealing with course of action. The definition of course of action.

Senator CHAFEE. You mean, by the community?

Mr. KOPLAN. Yes.

We were concerned about that aspect of it that allowed dipping into an existing Federal program and then combining it with the simplification or streamlining of governmental requirements. And we discussed this on the House side with staff.

That is something that is still under discussion.

I would point out that Representative Garcia has cosponsored, although he has introduced the urban enterprise bill on the House side with Representative Kemp, he has also cosponsored H.R. 3218.

We are all looking at the same problem and trying to get at it. But, we have eligibility criteria in H.R. 3218 that would require an applicant to submit a plan that spells out how the applicant sees this would work.

I would just point out one part of it. The applicant's plan should include details concerning production, distribution, sales plans, including a tabulation of expenditures and sources of revenues needed to execute the plans. And the productivity improvement plan setting forth steps to be taken by the applicant, its management and its workers to achieve a higher productivity growth rate, and provisions concerning compensation, benefits, wages, work rules and practices, staffing and organization.

There are a series of criteria, eligibility criteria so that a written plan could be evaluated. And, I would just suggest to the Senator that at some point further down the road, you might want to compare the eligibility criteria contained in H.R. 3218 to the "course of action" provision in S. 1310.

Senator CHAFEE. Good.

Mr. KOPLAN. The only other thing——

Senator CHAFEE. That's a good suggestion, we will do that.

Mr. KOPLAN. Thank you, Senator. The only other thing I wanted to mention, and Mr. Cantor has discussed this in the prepared statement, is that I don't think any of us can look at this—and, I think you have said this too—in isolation.

You pointed out that the tax bill that has now been reported out by the Senate Finance Committee, contains rehabilitation credits that I think add up through fiscal year 1986 of a little over $1 billion; that is the revenue estimate that the joint committee has made.

Also, for example, in the House tax bill that is now under consideration, the Ways and Means Committee arrived at a tentative decision to include in their bill a 200 percent double-declining balance method of depreciation for structures in depressed areas described as pockets of poverty.

That, I was told at the time, was taking into account or thinking of this proposal that you all have introduced.

So, I think that the timing of consideration of the urban enterprise bill is good in that it comes after whatever is done in the omnibus tax bill, because some of the things that you are aiming at are also included in the overall "economic recovery act" package, and I don't think you can look at the urban enterprise bill in isolation without having the final result of the omnibus tax bill; and I would just make that suggestion.

Senator CHAFEE. Fine. Thank you very much.

[The statement follows:]

SUMMARY OF STATEMENT OF ARNOLD CANTOR, ASSISTANT DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AFL-CIO

The measure adds up to an array of tax reductions and other devices which directly or indirectly encourage a diminution of government revenues, programs, standards and safeguards. It would not create additional jobs nor help solve urban problems.

The major tax provision of the bill would allow an Enterprise Zone business to deduct 50 percent of its gross receipts from its taxable income and could have the effect of wiping out any federal income tax liability and could generate artifical losses which could be washed out against other income.

The principal beneficiaries would be profitable firms that can take full advantage of the opportunity.

This could trigger manipulation and imaginative bookkeeping to avoid taxes through shifting reported income into the zone.

A firm outside the zone, employing many zone residents would get no benefit. This would lead to inequitable situations and a powerful incentive for shut-downs and relocations and counterproductive competition for foot loose firms that adds nothing and could detract from economic development and job creation.

It is also likely that many stable, existing firms in the zone that are and have been providing employment may not be able to meet the bill's qualifying criteria for financial or other reasons and would be unable to compete with a new firm that is heavily subsidized through the tax benefits.

A resident of the zone, working within the zone would receive the 5 percent wage credit. Yet, his or her neighbor whose job is outside the zone would get no such benefit. And, someone "performing" 50 percent of their "services" in the zone, but residing elsewhere would get up to the $1,500 tax break.

The 100 percent capital gains exclusion is of no benefit to ongoing firms and could serve as an inducement to sell out and leave the zone, since there'd be no tax liability on the profit of selling the business.

The section of the bill pertaining to local commitment and course of action requirements presents criteria that are vague, unenforceable and loaded with potential for confusion, political manipulation and an undermining of programs, standards and protections.

We see this, as a clear inducement to cut local taxes despite the fact that the enterprise zone areas are most likely to be in dire need of revenue.

Does funding from the proceeds of "any" Federal program mean that Federal aid programs could be used to reduce local business taxes?

What does simplification or streamlining of government requirements on employers and employees encompass? Does this mean local building codes, safety, health, sanitation and environmental standards, state or local wage, hour, and child protection laws?

We do feel that tax incentives—if effectively targeted—could be a useful economic and job development tool. We have supported a reindustrialization business tax cut which could effectively target funds to the industries, areas and people where the needs are greatest at minimal cost and risk. The concept, incorporated in a bill sponsored by Representatives Guarini, Brodhead and others (H.R. 3218) would represent a major beginning toward the revitalization and rehabilitation of this nation's basic industries and economically distressed areas.

In view of the major, basic flaws we have outlined, the AFL-CIO cannot support S. 1310.

Prepared Statement of Arnold Cantor, Assistant Director, Department of Economic Research, AFL-CIO

The AFL-CIO is pleased to have this opportunity to present its views on S. 1310—the "Urban Jobs and Enterprise Zone Act."

Before commenting on some of the specifics of this proposal we should like to note that last February the AFL-CIO Executive Council addressed itself to an earlier version of this measure, characterized it as based on a ". . . false notion that local economic problems will disappear if government would spend less, tax less and protect less," and stated that the proposal was ". . . a tax cut package, not a program to correct urban problems." (text of statement attached)

S. 1310's specific provisions differ from the 1980 Enterprise Zone bills (H.R. 7563 and S. 2823) but the essential premise is the same, the tolls are similar and its potential for creating additional jobs or forwarding other urban revitalization goals is just as limited.

Thus, the measure adds up to an array of tax reductions and other devices which directly or indirectly encourage a diminution of government revenues, programs, standards and safeguards. Like its predecessor it would not create additional jobs nor help solve urban problems.

As we understand it, the concept is to designate certain areas for special economic aid to residents and businesses. The AFL-CIO has no quarrel with the concept of targeted assistance, but we believe it should be done directly and not in a fashion which has so much potential for inequity, waste and abuse.

The major tax provision of the bill would allow an Enterprise Zone business to deduct 50 percent of its gross receipts from its taxable income until 1997. This would have the effect of wiping out any federal income tax liability on income earned in the zone for many if not most "qualified" businesses. In addition this would generate artificial losses which could be washed out against other income.

The deduction would taper off by 10 percent per year beginning in 1998 and be eliminated in the year 2001. Lenders (whether in the zone or outside) would also be permitted to exclude one half their interest income from any loan, mortgage or other type of financing provided to qualified business.

The bill would also:

Eliminate capital gains taxes;

Provide a refundable tax credit for employers equal to 5 percent of the wage paid to CETA eligible employees.

Provide a refundable employee tax credit of 5 percent of wages (maximum of $1,500) for all employees of the business so long as at least 50 percent of their services are performed within the zone. Moreover, this tax credit would be retroactive for 3 years.

To benefit from these tax breaks an existing business in the zone must increase its average number of employees by 10% over the preceding year (40 percent of the 10 percent must be CETA qualified employees) and a new business must have 40 percent of its employees "qualified."

Among the inequities and flaws we see in those measures are:

The major tax breaks provide no "up front" money and the principal beneficiaries would be profitable firms that can take full advantage of the opportunity to reduce or eliminate tax liability by deducting half their gross receipts from taxable income. As we see this provision's impact, there would be a substantial inducement to establish relatively high volume, low employment ventures—such as sales offices, warehousing and distribution operations, professional offices, and the like as opposed to firms engaged in more labor intensive tax activities.

In addition this could trigger a good deal of manipulation and imaginative bookkeeping to avoid taxes through shifting reported income into the zone. The major tax benefits are in effect a function of the firm's gross receipts rather than its employment, payroll or investment in productive plant, machinery or equipment.

The tax benefits are limited to firms within the designated zone. However, in many urban areas existing and potential employment is outside the zone. Thus, a firm outside the zone, employing many zone residents would get no benefit. This, of course, would lead to extremely inequitable situations and a powerful incentive for shut-downs and relocations and counterproductive competition for foot loose firms that adds nothing and could detract from economic development and job creation.

It is also likely that many stable, existing firms in the zone that are and have been providing employment may not be able to meet the bill's qualifying criteria for financial or other reasons and would be unable to compete with a new firm that is heavily subsidized through the tax benefits.

A resident of the zone, working within the zone would receive the 5 percent wage credit. Yet, his or her neighbor whose job is outside the zone would get no such benefit. And, someone "performing" 50 percent of their "services" in the zone, but residing elsewhere would get up to the $1,500 tax break.

The existing 50 percent of wages Targeted Jobs Tax Credit has been a widely acknowledged failure in generating new jobs. How can a 5 percent of wages employer credit be expected to accomplish anything?

The interest income exclusion would raise the effective yields to lenders, which would heighten the competition for available funds and raise the cost of money to other borrowers—including municipalities and provide windfall benefits to banks and wealthy lenders. It would be impossible for the IRS to effectively monitor this provision.

The 100 percent capital gains exclusion is of no benefit to ongoing firms and could serve as an inducement to sell out and leave the zone, since there'd be no tax liability on the profit of selling the business.

We would also like to question how this measure would interact with the tax bill just completed by the full Committee. It seems to us that the business tax provisions proposed in the "Economic Recovery Act" would overshadow and negate any impact this measure could have on channeling business investment.

The section of the bill pertaining to local commitment and course of action requirements is equally disturbing. Specifically, the bill requires as a condition of enterprise zone designation that the local government follow a course of action which "may be funded from the proceeds of any Federal program and may include" . . . "a reduction in tax rates or fees . . . and increase in the level of efficiency of local services . . . simplification or streamlining" of governmental requirements on employers or employees.

We feel these criteria are vague, unenforceable and loaded with potential for confusion, political manipulation and an undermining of programs, standards and protections.

We see this, first of all, as a clear inducement to cut local taxes despite the fact that the enterprise zone areas are most likely to be in dire need of revenue.

Does funding from the proceeds of "any" Federal program mean that Federal aid, for example, from urban mass transit, community development block grants or revenue sharing programs could be used to reduce business taxes?

Increasing the level or efficiency of local services is a phrase that could be interpreted in many ways. Consolidations of police and fire stations are, for example, frequently made in the name of increased efficiency.

What does simplification or streamlining of government requirements on employers and employees encompass? Does this mean local building codes, safety, health, sanitation and environmental standards, state or local wage, hour and child protection laws?

Mr. Chairman, it seems to us that these criteria would either be the subject of continuing controversy and potential abuse or would require a level of administrative decision making, regulation and enforcement that is not provided in the bill.

We do not wish to be negative, and we do not take any proposal which could help solve the nation's urban problems lightly. We have long been concerned about the special development needs of inner cities and have been constant advocates of public and private efforts to meet these problems. The attached resolution adopted by the last AFL-CIO Convention fully outlines our position and recommendations.

In addition we do feel that tax incentives—if effectively targeted—could be a useful economic and job development tool. To that effect we have supported a reindustrialization business tax cut which could effectively target funds to the industries, areas and people where the needs are greatest at minimal cost and risk. The concept, incorporated in a bill sponsored by Representatives Guarini, Brodhead and others (H.R. 3218) would represent a major beginning toward the revitalization and rehabilitation of this nation's basic industries and economically distressed areas.

That measure was outlined in detail before the full Senate Finance Committee on May 20, 1981 by AFL-CIO President Kirkland. We have attached an excerpt of that part of President Kirkland's testimony and would appreciate if it be made a part of the record of these hearings.

In view of the major, basic flaws we have outlined, the AFL-CIO cannot support S. 1310.

Statement of the AFL-CIO Executive Council, February 16, 1981

URBAN ENTERPRISE ZONES

The "urban jobs and enterprise zone" proposal has received much recent attention as a targeted approach to meeting the problems of urban decay and inner city poverty and unemployment. Unfortunately, in its present form, the concept amounts to little more than a localized version of "trickle-down" economics.

This proposal is based exclusively on the simplistic but false notion that local economic problems will disappear if government would spend less, tax less and protect less.

It is a tax cut package, not program to correct urban problems: local real estate taxes would be cut, regardless of the tax base or public service needs; Social Security contributions would be reduced; the capital gains loophole widened; business depreciation write-offs speeded up, and corporate tax rates slashed.

There is no requirement that the business recipients of such special tax largesse add to their workforce of increase investment levels; and no provision to compensate localities for lost property tax revenue. Existing firms in zone areas may well reap a windfall for what they are already doing. Landlords are not required to pass property tax reductions on to tenants.

Because the plan lacks a mechanism to deny benefits to firms that move from other areas into "enterprise zones" merely to exploit the tax breaks, the result could be shifting unemployment from one area to another rather than a net increase in jobs.

A key provision in it would permit a 90 percent reduction in employer and employee Social Security taxes for workers in the "zone" under the age of 21 and a 50 percent reduction for all other workers. Such a measure would endanger the social insurance principles of the Social Security system and undercut its financing. It would constitute a clear inducement for employers to fire parents to hire their children, and add another form of discrimination based on age.

While we are pleased that the authors and supporters of this measure recognize the need for specific, targeted approaches to inner city problems, we cannot support this proposal in its present form. The AFL-CIO has supported selectively targeted policies for particular areas, industries and people, including tax concessions. But we are convinced that any tax reductions must take place within the framework of a coordinated national economic revitalization program involving all sectors of the economy and using the government's full range of economic tools—training, public facilities and direct loans or grants.

ADOPTED BY THE 13TH CONSTITUTIONAL CONVENTION OF THE AFL-CIO, WASHINGTON, D.C., NOVEMBER 15-20, 1979

URBAN DEVELOPMENT

The key ingredient needed to rebuild the nation's urban economic base and to restore the nation's confidence is jobs. Reducing unemployment and increasing purchasing power are essential to an urban environment in which people and their communities thrive and prosper.

The manner in which fiscal and monetary policy is administered by the federal government will determine whether Americans are to be provided the most basic of needs—jobs at decent wages for all those who are able and willing to work. These jobs provide the tax base urban areas need, and, at the same time, eliminate social problems which result from severe unemployment levels.

The AFL-CIO supports the following federal actions:

Each of the economic development programs, such as the Urban Development Action Grant Program of the Department of Housing and Urban Development and the Economic Development Administration Program of the Commerce Department, should require—as a prerequisite for assistance—a definite commitment by an employer of a specific number of jobs requiring specified skills. Where such skills are not available, unemployed people should be trained while the facility is being constructed.

To help meet the need for assisted capital investment in areas of high unemployment, adequate funding should be provided for the development financing program that has been established to provide up-front money grants and below-market interest rate loans, in coordination with the expended development efforts of the EDA and the UDAG programs.

Increased funding should be provided for the upgrading and expansion of urban mass transit systems, in order to accommodate the increased demands being placed on such systems because of the energy crisis. Funds should also be provided for the subsidization of low public transportation fares.

EXCERPT FROM MAY 20, 1981, STATEMENT OF LANE KIRKLAND, PRESIDENT, AFL-CIO, BEFORE THE SENATE FINANCE COMMITTEE ON THE ADMINISTRATION'S TAX REDUCTION PROPOSALS

The reindustrialization business tax cut alternative in H.R. 3218 would efficiently target funds to the industries and areas where the needs are greatest at minimal cost and risk. It would represent a major beginning toward the revitalization and rehabilitation of this nation's basic industries and economically distressed areas.

Briefly, it calls for the establishment of a tripartite—business, labor and government—Reindustrialization Board. Under this Board, a Reconstruction Finance Corporation (RFC) would be set up to channel public and private funds into reindustrialization projects primarily in areas most in need.

The RFC would have initial authority to allocate $5 billion in tax expenditures and an additional $5 billion in loans, loan guarantees and interest subsidies which, in turn, could leverage a total of $25 billion in private capital. The emphasis would be on basic industries, and allocation decisions would include factors such as eliminating capacity "bottlenecks," helping new U.S. industries with a high growth potential and aiding firms that have difficulty competing because of unfair foreign practices.

Eligibility considerations include reasonable demonstrations that the aid would be used to finance net increases in domestic investment and would be compatible with the local area's development plans and needs. All recipients would have to comply with nondiscrimination provisions of federal civil rights and labor laws.

The funds of the RFC could be augmented by investments from pension plan funds, as well as other sources of private capital, thereby tapping a huge source of funds for new investment. To assure that the interests of the pensioners are protected, the bill provides a government guarantee of the invested funds that are placed in the RFC.

Senator CHAFEE. We now have Mr. Schlenger from Baltimore and Mr. Haigh from Toledo.

Also, a very distinguished colleague, Senator Mathias, who we welcome here with fanfare, to introduce Mr. Schlenger.

Senator MATHIAS. Mr. Chairman, it is my recollection, if I can trust my memory so far, that when you were presiding over the U.S. Navy, that there was a doctrine that you would fly before you buy. That you wanted to be sure that the products that you acquired for the use of the Navy were dependable and serviceable and efficient and economic. I think that you could apply that doctrine of fly before you buy to Mr. Schlenger, and to the Greater Baltimore Committee, which, in a sense, he represents here today.

The Greater Baltimore Committee has been an enormously effective group of businessmen, public leaders, union leaders who have come together for the purpose of looking at urban problems and solving them. And, they have done that to a degree that I think that has not been surpassed anywhere in the United States. Perhaps, it's not too much to say any place in the world.

The number of people who go to Baltimore today to see the work Baltimore has done is extraordinary.

Mr. Schlenger comes today as the chairman of the Enterprise Zone Subcommittee of the Greater Baltimore Committee.

And, I would like to say just a word about him personally. He is the managing partner of Venable, Baetjer & Howard, which is a law firm that is of such eminence and distinction that it's part of the historic landscape of the city of Baltimore itself.

Mr. Schlenger is a tax expert. He is one of those lawyers who develops such eminence in a particular branch of the law, that when you think of that subject, when you think of tax problems in that subject, you think of Jacques Schlenger.

So, he comes to you with the kind of expertise, and the kind of knowledge which I think will be enormously helpful to this committee.

And, it is my great pleasure to introduce him to the committee this morning.

Senator CHAFEE. Thank you, Senator. I must say Mr. Schlenger could not have a better advocate before this committee than the distinguished senior Senator from Maryland who is regarded with such affection, awe, and esteem in this body.

I also notice Mr. Schlenger, that you have a Rhode Islander on your Enterprise Zones Subcommittee in the personage of William H. Choquette, from the Gilbane Building Co. So, you've got everything going for you. [Laughter.]

STATEMENT OF JACQUES SCHLENGER, MANAGING PARTNER, VENABLE, BAETJER & HOWARD, BALTIMORE, MD., AND GEORGE W. HAIGH, CHAIRMAN, TOLEDO ECONOMIC PLANNING COUNCIL, TOLEDO, OHIO

Senator CHAFEE. Also, you were sitting here during the testimony of the AFL-CIO people and in the course of your remarks, I would be interested to hear what you have got to say about their viewpoint.

Mr. SCHLENGER. I would be happy to do it.

If you would turn to page 22 of my submission, where we summarized our points. The first is, on page 22, the enterprise zone should be viewed as an experiment. We think even its proponents say that. I am talking about Dr. Butler, Peter Hall, and so forth.

Contrary to a lot of the witnesses, we think there should be no more than 10 zones. So that we can——

Senator CHAFEE. Ten per year?

Mr. SCHLENGER. Ten per year. So that we can have a careful experimentation.

We do not advocate 75 or 100, or the political things I can't speak to. But I think it would be promiscuous and would eliminate the possibility of evaluating the program.

The second point—and you stop me, Senator, if you have a question as we go along here—that the enterprise zone, itself, does not represent a complete answer. We think it requires the help of the other programs.

Third, we don't think it should be limited to small business. The big business may——

Senator CHAFEE. I agree with you, Mr. Schlenger. Somehow people have gotten the word "small business" in this, but the name of the act has nothing to do with small businesses—it's a jobs bill. And, I could not share more with your views on that. If General Motors wants to come in and put a plant in one of these zones, three cheers. It doesn't have to be only small business.

Mr. SCHLENGER. Well, I agree with you, Senator. There seems to be a great deal of confusion about what this bill is.

Many people say it's an urban policy which it isn't as such. It's not a panacea. It's a modest experiment, which we find as business people from that perspective, may help.

In Baltimore, City Venture Corp., Control Data started an area, Park Heights, it's the anchor. And, small business flows from it, we hope.

We also think that all the unemployed in the metropolitan area should be eligible, that it shouldn't be limited to industrial areas or residential—all types of impacted areas. We think, again, that like model cities, it should not be over extended. Because if it spread to 150 or 200 locations, and while I love rural America, it's difficult to see the justification in many small areas. Say parts of the great West, or Midwest, not having the same problems that this is intended to address—primarily, the chronically unemployed, the disadvantaged, and primarily in our large urban centers, where we haven't dealt with the problem.

We don't think from having talked to a number of people who might use this—large business, small—the small business people don't think it does much in the way of tax incentives. They don't help them.

Their reasoning is pretty simple. As one of them told me, "I don't have any income to worry about, so I won't have no taxes."

And, this is probably a fairly common plight. And, it goes back to your point that we have to have a combination of large, medium business, and small business. Small business, while under the MIT study creates more jobs than large, will not really be attracted sufficiently by the tax incentives alone.

We think the major omission is seed capital. Every small business that came in, they wanted money to start their business. Where do they get financing? The normal Government programs, MISBIC, small business, and all the others are bogged down in the bureaucracy of the Potomac, or have not been very effective.

In addition, traditional venture capital, with which I am quite familiar, generally doesn't want to do this level, this black box type. And, I think we are sort of talking about a dream, so far as small business is concerned, unless there is provision in the private or public sector for capital.

We think the enterprise——

Senator CHAFEE. What about that fact that the interest income from an investment in one of these places would be tax exempt?

Mr. SCHLENGER. I would think, sir, that that would be small potatoes, indeed. And, not really attractive.

For example, the failure rate in normal venture capital. I'm saying what I call second, third, fourth stage, where a group of wealthy families may put in together $3 or $4 million, is really very high, and when you drop down to the seed level, it is astronomically high, and whether you call it a loan, or whether you call it a stock investment, doesn't make much difference. It is very risky. Perhaps too risky.

I think that's where we really need help. And, we think that it really isn't an answer to say that the Government hasn't done a very good job of picking a business in the venture area. Neither has private industry. But it is something we have got to try if we are going to be successful.

Another point we think is that the provision of enterprise zones won't work without infrastructural improvements, that in the ballgame would be ammenities and facilities such as sewers, waters, roads, as Mayor Fraser said.

And, many times the local governments can't support that.

The same with police, and firemen. As we see in London, as we see in other cities, you can't have a plant in the South Bronx or in South Baltimore, without police protection, fire protection, and special things such as alcoholic counseling. It's a special work force in those areas—day care, drugs, skill training, job training.

And, it's easy to say that the cities should provide this, but our mayor, among others says they do not have the funds.

Senator CHAFEE. Who did you say—your mayor?

Mr. SCHLENGER. Mayor Schaefer.

Senator CHAFEE. Mayor Schaefer.

Mr. SCHLENGER. Who will testify, I believe Thursday, with his usual enthusiasm and passion. Because he is a great mayor. Says they don't have the money. And, it makes little sense, we think, to create enterprise zones unless you regard the entire organism of urban economic development, meaning tangible roads, services, and in addition to regular social services, business services.

I am a lawyer. And I am, of course, aggrieved when small business people complain they can't afford the fees. They don't know where to go. The big-time lawyers, the accountants, the management computers.

But, you cannot operate a business enterprise today without that.

This is part of the cultural deprivation of the poor. As an entrepreneur, an employee, in our large urban areas, they must have these services made available.

The City Venture Corp. is trying to do that in the Park Heights area in Baltimore.

And, perhaps a private solution along with some Federal funding may be feasible.

The last point I would like to make is that the legislation's final form, we urge this should be simple, very simple.

I have read this bill, and as a tax lawyer, I can tell you it's a little mushy.

It probably creates another bureaucracy. And, we were hoping for a bill that would be so simple in its structure that a normal human being, not a lawyer, could read it.

Also, that we don't spawn another industry of consultants who write reports or applications to the Federal Government.

One also cannot be but somewhat pessimistic about the future of enterprise zones if there must be administration here in Washington, again by the traditional Government agencies. It may take so long, and be so inflexible.

One of the things here is we hope the Federal Government can overcome its myopia, and its fascination, with protecting us from fraud. If this type of program is to work, we must be willing to take the risk as well as the new entrepreneurs. It would probably be better to keep it simple, risk losing some money, but take a chance on an experimental basis and see how it works.

Last, Mr. Chairman, we would like to say, and this is, of course, dispassionate, not chauvinistic, that Baltimore would be the perfect place in which to start. [Laughter.]

Senator CHAFEE. Well.

Mr. SCHLENGER. We have a great mayor, a great record of civic achievement. I know other cities can perhaps make the same general claim.

But, we have something else. You can come and visit us. You can leave in the morning. Have lunch at Harbor Place and return here to enact further laws. And, we think no other city offers that to the Federal establishment.

And, so in closing, Mr. Chairman, I hope seriously that we have presented a businessman's perspective of an interesting idea, but not a panacea. Something worth trying. But something that requires more simplification, more restraints, but does not become a Christmas tree for both conservatives and liberals. And, that maybe it may contribute in a small way, along with the other programs, to refurbishing, revitalizing our urban areas economically. And giving the chronically unemployed and disadvantaged the chance.

Senator CHAFEE. Thank you very much, Mr. Schlenger. What we will do is hear from Mr. Haigh and then we've got some questions, undoubtedly, for both of you.

So, why don't you go ahead, Mr. Haigh. Glad you are here.

Mr. HAIGH. Thank you, Senator Chafee, and good morning. I assume my testimony was submitted in advance and I just will make some summary comments.

Senator CHAFEE. Yes. We have that.

Mr. HAIGH. I am George Haigh, currently the chairman of the Toledo Economic Planning Council in Toledo. And I appear today before this subcommittee in support of your bill, S. 1310.

The Warren-Sherman urban redevelopment project in Toledo, Ohio, is a project that is very consistent with the intent and qualifications set forth in this bill.

I appear today on this matter on behalf of the Toledo Economic Planning Council; the city of Toledo, which has given very strong support to the project; the community of Warren-Sherman itself, and the neighborhood residents within that area who are offered hope because of this bill; the corporations which have already made commitments into this area, including City Venture Corp., a partner with Toledo for some time, the Warren-Sherman project being probably the most advanced model of City Venture and with a sizable current investment by Control Data in Toledo. I also am here as the chief executive officer of the largest financial institutions in Toledo, Toledo Trust Co., which is doing a considerable amount of financial risk taking in this area.

The subcommittee is to be commended for beginning prompt congressional hearings on an idea which should become a reality, I hope, at the earliest possible date.

Much is already known about the urban enterprise concept. Competing proposals have been examined in the adversarial context of conferences and academic studies. This administration, as well as Congress, has obviously more than one concept under consideration. There have been several projects like our Warren-Sherman project, which have yielded evidence on what really works.

Urban redevelopment could be slowed by any inexplicable delay in Congress setting forth this urban policy and its statutory framework for future urban development.

The Warren-Sherman project, Toledo's successful effort to revitalize its most distressed inner city neighborhood, provides, in my estimation, an excellent model for demonstrating how a city's private and public sectors can join forces to solve the urban problems.

This project has as its goal the restoration of economic and social stability to a neighborhood that is characterized by high unemployment, poverty, welfare dependency, blighted housing, and other indicators of urban decay.

Today Warren-Sherman is well on its way to becoming an attractive and viable neighborhood, because of a few unique combination of factors. Including—

(1) The comprehensive nature of the project approach, addressing jobs, job training, enterprise development, redevelopment of commercial services, health care, day care, recreation, and other social support services.

(2) A triad of interests: That is, the private sector, the public sector, and a nonprofit developer. Resulting currently in commitments of over $30 million of private investment and an estimated 1,500 jobs within 5 years.

(3) The way in which residents of the neighborhood have participated in this project, including the establishment of project goals, planning of project elements, and an actual taking part in its many components from the beginning.

Mr. Chairman, the Federal role is crucial. Tax incentives, economic development block grant programs, and targeted job training will provide important assistance in creating environments for the attraction of private investment to inner city neighborhoods.

The Warren-Sherman model cannot necessarily be duplicated nationally without Federal assistance, since other cities would have a different cast of characters.

The Federal role can provide the proper incentives to get people to come together to form a partnership to revitalize decaying neighborhoods.

The proposed Urban Jobs and Enterprise Zone Act will be a key component, in my estimation, in maximizing the benefits from such projects.

I think the response will be very rapid, and significantly so, from the private sector.

Thank you.

Senator CHAFEE. Well, thank you both, gentlemen. Let me ask a question.

As Mr. Schlenger pointed out, the capital problem is fundamental. But to expect the Federal Government to provide capital seems to make this process even more complicated. It is one thing for the Federal Government to go ahead and say, if you do such and such within this zone, then we will relieve you of taxes or reduce your tax burden. But, then to follow it up by saying we'll provide capital at a low rate of some manner adds a whole new dimension to it. I don't think we can look to the Federal Government for capital.

I didn't understand your rationale concerning our provisions wherein we exclude 50 percent of the interest income from taxation and we eliminate the capital gains. You said that with all the high failures that's not much. But it pebbles the rate of return, doesn't it?

Mr. SCHLENGER. Well, let me give you an example, Senator, if I may. Suppose there is a small business. George Jefferson wants to start a new cleaning establishment, and he wants $150,000 for equipment and the like. This money is advanced, and because of this tax provision, it is cast in the form of a loan. And the loan would pay 10 percent a year or $15,000. So half of that is tax exempt.

Well, the problem is that at the beginning, the Jefferson Cleaners probably won't have the funds to even pay the interest. It may not be paid for several years during the startup period. And, then if the thing goes under, it doesn't generally make a lot of difference whether you've called it in a startup venture capital, either a debt or a capital instrument.

Instead to me, there are probably ways to subsidize this. And I agree with the difficulties with the Federal Government.

One might be to set up an independent venture capital corporation, or regional corporations. A partnership of maybe the Federal Government in part and local businesses. And, to give a tax subsidy in that if the investment goes bad, you may get your money back with a return—a modest return.

So there is an incentive to take ~~the~~ chance, and put your know-how in there, which is as important as anything. I think that, and perhaps my banking friend here, have a slightly different view; but from a venture capitalist's point of view, which I do a lot of, the incentives are not nearly enough to do this sort of thing.

Senator CHAFEE. Tell me a bit about the Greater Baltimore Committee. How did you achieve success in your waterfront redevelopment?

Mr. SCHLENGER. Be happy to do it. Bill Boucher here, who is the executive director, and the great man of the Greater Baltimore Committee, perhaps tells it a little better if he'll forgive me.

It's a 30-year-old organization that was founded by some great men. Among them, Clarence Miles, who brought the Baltimore Orioles back from the woes of St. Louis, and James Rouse and others like him. And what these men did was to form this group of only the presidents, the chief executive officers, of the local businesses—100 members. So that there was no delegation to second-line executives, and these men could sit down and write a check or make a decision like that.

They attracted great men to work on a volunteer basis during the redevelopment, such as the late Jeff Miller. And what they did was, they helped support the initial planning by private funds, bringing in Dave Wallace, I believe it was, and others with the then-Mayor D'Alesandro, as we call him, the "Elder" or the "First". And started the redevelopment process and the planning and the business community helped. And they helped push it through, gave financial advice, a little help when it was required, and commitment—commitment of men. As the program developed, we had great mayors.

We had Mayor D'Alesandro the "Younger", and now we have William Donald Schaefer. And each of these men has really invigorated the city, along with the business community.

For example, even today, we have committees like this working with the city officials. We meet regularly with the city officials.

It is not a combative enterprise. And we think that in many ways, no Federal, State, and particularly local government can have the same resources, particularly of personnel, that the large business enterprises and their advisers may have. That's what the Greater Baltimore Committee can do.

It is a loan, in the sense of talent. We hope that talent has been loaned and shared with our city. I hope that's fairly responsive, Mr. Chairman.

Senator CHAFEE. How do you raise capital for ventures there?

Mr. SCHLENGER. Well, we don't. The Greater Baltimore Committee, itself, does not raise capital.

When I spoke of my venture capital experience, it was in the private sector—clients who do this.

On the other hand, our mayor has had one thing—say, the last 10 years—that has attracted some interest, and at times, some criticism. He has adopted flexible financing, I think is a fair way to put it, through a trustee system that holds city funds, substantial funds.

These trustees will be able to move quickly without the normal impediments of local government to make loans or investments in a variety of enterprises that we think trigger or help the cities. Such as the apartment house developments, factories, all that sort of thing.

So, we really do, to that extent, have the city government participating in venture financing.

In addition to that, we have the usual panoply, as most cities do, of industrial development bonds, State financing, and various Federal things.

We have been very fortunate, too. Bob Embry was a lawyer in Baltimore and then moved on to higher things—running for public office and then our housing commissioner, before he came over here. And with Mayor Schaefer, they developed very unusual urban programs in this partnership concept.

And then when Bob and Dave Cordish, from Baltimore, moved over here, they helped administer the UDAG program. We have used the UDAG program. Recently, for example, the new Hyatt Regency Hotel that will shortly open is helped, really put over the top by UDAG.

This will create hundreds of jobs in that level of our society which we refer to as chronically unemployed.

Senator CHAFEE. Thank you. Those gentlemen are both written up in an article today, I believe it is in the Post.

Mr. SCHLENGER. Yes.

Senator CHAFEE. Mr. Haigh, how do you work it in Toledo? Does the bank provide most of the financing?

I take it that these areas that you have had help from major corporations that have developed facilities. Is that right?

Mr. HAIGH. Right. The assumption in the Warren-Sherman project, which is on the edge of that downtown portion which is in the process of major redevelopment, was that the neighborhood would become an island unto itself, if it were not included in that redevelopment.

The area is blessed with seven of the Fortune 500 companies and advanced civic and corporate leadership. Together, with Toledo Trust Co. and because of its size, that leadership determined that it had to attack the problems of this Warren-Sherman area of high unemployment, mostly black, and, in effect, to help them get back onto payrolls.

With the city, we have instituted what I call a complete, A to Z, comprehensive approach from housing to jobs and job training. Control Data came in and joined us.

EXCERPTS FROM THE TESTIMONY AND ADDENDUM OF J. HARRINGTON, VICE PRESIDENT, CITY VENTURE CORP.

In Toledo, where City Venture is furthest along, and our goal is the creation of 2000 jobs over a five year period, we have used a combination of funding sources to develop the 23 acre job development area within the Warren-Sherman neighborhood. Preparation of the physical infrastructure is jointly financed by two government funding programs: the EDA and UDAG. Their total commitment is $7.5 million. This is turn led to the commitment of investments by Control Data's Business and Technology Center, Libbey-Owens-Ford, Inc., and Owens-Illinois. Financing of the industrial, commercial and residential developments has resulted in a leveraging ratio which is growing from three private dollars for every public dollar granted. And of course, the future of economic development in Warren-Sherman will continue to grow.

WARREN-SHERMAN, TOLEDO, OHIO

City Venture's; first client city was Toledo, Ohio. The project is in the Warren-Sherman neighborhood, located just west of downtown Toledo. The neighborhood occupies approximately 300 acres and is home to 3,500 people in 1,200 households. Of the total population, 90 percent is black, 40 percent has no high school education, and in 1979, an estimated 32 percent of the neighborhood's heads of households were unemployed, compared with 12 percent for the City.

City Venture's goal in Warren-Sherman is the creation of 2,000 new jobs over a five-year implementation period. These jobs are entry-level positions, for which residents will be trained and which offer opportunities for advancement. The jobs created are targeted to Warren-Sherman residents. Other project objectives were also specified in the areas of workforce mobilization and stabilization and community revitalization.

The strategy development phase of the project was completed in the spring of 1980 with the implementation phase commencing thereafter.

Toward the fulfillment of the job creation goal, 23 acres have been identified for the development of a neighborhood industrial park, to provide 570,000 square feet of industrial space. Groundbreaking for the park is scheduled for Spring, 1981. Fully developed, the first phase of the industrial park is expected to provide a total of 1,300 jobs.

Preparation of the park's physical infrastructure is jointly financed by two government funding programs: the Economic Development Administration and the Urban Development Action Grant Program. United States Government commitments of $7.5 million have been received. Private sector commitments for the industrial park are led by Control Data's Business and Technology Center; other commitments have been made by Libbey-Owens-Ford, Inc. and Owens Illinois.

The Business and Technology Center (BIC), constructed by Control Data Corporation, is one anchor for the industrial park. As previously described, the BTC is an incubator for the creation and development of new, small businesses. Marketing of the BTC began in October of 1980. The Center will open in the summer of 1981 and when completed, will have created an additional 440 jobs. An annex to the BTC, with 15,000 square feet available for industrial rental, opened in December of 1980.

Another project in Warren-Sherman is the creation of a neighborhood-based property maintenance and management company. The total projected employment of the company is 12 full-time positions.

Also recently located in the Warren-Sherman neighborhood is the Brown Packaging and Bindery Company, which at full-scale production will employ 80 people part-time. The company was incorporated in December of 1980. City Venture staff worked with the company to secure a seed capital loan for start-up. City Venture also assisted the company in acquiring the lease for a building for the company's operations. One-half of the total 80 jobs in the packaging and bindery company will be targeted to neighborhood residents whose special needs require a part-time job. The other half will be open to Fair Break clients, to become the work experience component of the Fair Break program.

Additional federal funds are being used in the project area, together with funding provided by the Toledo Trust and other local banks, to develop a neighborhood shopping center. Chosen by the neighborhood residents as a priority project for job creation, groundbreaking for the 4.5 acre shopping center will occur in spring of 1981. The center will create 100 jobs and will offer 50,000 square feet of commercial space for 12 commercial activities, concentrating on grocery, hardware, and drug stores.

The Toledo Trust Bank also recently announced plans for the construction of a Branch Bank and Professional Office building in the Warren-Sherman neighborhood. The building will provide 12,500 square feet of business space and will be located directly across the street from the shopping center.

Two job-related programs are being implemented in the project in an effort to target the jobs created in the neighborhood to Warren-Sherman residents. The Warren-Sherman Fair Break Center opened last September. As already described, it is a job preparation and training program. The Center offers work experience (40 part-time jobs at the packaging and bindery company) and plans to serve 160 clients annually. Through January 1981, 38 clients had been enrolled in the program.

A job matching system has also been established in the project area, with the purpose of placing residents in neighborhood jobs. During 1980, the system was manually operated. By the end of January 1981, use had expanded from 120 to 215 clients.

In the area of community revitalization, one early implementation project in the Warren-Sherman area was a solar demonstration house—the rehabilitation and retrofitting of a six-unit abandoned building located in the neighborhood. Financed by both City Venture and federal funds available to the City, the building was rehabilitated by a local minority contractor and equipped with a complete active solar heating and cooling system. Resident were hired and trained to work on the rehabilitation.

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Today, housing units in the "solar house", as it is called, are being rented to neighborhood residents, some of whom were displaced by the industrial park development. In addition, the house remains a visual example within the neighborhood of energy conservation and efficiency in living.

Other housing-related projects include a $1.2 million interest subsidy program, which uses both federal and local private funds, for home purchase and rehabilitation; moderate rehabilitation of 50 units of rental housing; and rehabilitation of scattered public housing (to date including five buildings and 22 units). Future plans include construction of 300 factory built housing units, and two house moves from the industrial park area to vacant property adjacent to the solar house, with subsequent rehabilitation of the housing.

Human services programs have also been developed. In the spring of 1981, a health care center will be established in the neighborhood, in conjunction with a local hospital. The health center will be located in a community service center and will focus on delivery of primary health care services to mothers and small children.

Because arson has been a particular problem in the neighborhood, a community anti-arson conference is being organized, with related programs to be subsequently initiated using local resources. Responding to the day care needs of the Warren-Sherman residents, a neighborhood elementary school, recently closed by the school board, is undergoing reuse as a Head Start Day Care facility, to be operated by the local Economic Opportunity Planning Agency.

Financing of the industrial, commercial, and residential developments has involved a combination of public and private funds, with a leveraging ratio of private to public contributions of approximately 3.0. It is anticipated that the job creation projects that have occurred to date will be the catalyst for further private investment in the Warren-Sherman neighborhood.

Senator CHAFEE. You pulled a plant in there?

Mr. HAIGH. Yes.

Senator CHAFEE. A Control Data plant?

Mr. HAIGH. We have a Control Data Business Technology Center, probably one of the most advanced in the country, including Minneapolis.

In this area will be the entrepreneurship of both small business and older, larger businesses.

I think one interesting thing is that Toledo has done this without tax incentives. We have done it with sizable help from HUD's UDAG and Commerce's EDA programs. But the reason why we think this bill is important, is that it will further consolidate and keep on a permanent basis those jobs already committed and those being committed for the residents.

We are more stringent in our Warren-Sherman project. We say 100 percent of Warren-Sherman area residents will be employed first, before outsiders are. We did that because we felt it was an important commitment to the neighborhood.

In this bill, it is less. But we think that, if we didn't do that, we would get people coming across the street, so to speak, to get a job in that area when in effect they live in another.

Senator CHAFEE. Take the situation of Control Data with their facility. That sounds like a very technical type of work that wouldn't be compatible with CETA-eligible employees.

Mr. HAIGH. I think the Control Data Center has many things, some which are about as basic a job as can be, but through the job opportunities it provides, it will raise the educational levels upward.

This center is really a centralized service building that brings in many small businesses.

For example, we just created a new black-owned business which mixes chemicals and sells them to the cutting tool industry. Its jobs are really quite simple.

Control Data is in there, because of its belief that the redevelopment of urban neighborhoods starts with job creative ideas. They felt that Toledo offered the perfect model. And, it has become, in my estimation, just that. It addresses the unemployed.

Senator CHAFEE. Thank you both for coming, gentlemen. Obviously the leadership that you have given in your respective communities has been terribly important. I think the point that Mr. Schlenger made about the leadership of the mayor is very important too.

Excuse me, my distinguished colleague is here and might have some questions.

Senator Grassley?

Senator GRASSLEY. No, I didn't have any questions, but I did want to come to the meeting to reiterate my support for the concept. In the process I want to obviously thank you for the leadership you have shown in the private sector irrespective of any Government impetus. Because, it is that sort of leadership that we are going to need to make the whole concept work.

But, what we want to do is have a response other than the usual response that has been used for the last 20 or 30 years where a solution to an inner city problem has been sought by a subsidy from the Federal Treasury without any impetus for private investment.

We think the private investment is the long-term solution to these problems.

So, you are to be complimented for your leadership in this area. Thank you, Mr. Chairman.

Mr. SCHLENGER. Senator, if I could just make one statement to Senator Grassley.

Bill Boucher who is both my mentor and amanuensis sends me a note that of the $900 million so far invested in the reinvestment in Baltimore, 80 percent of it is from the private sector. So, the other 20 percent, the panoply of Federal programs and local, that was the seed money to trigger this private effort.

Senator CHAFEE. You have the ship *Constellation* there?

Mr. SCHLENGER. Yes, Sir.

Senator CHAFEE. Is it quite well restored?

Mr. SCHLENGER. Yes it is. And, we also have another ship there called the *Pride of Baltimore* which sails around the United States promoting the great city and Port of Baltimore. We have found that very effective.

We welcome any visitors from Washington, without attempting to distinguish among or between them, who would like to come to Baltimore and ride either one.

Senator CHAFEE. Well, you certainly are an elloquent spokesman for Baltimore. Glad you are both here, gentlemen. Thank you for coming.

[Statements follow:]

REPORT OF THE ENTERPRISE ZONE SUBCOMMITTEE OF THE GREATER BALTIMORE COMMITTEE, INC.

INTRODUCTION

The Greater Baltimore Committee is a business organization with a membership of over eight hundred Baltimore area firms and is the Chamber of Commerce of Metropolitan Baltimore.

The Enterprise Zone Subcommittee was established by the Board of Directors of the Greater Baltimore Committee (GBC) on February 13, 1981, and subsequently appointed by Bernard Manekin, Chairman of the GBC. The Board of Director's action was taken in response to a letter sent to William Boucher, III, Executive Director of the GBC, by Congressman Jack Kemp (R-N.Y.), in which Mr. Kemp asked the Greater Baltimore Committee for its views on Enterprise Zones. The Enterprise Zone Subcommittee began work in early April and subsequently met many times. The meetings were held both among the members of the Subcommittee and with the attendance of various experts and interested parties who gave presentations and then answered questions.

The guests who have advised the Committee are as follows: Mr. Frederick E. Barrett, President, Sequerra Company, Inc.; Mr. Bernard L. Berkowitz, President, Baltimore Economic Development Corporation; Dr. Stuart M. Butler, Policy Analyst, Heritage Foundation; Mrs. Elizabeth Duklewski, Mr. James Duklewski, and Mr. Sam Duklewski, Roberts Manufacturing Co.; Mr. Robert C. Embry, Jr., Formerly Assistant Secretary of the Department of Housing and Urban Development; Mr. Martin H. Kramer, Chief, Advanced Planning and Programming, Department of Housing and Community Development; Ms. Mary McConnell, Congressman Kemp's Office; Mr. Lawrence Revzan, Director, Economic Development and Project Analysis Group, Coopers and Lybrand; Mr. David M. Smick, Chief of Staff, Congressman Jack Kemp's Office; Mr. Herbert F. Trader, President, City Venture Corporation.

The Subcommittee has also reviewed a large body of literature that has appeared about or in connection with enterprise zones and urban policy. Much of this material has served as the basis for theories espoused by proponents and opponents of enterprise zones. A list of information reviewed by the Subcommittee is set forth in the bibliography following this report.

As important as the information presented to the Subcommittee is the Enterprise Zone Subcommittee's composition. The Subcommittee was selected to reflect the diversity of the Baltimore business community and those fields of business that would become active in enterprise zones should they come into being. Present within the makeup of the Subcommittee is the knowledge necessary to provide a business viewpoint analysis of a complex urban issue such as enterprise zones. Venture capitalists, bankers, economists, lawyers, accountants, builders, retailers, distributors, university educators, and residential, commercial and industrial developers are all represented. The Subcommittee was particularly careful during its deliberations to seek out the views and advice of small businesses.

After careful consideration of written information and information presented personally by experts and interested parties, the Subcommittee has reached some conclusions and feels able to make some suggestions regarding enterprise zones. The Subcommittee does not believe that it represents the complete expert on enterprise zones nor was this ever the Subcommittee's goal. Rather, the Subcommittee, through its members, has acquired a sufficient grasp of the issues involved to offer an informed view of the enterprise zone concept from the perspective of the business community of Metropolitan Baltimore. The purpose of this report is to provide a business insight into the concept with the hope that, as the recently introduced enterprise zones legislation is revised and implemented, these views will be considered where appropriate.

BACKGROUND AND PROPOSED LEGISLATION

The enterprise zone seemingly represents an attempt, through legislation, to create jobs in depressed urban areas through promoting an environment which is conducive to business start-ups and expansions. While there historically have been several similar business development policies and attempts, the enterprise zone concept now being discussed in the U.S. had its origin in United Kingdom where it was first proposed by Professor Peter Hall.

Enterprise zones are also new to the United Kingdom. Enterprise zone legislation was first passed in the fall of 1980 and is currently in the early stages of implementation. The enterprise zone concept in the U.K. calls for deep cuts in Government imposed taxes and regulations. Since it is realized that the enterprise zone is an unproven concept, the enterprise zone is viewed strictly as an experiment and the number of zones that may be established is limited to about eleven.

Of the enterprise zones being established in the United Kingdom, one of the most advanced is located in Clydebank, Scotland. Clydebank was once the site of a thriving shipbuilding industry which produced some of the world's greatest ships including the Queen Mary and the Queen Elizabeth. However, as the shipbuilding industry declined in the United Kingdom so did Clydebank. The Clydebank enterprise zone seeks to replace the now declined shipbuilding industry with other industries. This will require significant capital investment in the area. Larger businesses are, therefore, expected to play an active role in the redevelopment of Clydebank.

Also most noteworthy is the use of seed capital. As will be discussed later in this report, new businesses have a critical need for start-up money. At Clydebank a pool of seed money was created. Half of this money came from national accounts, and the other half was raised locally.

The American enterprise zone concept, as introduced and articulated by Stuart M. Butler, targets residential areas. Because recent studies indicate that small businesses account for most new jobs in America, proponents of enterprise zones are particularly interested in creating an environment conducive to small business start-ups and expansions. This is to be accomplished primarily through reducing business taxes in zone designated areas.

On June 3, 1981, Representative Jack Kemp (R-N.Y.) and Robert Garcia (D-N.Y.) introduced the Urban Jobs and Enterprise Zones Act of 1981 which represents the most recently proposed enterprise zone legislation. This legislation appears to have gained the initial approval of the Reagan Administration and many believe that enterprise zones will become a central part of the Administration's urban policy. Under this bill, a specific area of at least four thousand residents located within a city with high levels of poverty and unemployment may be designated as a zone.

The legislation proposes that within the zone the Federal Government will (1) eliminate capital gains taxes on investments; (2) exclude from income taxes half the income earned by enterprises located in the zone; (3) exclude interest income earned on loans to zone businesses from taxation; (4) extend the loss carryforward to twenty (20) years, thus allowing zone businesses to write off initial losses against long-term gains; and (5) allow businesses with gross receipts of two million dollars ($2,000,000) or less to use the cash accounting method, thereby potentially reducing tax burdens.

In order for a business located in an enterprise zone to qualify for these tax reductions it must hire forty percent (40 percent) of its employees from among CETA-eligible workers. To further encourage the employment of disadvantaged workers, the Act offers a refundable income tax credit equal to five percent (5 percent) of the wages paid to CETA-eligible employees. Proponents of the legislation hope the disadvantaged will be encouraged to seek employment through the offer of a 5 percent refundable personal income tax credit for wages earned by all zone employees, up to a cap of one thousand five hundred dollars ($1,500). This provision is also designed as an incentive for skilled workers to seek employment in enterprise zones.

The legislation requires local governments desiring to have an enterprise zone located within their borders to commit to a course of action designed to reduce the various burdens borne by employers and employees in the zone. Such a program could include reductions in rates and fees; an increase in the efficiency of local services; and a commitment for private entities in the area to provide jobs and job training.

The Subcommittee recognizes the significance of this legislation and has given it consideration in writing its report. The Subcommittee has been most concerned with analyzing the conceptual framework of enterprise zones because the legislation is expected to be modified as it journeys through the legislative process.

ACTIVITIES OF THE CITY OF BALTIMORE

Perhaps more than any other City, Baltimore has given great attention and consideration to the enterprise zone concept. Baltimore City first expressed an interest in the concept over a year ago when the Department of Housing and Community Development invited Dr. Stuart M. Butler to come to Baltimore and explain the enterprise zone concept in detail to the Department's staff.

Since that time, an inter-departmental working group has been actively studying enterprise zones and Baltimore City officials have presented their views and support of enterprise zones in several forums nationwide. In an appearance before the Subcommittee, Baltimore City officials revealed that they have had four areas under study as possible sites for enterprise zones for some time.

Among the sites under study is the Park Heights area of Baltimore City. Park Heights seems to be well suited to the enterprise zone concept. Park Heights is a depressed area with high unemployment and is somewhat unique in that it is a residential area with good quantities of open land available for capital investments. Baltimore City has moved ahead with an aggressive business development program which has been substantially aided by federal programs which may be discontinued as well as being enhanced by private sector commitments to the area. Among the elements of the Park Heights effort are the following:

(1) An industrial park to be developed with great job density and acreage sold at low cost by the City.

(2) A City commitment to make street and utility improvements in the area of the industrial park.

(3) City Venture Corporation, a Control Data affiliate, will build a one hundred twenty thousand square feet (120,000 sq. ft.) "Business and Technology Center." The Center will provide low rents, counseling, typing, duplication, and other business services to embryo small businesses.

(4) Commerical Credit Company has opened a bindery plant which will eventually employ two hundred people, and C and P Telephone has invested in a new facility in the area.

(5) A counseling service for the unemployed gaining employment is being established.

The City hopes that its efforts will yield two thousand five hundred jobs (2,500).

In reviewing the Park Heights program, it is interesting to note that the local government commitments required by the new Urban Jobs and Enterprise Zones Act are already in place and, therefore, Park Heights is already an enterprise zone. All that is missing are the continuing and additional Federal commitments.

In addition, enterprise zone law has been enacted by the Maryland State Legislature with the support of the City. This enabling legislation was passed to ensure that Maryland law will not conflict with Federal enterprise zone legislation.

FINDINGS AND RECOMMENDATIONS

Objectives

Even among the proponents of enterprise zones, who congressionally represent the marriage of an apostle of new supply side economics and a patterned urban liberal, there appears to be a lack of a clear focus as to what economic goals it hopes to foster or achieve. As suggested earlier, the principal objective would appear to be the creation of a healthy and more creative business environment. From this background it is hoped there will come more entrepreneurs, and from the entrepreneurs will come successful businesses which will employ more people, particularly those who are chronically unemployed. A corollary principle of the enterprise zone seems to be a belief that those governmental programs which have gone before have involved large expenditures with relatively low achievement in terms of jobs or new business. Enterprise Zone proponents believe programs of direct assistance are doomed to failure because they will not reach a large enough portion of the total number of needy businesses.

When the enterprise zone concept is considered from the viewpoint of creating more entrepreneurial activity, emphasis is placed on the emergence or expansion of small business entrepreneurs. The reason for this emphasis is the expectation that more jobs will be created by small businesses in urban areas where unemployment is serve. This expectation is based on recent studies by the Massachusetts Institute of Technology indicating that small businesses create more jobs in the aggregate that large businesses. The Subcommittee believes that enterpirse zone legislation should not only encourage small business entrepreneurs, but that larger business participation should be fostered as well. The Subcommittee draws this conclusion on the theory that a large business may serve as an "anchor" in the development of a depressed area.

Evidence of the importance of investment by large businesses was brought to the attention of the Subcommittee during its deliberations. The Subcommittee learned that the economic development prospects for the Park Heights area of Baltimore City have been significantly enhanced by investments of two large firms. The Chesapeake and Potomac Telephone Company and the Commerical Credit Company are both investing in new facilities in the area. There is a sense that these investments by two major Baltimore firms will inspire confidence in the Park Heights area as a sound location for investment and, thereby, attract further investments.

The new Urban Jobs and Enterprise Zones Act of 1981 does not discourage activity within zones by large businesses and, in fact, allows them the same benefits as smaller businesses. The Subcommittee hopes that participation by larger firms will continue to have a place in the final version of enterprise zone legislation after the legislative process has concluded.

The Subcommittee is also concerned, however, that there not be an over concentration of larger businesses in enterprise zones. To this end, the Subcommittee recommends that a mechanism be devised and placed in the legislation to allow for the election of some large businesses for participation in enterprise zones. A key component and objective of this system should be to discourage large businesses from moving plants to enterprise zones from other areas thus adversely affecting those areas left behind. Only those large businesses wishing to open new plants should be encouraged to participate in enterprise zones.

Schematic framework

Turning to the general scheme of enterprise zones, the Committee has some concerns. Regarding eligibility for employment within zones, the Subcommittee is concerned that an enterprise zone be sufficiently flexible to allow for the employment of chronically unemployed people residing within the entire contiguous metropolitan area and not from within the zone alone. If the objective of enterprise zones is to put the chronically unemployed to work, it makes little sense to exclude large segments of unemployed people from employment within enterprise zones. The Subcommittee hopes that the provision of the new legislation allowing for eligibility of all CETA-eligible people in a municipality will be maintained.

The Subcommittee sees no reason to target residential areas for enterprise zones designation alone. The major criteria in selecting an area for enterprise zone designation should be that area's economic development and job creation potential. To this end, declining industrial areas and areas containing large tracts of clear land may be much more promising than residential areas. Indeed, Baltimore City officials have non-residential areas under study which they believe would hold out great potential as enterprise zones. As noted earlier, the United Kingdom concept targets declining industrial areas such as Clydebank.

Business development concerns

The Subcommittee does not feel that the tax reductions will do much to solve the problems of small business development and thus relieve chronic urban unemployment. This belief is based both on the Committee's own collective experience and the very clearly expressed views of small businesses who addressed the Subcommittee. Small business representatives were not overly impressed with capital gains or income tax relief because they make little or no taxable income. What most concerned the small business interests was cheap or free seed capital, subsidies for cheap labor, cheap property, service amenities and facilities, and relief from burdensome federal, state and local government paperwork, such as licenses, permits, reports, etc.

The tax subsidies offered by enterprise zones may not be without impact. Some business earning a taxable profit, mostly larger businesses, could be influenced when making location decisions by, among other factors, the existence of tax subsidies in enterprise zones. As stated earlier, we believe the activity of these larger businesses in enterprise zones would be helpful. In addition, those smaller businesses that do earn a taxable profit may find tax subsidies attractive. Still, if the objective of enterprise zones is to encourage small business developments, tax subsidies alone are ineffective.

Virtually everyone who appeared before the Subcommittee and the Subcommittee members themselves, perceived the lack of a provision for start-up capital to be the major omission in the enterprise zones concept and legislation. There are a variety of forms of government financing available including Small Business Administration (SBA), Urban Development Action Grants (UDAG), Economic Development Grants (EDA), as well as traditional creditor institution financing and venture capital. Almost none of these methods provide sufficient funds, particularly start-ups, at what small businesses regard as a fair rate while also avoiding unduly burdensome forms and applications.

The small business entrepreneur resents having to give up a share, often a large share, of his business for financing, although this seems to be an accepted mode for venture capital in large business enterprises. This is the origin for the fairly time-honored complaints of the small business entrepreneur that he cannot obtain cheap capital.

The policy issue to be resolved at the various levels of government is whether the public should remedy this omission of economic packaging through the subsidy of "seed money" (meaning low cost or free capital financing as opposed to "venture capital" invested for profit). This could be done through government financing or through privately subsidized funds on a non-profit basis as some communities have done or are doing. If done promiscuously, free or cheap business capital tends to be abused bureaucratically and politically, with unfortunate consequences. The Subcommittee feels that, if done with restraint and prudence, the case for positive government subsidized seed money for business start-ups seems as supportable as the traditional range of general and specific subsidies.

Another feature which the Subcommittee believes should be included in enterprise zones, and which most who appeared before the Subcommittee believe to be very important, is a provision by the Federal Government for the amenities and facilities (in the modern vernacular "infrastructure") needed to develop and support an area. These include roads, sewers, bridges, plant sites, etc. The Subcommittee believes that such provisions are a necessity because the depressed urban areas which will be targeted for enterprise zones will be largely lacking in the infrastructural assets required for successful economic development.

Here in Baltimore operating urban programs such as UDAG and EDA have been utilized effectively to bring about necessary improvements to the infrastructure of underdeveloped areas. Like almost any group of American business people, the Subcommittee believes the time has come for some Federal financial restraint, but it also believes that provision should continue to be made for infrastructural improvements. The Subcommittee feels that these Federal programs, or Federal provisons similar to them, are an essential ingredient of enterprise zones.

Also viewed as vital are general supporting services such as police and fire protection. The Subcommittee believes a commitment to such services is necessasry because inherent in the enterprise zones concept is a requirement that businessmen choose to locate in high-risk areas. Without a strong commitment to these support services, the incentives for doing business in enterprise zones will be overshadowed by the risks of doing business in an enterprise zone.

Support services for employees are essential to assist the chronically unemployed in adjusting to a working atmosphere and working conditions. These services include psychiatric counseling, job counseling, skill and job training, alcohol and drug therapy, and day care centers. Without a commitment to these types of services within the zone, the Subcommittee believes that businesses could, in employing large numbers of the chronically unemployed, experience difficulties such as high rates of absenteeism and job turn-over.

The Subcommittee believes that an essential provision of any new enterprise zones legislation is a requirement for municipalities to provide the above described types of support services to businesses (fire and police) and to employees (day care and counseling). Such a required commitment is part of the recently proposed legislation. The Subcommittee hopes the above described support services will be encouraged or required as components of municipal commitment packages.

Small business representatives voiced a need for the provision of ancillary business services which they cannot otherwise easily or at least cheaply obtain. These ancillary business services include accounting assistance, management counseling, legal advice, labor relations advice, etc.

In the case of business services, the Subcommittee feels that the options are not limited to government subsidies. The private sector seems better qualified by experience and resources to fill the business services needs of small business. This could be accomplished in many ways, among them requiring or encouraging larger businesses locating in zones to assist a given number of their small business neighbors. As we have outlined earlier, the City Venture Corporation, with a significant infusion of Federal funds, is undertaking a similar initiative in the Park Heights area of Baltimore City.

Enterprise zones as a new "urban policy"

Very little in the way of social and business experimentation is ever completely new and so it is with enterprise zones. Many governments have been aiding in the economic development of specific areas through a variety of subsidies and supports such as tax abatements, tax holidays, cheap or interest-free loans, low cost use of land, and the provision of free or cheap ancillary services. In this context, enterprise zones represent a new, or another, attempt to provide publicly subsidized financial incentives to improve the economic lot of specific urban areas where business has not flourished and where unemployment is widespread.

While some have announced, and some have misperceived, that the enterprise zone concept represents a radically new and complete urban policy to replace all other devices, this certainly is not the case. Even the academic creators of enterprise zones caution that it should be viewed as an experiment, tested as an experiment, and not viewed as a panacea or a complete urban policy. The Subcommittee agrees with this analysis and urges that enterprise zones not be considered in vacuo and to the exclusion of the many other worthwhile and perhaps more flexible instruments used in the past such as UDAG, EDA, venture capital, etc.

CONCLUSION

With these cautions, and with the hope that the enterprise zones concept and legislation can be refined and improved, the Enterprise Zone Subcommittee believes that the enactment of enterprise zone legislation may be of some help to the difficult process of making the urban centers of our nation more effective economically in terms of new business and new jobs.

It appears to the Subcommittee that while existing urban programs have positively aided in urban revitalization, they have not made significantly satisfactory inroads in widespread unemployment or economic development. Once again, it is urged that the adoption of the enterprise zone concept be tempered by the relization of its possible limitations.

We believe the Legislation's final form should be simple in terms of comprehension so that the incentives may be clearly understood and evaluated. The enterprise zone law should not be so loaded with benefits and reporting requirements that it becomes a Christmas tree, meaning all things to all people, rather than a simple experiment. We also urge that enterprise zone law and administration not be saddled with onerous or burdensome bureaucracy and paperwork that has bedevilled so many other programs. If entrepreneurs are to be encourgaged to take a chance on enterprise zones, so should the government. Flexibility should not be sacrificed to some mythical accounting of public dollars. The Subcommittee recognizes that provisions in the new Urban Jobs and Enterprise Zones Act that would encourage administrative streamlining and ease the regulation burden on businesses. The Subcommittee hopes these provisions will be maintained and strengthened.

The Subcommittee feels the establishment of ten to twenty-five zones per year for three years extends the enterprise zone concept beyond the realm of experimentation into the inventory of proven, operational public policy. The Subcommittee suggests that the refined enterprise zone be established in a limited number of sites not to exceed ten. This limited scale is sufficient to allow due attention to be given to regional differences and allow for careful consideration of the advantages and disadvantages of the concept on an experimental scale. The establishment of only a moderate number of enterprise zones will also ensure that adequate resources will be allocated to zone designated areas. The establishment of enterprise zones on the scale proposed by the new legislation threatens to dilute the resources available to zones and cripple their potential for success.

The Subcommittee is quite familiar with what Baltimore has done in terms of economic development and what remains to be done to cope with its problems of unemployment and underdevelopment. The Subcommittee is also familar with the City's pioneering in what is in effect an enterprise zone in its Park Heights development, and the City's desire to continue its tradition of aggressive experimentation by becoming an enterprise zone test city. The Enterprise Zone Subcommittee believes that Baltimore should, for these reasons, make an excellent site for the experiment and so recommends. With all of the tools for economic and social development and support in use in Baltimore, the enterprise zone may add still another dimension that may contribute, within the limits set by its proponents.

In sum, the findings and recommendations of the Subcommittee are as follows:

(1) Enterprise Zones should be viewed as an experiment and not more than ten zones should be designated until the concept has been proven effective. Newly proposed legislation would allow up to seventy-five zones to be established. This would thrust enterprise zones will beyond the realm of experimentation.

(2) The enterprise zone by itself does not represent a complete urban policy and will require the assistance of some existing urban programs.

(3) Enterprise zone legislation should not only encourage small business entrepreneurs, but larger business participation in enterprise zones should also be encouraged. A selection mechanism should be established to discourage larger businesses from moving their plants from other areas to enterprise zones. Only large firms opening new plants should be allowed to operate in zones.

(4) Enterprise zones should be sufficiently flexible to allow for the employment of chronically unemployed people residing within the entire metropolitan area and not from within the zone alone.

(5) Declining industrial areas, and not residential areas alone, should be targeted for enterprise zones designation as is the case in Great Britian.

(6) The tax incentive offered by enterprise zones will not do much to solve the problems of small business development and thus relieve urban unemployment.

(7) Start-up capital is a major omission in the enterprise zone concept and legislation. If done with restraint and prudence, the case for positive government subsidized capital for business start-ups seems as supportable as the traditional range of general and specific subsidies.

(8) Enterprise zones should include Federal provisions for infrastructural improvements.

(9) Adequate support services to businesses (police and fire protection) and employee services (day care and counseling) are required to make enterprise zones successful. These services should be required of municipalities in seeking enterprise zone designations. Cities such as Baltimore believe that they will not be able to provide the funding for these services without federal financial support.

(10) Needed business services (management counseling, legal advice, labor relations advice, etc.) could be supplied to small business enterprise by larger businesses wishing to take advantage of tax incentives provided in enterprise zones.

(11) The legislation's final form should be simple in terms of comprehension so the incentives may be clearly understood and evaluated.

Some of the above recommendations and reviews are incorporated in the new Urban Jobs and Enterprise Zone Act of 1981 and will hopefully appear in the bill's final form. Where these suggestions are not part of the new legislation, the Subcommittee urges the legislation be amended so they may be included.

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Prepared Statement of George W. Haigh, Chairman, Toledo Economic Planning Council

SUMMARY

Congress should enact an urban jobs and enterpise program without unnecessary delay. Urban redevelopment could be slowed by an inexplicable delay in Congress setting forth the policy and statutory framework for future urban redevelopment.

Toledo, Ohio has undertaken a successful effort to revitalize its most distressed inner-city neighborhood, Warren-Sherman, and that project could provide a model for demonstrating how a city's private, public and non-profit sectors can join forces to solve urban problems.

Warren-Sherman is a successful project because of a unique combination of factors, including:

The comprehensive nature of the project approach, addressing jobs creation and job training, enterprise development, redevelopment of commercial services, health care, day care, recreation and other social support services;

A triad of interests, that is the private sector, the public sector, and a non-profit developer, resulting in over $30 million of private investment and an estimated 1,500 jobs within 5 years;

The way in which residents of the neighborhood have participated in the project, including the establishment of project goals, planning of project elements, and an actual taking part in its many components.

The Federal role is crucial. Tax incentives, economic development block grant programs, and targeted job training will provide important assistance in creating environments for the attraction of private investment to inner-city neighborhoods.

The proposed Urban Jobs and Enterprises Zone Act will be a key component in maximizing the benefits from such projects. The response will be rapid and significant.

STATEMENT

Mr. Chairman and Members of the Committee, I am George W. Haigh, chairman of the Toledo Economic Planning Council. I appear before the Subcommittee in support of S. 1310, the proposed Urban Jobs and Enterprise Zone Act, and the Warren-Sherman urban redevelopment project in Toledo, Ohio, a project consistent with the intent and qualifications set forth in S. 1310. I appear in this matter on behalf of the Toledo Economic Planning Council (TEPC); the city of Toledo, which has given strongest support to the project; the community and neighborhood within which it is located and offering hope to those persons living there; the corporations which have located in the area and created additional jobs by doing so; and the Toledo Trust Company, the principal financial supporter of the project, of which I am also president and chief executive officer.

The Subcommittee is to be commended for beginning prompt Congressional hearings on an idea which should become a reality at the earliest possible date. Much is already known about the urban enterprise concept. Competing proposals have been examined in the adversarial context of conferences and academic studies. The Administration, as Congress, has more than one concept under consideration. There have been several projects, like Warren-Sherman, which have yielded evidence on what works. Urban redevelopment could be slowed by any inexplicable delay in Congress setting forth the policy and statutory framework for future urban development.

The Warren-Sherman project, Toledo's successful effort to revitalize its most distressed inner-city neighborhood, provides an excellent model for demonstrating how a city's private and public sectors can join forces to solve urban problems. This project has as its goal the restoration of economic and social stability to a neighborhood that is characterized by high unemployment, poverty and welfare dependency, blighted housing and other indicators of urban decay. Today, Warren-Sherman is well on its way to becoming an attractive and viable neighborhood because of a unique combination of factors.

Comprehensive redevelopment

Perhaps the most important of these factors is the comprehensive nature of the project approach. Previous experience throughout the country clearly demonstrated the futility of one-dimensional attempts to deal with urban development problems. It was recognized at the inception of the project that the ability to effectively coordinate economic, social and physical improvements was a prime requisite of success. Consequently, the project has been oriented toward viable solutions to a wide range of problems, and addresses job creation and job training, enterprise development, redevelopment of commercial services, health care, day care, recreation, and other social support services. Job creation was of immediate concern, since little impact would be expected from other efforts without employment opportunities for the neighborhood residents. Jobs would have to be closely matched with the abilities of the residents, and job training programs were developed for those without skills. Support for the development of small businesses was designed into the project. It was obvious that significant improvement of the housing stock would be a major need, and the project includes development of substantial new market-rate housing, as well as new subsidized housing and extensive rehabilitation. The neighborhood has no local convenience of commercial services, and this is being remedied by development of a neighborhood shopping center and a commercial development. Health care, day care, and other social services are also being dramatically improved. Essentially, the Warren-Sherman project addresses the need to deal with all of the major problems facing the neighborhood. For example, jobs without improved housing, commercial redevelopment, and social services would lead to further abandonment and blight even if it were intitally possible to attract jobs into the neighborhood without these improvements. On the other hand, improvements in social and physical characteristics of the neighborhood without providing mainstream economic participation for the residents is unlikely to lead to a viable neighborhood. While the coordination of this effort is difficult, any approach less comprehensive in scope would not be successful.

Triad of interests

A second major factor contributing to the success of the project is the unique triad of interests which are working together to bring the plans to fruition. These are the private sector, the public sector and a non-profit developer. The private sector involvement is led to Toledo Trust, the City's largest financial institution, which has been instrumental in obtaining private sector support, investment, and job commitments, and arranging financing for various project components. The bank's willingness to take a lead role and its excellent contacts throughout the business community have been extremely important. Also participating from the private sector are several Toledo corporations which have made commitments to establish light manufacturing facilities in the neighborhood and provide jobs for neighborhood residents. These include Owens-Illinois, Libbey-Owens-Ford, and Sheller-Globe Corporation. Their commitments, along with others now being actively pursued, will provide the employment base for a redeveloped community. Finally, an important private sector actor has been City Venture Corporation, a for-profit marketer of private sector expertise in urban development. One of City Venture's major stockholders, Control Data Corporation is making a substantial neighborhood investment in developing a Business and Technology Center, a small business incubator, and is also under contract to provide unique job training to neighborhood residents. The public sector is represented by the City of Toledo and its Department of Community Development, who have taken responsibility for all public improvements including housing, land acquisition, and street and utility upgrading. The City's strong support for this project, led by the Mayor and the Community Development Director, has ensured that available public sector resources have been directed to the project. The state of Ohio is becoming actively involved in the project and is expected to provide support for several project components. Governor Rhodes recently expressed his strong endorsement of the Warren-Sherman project and its conceptual approach to urban development in letter to President Reagan, and Congressman Weber from Toledo's 9th District, and has taken an active interest in furthering the project. The third partner in the triad is the Toledo Economic Planning Council, a non-profit development corporation, which has served as overall project sponsor and is acting as developer of the 23 acre Warren-Sherman Industrial Park. This organization has served as an important project facilitator by providing a bridge between the public and private sectors who are jointly represented on its Board of Directors. The cooperation of all these participants has been one of the key ingredients to the project's success which has resulted in over $30 million of private investment and an estimated 1,500 jobs within 5 years.

Neighborhood involvement

The third major factor is the unique way in which residents of the neighborhood have participated in the project. One of the primary concerns in planning the project was to ensure that the benefits accrued to current residents. It was important not to create a situation in which residents would not be able to obtain the new jobs or afford the new housing in the neighborhood. Consequently, neighborhood residents, under the leadership of a strong neighborhood organization, have been extensively involved in the project since its inception. In a continuing series of neighborhood meetings, residents have participated in establishing project goals, planning the project elements, and are taking part in implementing the various components. Early and continuing participation by the residents has not only ensured their acceptance and support but has improved project concept through utilization of their suggestions and desires.

The role of the Federal Government

The combination of the above three major factors provides perhaps the best available model for redeveloping inner-city neighborhoods. The Warren-Sherman approach should be duplicated and, in fact, is being used in two other Toledo neighborhoods at present. Every major city in the United States has at least one neighborhood similar to Warren-Sherman and the elements necessary to follow the Warren-Sherman approach. Cities, by providing leadership, commitment, local planning, and vision, can establish most of the basic conditions necessary to redevelop their innercity neighborhoods. However, many cities do not have the resources to undertake basic public improvements.

Therefore, the Federal role is crucial. Tax incentives, economic development block grant programs, and targeted job training will provide important assistance in creating possible environments for the attraction of private investment to innercity neighborhoods. In order to ensure the success to these programs, it is suggested that they would function most effectively if the key components of the Warren-Sherman approach were present. A comprehensive redevelopment effort will ensure maximum impact from each project element; strong partnership between the public and private sector will maximize response to development opportunities; and effective participation by neighborhood residents will assist in creating project concepts that are feasible and accepted.

The proposed Urban Jobs and Enterprise Zone Act will be a key component in maximizing the benefits from the Warren-Sherman project. The tax incentives contained in the Act will ensure a rapid and significant response by Toledo's business community to the opportunities now existing in Warren-Sherman. As successful as the project has been to date, incentives such as those contained in the Enterprise Zone Concept are still necessary to overcome initial resistance and provide a sound future basis for healthy private sector growth. Warren-Sherman, because of the preparatory work now nearing completion, will, in fact, provide a very useful model to demonstrate the positive impacts of tax incentives on urban development.

Using the Warren-Sherman model, other cities and states could program proposed economic development block grant funds to provide public improvements, organize effective partnerships, and utilize the tax incentives contained in the Urban Jobs and Enterprise Zone Act to attract private investment to inner-city neighborhoods.

While my comments have been necessarily brief, I am appending a more completed description of the project for your examination. Please feel free to call on Toledo if there is any way in which we can be of assistance.

Thank you.

STATE OF OHIO, OFFICE OF THE GOVERNOR,
Columbus, Ohio, July 2, 1981.

Hon. RONALD W. REAGAN,
President of the United States,
The White House, Washington, D.C.

DEAR MR. PRESIDENT: You have made the economic recovery of the Nation your highest immediate domestic priority, and the people of Ohio support your effort. It is most encouraging that the recovery plan includes a clear-cut plan to return the residents of inner cities to the mainstream of America's economy. I refer, of course, specifically to your intention to create jobs for urban area residents through the establishment of enterprise zones.

Consistent with your philosophy of government, Ohio's private sector has never abandoned its commitment to create jobs. The private and public sectors in Ohio have worked closely together to foster the climate required for creating jobs for its citizens. Partnership with the private sector is a must to insure success for a governmental venture aimed at improving the economic status of a specific group of residents. I want to mention to you an example of cooperation that shows what can be accomplished in urban redevelopment.

This is the story of Toledo's Warren-Sherman neighborhood, a 100-year old section that is home for 3,500 people. Until recently, this neighborhood was a mirror image of decaying areas found in cities throughout America.

Warren-Sherman is an area of 300 acres, adjacent to Toledo's downtown. Of its 3,500 residents, 90 percent are black and 40 percent earn less than $5,000 a year. The jobless rate in this area surpassed 30 percent, with job opportunities very limited. Forty percent of the residents had not finished high school and crime was rampant. In short, there was little hope that conditions would improve, and there was less hope that anyone outside the area really cared.

Some people, however, did care. A few at first, and then many joined after a well-defined, workable program to help Warren-Sherman emerged. Through the leadership of Toledo Trust, a Toledo Trustcorp bank, support of the private and public sectors at all levels was harnessed. The basic concept was simple: banks are members of their communities; they are not institutions set apart. They have a very real stake in everything that happens in their cities and neighborhoods. So, too, do the businesses which, in the absence of a healthy economic environment, consider locating elsewhere.

The Toledo Economic Planning Council was formed to focus the community's commitment, and the private sector stepped forward with its contribution. Today, Owens-Illinois Inc., Libbey-Owens-Ford and Cotrol Data Corp., have agreed to build facilities in the Warren-Sherman area, creating new jobs where they are needed the most. Toledo Trust has invested $5 million in loans and investments in the neighborhood.

Warren-Sherman is a story that the Nation should hear. It wasn't easy, but the results are worth the hard work. Warren-Sherman exemplifies what can be accomplished in America's urban areas; helping the most disadvantaged help themselves to become productive members of society. Warren-Sherman need not be an isolated success story. Its experience can be the model for other cities, showing that urban enterprise zones are the building blocks needed to restore economic health.

Warren-Sherman can play an important role in proving that the enterprise zone is not only a concept, but is a reality. Warren-Sherman can be the showcase to which you can point in urging Congress to enact enabling legislation. Warren-Sherman can also be the one zone that has sufficiently progressed so it can be a reference point to other cities that decide to use this approach to fight economic blight.

I therefore not only support the urban enterprise zones proposal now being finalized by your office, but urge the inclusion of the Warren-Sherman project among the zones selected by your administration. Warren-Sherman can be the ongoing model upon which others can look for help and guidance.

Sincerely,

JAMES A. RHODES, *Governor.*

WARREN-SHERMAN, TOLEDO—CHALLENGE OF THE 1980'S FOR BANKERS

The basic idea is simple—banks are members of their communities; they are not institutions set apart.

Banks have a very real stake in all that happens in their cities and neighborhoods. When bankers see themselves in a partnership with the public sector, the neighborhoods, and most importantly, the people, they open up avenues for positive change. Positive changes for their communities which, in actuality, would many times be impossible without the banker's influence and leadership position.

Cities, and the neighborhoods which form them, are constantly changing and evolving; and banks with their wide community involvement, their financial base, their leadership potential can affect this evolutionary process in ways no other group or institution can touch.

Banks are in a position of almost natural community leadership. To not seize this role is to lose sight of the communities, the neighborhoods, the people from whom you draw your strength.

THE STEP FORWARD

The acceptance by Toledo Trust of its exciting and vital role in Toledo's future, specifically the Warren-Sherman neighborhood, began when Toledo Trust decided to construct its new $10-15 million headquarters building in the downtown.

Toledo Trust believes that if the heart of a city dies, the city as a whole will die. And Toledo Trust also believes that as the city declines, everything—the entire community—will slowly fall. The tax base will decrease fostering more deterioration. Corporations will decide to move elsewhere as the city beomes more and more unattractive. The banks will find their business declining as the local economy declines.

And Toledo Trust's belief in a vital downtown is backed by even more than its commitment to build a new headquarters building downtown. Toledo Trust has committed millions to other projects to keep Toledo strong.

Toledo Trust will build several new mini walk-up/drive-up branch facilities in various neighborhoods throughout Toledo.

At Toledo Trust's Rivereast branch an innovative $100,000 remote television drive-up facility was built. This has added to revitalization efforts on the East side of Toledo and better serves the banking needs of this neighborhood.

Toledo Trust made a $6 million loan to AMC-JEEP; this loan allowed increased production to continue, preserved 5,000 jobs, and will make possible 2,000 more jobs.

Toledo Trust has committed $5,700,000 for loans for various neighborhood redevelopment projects—

Warren-Sherman Housing Loan Program	$1,000,000
Warren-Sherman Inner City Commercial Economic Revitalization Program (Small Business Assistance)	1,000,000
Storefront Loan Program (UDAG)	1,000,000
Warren-Sherman Shopping Center Construction Loan Commitment	1,000,000
Warren-Sherman Shopping Center Long-term Financing	500,000
Minority Construction Loan Program (Minority Business Enterprise)	1,000,000
Home Rehabilitation Revolving Loan Fund Program	200,000

A $5 million UMTA grant was awarded Toledo to build a pedestrian connector system in the downtown because of the commitment of Toledo Trust to build its $15 million headquarters and an additional $200,000 commitment by the bank to the connector system.

Toledo Trust entered into a downtown revitalization program which included—

$100 million world headquarters for Owens-Illinois;

$60 million government office tower;

$4 million renovation of an historic block called Fort Industry Square into new offices, shops, and a fine old restaurant;

Improvements in downtown area—new streets, boulevards, parks on the riverfront and elsewhere;

Renovations on two old buildings downtown totaling $9 million.

All these projects are happening in the Central Business District. With these commitments, the revitalization of the downtown is on its way. During the next several years, more than $400 million will be invested in the downtown.

But for Toledo Trust the questions nagged.

How will the downtown efforts survive in the long-term?

How can a central core remain vital when it's surrounded by decay?

How can a quality life be secured and maintained in all of Toledo's neighborhoods for all Toledoans?

Toledo Trust saw the downtown as its neighborhood and realized that its neighborhood is surrounded by blight and decay. As in many cities, the old neighborhoods ringing the downtown are in various stages of deterioration.

It became self-evident to the bank that its contribution to the downtown must be expanded into the neighborhoods.

Toledo Trust saw that if the neighborhoods are not made whole again, the $400 million spent in the downtown will have been spent in vain.

With the acceptance of this realization, Toledo Trust began to have a sense of urgency about Toledo's decaying neighborhoods.

It's coincidental that at this point, the Toledo Economic Planning Council was formed with the strong leadership support of Toledo Trust. the TEPC is a private-public body established to lead the economic development planning and implementation in the City of Toledo. The Mayor of Toledo appointed the President of Toledo Trust to serve on the Council and George Haigh was elected chairman of the TEPC.

The Planning Council is currently made up of nineteen members from business, city and county government, the University of Toledo, labor organizations, development groups, and citizens. More than 100 committed people work on TEPC subcommittees.

It's important to note that the strength of the TEPC is that it serves as a bridge between the private and public sectors and it is also a forum where the two sectors can meet. Without this linkage neither sector would move forward efficiently.

The task was clearly known—the private and public sectors stepped forward saying we have a need to stabilize. They joined in a partnership for change.

THE WORK BEGINS

The leadership was firmly established and the TEPC with George Haigh as Chairman began to work. One of the goals is to make Toledo a city of strong neighborhoods. A city where people want to live and work. A city in which Toledo businesses will want to locate and to stay—where businesses and people will flourish.

Neighborhood revitalization has been tried before and it has failed. It failed because the attempts were only piecemeal—they were never part of a comprehensive redevelopment effort which could be applied wherever neighborhoods were in need of help.

The chairman of the TEPC wrote a letter of invitation and proposal to William Norris, Chairman of Control Data Corporation. The letter invited Control Data's City Venture to come to Toledo. City Venture is a private business and, as its name foretells, it embarked, more than a decade ago, upon a challenging experiment in one of Minneapolis' most decayed and blighted neighborhoods. Its efforts worked.

City Venture's basic premise is that jobs and economic revitalization are the keys which can unlock the complex puzzle of neighborhood, and therefore people, decline. City Venture successfully played out its role of catalyst and coordinator of private and public resources to rebuild an area in Minneapolis which had been given up for lost. George Haigh believed in the City Venture philosophy and the TEPC asked City Venture to participate in the development of Warren-Sherman—an old decaying area of Toledo which is believed to be rich in potential for rebuilding into a thriving community of business, industry and homes. City Venture accepted the challenge.

Again because of the private sector's involvement with the public through the TEPC, the process went faster than normal. The paperwork needed in order to apply for an Urban Development Action Grant was prepared in record time.

The UDAG application asked for $8.7 million for the Warren-Sherman project. $4.5 million of the federal grant has come through for Toledo—the remainder will be forthcoming.

Even before this success was known, however, work began within the neighborhood. Warren-Sherman will be unlike projects attempted in the late sixties—money alone will not be viewed as the panacea for all the neighborhood's problems. Warren-Sherman will be redeveloped with the strong participation from the people in the community.

The views of the people who live and work in Warren-Sherman are most important in this effort. As a consequence, local community organizations undertook the task of gathering information. What did the people see as their health needs, shopping, recreation, employment, and housing needs? Developers in Warren-Sherman must know what the people think and offer them assistance and help. A partnership must be formed in order to rebuild.

Obviously there was resistance and general suspicion when these statements of concern and offers of help were first made in the churches of Warren-Sherman. It seems understandable that these statements from the larger community to a small minority community were not trusted. But the statements offering help persisted, were finally heard, and then accepted.

The people of Warren-Sherman found that the people interested in rebuilding their neighborhood wanted for them what they wanted for themselves—jobs, decent housing, their community filled with business, recreation, and people full of life.

As the relationship between the residents of Warren-Sherman and the larger community was established, the data was gathered, the goals were set.

WARREN SHERMAN

The Warren-Sherman neighborhood is 100 years old. It is an area of 300 acres adjacent to Toledo's downtown.

About 3,500 people live here. 10 years ago the population was 6,500. 90 percent of the resident are black. Pre-school children make up 15 percent of the people who live here.

The average household is more than three persons; and 25 percent have a single parent as the head. 75 percent of the households have lived in Warren-Sherman more than three years.

Unemployment is very high at 32 percent.

Incomes are low—40 percent less than $5,000 a year. Nearly two-thirds of the incomes are under $10,000.

There are 79 businesses in Warren-Sherman—the average employs 17 people. St. Vincent Hospital, which is located in the neighborhood, is not included in this average. The hospital is located on the north edge of Warren-Sherman; it owns 27 acres and employs 2,500 people.

40 percent of the Warren-Sherman residents have not finished high school; but 15 percent have had some college or vocational schooling.

Crime is perceived to be a major problem of the area. Arson is visibly apparent.

Most residential buildings were built before World War I. But in the last 10 years five subsidized housing projects have been built. These nearly 600 units comprise 40 percent of the total housing available in Warren-Sherman.

Much of the older housing is dilapidated or completely unusable as it is. Most all the old houses need to be made more energy efficient.

Less than half the residents own cars, but the car is the major form of transportation—sharing rides with families and friends is common. Second to the "shared ride", walking is the way people get around. Busses are readily accessible.

More than half the residents purchase groceries within the neighborhood—little comparison shopping is done.

50 of the 300 acres of land in Warren-Sherman are vacant. 40 acres are used by industry or for commerical purposes and an equal amount is used by institutions. Only 2 percent or 4 acres is used for parks or open space and 78 acres are used for all types of residential buildings.

Problems:	*Goals:*
Unemployment—32 percent	1,000 additional jobs in 3 years. Training and education for hundreds.
Only 12 percent of the current jobs in Warren-Sherman are held by residents of the area.	Increase the 12 to 24 percent in 3 years. Develop a 23-acre industrial park. New shopping center should bring new employment.
64 percent of the households have incomes under $10,000.	Coordinate public and private efforts in job training and creation of jobs. Create 100 part-time jobs.
Lack of assistance for small businesses	Establish the Business and Technology Center. Encourage and assist minority businesses.
Inadequate shopping	Develop a 50,000 square foot shopping center.
Inadequate Day-Care and other services for pre-schoolers.	Create more Day-Care facilities and health clinics for babies. Develop tot lots in residential areas.
Less than half the buildings in Warren-Sherman are in sound condition.	Rehab 100 housing units in 3 years. Increase the number of owner-occupied housing units from 24 percent to 40 percent.
Inadequate insulation in homes—high utility bills.	Create 100 resource efficient owner-occupied housing units.
Less than 2 percent of the land is park land.	Develop parks and other land for recreational use.

The problems are immense; the goals substantial but not unreachable. City Venture gives the rebuilding of Warren-Sherman the continual, day-to-day thrust foward which is needed; but the total project will only be accomplished because of the partnership and commitment between the public and private sectors. The dollar commitment alone is almost $39 million—$29,800,000 from the private sector and up to $8.7 million from the public sector in the form of an Urban Development Action Grant.

EMPLOYMENT

The job training and education needs will be met in a variety of ways. City Venture will work closely with the Toledo Area CETA Consortium. It will utilize the Control Data Corporation's Fair Break program developed in Minneapolis.

Fair Break has a $400,000 contract with CETA for training services. During the year the 160 students will work part-time in jobs in local industry which are found by City Venture. They will spend 4 hours on the job and 4 hours in a computer based learning center. Fair Break and CETA have committed to place these trainees in jobs or to give them more training when the classes end.

Other job training programs will include the establishment of a Community Learning Center. The Center will utilize Control Data's Computer-Based Education system called Plato. Training for neighborhood residents in the construction trades will be sought through the unions; contractors working in Warren-Sherman will be encouraged to commit to hiring residents as apprentices; and, a property management and maintenance company will be established by City Venture to train and employ residents.

A job bank will be created. And the Ohio Bureau of Employment Services which already is located within Warren-Sherman will work with the city's affirmative action program and City Venture to develop a program specifically for Warren-Sherman residents.

A business will be formed in Warren-Sherman specifically to employ workers part-time. People will work part-time shifts according to their needs. Many residents may find full-time employment impossible because of family responsibilities but these same people are valuable part-time employees.

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Child care, transportation, employee counseling, and other programs are also components in the plans to provide employment opportunities for the citizens of Warren-Sherman.

BUSINESS AND INDUSTRIAL DEVELOPMENT

Again the private and public sectors work hand in hand. The goal is to create a minimum of 200 new industrial jobs within a year.

The TEPC has the contractural responsibility for attracting industry into Warren-Sherman. The TEPC has gained commitments from several companies—Libbey-Owens-Ford, Owens-Illinois, Sheller-Globe, Toledo Testing, and others—to locate new facilities in the 23 acre industrial park.

The TEPC will develop the land and build the shell structures for the industrial tenants. This will be financed through a combination of EDA funds, industrial development revenue bonds, and conventional financing. These investments total $7 to $10 million.

City Venture's main work in this area will be with small businesses. Control Data will establish a Business and Technology Center in a large old factory building in Warren-Sherman. The Business and Technology Center is itself a business and will offer an environment for entrepreneurs providing them joint services such as an answering service and financial advice as well as rental space. The Business and Technology Center incorporates in one building employment, education, and support services.

The TEPC and City Venture will explore all sources of low interest loans for use by business or industry wishing to locate in Warren-Sherman.

$3 million will be spent to help small businesses and other businesses expand and grow in Warren-Sherman. Toledo Trust has committed $1 million for loans to help businesses and commercial ventures in the neighborhood.

A $3 million, 50,000 square foot shopping center is proposed for the center of the neighborhood. 4½ acres have been cleared for this purpose by the City's Community Development Department. The shopping center is to have a range of services anchored by a supermarket and drug store. Minority business ownership will be encouraged. Toledo Trust has committed $1,000,000 to the shopping center project. The center should also increase employment opportunities for residents.

HOUSING

For many Warren-Sherman residents, high interest rates make home ownership impossible. UDAG funds will be used to subsidize mortgages and make ownership more affordable. Other sources of low interest loans will also be available. Toledo Trust has committed $1,000,000 for loans for mortgages and rehabilitation.

City Venture will find developers to construct a cooperative of 100 units of low to moderate cost housing. The exact form of the cooperative will be decided by the Warren-Sherman Community Council, City Venture, and the developer.

City Venture will also encourage and facilitate various subsidized housing possibilities and other types of housing available at lower costs.

Energy saving information will be provided to homeowners by City Venture, but the emphasis on saving energy will go far beyond just providing information.

One energy saving project—the rehabilitation of a six unit apartment building—is already underway. In addition to insulation, double glazing and other passive measures, the building will have an active solar system for both hot water and for space heating.

An earth sheltered house is being considered for one southward sloping piece of vacant land.

Ways to encourage better maintenance and management of homes and rental properties will be undertaken. Code enforcement and education of residents will be done. A tool lending library will be established to make rehabilitation and repair work possible by area residents.

Federal housing programs such as the Neighborhood Housing Services and Section 8 programs will be utilized where possible in Warren-Sherman.

Altogether $5,000,000 will be spent to build new housing or rehabilitate older housing in Warren-Sherman.

URBAN DESIGN

All the planned components—housing, job, needs, economic development are coordinated into a design for living.

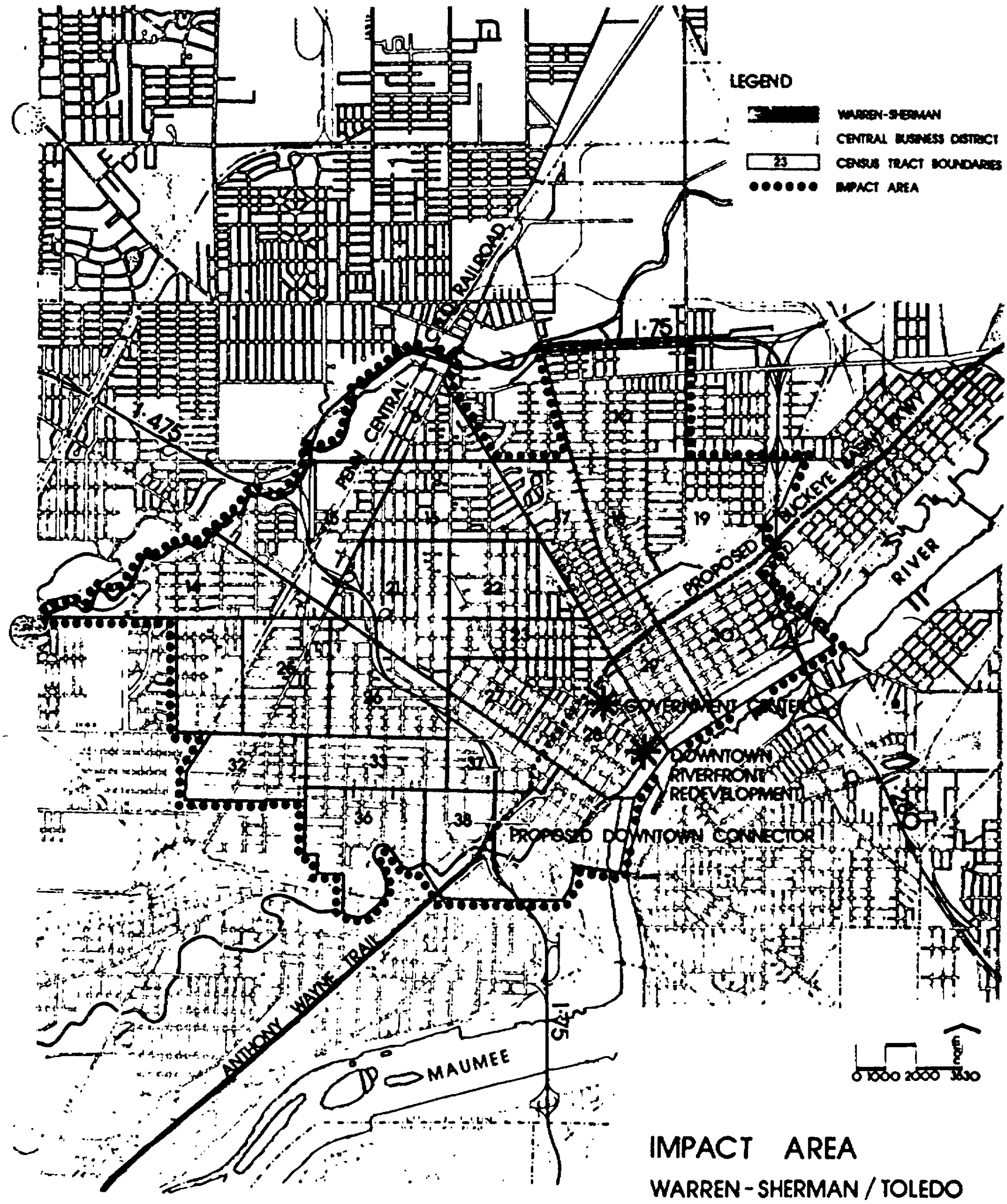
Warren-Sherman is filled with trees, brick streets, attractive street lamps and stone curbs. One portion is located on a ridge line which, because most of Toledo is flat, gives Warren-Sherman views outside the neighborhood into Toledo's downtown.

Many of its streets are canopied with trees and the old style wood frame homes give the neighborhood a restful setting. Warren-Sherman's 140 year history gives it a variety of architectural styles from various social groups. The Maumee Valley Historicial Society is identifying significant buildings in the area which will be restored and saved if possible.

The industrial park will be built where industry now exists, parks will be developed in natural congregating places, retail shopping will be designed for people—everything possible will be done to maximize the potential of Warren-Sherman and to ensure that it is a vital, alive neighborhood.

What you have just read is the story of Warren-Sherman—the story of successful renewal. A story which would not have happened without the involvement of Toledo Trust. It would not have happened if Toledo Trust had not broken tradition and stepped forward.

Every city has its decaying neighborhoods and every city has its potential leaders, but only Toledo has Warren-Sherman.



IMPACT AREA
WARREN-SHERMAN / TOLEDO
CITY VENTURE corporation

FIGURE 10-1

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENATIVES,
Washington, D.C., July 10, 1981.

THE PRESIDENT,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: I wholeheartedly support the concept of urban enterprise zones as a means of urban neighborhood revitalization.

The Warren-Sherman Project in Toledo, Ohio is a shining example of successful application of the theories and principles of urban enterprise zones. Because Toledo's public and private sectors have worked together to make this project succeed, it stands as a model for cities wishing to undertake a similar program.

Until recently, Warren-Sherman was considered "a hopeless case." The population of this 300-acre area faced more than 30 percent unemployment, severely limited job opportunities, high crime rate, low-level formal education, and property deterioration due to arson and vandalism. Of the 3,500 residents, 90 percent were Black and 40 percent earned less than $5,000 per year. There seemed no way out.

The formation of the Toledo Economic Planning Council, consisting of private and public sector representatives, established the bridge that was needed in order to allow the entire community to work efficiently to solve the problem of Warren-Sherman. It hasn't been easy. The work has been arduous and the workers dedicated; as much has been learned through our mistakes as our successes.

The people living and working in Warren-Sherman were skeptical at first about the depth of community commitment to the revitalization of their neighborhood. But as work continues and there is steady progress in rebuilding and job development, relations between Warren-Sherman residents and the entire Toledo community continue to improve.

The Warren-Sherman Project would be an excellent model for other cities as they attempt similar programs. After urban enterprise zone legislation is enacted Warren-Sherman, if selected, would be several steps ahead of other selected sites and could provide valuable guidance and experience. I am proud of what has been accomplished in this once-blighted neighborhood.

Sincerely,

ED WEBER, *Member of Congress.*

Senator CHAFEE. Last panel: Mr. Roberts, Mr. Pryde, Mr. Frazier. This panel will be 30 minutes.

Gentlemen, why don't you each take 5 minutes by the clock and then we will have a chance to ask some questions.

A PANEL OF: JIM ROBERTS, CONSULTANT, FREE ZONE AUTHORITY SERVICES, ALEXANDRIA, VA.; PAUL PRYDE, JANUS ASSOCIATES, WASHINGTON, D.C.; MARK FRAZIER, SABRE FOUNDATION, WASHINGTON, D.C.

Mr. ROBERTS. Good morning.

I appreciate the opportunity to speak with you this morning and I would like to go on the record before I get too far into my remarks—I am in favor of enterprise zones.

I wanted to make a personal statement that I am in favor of enterprise zones. It is not a panacea. It is not an answer to a lot of things, but it is an exciting opportunity.

The reason I am here this morning though is that I want to speak from some experience that I recently acquired working with communities and helping them to set up enterprise zones. I think there is some valuable lessons that I have found in doing that work, and I wanted to share them with you this morning.

I have been a consultant with Free Zone Authority Services. We are in the business of helping communities set up enterprise zones.

We have worked in probably half a dozen communities. It is an interesting phenomenon to see how communities are, in fact, responding to this.

One of the, I want to catch up a lot of threads that have been mentioned this morning, one of the key findings or observations that we have found is that an enterprise zone may be independent of geography. I think the focus intially was on a geographical area. What I am finding now is there is, it is essential that there be the local commitment that is probably pretty vaguely worded, but probably deliberately so when you see what the communities, in fact, do with that idea.

It turns out that the management, the ownership, the structure of the political deal, and the economic deal that has to make that local commitment work is essential.

So it is something that I think was probably unforeseen in the drafting of the legislation. But, what I am finding is that the ability of business, of labor, of community organizations, of State officials, of city officials, to work together to put together the local commitment is probably, in my experience, unprecedented.

And, in fact, that type of cooperation I am beginning to observe in some of the communities that we have been working in.

Let me talk about some of the ideas, what people are doing with the enterprise zone idea in communities.

One lesson is that communities are so enthralled with the idea that they, many of them are saying that they would like to ignore the Federal incentives if they possibly could. They think it is a good idea, that it makes good sense.

Senator CHAFEE. I am not too clear what you are talking about when you are talking about enterprise zone. That is not as we define it here. Is it something that you have already done?

Mr. ROBERTS. No, sir. There is no enterprise zone in the United States. These are communities that are trying to keep up with, and get ahead of the Federal legislation, as well as track State and local initiatives. What they are now doing is preliminary planning, positioning themselves so that when the Federal legislation is complete, they will be in a good situation that day.

Senator CHAFEE. You mean for this legislation?

Mr. ROBERTS. Yes, Sir.

Senator CHAFEE. I see.

Mr. ROBERTS. The kinds of ideas that they are putting into an enterprise zone. The kind of thinking that goes, that they are currently looking at is, they are looking at a mixture of land uses so that there can be a combination of industrial, commercial, residential properties within an enterprise zone.

They are looking at a so-called, what I have called, a mixed economy approach. That is that they obviously would have to target on the worst of distressed by the high criteria.

But, in addition to that, they would like to draw their boundaries around some anchors so that they can begin to use the strengths of the areas that they are potentially designating as enterprise zones to feed, or to fuel, some of the job training, some of the day care, some of the other services that might be required to make the enterprise zone work.

Some of the types of incentives. Just to—it has been eye opening for me, and I will reveal some of these kinds of ideas that they are talking about.

One of the encouraging things is the whole putting together of an enterprise zone unleashes quite a few ideas.

Examples would be lease of surplus lands that are held by major corporations. Turn it over to zone sponsors who in turn lease it to new businesses over a long period of time.

There was a discussion in one community that I was in of conversion of public housing, donated by public officials, donating it over into a cooperative use.

Dedication of vacant schools to zone sponsors for potential use as housing for the elderly.

Provision of administrative support for the target jobs tax credit program. Apparently the neglected side of that is the incentive is popular, the administrative side of it is burdensome, local governments or zone sponsors are willing to take that on as part of a zone deal.

Use of value capture techniques from land development to help pay for fund activities so that it can be in some senses internally financed.

I have some suggestions or recommendations based on the experience that has been acquired in this number of communities that are in the bill, small number of them, but I think some tinkering about that might be warranted with the bill.

Let me make some summary statements on this. I think that it is, one key finding is that communities feel this will not work by itself. The relevance of other Federal programs—the necessity of integrating this with other Federal programs is apparent.

One of the interesting things about this that is new is that it is not programmatic. What has happened to cities that they have had this whole delivery of Federal programs time after time. What they find in this is the ability to cut through all of that, and tie it together in a way that is useful for them on their local level, and helpful to them.

I think it leads to some coalition building that hasn't occurred. One of the gratifying things, again, you have government agencies that haven't talked to one another, you have the private sector talking to the public sector, and I think as the Federal legislation becomes clearer, the State and local responses to that. I think you will see some very innovative ideas in putting together enterprise zones.

Thank you.

Senator CHAFEE. All right, Mr. Pryde.

Mr. PRYDE. First of all, Senator, I would like to thank you for the opportunity to state my views on S. 1310. I have submitted a written statement for the record, so I will just try to highlight what that says.

First of all I want to say that like several other witnesses, I believe that S. 1310 is a much improved bill. It is a much improved bill over the legislation introduced last year.

Now rather than attempting to influence the location decisions of major companies, the bill is aimed at stimulating the formation in distressed communities of the young small enterprises which create most jobs.

As S. 1310 implicitly recognizes, besides the availability of markets, there are two factors which largely determine where new and expanding firms tend to locate.

They are: The availability of capital, especially risk capital; and the availability of an adequately trained labor supply.

S. 1310 has four incentives aimed at increasing capital investment: The elimination of capital gains taxes, the 50-percent taxable income exclusion, the optional cash accounting system for small firms, and the extension of the net operating loss carry forward.

Senator CHAFEE. Now you heard Mr. Schlenger testify? He didn't seem to give much credit to these points.

Mr. PRYDE. Well, I have some changes I want to recommend which I believe would create a margin, a necessary margin, between investments in enterprise zones and conventional investments elsewhere.

This margin is needed, in my judgment, to compensate lenders and investors for taking on what they perceived to be the increased risks and costs of investing in otherwise unattractive areas.

The changes I would make, rather than eliminating the capital gains tax and allowing operating companies as opposed to financial companies to reduce their taxable income by 50 percent, I would propose the deferral of taxes on capital gains as long as the proceeds are reinvested in the enterprise zone.

Second, I would recommend an immediate writeoff of an investment in the equity securities of any enterprise zone company.

Third, I would recommend a 50-percent reduction in taxable income only for financial companies.

What I was thinking——

Senator CHAFEE. Your first suggestion is a rollover on the capital gains tax. How about when you finally take it out, what would that be?

Mr. PRYDE. Well it would then be centered at ordinary levels, whether it is 28 percent or 20 percent as has been proposed.

Senator CHAFEE. You would not even cut it in half though, as we proposed?

Mr. PRYDE. Well, I did some numbers on a hypothetical investment.

If you took a $10,000 investment which grew to about 500 percent over a 5-year period, under existing tax law, the rate of return on that investment would be, I believe, around 33 percent.

With a zero capital gains tax, the rate of return, the internal rate of return would be 38 percent.

I don't think 500 basis points is enough, enough compensation. I think lenders and investors will still refuse to invest in enterprise zones.

But, if on the other hand, you were say you can take off, you can writeoff on your taxes the entire $10,000 in that first year and defer your taxes as long as you reinvest, the rate of return goes up to 44 percent.

So what you have got is a substantial margin between an investment in enterprise zone and one elsewhere. With, I don't think a very large cost to the Treasury.

Two reasons for that, one is that if you reduce the taxable income of successful firms over a period as long as 20 years, that's an enormous amount of income forgone.

If on the other hand you just reduce, allow a person to writeoff his investment in the first year, you've got a one-time loss which is more than compensated for by a stream of revenues over the succeeding years.

Second, it is my belief that if you make investments in enterprise zone company equities, the equivalent of a tax shelter, what you won't do—what you will do is essentially shift income from or investment from unproductive tax shelters to what you might consider a productive tax shelter—that is one which creates jobs.

Senator CHAFEE. All right, why don't you proceed.

Mr. PRYDE. I would also add that the optional cash accounting system is a good idea. But, I think it invites a lot of funny accounting; and, therefore, I would limit its use to 3 years for a company.

I would like to add two other suggestions, four actually.

One is to extend the existing broadcast property tax certificate which is available to sellers of broadcast properties to minority groups to any sale of an enterprise zone company to its employees or member of a minority group.

And, a supplemental Federal neighborhood assistance tax credit which would go along with State tax credits. That gives corporations, which contribute to eligible activities, a tax credit on their State income taxes. I think this provision, in the Federal legislation, would encourage both more States to do this sort of thing, and second encourage private investment to offset some of the reductions and Federal spending decreases.

Lastly, I would recommend the elimination of the 5-percent refundable employee tax credit and replace it with a $2,500 voucher or refundable tax credit for training undertaken with enterprise zone employment.

What I think we have before us, Senator, is a major restructuring of the U.S. economy. What we want is to create incentives, I think, for people to invest in training which will prepare them for the jobs of the future.

As you proceed with the structuring of this legislation, it needs, in my judgment, to be done with a careful eye to other actions by the Senate Finance Committee and the House Ways and Means Committee.

Because, if, for example, certain measures which are now under consideration pass, it is going to reduce the value of incentives available in the enterprise zone legislation.

Senator CHAFEE. Such as?

Mr. PRYDE. For example, if you were to reduce substantially corporate income taxes, which has been proposed by the House Ways and Means Committee, from the 17- to 46-percent range to the 15- or 43-percent range, or integrate and personal income taxes—therefore, wiping out the corporate income tax essentially, any tax reductions for corporations available in enterprise zones won't mean very much.

The same thing is true with capital gains tax reductions. Right now the capital gains tax is essentially 28 percent. A reduction of 20 percent decreases the value of a further reduction to zero. And, if you, as some people have proposed, eliminate capital gains taxes entirely, then you have no differential within an enterprise zone.

So the blend has to recognize not only existing tax policy, but also new changes now anticipated in the tax code.

Senator CHAFEE. I suppose that would apply, as others have pointed out, to the more rapid depreciation of buildings that we provided for in the bill that came out of the Senate Finance Committee. If you are going to depreciate all of those and a double declining balance 15 percent, there is an incentive to go out into the rural areas and not go into the cities.

Mr. PRYDE. Precisely right.

Senator CHAFEE. But, overall, you think there are some possibilities in this legislation.

Mr. PRYDE. Yes, as long as we recognize that you need lenders and investors are not going to invest in the distressed area if they can get the same or equal return elsewhere. So you have to create a large enough margin without terrible cost to the treasury that a person looking at investments will look at an investment in an enterprise zone company as being competitive. And, I feel that margin has to be, just off the top of my head, one-third. In other words, if you can get 10 percent inside of an enterprise, outside of an enterprise zone, you have got to get a margin of at least one-third above that out—in an enterprise zone just to make it attractive to investors.

The reason I——

Senator CHAFEE. Well, haven't we done that in this legislation?

Mr. PRYDE. I don't think so. Now you——

Senator CHAFEE. I think we have given 50 percent if your interest income from a loan is only 50 percent taxable.

Mr. PRYDE. That is true on the lending side, but on the investment side, it is not true.

If we are looking at the need for risk capital, rather than loan capital, you really have got, it seems to me, to provide incentives for investors—the providers of risk capital—who tend to be the friends and family and associates of an entrepreneur. You have got to provide an incentive for them to take the risk rather than to invest the money elsewhere.

Senator CHAFEE. You mean the equity portion?

Mr. PRYDE. That's right.

Senator CHAFEE. That's a good point.

All right fine, Mr. Frazier.

Mr. FRAZIER. Thank you.

Senator, our foundation appreciates the chance to offer some views today on enterprise zones. It is late in the hearing so I will be brief.

For the past 9 months, we have had a group of approximately two dozen people looking into various aspects of enterprise zones. We have identified some problems—which we feel are fundamental—that are not addressed in the current legislation.

Our research indicates that there will be two kinds of enterprise zones if the bill is enacted in its present form.

The first type will be brilliant successes. These will be in the areas that are already close to economic revival.

Senator CHAFEE. Like Baltimore, for example.

Mr. FRAZIER. Yes, some of the fringe areas around Capitol Hill would be another. But many other areas are likely to fail under the present proposal, because the benefits being talked about are insufficient to offset the deterrents that businesses encounter—crime, decaying infrastructure, poor services. In these areas, the zones are unlikely to cross threshold of economic takeoff.

Under the present proposal, even the successful zones, the ones that do take off, may prove to be mixed blessings.

Any measure which improves the attractiveness of an area to work and live in is going to push up housing costs, property values in that area.

We see right here on Capitol Hill, and in other gentrifying spots around the country, what can happen even without enterprise zone incentives. If the economic conditions look good, investors will go in. Housing costs quadruple, quintuple, and you drive out the existing residents.

We feel that there has to be some attention paid to this effect. If enterprise zones really succeed, we are likely to dislodge and displace the people that they were designed to help.

You and other sponsors of the bill have taken care to put in a 40-percent hiring requirement to protect the interests of existing poor residents. But even this safeguard will be unlikely to protect them against displacement, because the sorts of jobs which CETA-eligible workers would get are unlikely to be high paying enough to allow them to stay in an area which does gentrify.

Inadequate protection against displacement is the first problem that we see with the enterprise zone hiring requirement. The second problem with the hiring requirement will be its effect upon areas with very deep problems of crime and poor services and poor infrastructure. In areas with an unpromising investment climate, the 40 percent hiring requirement is going to frighten away a lot of investors who might come in there. Again, the 40 percent hiring requirement is not going to accomplish what we feel should be accomplished.

Senator CHAFEE. What is your alternative to that?

Mr. FRAZIER. There are some alternatives.

We feel the most important one is to create equity in enterprise zones for the existing residents.

That gives them a stake. The more the zone succeeds, the more they prosper from it. It allows them to stay in. But we feel that equity should be made conditional upon the participation of these residents in various improvement efforts to make the neighborhood more inviting to business and to people who want to live there.

What we propose is that the publicly held properties within enterprise zones—in the South Bronx, 40 or 50 percent of the total land—be deeded over or leased over at nominal rates to neighborhood associations or block associations, which would then get revenue by leasing these lands to business.

The more effective their steps were to reduce crime in the neighborhood, or to arrange for better services, the more valuable their lands would become. We feel there is enormous potential to tap private voluntary actions in the task of reducing the primary barriers to inner city revival, which are crime, poor services, and infrastructure.

As an example of how that might work, there are already condominium-style self-assessing associations of businesses and residents which are taking on responsibility for things like controlling crime, for improving services, and maintaining infrastructure.

Senator CHAFEE. Where is this?

Mr. FRAZIER. There are about 40,000 such contractual associations now operating. There were just 500 in 1965, but these property owners associations have multiplied around the country. You find them in residential developments and in industrial parks. They are a very effective way for the private sector to take on traditional public sector responsibilities.

In enterprise zone legislation, we would urge the committee to invite cities to get the private sector involved in these new ways to give residents equity in the enterprise zones which they now lack.

Under this approach we feel the existing residents will be able to participate in the benefits more effectively. And business will find enterprise zones more attractive to invest in.

Senator CHAFEE. Well, you have heard Mr. Schlenger testify that we must keep this simple. If we are going to get the residents to have an equity investment we would complicate it, add a new dimension. I am not sure that what you are proposing isn't adding a dimension of complexity to this.

Mr. FRAZIER. If I might respond.

One of the major deterrents, far bigger I would think than most taxes or virtually any regulation, is crime. Police are not really effective—stepping up police patrols doesn't show results in reducing crime. It is a very expensive approach, and you may displace crime a little bit. But it is not a lasting solution. What does work in reducing the deterrent of crime—which is essential to reduce if enterprise zones are to work—is neighborhood action such as block watches.

There are two problems that now face neighborhood groups in undertaking any such improvement effort.

One is financing for those efforts. The second is the problem of the guy who sits back and lets you do the work—the "free rider."

If enterprise zones offer equity to neighborhoods that create linkages and structures undertake crime prevention activities, day care centers, or whatever, then you can begin to overcome these problems. You can say to organizations "here is some real estate that we will deed to you if you get half of the residents on your block as active members in crime prevention activities.

Senator CHAFEE. Who is going to deed over the real estate?

Mr. FRAZIER. Well, the city governments now hold a lot of tax defaulted property. The cities could, if encouraged by the legislation, move in that direction. Plus the Federal legislation might offer tax incentives for private property owners in the enterprise zone area to deed over their land under lease-back arrangements or tax-free income sharing agreements.

Senator CHAFEE. Let's say there are 5 acres of city land in a depressed area in the city. Under your proposal, the city would say to family A, B, C, and D, identifying them, that you now own this 5 acres of land. We will rent it to Control Data, who will build a plant. Control Data pays the property owners. Is that the way that it would work?

Mr. FRAZIER. Not exactly. What would, I think, be a better approach would be to go the community development corporation or any community-based organization there and say if you can get *x* percent of the block residents as active members—meaning that they are putting in time every week or every 2 weeks on some improvement project—then you have become owners of this property. You can get a share of the income.

Senator CHAFEE. You mean that the income is paid out to the various families or the individuals?

Mr. FRAZIER. Yes, to the active members. The people who are out there cleaning up the neighborhood.

Senator CHAFEE. Have you ever seen that done?

Mr. FRAZIER. There have been some community organizations which have acquired public lands. The Trust for Public Land is the most active group in trying to do this.

Senator CHAFEE. I can see the community organization holding the property in trust and then building a day care center or building a community pool for the children in the summer, but I would be astounded to find that they would pay out dividends to the individuals. Is that what you are proposing?

Mr. FRAZIER. That is the new aspect. It might require some changes in the Internal Revenue Code, but that would be one approach. An alternative, without changing the code, would be to use the surplus to pay active members for their time.

Senator CHAFEE. Well, I think the other residents of the city might be concerned.

Well, in any event, it is a thought.

Thank you all for coming.

[Statements follow:]

PREPARED TESTIMONY OF JAMES S. ROBERTS, DIRECTOR, DOMESTIC OPERATIONS, FREE ZONE AUTHORITY SERVICES, INC., WASHINGTON, D.C.

WHAT IS THIS TESTIMONY?

This testimony presents a perspective on the proposed enterprise zone legislation from communities that are considering and actively engaged in establishing enterprise zones. The observations are based on our work with communities, and represent our personal reflections and opinions. However, this experience has been valuable for us, and should prove valuable to the members of the Subcommittee on Savings, Pensions, and Investment Policy, for knowledge of how communities are likely to respond to the proposed legislation would seem essential to the deliberations of the subcommittee members. I am pleased to provide this testimony, and hope that it will help shape the direction of the refinement of the enterprise zone concept.

In this testimony, I will present a brief summary of the background upon which my remarks are based, summarize what communities are doing to apply the enterprise zone concept, draw conclusions from the communities' experience, define issues that confront communities, and make recommendations on the proposed legislation that will address many of the issues raised by communities.

WHAT IS THE BACKGROUND?

Free Zone Authority Services, Inc. is a non-profit consulting organization, establishing to assist communities in developing enterprise zones, foreign trade zones, and free trade zones in foreign countries. As part of our consulting practice, we have been actively counseling communities on how to develop enterprise zones, assisting by providing background on the enterprise zone concept, developing a local commitment, analyzing incentives, developing a final concept, providing an action plan, and managing the planning and development process. Work in a half-dozen communities is the basis for our testimony, as well as informal discussions with zone planners and sponsors in another 15 to 20 cities.

The main source of information for this testimony results from conducting workshops in a number of communities we have served. In those sessions, we have attempted to provide a common understanding of what is entailed in establishing an enterprise zone in the community, to develop a specific zone concept for the host community, and to provide them with an action plan to guide them in further work in developing an enterprise zone.

WHAT ARE COMMUNITIES DOING?

There is no single approach nor common result from the application of the enterprise zone concept in the communities with which we are familiar. However, it is possible to generalize from this experience and to provide observations on the following issues:

A. What are the types of applicants?

B. What incentives—to lower barriers to business investment and economic development—are being considered?

C. What strategies are communities using?

D. What is the current status of zones in communities?

E. What observations can be drawn from this experience?

These issues are discussed in turn.

A. What are the types of applications?

There is a range of types of applications. In one city, four potential sites have been identified, and are now under detailed investigation—to inventory present uses, identify major problems or requirements for economic development, analyze prototype buildings or businesses to determine which incentives would be most effective, and determine community organizations that would contribute to activity in the zone. The intention of the city is to designate one of the candidate sites, and thus must develop a basis for selecting among them.

A second case, a large city with a manufacturing base, is considering applying for designaton of an entire township, containing the central business district, major manufacturing centers, areas with both standards and substandard housing, and commerical strips. The area could encompass ten square miles. The proposed project would contain several vacant sites suitable for development. By linking in with existing economic development programs, anticipated federal and state incentives would enhance economic development prospects.

A third city, dominated by a single manufacturing employer—currently in a slump that results in over 20 percent unemployment, is considering the creation of a single enterprise zone with a collection of manufacturing, commerical, residential, and vacant uses in it.

A final case is a multi-county, multi-jurisdictional planning and development commission, which is considering establishing an enterprise zone to cover the entire area. With careful and judicious use of incentives to assure economic development, they hope to reverse the present overall 11 to 12 percent unemployment in the area. They face problems with industries that are suffering from foreign competition, obsolete plant and equipment, and a shortage of capital for investment purposes.

This is not a complete listing of the types of approaches that communities are considering, but the differences in the areas, types of economic activities, and economic problems that are addressed are apparent.

B. What incentives are being considered?

One of the most interesting aspects of assisting communities in developing enterprise zones is the inventiveness in providing local incentives and in reducing barriers to economic development. Some of the ideas that have been discussed by communities include the following:

Donation of publicly owned land to community organizations;

Lease of surplus lands held by major corporations to zone sponsors, who in turn will lease it to new businesses over a long period;

Possible conversion of public housing, donated by public officials, to cooperatives or even deeded over to present tenants as condominiums;

Dedication of vacant schools to zone sponsors for potential use on housing for the elderly;

Provision of administrative support to the targeted jobs tax credit program, relieving businesses from any administrative requirements in using it;

Use of value capture techniques from land developments to fund zone activities;

Designation of block funds to provide loan guarantees to encourage lending to zone businesses;

Dedication of services by community organizations in support of the enterprise zone;

Shifting licensing and permitting of small businesses from city hall to mobile trailers in neighborhoods; consolidation of administrative procedures to a single visit.

The range of ideas is broad, but these are illustrative of the kinds of incentives that are being discussed in local communities.

C. What strategies are cities using?

Cities are responding to the proposed enterprise zone concept with several elements to an overall economic development strategy. First, communities are targeting larger areas than might have been expected, partially to avoid concentration on only the worst distressed areas. Rather, many communities are combining the worst areas with areas where moderate treatment will yield rapid economic development, which in turn will be used to provide resources and momentum for the areas of clear distress and impoverishment.

A second element to the strategy is to include a mixed set of activities in the zone. There is not an exclusive focus on residential, commercial, or industrial development. Rather, communities are considering a mixture, such that as one area improves it can lead to improvement in others. A scenario such as this is being adopted in communities: the incentives are used to improve economic activity in vacant but useable sites; that activity is then used to trigger development in underutilized industrial space; residents of the area use the incentives to improve housing conditions; the stabilization of neighborhoods and an increase in income in the area, plus the availability of the incentives, then causes improvement in local commercial activities.

A third element that communities are adopting is internal financing, as best as possible. Many cities are viewing their projects as investments in a traditional business sense. Risk capital needs to be supplied up-front to get the project moving, and then revenues from the activities in the zone will be used to retire the initial debt, as well as provide a stream of earnings to pay for improvements, overhead and administrative expenses, and for support services for the operation of the zone.

A fourth element is the carefully targeted and phased use of incentives. According to this thinking, not all the federal incentives would be used at one time in all parts of the zone. Incentives would be parceled out to sectors of the zone at certain points in time, to build overall momentum and to create economic value for the entire project.

A final element is the use of state and local incentives to complement federal incentives. This may mean delaying or accelerating non-federal incentives, working around or dovetailing with the proposed federal incentives.

In summary, cities are developing strategies for the use of incentives, where the federal, state, and local components reinforce one another, and all contribute to an areawide and time-phased approach to economic development.

D. What is the current status of zones in communities?

A number of communities have moved rapidly to explore and implement the enterprise zone concept. Similarly, a number of states have been active, and a few have passed enterprise zone legislation. Many communities expressed a willingness to pursue the enterprise zone concept independently of the federal government, if necessary; their intent was to move ahead, keeping their options open and waiting to see the nature of the federal legislation. If the federal government chose not to designate their community, of if they were not eligible, they indicated they would proceed to use whatever resources or techniques they could on the local level to encourage economic development.

Many cities are currently getting up to speed, appointing task forces to explore how to apply the concept and to monitor the federal and state legislation. Most communities want to be prepared as soon as possible with a zone concept, for that will not only help the community itself, but will also provide experience that might aid other communities in establishing enterprises zones.

E. What observations can be drawn from this experience?

First, cities seem to have a number of objectives in mind when they consider developing enterprise zones. They are interested in developing small businesses, expanding existing businesses, attracting new businesses, creating jobs, causing physical revitalization, and encouraging community development and organization. Although there may be potential conflicts among those objectives, for the present, communities seem to be able to deal with a number of objectives in the same enterprise zone approach. Difficulty may arise further into zone development, when it may appear that all the objectives cannot be attained at the same time. For now, it is not a problem or source of divisiveness.

Second, geography of zones is not the most important factor. Given the manner in which the statistical indicators in the legislation are defined, many communities will have no problem designating areas so that the minimum criteria are met, while finding creative and useful ways to combine activities to foster sensible economic development.

Third, there is clearly an emphasis on deal-making. The essence of putting together a local commitment is to find an agreement that all parties—cities, states, businesses, labor, neighborhood organizations, and others—can agree to, and live by for a number of years in the future. Although the process of putting together such deals is only beginning, and could break down as more detailed analysis and final information on the federal approach is developed, there is a genuine receptiveness to and possibility for common agreement.

Fourth, management of enterprise zones is a key issue. Both in the initial stages of design, development, and application for designation, and in later stages of operation and management, the type of organization that would make decisions, allocate resources, monitor the use of incentives, and measure the progress toward economic development is important.

Fifth, a common observation is that local discretion and flexibility is essential. The ability to use the incentives to encourage economic development in creative, yet obligatory ways is important to the success of local initiatives. Because the range of approaches, problems, participants, and incentives will vary considerably from community to community—and the initial economic and political circumstances under which the zone was established will certainly change—the ability to accomodate those differences and changes is critical to the successful application of the enterprise zone concept.

Sixth, most local groups are pragmatic is establishing a zone concept. They are attuned to the basic underlying reality of the marketplace, recognizing that even with tax incentives and regulatory relief, there still must be sufficient demand and a solid market for zone products and services before consideration of how the zone might be structured or what incentives to offer can occur. There was a uniform endorsement of the idea that fundamental economic factors had to be present before serious thought could be given to reversing economic situations that had been out of the mainstream for a number of years.

Seventh, no single type of organization or structure would be used by communities. In most cases, the initial activity was sponsored by city officials, although in others, business leaders—typically through chambers of commerce—would take the lead. For zone operations and management, many communities felt that an entity somewhat removed from city politics or administrations would be favored—using existing economic development corporations or creation of zone management entities to conduct on-going zone activities.

Last, community representatives welcomed the opportunity to deal with local economic development problems in a comprehensive fashion. Previous attempts mandated by the federal government required a programmatic focus, to some extent. With the development of an enterprise zone concept, and the need to consider all aspects of economic development at the same time—projecting how those components would fit together over a long period—zone planners were able to cut across program areas and to integrate requirements for economic development.

In summary, communities have responded quite enthusiastically to the enterprise zone concept—in spite of being aware of the rather slim chances of a single community receiving one of the limited number of available designations, as the bill is presently drafted. Many communities felt that the effort to plan economic development, to put together a suitable strategy, and to encourage community participation that is entailed in establishing an enterprise zone would be worthwhile even if federal designation would not be available. In fact, a number of communities have actively considered proceeding on their own, even if federal incentives are not available.

WHAT ISSUES HAVE RESULTED FROM COMMUNITY EFFORTS?

The types of issues that communities have raised are summarized; these issues should be addressed by the proposal legislation in order to add to the potential success for the enterprise zone concept. The major issues that have emerged include the following:

Relationship to other federal programs.—A recurring theme is whether the proposed enterprise zone legislation could be considered a substitute rather than a complement to present urban programs. In spite of assurances to the contrary, many communities are not certain how those programs will relate to enterprise zones. Furthermore, there is not certainty on how the overall Economic Recovery Program of the Administration will relate to an enterprise zone program—for if incentives to business are commonly available, they lose their appeal for use in conditions of severe economic distress.

Role and responsibilities of HUD.—There is currently concern over the role of HUD with regard to enterprise zones. One major issue is how long it will take to complete regulations on the program, and another concern is the extent to which local initiatives will be limited because of restrictive requirements that may be imposed by HUD program managers. Related to these concerns is a question of whether the agency can administer the program in a flexible, creative, and innovative manner. These are important issues, for if HUD should fail to act in a reasonable and timely manner, the local commitant—carefully constructed and artfully negotiated—could become unraveled.

Performance guarantees by HUD.—The proposed legislation seems to imply that HUD has the responsibility for advocacy of zone concepts or applications to other federal agencies. Similarly, since many decisions on the local level—both public and private—will be based on HUD assurances, speaking not only for itself but for other agencies as well, the nature and type of performance guarantees that HUD will provide will be important to the mutual agreement that must be reached among zone participants.

Enforcement of zone agreements.—A particularly troubling issue is who will enforce zone provisions—or even monitor whether they are being obeyed. If businesses in the zone undertake this on their own behalf, it would defeat the intent to reduce paperwork and regulation. Some consideration of making these chores a part of zone management and operation has been made in communities, but the issue has not received final resolution.

Sources of start-up capital.—Many communities, once they understand the requirements for an effective, locally responsive, and competitive zone application, are bothered by the amount of time and effort needed to complete a zone application. Some communities may want planning funds, but must reconcile themselves to getting assistance from other sources—in-kind contributions, business sources, or foundation grants.

Adequacy of authority and flexibility in zone management.—A recurring and major concern was whether federal program sponsors would allow sufficient flexibility and discretion to local zone managers to provide authority over local decisions. If HUD does not impose itself on local activities, there is the real potential for nonperformance and maladministration. On the other hand, too heavy a hand by HUD will hamstring local operations and certainly doom the enterprise zone concept to failure.

Emphasis on statistical indicators.—An issue that arose in a number of communities was the accuracy, currency, and relevance of statistical indicators of distress. There seemed to be widespread concern over collecting the most impeccable set of numbers, documenting poverty, unemployment, and so forth, and not enough attention on how the incentives should be used and what they are intended to accomplish.

Accommodation to long-term changes.—A major issue that arose was whether long-term agreements, based on an initial assessment of problems, could result in loss of designation. If economic conditions improve, so that conditions of poverty are no longer present, the question would be whether zone sponsors would retain the authority to use incentives.

Appropriateness of CETA eligibility criteria.—Questions were raised on the CETA eligibility criteria on several fronts. First, who is responsible for registering and certifying CETA eligibles—many could not see it added to the responsibilities of businesses in the zones, but local government would have to gear up to perform that function. Second, what happens to CETA eligibles once they are employed—over a period of time, once employed, they may no longer be eligible for the employer's wage tax credit. Third, there were comments on how this requirement would relate to very small businesses that might locate in zones—with only a small workforce, and in some cases with requirements for specific skills; in these cases, the eligibility requirement would prevent a number of businesses from qualifying for the incentives.

Ability of HUD to make revocation work.—There is some question whether a community, once designated, would ever be exposed to revocation, or would instead expect a long and protracted series of negotiations over zone performance. In spite of the authority to revoke a designation, many communities felt that HUD would not exercise that authority.

WHAT RECOMMENDATIONS CAN BE MADE?

The specific recommendations that would be suggested for either the legislation or program administration by HUD include the following:

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HUD regulations.—HUD should be given a deadline for drafting regulations for the enterprise zone program that is fairly short. Then operation of the program under the draft rules should be continued for a fairly lengthy period, up to a year. At the end of that time, an evaluation of the program will show how improvements can be made. In the meantime, enterprise zones can be initiated and the necessary experience can begin to build.

HUD designation.—HUD should select an initial group of designees from a range of community types, including Indian reservations, rural and multi-jurisdictional applications, and large and small communities. This will ensure that a variety of types of enterprise zones can be tested under operating conditions.

HUD revocation.—The proposed legislation should be amended to allow a lesser action than revocation; temporary or selective suspension of incentives would be an effective means of enforcing a zone agreement without the ultimate step of revocation; that should be held in reserve only for the most critical circumstances.

Statistical indicators.—Although it has been discussed, the proposed legislation does not explicitly permit an alternative approach to statistical proof of economic distress; applicants should be permitted to make a convincing case for economic distress, arraying data sources and evidence in whatever manner necessary; the data should be accurate and sources should be documented, but dependency on data analysis should not be a bar to zone designation.

Management by performance.—All zone applicants should be required to submit a business plan when filing for designation, documenting the local commitment and analyzing probable costs and benefits from use of the incentives for economic development; the business plan should be updated every year and should be extended as far into the future as possible to guide zone activities; the plan would also provide a basis for measuring performance in the zone, and if costs and benefits are aggregated for all applicants or designees, an estimate of national program costs can be obtained.

Number of designations.—Applications should be ranked according to need (degree of economic distress), quality of approach or local commitment, and ability of the zone sponsors' to perform according to their plans; HUD should then select among the applicants from the top-ranked proposal down, summing federal tax consequences as defined in the proposals (tax benefits gained versus tax incentives spent) until it reaches an arbitrary limit on tax incentives; that level would be the amount of "risk capital" that the nation would be willing to invest in applications of enterprise zones each year; presumably the potential benefits would clearly and overwhelmingly outweigh the costs of the tax incentives.

Additional criterion for selection.—An added criterion should be added to those stated in the legislation (and in the previous recommendation). To encourage local communities to use the tax incentives in a judicious and careful way, a criterion for selecting among applicants should be minimization of costs to the federal government; this approach may allow a larger number of designations for the national dollar expenditure.

CETA eligibility.—A small business threshold should be set—at about 10 to 20 employees; below that limit there would be no mandatory CETA hiring requirement; rather there should be a substantial reward for hiring CETA eligible employees (using an expanded targeted jobs tax credit, on a refundable basis, for example); local government or zone sponsors should be expected to perform the administrative and monitoring functions for such employees, to lift the burden from small businesses. Above the threshold, the hiring requirement would be in effect, as indicated in the bill.

Flexible use of incentives.—Local zone sponsors should have the authority to negotiate deals with interested parties in the zone; the authority would include variable use of federal incentives—all or in part, and for the full term of the zone or only for part; zone sponsors should also be certain that as a result of the negotiations over incentives, performance can be measured and assured; the use of incentives should be considered for how it will reinforce the timing, phasing, and targeting of economic development that may be essential to the success of a project.

WHAT IS THE CONCLUSION?

The possibilities that are found in the enterprise zone concept are exciting, and it shows promise of reversing the years of deterioration and disinvestment in urban centers. I am pleased to be able to submit my views on the proposed legislation and potential program administration. I look forward to passage of the legislation, and then to the successful application of the idea to American communities. Based on my experience working with communities, they are eager to begin, also.

STRENGTHENING ENTERPRISE ZONE PERFORMANCE—PREPARED STATEMENT OF MARK FRAZIER, DIRECTOR, SABRE FOUNDATION, WASHINGTON, D.C.

Over the past nine months, the Sabre Foundation has conducted an extensive investigation into the prospects for Enterprise Zones to revive depressed communities. Our major conclusion is that Enterprise Zones have the potential to achieve their desired results. Stimulating private action through tax and regulatory relief can lift urban economies more effectively than has been possible through traditional approaches. In contrast to past programs, Enterprise Zones promise to create true climates of economic opportunity.

Yet basic problems exist with the proposal at present. The first rests with the weakness of its proposed stimulus for many inner cities. In practice, high crime, poor services, and decaying infrastructure tend to far surpass taxes and regulations as influences upon business activity. These impediments—the results of decades of municipal failure—must be reduced through new private sector and community efforts if zones are to work in the most devastated areas. The present bill does little to ensure that cities will act against such deterrents in an effective manner.

The second problem concerns an absence of effective safeguards for existing residents of the proposed zones. In distressed areas that are now close to economic revival, introduction of tax and regulatory relief will undoubtedly trigger inflows of investment. Such success, however, threatens to displace poor citizens from their residences. Any measure which increases the attractiveness of an area in which to live and work will produce proportional increases in demand for properties there. The more an Enterprise Zone improves conditions, the more housing prices will rise. Property values often quadruple in gentrifying urban neighborhoods, even without special inducements. Tax incentives for investing in Enterprise Zones could result in even more dramatic appreciation of property values, and correspondingly greater disruption for tenants.

Enterprise Zone legislation can overcome these problems. The proposed bill can encourage businesses and residents to form contractual self-help organizations at the neighborhood level, as a means of reducing impediments to revival on a comprehensive basis. To protect residents against displacement, these organizations, which we refer to as "Enterprise Associations," can share revenues from appreciated land values with residents who cooperate in improving conditions for business.

EXPANDING THE ENTERPRISE ZONE STIMULUS TO INVESTMENT

Removing taxes and regulatory burdens in Enterprise Zones can do much to improve the attractiveness of areas for investment. To increase their stimulus in inner cities, zones should go even further than presently proposed to create a liberal tax and regulatory environment for business. Yet simply removing direct deterrents to investment will not be enough to revive an area in many instances. Economic analyses and business surveys show that tax and regulatory burdens generally play a secondary role in investment decisions by firms, especially in distressed areas. More important are such conditions as the incidence of crime, quality of local services, and adequacy of infrastructure.

Many municipalities found it beyond their ability to improve the basic conditions of inner cities even during eras of fiscal health. Today, budgetary strains greatly hinder the ability of cities to make the expenditures necessary to bring about lasting improvements through conventional approaches. In addition, rigidities in municipal bureaucracies have kept many communities from developing state-of-the-art service capabilities. The picture is not entirely grim, however. An increasing amount of evidence suggests that private efforts may be effective in areas where governmental attempts have been failing.

Ensuring civil order—a low level of crime—ranks as perhaps the most important requirement in making zones attractive to business. Increasing the level of police patrols, however, consistently shows few results in reducing the incidence of inner city crime. The most effective crime prevention activities are those arising from neighborhood action, rather than from the police department. Block watches and block patrols may be keys to crime reduction in Enterprise Zones, provided that they are harmonized with police and the criminal justice system.

Service provision also heavily influences investment decisions by business. Many municipal services have grown ineffective and unresponsive, as well as unduly expensive, for the public. Alternative arrangements have achieved significant improvements in effectiveness and economy for a variety of communities. Because of their impressive records of performance, nongovernmental service providers are becoming more numerous in fields such as refuse collection, daycare centers, fire protection, and schools.

In many distressed areas, decayed infrastructure also deters potential investors. Maintenance of water, sewer, and street systems has often been neglected by public bodies in favor of more politically appealing projects. Some communities have resolved this problem by engaging individuals and firms in residential, commercial, and industrial "owners associations." These associations make all private parties automatic members of a self-assessing organization, supporting maintenance and improvement of their common facilities through membership fees. As needed, the associations can require inkind services in lieu of financial payments from their members.

The key to improving basic Enterprise Zone conditions appears to rest with tapping private energies of these sorts. To do so, Enterprise Zone incentives must activate businesses and residents in capacities beyond their roles of employer and employee. In the same way that financial incentives can stimulate business investments in areas that firms might otherwise overlook, incentives can strengthen self-help organizations by encouraging membership and contributions.

At present, two overriding obstacles hold back self-help efforts by residents and businesses: an absence of financial rewards for participants, and problems with "free riders" who enjoy the benefits of neighborhood improvement efforts without contributing towards their support. These obstacles are not insurmountable for voluntary organizations. Legislation can help cities to overcome these problems by stimulating formation of Enterprise Associations—self-assessing neighborhood organizations in depressed communities.

Financial rewards.—To overcome the lack of financial incentives for residents to participate in improvement projects, Enterprise Associations could be granted forms of equity capable of yielding major revenues as zone conditions grew more attractive to business. Ownership of properties suitable for leasing to companies is one example of such equity. Municipalities now holding large tracts of idle, abandoned lands in inner cities might transfer these properties to neigborhoods which organized self-help groups. As crime decreased, services improved, and infrastructure became better maintained as a result of Association actions, revenues from leasing of zone lands would appreciate dramatically. The presence of tax and regulatory incentives would give a powerful further impetus to property values.

Enterprise Associations could distribute shares of their lease earnings to those whose efforts made the area more attractive to investors. To receive shares of the lease income, residents would have to actively contribute to crime prevention activities and other improvement projects for the area. Association members would set the types and levels of contributions expected for crime reduction efforts, service improvements, or facilities maintenance, along the lines of self-assessing owners associations and commercial condominiums.

Overcoming free riders.—Problems with "free riders" can be resolved by making transfers of equity to Enterprise Associations contingent upon participation by a threshold percentage of residents and businesses on a block. Once such a level was reached, a sponsoring municipality might transfer city-owned lands within the zone area to the Association or its designated property management agent, which could then lease properties to businesses. Many inner city sites could acquire exceptional value in a successful Enterprise Zone. In cities with few publicly-owned properties to transfer, strong tax incentives could encourage private owners to deed their lands to the Associations and share in the subsequent earnings.

The approaches described above would accelerate the economic and social recovery of areas designated as Enterprise Zones. Contractual mechanisms could make headway against the formidable problems of crime, inadequate services, and decaying infrastructure which have eluded solution in inner cities. Social fabric would grow stronger in neighborhoods now lacking cohesion. Equally important, existing residents would gain a substantial measure of protection against displacement as the inner cities revived.

MINIMIZING DISPLACEMENT

Sponsors of Enterprise Zone legislation are unanimous in their hopes that the initiative will improve conditions for disadvantaged residents of depressed communities. The Kemp-Garcia bill would make employers ineligible for tax relief unless CETA-eligible workers made up at least 40 percent of their workforces. Unfortunately, the benefits to the poor from this provision may prove to be less than they seem. Rising property values in a successful zone may force existing residents out of their neighborhoods regardless of their job status. As previously mentioned, three to five-fold leaps in housing prices are common in inner city neighborhoods undergoing gentrification. Strong tax and other incentives may create even greater appreciation. For zone residents who take unskilled, entry-level jobs, it will be exceptionally difficult to live in an area that prospers. For those who do not find jobs, the threat of displacement will be even greater.

Establishing equity in Enterprise Zone properties has the potential to protect disadvantaged residents from dislocation. Residents who participate in Enterprise Associations would gain potentially very large revenues as crime rates fell and other improvements took effect. The growth of such alternative income sources, coupled with the jobs available in an Enterprise Zone, would greatly minimize the vulnerability of residents to displacement as the zone prospered. Income shares to members from lease of Association properties would tend to rise in step with housing costs in the zone.

Equity for community self-help organizations in Zone lands would also render unnecessary the proposed CETA hiring requirement. Businesses express deep reservations about operating in Enterprise Zones if the 40 percent hiring quota is kept. Removing this restriction, while ensuring that disadvantaged residents have a financial stake in zone property appreciation, will make the zones attractive to many more employers.

The approach outlined above would have beneficial consequences for businesses and residents alike. It could ease spending burdens, moreover, upon governments sponsoring Enterprise Zones. Strengthening neighborhood self-help capabilities would minimize the need for new municipal outlays, and reduce needs for existing public services. As the zones grew in self-sufficiency, surrounding taxpayers would welcome a lessening of demands upon the public purse.

An opportunity for reversing urban decay is at hand. Properly designed legislation can transform conditions in depressed American communities. By reducing barriers to revival on an across the board basis, and giving the poor a new way to share in the subsequent prosperity, Enterprise Zones can benefit all who have a stake in the future of our cities.

[Whereupon, at 12:25 p.m., the hearing adjourned, subject to the call of the Chair.]

URBAN JOBS AND ENTERPRISE ZONES ACT

THURSDAY, JULY 16, 1981

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS,
AND INVESTMENT POLICY
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senators Chafee and Bradley.

Senator CHAFEE. The hearing will come to order.

Our first witness is Senator Boschwitz. Glad to have you with us, Senator Boschwitz. You may proceed.

STATEMENT OF HON. RUDY BOSCHWITZ, U.S. SENATOR, STATE OF MINNESOTA

Senator BOSCHWITZ. Thank you, Mr. Chairman. I am very pleased that the finance committee is so quickly bringing this act to active consideration. As you know, my experience before coming to the Senate was that of a businessman.

So I looked on this act and looked at the whole business of inner cities from the standpoint of my background. And this is a good act. It emphasizes the private sector and by and large emphasizes small business where most new jobs are created. This is well pointed out in a study done by Dr. Birch from David Birch of M.I.T. I understand that he also is among your witnesses today and I am very interested in seeing and reading his testimony.

Basically, as you well know, Senator, what we are doing is putting together a package of tax incentives. I won't review the incentives at this time because I'm sure that has been done by many witnesses and is something that we both well understand. However, I have a list here should any of the members wish to have a capsulized form of those incentives.

There are two important things. No. 1, that we have a package of incentives and No. 2 that the States and localities have to bid for the opportunity of obtaining enterprise zone designations. That means that they have to come up with their own package, and be judged against others who apply for enterprise zone designations as well. Therefore, there is a great incentive not only to use the tax advantages that we grant in the Congress, but also to come up with a good package of incentives for the purpose of having your area designated as an enterprise zone.

Therefore, not only are the tax incentives meaningful, but perhaps even as meaningful is the fact that you have to bid to become an enterprise zone. Only 10 to 25 enterprise zones will be granted in the first year. That may be a little bit on the low side, but as you know that was the result of some negotiation.

These 25 zones, I think, are going to put together a good package of tax advantages and other benefits that would draw businesses into that area. And drawing businesses into those enterprise zone areas will create jobs.

I look at the kind of business that I was in, retailing. Most retailers probably that will not be attracted to an enterprise zone, because frankly it is hard to attract customers to a depressed area. However, I also in my business career had a very large wholesaling function. And that would be a very appropriate business for an enterprise zone. In our wholesaling operation we probably have 40 or 50 people employed which is just the kind of business we hope to attract to an enterprise zone area.

Small businesses with individual entrepreneurs, know their employees. They are more able to make individual evaluations of employees and so are willing to take chances and give them more responsibility. These are the kinds of employers that we want to attract into such a zone.

I have found that an employee working in a smaller company always feels more like a member of the team, more involved in the action. This results in greater opportunities as well, because the employee is always well known to the three or four people who run the company.

This is a good bill, Mr. Chairman. In my judgment this bill is not going to cost the Government any money. There have been some estimates of tax expenditures of various amounts. I don't think it is going to amount to anything. If what we believe is true—and from my business experience I'm sure that it indeed is—this will stimulate job creation. Quite clearly, the Government will benefit from it in any number of ways that really don't even require explanation.

We have a good bill, and look forward to working with you, Mr. Chairman, in seeing that it is implemented. It is a bill that emphasizes a new approach in solving urban crises. It is a bill that requires speedy consideration and so I thank you for bringing it to the attention of this committee so rapidly.

Senator CHAFEE. Well, thank you very much, Senator. Of all the witnesses we have had here, and those we have coming up, I think you probably have had more direct experience as a businessman than any that we have had that I can think of.

So I think your testimony, not only as a Senator, but also as relying upon your long and very successful career in business has been helpful here.

Mayor Frazier from your home city or close thereto testified in the last hearing we had and he indicated that he thought the number of possible designations was way too low. You indicated that perhaps it's too low. There is nothing magic about the figure 10-25 but Mayor Frazier was fairly critical of that. He felt concerned about the bidding war that you indicated was perhaps an asset. Mayor Frazier thought that you would have some communities that are experienced with grantsmanship and would thusly be able to put together the flashiest package to present to HUD and get certified.

Do you have some thoughts on Mayor Frazier's comments?

Senator BOSCHWITZ. When I first saw the figure of 10 to 25 I thought that 10 was obviously very low and that even 25 might be on the low side. But I liked the business of a bidding competition between the cities.

Quite clearly, no matter what Government program exists, some localities are better equipped than others to obtain whatever kind of help the Government has to give.

If the enterprise zone is to be successful, it has to relieve some of the burdens that the businessman is going to encounter. We have given some Federal relief on the income tax. But we must also consider the types of taxes that a business is going to have to pay no matter if they make money or lose money, such as real estate taxes or witholding taxes.

What I mean to point out is I like the bidding war. I like the fact that there is some competitive aspects to granting the enterprise zones. I think that 25 the first year is a little on the low side, 100 is on the high side. We have to let the folks here in Washington get wound up so that they can understand how to go about it. They also have to be able to reject some application so that those folks will come back with better offers next year.

So I don't mind the fact that there are only 25. If there were 40 maybe it would be better, but 25 is not so bad.

Senator CHAFEE. I just don't want this to be one more scatter shot approach that everybody jumps into and then get discouraged after not having really thought it through and then it fizzles. People say, "Oh, well, it didn't work and now let's try something else." So, I am sympathetic to the approach that you take. I also think there's nothing magic about 25. Maybe 40, maybe 50, I don't know.

Senator BOSCHWITZ. I'm satisfied with 25 in the initial year and I think your point is well made. If it does become scatter shot it becomes less meaningful and the necessity of having communities come up with good offers is minimized. That would defeat the ultimate purpose of the bill. You know, not to establish a whole bunch of enterprise zones it's to establish a whole bunch of jobs. And the jobs will be best created if the incentives for creating them are heightened.

Senator CHAFEE. From your business point of view, Senator, do you think that the provisions dealing with the recovery of capital, the capital gains, and the 50-percent interest deduction are adequate incentives to get people to put money into an area that by its very nature is not very attractive?

Senator BOSCHWITZ. I think that in most instances those provisions would apply to a partnership. In my business career I have never been involved in a partnership. I never went outside of my own resources other than bank loans. And making half of the interest payments deductible will encourage banks to make more loans.

I think that those items are good for the purpose of obtaining early capital and making the capital more obtainable. I think that those are good provisions, yes.

I am more interested, as I mentioned, Senator, in provisions that the businessman would look at and say, "This is an expense that I will save. These are taxes that I will have to pay if I start up in a more amenable suburb and these are taxes that I will not have to pay if I start up in an area where it is a little chancier."

Senator CHAFEE. Thank you very much, Senator. On behalf of everyone interested in this piece of legislation I want to thank you for your continued interest and support. We certainly look to you for continued counsel as we proceed.

Senator BOSCHWITZ. Thank you very much.

[Statement of Senator Boschwitz follows:]

STATEMENT OF SENATOR RUDY BOSCHWITZ

I appreciate this opportunity to testify in favor of the Urban Jobs and Enterprise Zone Act, introduced by Senator Chafee and myself. I commend this committee for holding hearings on this bill so soon after the bill was introduced. That's important because the problems of urban decay and inner-city unemployment are immediate. I don't think we should delay passage of the Enterprise Zone bill any longer than necessary to assure that what we have is the best possible approach.

First of all, let me say that in no way is this bill considered by any of its sponsors as an alternative to current urban programs. The Enterprise Zone bill crosses ideological lines: we are all unanimous in our belief that we need to do something more to revitalize urban areas. This bill epitomizes our belief that the primary ingredient in urban revitalization is jobs.

I think the most significant feature of the Enterprise Zone Act, and what has attracted so much interest by members of Congress, the Administration, urban groups and so on, is the emphasis it places on the private sector. This bill is a major departure from the traditional approach to urban decay. Instead of creating a new government program which funnels money into these areas, we are encouraging businesses themselves and the people employed by them to directly participate in urban revitalization. They will be the determinants of whether this legislation works or not. This is important because it is the private sector, particularly small business, that creates new jobs that can give to the under- or unemployed city residents the chance to build a good future for themselves, their families and their communities. People living in these areas that will become enterprise zones are willing to and capable of contributing to our economy. The problem is the jobs are not where they are. This bill will bring the jobs to the people.

As a small businessman myself, I know the value and contributions of my employees. As the business has grown, so have their responsibilities and positions within the company. Small businesses are willing to take chances on employees, and let their employees prove themselves in positions of greater responsibility. It is also small businesses that provide almost all of our new jobs. And by the way, I was interested to see that David Birch of MIT who has done some of the pioneer studies into job creation, is here today to testify. I look forward to his views.

But these two points, the creation of jobs themselves and the opportunities for advancement are why our bill focuses on small business.

I think the incentives we have built in will prove very attractive to potential entrepreneurs. In particular, the elimination of the capital gains tax and the refundable tax credit for part of the employees wage are significant, and address two of the problems that most businesses face in their early years. That is, start-up capital and cash flow. There are other incentives as as well, such as reducing taxes in half, allowing cash accounting, extending the loss carryforward and so on. Each one is designed to encourage business activity. We are trying to eliminate as much as possible burdensome regulations and report filings by using a route that businesses must follow in any event, that is, the tax code.

Over the past year, as Senator Chafee well knows, we have received many comments and suggestions from a whole range of individuals and organizations. The bill that we have before us today is the result of all these helpful contributions. I believe it is a good bill and a workable approach. These hearings are a continuation of that process. The interest this bill has generated is enormous. The resources and talents of all the people involved in this legislation I think will ensure that we come out with a bill that is well-tailored to meet the needs of depressed areas.

Thank you.

Senator CHAFEE. Thank you.

Would you like to join us up here. I know you have a busy schedule. But if you would like to sit up here for a minute or two you are certainly welcome. I know that you have other commitments so feel free to——

Senator BOSCHWITZ. That is very kind. I would then——

Senator CHAFEE. Representative Jack Kemp was to be the next Representative. He is not available right now because of a Republican conference in the House of some nature. So, therefore, we will host him when he arrives.

Meanwhile let's proceed with the next panel of three distinguished gentlemen. Mayor Voinovich of Cleveland, Baltimore Mayor Donald Schaefer, a noted swimmer, and the Honorable John Mutz, Lieutenant Governor of the State of Indiana representing the National Governors' Association.

Mayor Voinovich.

A PANEL OF: HON. GEORGE VOINOVICH, MAYOR OF THE CITY OF CLEVELAND, OHIO, REPRESENTING THE NATIONAL LEAGUE OF CITIES; HON. DON SCHAEFER, MAYOR, CITY OF BALTIMORE, MD.; AND HON. JOHN MUTZ, LIEUTENANT GOVERNOR, STATE OF INDIANA, REPRESENTING THE NATIONAL GOVERNORS' ASSOCIATION

Mayor VOINOVICH. Thank you, Mr. Chairman.

Good morning.

Senator CHAFEE. Good morning, gentlemen we are glad that you are here.

Mayor SCHAEFER. Glad to be here.

Mayor VOINOVICH. Good morning, Mr. Chairman.

Mr. MUTZ. Good to be here.

Senator CHAFEE. Thank you.

You are all well known to readers of the Washington Post and so why don't we take you in the order that you are listed here. Mayor Voinovich, won't you proceed?

Go right ahead.

Mayor VOINOVICH. Senator Chafee and members of the committee and staff, I might begin by saying that I was told that I have 15 minutes and I understand that I have 7 so I'm going to sort of skip through this.

I am here representing the National League of Cities, an organization with which you are familiar. And I am also going to make some comments from my perspective as the mayor of the city of Cleveland.

Senator CHAFEE. What is the difference between the National League of Cities and the Conference of mayors that Mayor Frazier headed up? Is the National League of Cities made up of chief executive officers of cities, only?

Mayor VOINOVICH. The National League of Cities includes legislators and chief executive officers, whereas the U.S. Conference of Mayors is restricted to mayors and it has more of a large-city bent than, I think, the National League of Cities. But the man that is most qualified to comment on that is Mayor Schaefer from Baltimore, who has been in this business a lot longer than I have.

Senator CHAFEE. I mentioned earlier that Mayor Frazier had been here representing the Conference of Mayors. But the National League of Cities would include, a council member, for example.

Mayor VOINOVICH. That is right.

Senator CHAFEE. And down to small communities. But they would have to be a city.

Mayor VOINOVICH. That is right. I think that the U.S. Conference of Mayors is more provincial in it's attitude because they are looking more at the big city problems. And the National League of Cities is, in order to get some kind of consensus—though I am quite surprised that many of the positions it takes are very supportive of large cities like Cleveland—but you have a larger cross-section of cities to deal with in the NLC than you do with the U.S. Conference of Mayors.

Senator CHAFEE. Fine. Won't you proceed.

Mayor VOINOVICH. I would like to comment on a couple of questions that you asked, Senator Boschwitz.

I am in favor of even a smaller number of zones than the number that has been supported in the bill. I think that this legislation should be experimental to see if it really works.

I think that the Federal Government has become involved in too many programs on too large of scale that people really weren't sure were going to work. And they were held out as being a panacea and they turned out to be flops. That's why we have so much unemployment in a lot of our urban areas today in this country.

So I would like to see it on an experimental basis. And I don't know how many of those there are going to be, but the smaller the better as far as I'm concerned. Let's see if this thing works.

Second of all, if anyone says that major manufacturers around this country, because of enterprise zones are going to put their next plant in Cleveland or some other major city, they're foolish. Because I've had our major manufacturers in Cleveland, TRW, Eaton Corp., and many others, who haven't built a plant in Cleveland for the last 12 or 13 years. They have looked this legislation over and they said in spite of it they won't build their next plant in an enterprise zone.

So I think what we need to do is to focus this legislation on smaller businesses and those that have a possibility of getting into these zones. And perhaps forget about some of these larger enterprises that some people think are going to go into our urban areas.

We also have to understand that we are not talking about the United States any more, we're talking about an international economy. We have Taiwan and other places where the labor is very cheap. And many of those businesses that need masses of people are going to those areas rather than some of our large cities in the United States.

As I said, I'm here representing the National League of Cities and basically the league supports the concept that undergirds the enterprise zones legislation. Stimulating economic growth and employment in areas of poverty and high unemployment by encouraging business through federally targeted tax incentives and local initiatives to locate, remain, and expand in such areas.

The league doesn't endorse every provision of the bill. I will be submitting, with your permission, some written testimony as to the specifics, what NLC likes, what they don't like.

I'm chairman of the NLC Subcommittee on Enterprise Zones. We have been reviewing this legislation for a long time. I participated with a number of city officials around the country in reviewing versions of the bill and we set down some general criteria which I will outline for you.

No. 1, the NLC generally supports the eligibility and designation process contained in the bill which requires that all zones be in urban development action grant cities or pockets of poverty. That is a definition that most of us have signed off on. We think it's a good definition and we think that it should be the way to determine eligibility.

No. 2, we are very concerned that a State Governor would be allowed to veto a local government zone application. And we think that a Governor shouldn't have that power and also we believe that a Governor shouldn't be able to submit an application on behalf of a local government without the local government's permission.

Senator CHAFEE. I don't think there is any suggestion in here that the Governor would submit an application on behalf of the city. The city would have a veto, obviously.

But I think your first point is of concern and I'm not quite sure why we gave the Governor a veto over the application on behalf of the city. That's a good point.

Mayor VOINOVICH. We don't think that the veto is necessary.

It also provides that the Secretary of HUD may revoke a designation if the local government is not substantially complying with the course of action. There ought to be language in the legislation that says that before HUD revokes the designation that there be a great deal of discourse or dialog between the Federal Government and the local entity.

Particularly because businesses may have gone into an enterprise zone based on certain representations. And perhaps during the period of undertaking this course of action that is arrived at, the locality may find that changes need to be made in its strategy. Some of it may be good and some of it may be bad.

So we are just basically saying there ought to be some discussion back and forth between the Federal agency and the local groups before it is revoked.

We support a flexible package of actions, fundamentally, but what we are saying is local governments ought to be able to come in with all kinds of things that they believe will cause entities to locate in an enterprise zone, and then the Federal agency should decide after reviewing them whether they believe they are legitimate local incentives.

Senator CHAFEE. In Cleveland, is it possible for you, under your charter, and under the State constitution to give reduced real estate taxes in a certain zone?

Mayor VOINOVICH. Yes.

Senator CHAFEE. You can do that?

Mayor VOINOVICH. Yes, we have a wide variety of incentives that can be granted in the State of Ohio. And as a matter of fact, that variety is going to be expanded because of legislation that we have encouraged in the State legislature that is aimed at, hopefully, some enterprise zone legislation being passed here in Washington.

So not only will we have State incentives and local government, but we will have them combined.

S. 1310 requires that 40 percent of those persons employed in the zone must be CETA eligible. If I only make one point here today, I would like to make this point, and that is this. This is either going to have to be an economic revitalization bill or it is going to be one of those social welfare bills.

If you tie this legislation into all kinds ef AETA eligibility and if in order to come into a zone and you have to have x number of CETA eligible or unemployed or underemployed and so forth, I think the legislation is going to fall flat on its face.

We have spent years trying to go after the unemployed and the underemployed in this country. And the unemployment lines in our large cities are longer today than they have ever been before.

Our attitude should be to try to get the economy going in our large urban areas. And we ought to be doing that by trying to take the industry that we have and get it to stay and to expand.

We ought to be trying to get smaller businesses, those that will be the Fortune 1000 maybe 15 or 20 years from now. We need small business. We need venture capital.

And if you tell small business and venture capital that we would like to get into an enterprise zone, that 40 percent of your employees are going to have to be CETA eligible, you can just forget about it.

I think the main thing is to get something going in these cities. And I think some of the other aspects of this bill will take care of themselves.

So that should be the thrust. The thrust shouldn't be some bill aimed at trying to get at the underemployed and unemployed. Because there are a lot of people today that are unemployed that are very skilled workers and are out of work because their businesses have closed down. They have moved out of places where the jobs have gone to West Germany or Japan.

Senator CHAFEE. Go ahead. I want you to finish your points. You have time, because you are a very, very important witness. You are right out there on the firing line.

Mayor VOINOVICH. Well, I would just like to finish from the National League of Cities point of view. And that is, and I might say that the league's position is that there ought to be CETA requirements, that there ought to be an aspect of this. In fact the league says that at least 35 percent of the folks involved should be CETA eligible and it should never drop below 20 percent.

One compromise might be that if it is an entity of less than 25 employees, those CETA requirements would not apply, or maybe it would be a smaller number. But the idea is to get them in the zone. And have them start doing business.

We believe in the use of targeted tax incentives to create the jobs. We believe that tax incentives should be provided that are relevant to the needs of a variety of sizes and types of business. And that they are sufficiently oriented toward employment to achieve the job creation goals of program.

I think what you need to do is get the small business guy in here. Get the people, for instance, that are involved in making money, venture capital money. And say to them, hey, if this legislation passed would you go into that zone?

And I've talked to business people in the Cleveland area about a lot of these Federal programs. For instance, the targeted jobs credit that was supposed to be a whiz bang operation. Most of them won't participate in the targeted jobs credit. It's not enough and it's not long enough for them to get involved with it.

But we had the Department of Labor having the city spend thousands of dollars advertising targeted job credits, and if they had gone out and talked to some of the accountants and other people, they would have told them that there is not enough in here for us to get involved with the program.

So the thing is this has to be realistic legislation. And it shouldn't be sold as, I say, some kind of panacea that is going to solve the economic problems of this country's large cities.

A couple of other points. Technical assistance. Frazier mentioned the fact that some cities are more sophisticated than others. HUD ought to be in the position to provide some technical help to cities that are interested in getting into this program.

And last but not least, I think that there are a lot of other good Federal programs. There is no better person to testify as to their merit than the man sitting to my left, Mayor Schaefer, who has ably demonstrated what can be done if you have a good, creative staff of people working in your city and good leadership. He has transformed Baltimore through the use of many of these Federal programs.

And the EDA program is important, our UDAG program is important. Our CETA program is important, particularly in training people for private sector jobs.

So none of us, I think, would advocate that if you passed this legislation that you should forget about all of these other programs, that have very fine track records, and I think should be supported.

Senator CHAFEE. What we will do is have the testimony of Mayor Schaefer and Governor Mutz and then we have got some questions for you, I'm sure.

Mayor Schaefer, we are delighted you are here and look forward to your testimony.

Mayor SCHAEFER. Thank you very much, Senator, and I extend you greetings from the seals in the city of Baltimore. [Laughter.]

I went down to see the mayor seal early this morning and told him I was coming over and he wanted me to send special regards.

Senator CHAFEE. Well, I'm delighted. That opening is going to be in August, as I understand. Do we get another performance if it is not opened by then?

Mayor Schaefer. I'm going to be in that pool from August 8 until we get the doors opened. [Laughter.] And we are going to have a new head of the aquarium, I tell you that. [Laughter.] But we are going to open August 8.

I am very honored to appear with my good friend, the mayor of Cleveland. Lots of fresh air, very, very smart. Obviously a mayor that cares.

But the more I appear over here, the more difficult I see your position. Trying to draw a bill, as a law, that will apply to the city of Baltimore and to the city of Cleveland and to Houston, Tex. All of us very different, all with separate problems.

All trying to solve the things that they are concerned about. Now, I'm worried about a number of things.

I am worried about unemployment. It is very easy to say that. I am worried about business. I am worried about expansion, retention, investment in areas of need. I am worried about jobs, because we know that a person with money in his pocket is less apt to cause you problems on the streets. I learned that from a great mayor name of D'Alesandro.

I worry about the cycle of crime, and what a person does when they get in the cycle and when they are on their way out. Where do they go, what happens to them?

I am worried about those who don't know how to apply for a job.

Now it is almost impossible for the Members of the Senate and the House and mayors and others to understand the plight of a person who doesn't know how to apply for a job. It seems so simple. Where to go, how to approach a Senator. How to approach a mayor. How to approach an employer.

Worried about that. Worried about the alternatives in the event that you don't come up with a good law. You know, just say, well, you know, there have been too many programs over here in Congress. And too many things.

We have taken your Federal money and our State money and we have been able to demonstrate that if the program is good, and if we are able to really concentrate and work on them, they do work. And all the programs that were developed by Congress and that you passed, weren't bad programs.

We like to show you. I have the greatest difficulty in getting people over to show that the CETA did work. To show that UDAG did work. And the programs that didn't work, we readily admitted that. But many of them did work, and we were able to progress.

And then there is the question of, what are people going to do? You know, they have got to live. They have to survive. If they can't survive without a job, how are they going to survive? You just don't write them off. They are still there, and what do you do about them? And I'm worried.

Senator, you talked about bidding between cities. I can't bid against Houston. I don't have the resources to bid against Houston. Houston can expand tomorrow and put on 50,000 new acres of land if they want. They have got money running out of the soil that we don't have. They have got infrastructure and money that we don't have. And when I talk about building and bidding it is like the lame and the hulk bidding against each other.

Now I can compete. I can compete. We are good at draftsmanship and so forth.

But bidding against each other—what I think you have to have are cities where you have got to put an enterprise zone. Cities where there is a real need for an enterprise zone. Where there is a reasonable chance that it will succeed. Where the mayor wants to have an enterprise zone. Where business says we will try to help. Where there are unemployed. Where there is an area of unemployment. And where the possibility that the business that comes in the area will have a chance of making a profit. And if you think that any business, large or small, is going to come into the area without a reasonable chance of success, they are not going to do it—unless they are a gigantic corporation, that can just say, OK we will put in a half a million dollars because we are good people, good citizens. They are only going to be there for a short period of time.

So you have to have some incentives for small business to come into these zones where they will employ the people. And I will describe the people in just a moment. And create jobs for those who really need a job. Really need a job. Not a person who walks down the street, "I need a job." I'm not talking about them. But a person who will come up to you and say, "I just got out of jail. I don't want to go back to jail. I want a job." That is the kind of person that I would like to be able to find a way to get him into a job.

Now, what would I like in an enterprise zone? I would like to have an area where there is a need for the employees. Where small business can eventually expand. Not to shift a business from one area to another because there are tax incentives, and you have caused yourself a problem in another area.

Get away from all the redtape that we have in some of these programs. Flexibility on our level and on his level. He can do it. Not have so much control. And make sure that the business can make a profit.

That is just a preliminary statement. I guess it has taken all my time. But I would like to get into some of the things that I would like to say.

Senator CHAFEE. Go right ahead, Mayor.

Mayor Schaefer. You know, I have been over here many, many times. I come over here not to complain, and not to ask for money. I came over here to tell the people in the House and the Senate what will happen with some of the programs. What will happen when the programs are gone. Some of the successes we have had with EDA with UDAG and with CETA. Of course the response has been very good. We have been well received.

Now, what is an enterprise zone supposed to do? Now no one thinks that it is going to cure all of the ills. That as soon as you pass the enterprise zone the city of Baltimore's unemployment is over. Listen, this is another area of trying to find some way to employ people.

Among young blacks in the city of Baltimore, 50 percent unemployed in some areas. Fifty percent! That is a lot of people that are out of jobs, 40,000 people out of jobs in a city like ours.

Now, part of the package of incentives to business, the enterprise zone bill holds a partial success. As a local official, I know how difficult it is to bring business to a city.

If you think they are all lined up to come to Baltimore, where our tax rate is double the surrounding areas, where we have some problems in this city. And while I talk about all the good things in the city, I am also realistic. We have problems in the city.

So we have to do everything we can to get a business into the city. We concentrate first on retaining business. Then to expand business. Then to bring business in.

It is hard to bring a business—I can't go to Cleveland and say, "Come on over to my city. I want you to leave Cleveland." He's got problems over there. He is not trying to drain everything from Baltimore city.

Senator CHAFEE. OK. Can you give reduced real estate taxes?

Mayor SCHAEFER. No, sir. We can't do that.

Senator CHAFEE. Under your charter, or under the constitution?

Mayor SCHAEFER. Under the Constitution of the State. And the State, I know, unless there is a miracle going to happen, they are not going to change that law. So we can't do that. It is impossible for us to do it.

And if we could, I'm not so sure that I would really want to do that. Because we need the taxes in order to stay somewhat competitive with the counties.

We are at 593 with most of the poor, most of the unemployed, most of the needy senior citizens—you have heard that litany before—surrounded by Baltimore County with a tax rate of $3, very little public housing, very low unemployment. That is what we are competing with in an enterprise zone. So when I talk about areas of need, areas of need in Baltimore County—and I use that, and I'm not talking against Baltimore County—they don't need enterprise zones. We need an enterprise zone.

We have got an area where an enterprise zone could be set up right today. Perfect area. All set.

Senator CHAFEE. Are you allowed to build buildings and give a low rental on a building, for instance?

Mayor SCHAEFER. Those are part of the packages I think we should do. I think we should do things like that. I think we ought to package loans.

I think we ought to put in some infrastructure, all the things that we can do. Added police protection. All the things that we can do to put in a package to make an enterprise zone.

Senator BOSCHWITZ. Added police protection is not really the primary object of this act. Businesses can locate in the suburbs where they don't need added police protection. That's not an advantage, it merely evens out the two areas.

Mayor SCHAEFER. Not what, sir?

Senator BOSCHWITZ. Not an advantage. To have added police protection. You do not need added police protection if they locate in a $3 tax rate area.

Mayor SCHAEFER. Somehow, if you don't——

Senator BOSCHWITZ. You spoke about the problem in your city, and that you have a tax rate twice as high as your surrounding area. No wonder you have problems in your city if you have a tax rate twice as high.

I don't understand why you can't bid against Houston. Do you think they can give away more of their tax base because they have such a large tax base? Is that the idea? Or——

Mayor SCHAEFER. Have you ever been to Baltimore or Houston?

Senator BOSCHWITZ. I went to college in your city. That was some time ago, I admit, but I have been back there a number of times.

But certainly you can compete against whomever you wish. If there is any hope for Baltimore at all, quite aside from this urban jobs development bill, you had better be able to compete or bid against Houston. And you certainly have very many advantages over Houston. So it would seem to me that you would be able to do so.

Senator CHAFEE. I wanted to comment on Mayor Voinovich's remarks that he wants even fewer. I think that up to 25, 25 or even more is OK. I would like to respond to that. Otherwise I think that we might not get some people involved in the bidding process or the competing process as Mayor Schaefer likes to call it. If there are only three or four I think that there won't be enough hope for cities to participate. If there are only three or four I am afraid that the politics will get so involved in the selection, even with 25.

You know, we are going to be calling up HUD, bringing pressure——

Mayor SCHAEFER. I think the main point I am trying to make, Senator, is that it should be on an experimental basis.

Senator CHAFEE. Yes.

Mayor SCHAEFER. We are going to try this out and see if it works. And if it is 25 that you need to have in order to get some competition, and a good cross-section of people, then fine.

But I don't subscribe to some folks point of view that if we are going to get into this we have got to do it full blown throughout the country. I think that the Federal Government has the responsibility to do some research and development. And I don't think it has done enough research and development in a lot of areas where we have problems.

Senator BOSCHWITZ. I quite agree that we shouldn't go into it on a wholesale basis. I don't think 25 is too many. I am afraid that if you had many fewer than that the bureaucrats simply won't be able to make up their mind and will just go on and on in trying to make the decision so that having a couple of dozen or maybe even more than that is not too bad.

My experience with major manufacturers in Minnesota has been that if you find the right one—apparently you say TRW is not the right one—you find the right one, there has to be a certain, I suppose social conscience involved. If you find one, for instance Control Data in our State has put up a number of plants in what we would designate as an enterprise zone and has done so very successfully. So it really takes finding the right company and I hope you don't give up on the larger manufacturers. Larger corporations. As I pointed out in my testimony, I think that the act is directed at smaller employers and quite clearly the research that Mr. Birch has done, I'm sure we will talk about later on.

Mayor VOINOVICH. May I say this? I would like to submit and I will submit to the committee, with your permission, an analysis that was done by a cross-section of manufacturers in the Cleveland area. I just said, "Look at this and be honest with me, will you?"

I would like to say that maybe you will find that right one. I don't want you to assume that TRW or Eaton or many of our major corporations don't have a heart, Senator. Because they have big hearts. But they also have shareholders, and they have an obligation to pay dividends.

I think it is important to go to these people and really find out if we create this legislation, these businesses locate in enterprise zones. And if you won't go into enterprise zones, why won't you go into them? The bottom line for a lot of larger cities in the Northeast, Midwest, Senator, is the labor aspect of this consideration that has been detrimental in terms of their expanding in urban areas. That is why they have gone south and gone to other places.

I think we are naive if we think that tax incentives alone are going to solve that problem. Because when they look at cost of production, they look at productivity in certain locations versus our location, even with these incentives it is still cheaper for them to locate their plant in some other area.

Senator BOSCHWITZ. Well, I'm sure if you go and ask, "What do you think of this bill?"—I don't disagree with what you have said. But if you go and ask somebody, "What do you think of this bill?" If you came to me as a businessman and say "What do you think of this bill?" I would figure out a way to ask for more. Particularly if you are going to go down and testify and give your opinion to some Senators. [Laughter.]

Second, getting back to the large companies. I don't know the ownership of some of the companies in Cleveland. I again have found that if you find a larger company—and using the example of Control Data—where the original management, the entrepreneurs are still in control, I think you probably will find a large company that will be more willing to take a chance. More willing to go with risk and be much more risk oriented than a normal company.

So I don't mean to indicate that your companies don't have any social heart. I find that some do, some don't. And I am very disappointed in many instances.

But I think that you can, if you sought them out, you can find some.

Thank you, Senator, for letting me——

Senator CHAFEE. Mayor, won't you continue?

Mayor SCHAEFER. I have learned not to disagree with Senators. But, unfortunately, I didn't learn my lesson too well. [Laughter.]

Senator, I don't agree with that.

I know that you think that my testimony, possibly I don't know what I'm talking about. And I guess I don't. Big business or little business have one thing in mind, in my opinion, profit. You can't expect a big business to go into any zone or any place and keep pouring money in without a reasonable expectation of a profit.

Control Data that you used as an example, I think, is an exception. And in the testimony I will give today, Bill Norris is coming into the city of Baltimore and he is going to set up an enterprise zone type area in Park Circle. Park Heights. Right in the Park Circle, Park Heights area. This is a different type of individual. He has a great social conscience.

If all these big businesses were so nice they would have done it in the past. Bill Norris has done it because he believes in this type of thing. Now, he is setting up a boundary in our area. He is setting up a technical school same as he did out in the other place. And we are working our hearts out to try to make sure he is a success.

But if all these big businesses had felt the social conscience, they would have done it. Since the new administration has come in, and some of the things that they are doing I totally agree with. But there hasn't been a great shift to the private sector in picking up all the jobs that have been lost. And they can't do it. As things come on line, as incentives come in, I think there will be. But right now, if you are setting up a enterprise zone—and some of those things that they are taking those maximum risks in those areas—you would have to try to minimize those risks. But if there is a reasonable expectation of them making a profit——

Senator CHAFEE. It is not the thrust of the enterprise zone bill to rely upon social consciousness of investors. I want people to be able to go in there and make a profit.

Now, maybe the incentives that we have got here are not adequate. The indication from your testimony, Mayor, and that of Mayor Voinovich is that the bait isn't sufficient.

But I don't think we want to devise something that would be dependent upon some entrepreneur with a marvelous social conscience who is not interested in a profit. There are not many of those around, and if there are, they are not going to survive very long in these areas. So perhaps we have to boost the attractiveness of the incentives.

Mayor SCHAEFER. There is a number of things. Everything that the mayor said, I agree with. All the incentives that they have. But take Baltimore and you take an area in Baltimore. If you were a businessman, just a businessman, would you locate in a neighborhood with all vacant and rundown buildings. Would you draw your labor force from neighborhood residents who are unemployed. Haven't had a job. Lack skills? Who haven't even completed their high school education? Would you move into an area where there is higher insurance risks and greater incidence of crime? Would you go in an area where there is inadequate sewage, possibly. Where the lights and the roads are full of potholes?

Those are areas where there is real need. And if you were a real logical businessman, with no incentive to move in, and just relying on your social conscience, I don't think you would do it. I really don't.

And so what you have to try to do in these zones, as I would see it, is try to minimize the risks of those businesses that will go in there. And if you minimize the risk there is an opportunity to do it.

The package that you are putting together, I am all in favor of it. It is not wrong for a businessperson, in many instances, to ask for additional things. He is not going to get everything, but if they can ask for it, and some of the things are logical, I think that is proper.

Even though we have made great progress in the city of Baltimore, with Harbor Place and all the rest, we still have plenty of areas where there is neighborhoods, rundown neighborhoods, all the problems I enumerated over there, still there. Now, how can we continue to attract this business investment, new business development to our city?

We feel the enterprise zone is a move in the right direction. When I do say that the bill's tax incentives are not enough. Tax incentives may be a centerpiece for a larger package of business incentives. Programs similar to the urban action grant program must be used to leverage and start up capital so important for new businesses. Federal funds must be used to help finance roads and sewer connections.

In a city like ours, that has right now, many serious problems. If we are called upon to put in all the infrastructure in an enterprise zone, I am saying, and I think the Senator misunderstood me, we couldn't do it and a city like Houston could put in the roads in an enterprise zone at the drop of a hat.

I couldn't do it. So we would need some additional assistance.

To make it easier for zone residents to fill jobs, day care, help with transportation and other important human services will also be needed. When local government can see the economic and social benefits we will be willing to commit such services as extra police and fire protection for previously unused property.

The Senator seems to think that added police protection in certain areas where there is high crime is not one of the things that are necessary. If you have a high vandalism in an enterprise zone and you can put in some extra police protection in order to save the property, the business community won't ask for it they will expect it and demand it.

They are going to demand certain things that you have. That is the way you try to bring some of the business into the new area.

It is vital to the success of the enterprise zone legislation that formal linkage be established with other urban programs. For instance, in these days of tight credit and almost nonexistent construction loans, the lack of affordable capital is the greatest obstacle.

If you don't have some upfront capital for us, we are not going into the enterprise zones. And I learned it when I was up in New York with Congressman Kemp. The small business didn't care about all this tax incentives and all this.

Up-front moneys, moneys that allow them to move in.

Senator CHAFEE. I think that was the point that was stressed in Boston, when you and I——

Mayor SCHAEFER. That is exactly it. And to be perfectly clear, Urban Development Action Grant program has succeeded in an attempt to leverage private investment.

In August of this year we are going to open up the Hyatt Hotel. There are going to be 500 new jobs. And they will be filled with unemployed city residents who have come through the CETA program. Hyatt said to us, "Bring your CETA employees in and we will work through them." They have worked with Harbor Place and that is the type of thing that we need.

We also emphasized the need for adequate training in the CETA program. We had a successful CETA program. We took those people that I talked about that didn't know how to apply for a job. Started them off. They weren't in the credit ledger as getting jobs immediately, but you got people who were starting for the first time to find an opportunity for a job. And we support that.

Just let me mention the Park Heights area. We have a prime candidate for a enterprise zone in Park Heights. It is at the southern tip of an urban renewal area. The entire community has experienced an enormous disinvestment of all kinds. It is predominantly a black community. Disproportionate share of young unemployed; 50 percent in that area unemployed.

Full of social ills, but there is still hope. The Park Heights community, an area, is on its way to becoming a pilot enterprise zone thanks to Control Data Corp., City Ventures, and Commercial Credit.

In less than 3 weeks, Bill Norris, head of Control Data, is coming to Park Heights to break ground for a new business and technology center. I still repeat he is an exception. He is the exception. Once it is finished, the center will be an incubator for new business and new business means jobs.

Commercial Credit has already made a commitment for a boundary in the area. We are now trying to make sure that they have enough business to stay in business. He put the building there, he put the people there, but he still has to have the business pushed in there and he is looking to us to help get some business to keep it moving. Those are some of he risks he puts in. We hope eventually that will be 2,500 new jobs.

Just let me end by sending this summing up, what we would like to have. Economic development activities that help us increase the number of jobs. A combination of tax incentives and wage substitutes to employers who agree to hire the workers. Education and training programs that are carefully designed to increase worker productivity and marketability. And the creation of more small businesses because we think that is the real area of success in enterprise zones.

I will stop by saying there was a report by the Greater Baltimore Committee on the enterprise zone. Many of the things they have recommended are in your bill. So I would like to leave a copy of this with you. It was just published yesterday. Leave a copy of this bill with you.

Senator CHAFEE. Certainly, fine. Thank you.

Governor Mutz.

Governor MUTZ. I am pleased to be here today on behalf of Governor Orr of Indiana and the National Governors' Association. I might also say that in Indiana the general assembly has given me the responsibility of being the director of the Department of Commerce in our State.

So on a day-to-day basis I am involved in the administration of laws and rules and the promotion of job creation in our State. So I am pleased to have a chance to speak with you about this particular proposal.

I would like to share with you some of Indiana's approach to the enterprise zone as it applies to economic development. I think we all realize the shortcomings of simply throwing dollars at urban problems. In my opinion, enterprise zones don't throw dollars. They should plant dollars and give them a chance to grow where we plant them.

If this idea works, and I think it will, I think we will find some success in terms of putting people back on a payroll and off of the welfare system that we have known in the past.

Although I like the idea, I support the committee's current proposal to make this a demonstration project. One which can be tried out, amended and changed as different communities have a chance to work with it.

I think the effectiveness, as these two gentlemen have said, of an enterprise zone will finally be determined by the ability of these zones to attract new entrepreneurs and to increase the rate of business formation and to encourage expansion of existing small firms in the distressed areas we are trying to help.

Small businesses, in my opinion, are the key to job creation and economic growth. In the overall picture, that will not come from the Fortune 500 and second 500.

Some changes you have already made in the legislation, in particular the elimination of the capital gains tax, the provisions for the refundable job tax credit, I think are helpful. And will be good for the struggling kinds of firms that are likely to be located in these areas.

I would like to suggest one additional incentive in the Internal Revenue System. And that is to allow an enterprise zone entity to sell a loss carry forward to any other corporation that is willing to pay cash to buy it. The advantage of that idea, in my opinion, is one which gives us a chance to test an idea which others have talked about in a limited way. It also provides an influx of cash to the company that is involved, which is the thing it needs the most in the early years of its development.

And it is money that doesn't come from the public sector. It comes from the private sector. I think the free market would begin to determine the value to be placed on a loss carry forward. I notice the legislation includes a 20-year provision for carry forward or loss carry forward.

However, I think it is important to recognize that this group of tax incentives that you propose by themselves are not sufficient to make this program work. To beat the nearly impossible odds, a struggling small business in a distressed area will need a coordinated package of services.

Investments and incentives to be provided by State and local governments are the key to success. Basic improvements like stepped up law enforcement, housing, employment and training services, business loans and loan guarantees, and streamlined regulations will make a big difference as to whether these businesses survive or not.

In Indiana we view enterprise zones as fitting into a comprehensive framework for statewide economic development. We recently created a new commission on enterprise zones, to explore the feasibility of an enterprise zone program for Indiana.

The same time Governor Orr and I proposed to the legislature a package of 19 bills designed to implement our economic development plans for the State. The main feature of this package is the importance we place on small business development particularly in distressed areas.

We are creating a new corporation for innovation development that will generate private capital in the form of venture capital. Pools of venture capital will be made available for investment in the equities of businesses like the ones we have been discussing.

Owners of new manufacturing equipment in designated urban development areas can claim a 5-year property tax abatement. This is in addition to abatement on real property, which is available in certain areas in various parts of the State of Indiana, at the option of local governments.

Indiana's Neighborhood Assistance program, that provides State income tax credits to individuals and businesses for investments in distressed neighborhoods is another program that adds to the package that we have available.

Other specific job-creating steps in Indiana's new economic development program include more skill training for potential employees with specific grants for that purpose. Grants for rural economic development, which as I understand also is a consideration you are looking at in this program. New funds to help cities and towns pay for the infrastructure improvements that will be needed in these areas.

All these things are being packaged together so that we have a way to prepare the kind of program that we hope will work. These initiatives, together with the wide range of other continuing economic development programs, establish a good foundation for our State to play a constructive role in implementing enterprise zones.

More than 20 other States have passed, or are considering, enterprise zone legislation. Based on my experience in Indiana, I am convinced that States are suited and must be closely involved in planning and overseeing enterprise zone programs in their jurisdiction.

In our testimony there is a more lengthy statement of what I believe the State role should be.

The National Governors' Association, of course, is pleased——

Senator CHAFEE. Do you agree with Mayor Voinovich that the State should not have a veto power over a zone?

Governor MUTZ. No, I do not. I think more affirmative action on the part of State government is absolutely essential if we are to make this kind of thing work.

Senator CHAFEE. Yes, but suppose the city is prepared to go ahead and they are not looking to the State for great things, they are willing to plunge ahead themselves. Why should the State have a veto power over them?

Governor MUTZ. Well, In the early stages of your program I agree there is really no need for that. Because if you are only going to create 25 of these zones it is unlikely that one State is going to have more than one in the early phases of the program. Even after the end of the third year of your proposed program, it is unlikely.

But as we move to the point where more than one enterprise zone is located in the same economic jurisdiction, then there is the question of pirating economic resources from one place to another. Jobs from one place to another. Retailers from one place to another, et cetera.

I believe the State has a responsibility to make sure that sort of thing does not occur. In addition, one of the important elements of any program like this is job training. Specific job training. At least in Indiana all job training programs are coordinated and operated at the State level.

Senator CHAFEE. OK.

Governor MUTZ. So if we are going to have that kind of cooperation it is almost essential that the State be involved. I am suggesting the State, or the Governor should sign off on this program.

Senator CHAFEE. All right. Does that complete your testimony?

Governor MUTZ. Yes, I think it does, except to say that overall the Governors' Association, Governor Orr and I wholeheartedly support this program. We hope that Congress will move quickly to implement it and give us a chance—those of us who are on the firing line on a day-to-day basis in economic development activities—give us a chance to work with this program. We think it is a winner; one that will work.

Senator CHAFEE. Thank you, Governor.

Senator Bradley, do you have any questions?

Senator BRADLEY. I would like to ask the mayors if any of them have had experience with tax abatements in their own city? What their assessment is of the tax abatement program, and could they describe for the committee the basic contours of a tax abatement program that has either worked or not worked and why.

Senator CHAFEE. Are you talking real property?

Senator BRADLEY. Yes.

Governor MUTZ. First of all, let me say I'm not a mayor. I'm the Lieutenant Governor of Indiana.

Senator CHAFEE. That's right.

Governor MUTZ. So my perspective will be a little different, possibly, than my colleagues.

Senator BRADLEY. That's why I would just like to hear from the mayors, primarily. Or, if you have——

Governor MUTZ. No, we have a lot of experience in Indiana with tax abatement. And it is a State legislated program which is granted at the option of a local community in which the local county council or city council must authorize the tax abatement.

We have two kinds of tax abatement. We have a 10-year abatement, which phases in improvements on real property over a 10-year period. We have an abatement now available on business personal property, which is an important consideration in getting existing businesses to upgrade the quality of equipment, machinery and tools that are currently in those plants.

We are working with some very large companies in that respect to encourage them to make that investment decision in inner city Indianapolis rather than somewhere else.

So tax abatement, in general, in Indiana has been on our books for 4 years.

Senator BRADLEY. Four years?

Governor MUTZ. Four years. We have 19 cities in Indiana that have used it. I don't have accurate figures for all 19 cities, but in Indianapolis alone we have had an investment which is generally attributed by the mayor of Indianapolis, with encouraging, about $190 million dollars worth of new investment. And the creation of some 2,310 jobs.

Those figures, of course, are tough to really define because, as you know, the decision as to whether somebody created those jobs or not is not always correlated only to tax abatement. That is one of the factors involved.

We have had some experience.

Mayor VOINOVICH. We have had tax abatement in the State of Ohio for about the last 6 or 7 years, and there was a flurry of the use of it for a while. Now that has abated.

It has been very controversial in most of our cities. In some areas, I'm the former auditor and assessor of our county, many of us felt that it was given in many instances where it wasn't needed.

We have underway in Cleveland now, three and the new headquarters for Sohio and none of them have come to the city asking for tax abatement.

So it hasn't been a big deal in terms of the new development we have seen in the last couple of years in the city.

On the other hand, I think it is a tool that we have available to us and certainly if we had an enterprise zone, and the tradeoffs were right with the potential person going into the zone, it could be the difference between that individual coming in or staying out.

Of course, we are also fortunate that we have the urban development action grant program. And though we haven't had a large UDAG grant in the city of Cleveland, we have had a series of very small ones during the last couple of years. And I can testify today that they have made the difference in keeping many of our industries in the city. Where they were sought after by southern cities and also suburban cities, the fact that we have the UDAG available caused them to stay and expand in their present location.

So in effect, what we need is sort of a battery of various incentives. Put a package together and then see what the tradeoffs are and then go forward.

Senator BRADLEY. So if you were going to list the tools that are available to you, to complement the urban enterprise zone, you would list the tax abatement possibility, the UDAG grant, the EDA——

Mayor VOINOVICH. I think EDA and UDAG and some of the things that we have done with our community development block grant program are a whole lot more important than the tax abatement incentive.

Mayor SCHAEFER. I agree. We don't have tax abatement at all and to put it in the bill—we are ineligible. We would need a constitutional amendment.

I don't think it is that important, and I wouldn't favor tax abatement. As the mayor said, the EDA, UDAG, and CETA are the real important parts from our standpoint.

One thing I just hope you won't have a veto power on the State level. Because you will be creating greater bureaucracy than you have ever seen on the Federal level. Cities will not be able to move if the States are vetoing things that we want to do.

This rivalry and trying to pull businesses from other areas, I don't think that is quite as serious as having the State tell you, a big brother attitude, you can't have an enterprise zone.

Senator BRADLEY. So you don't use tax abatement, though?

Mayor SCHAEFER. No.

Senator BRADLEY. I was interested in your question, that you felt that the incentives that were offered in this program were insufficient.

Some of these incentives are forms of much lower taxes. And yet on the one hand you are asking for greater assistance from EDA and UDAG and CETA and other Federal commitments to the cities, including commitments also in the form of tax reduction at the Federal level. And then some of you at least are saying that tax abatement at the local level is helpful in trying to generate economic development.

My question to you is, "if there were tax abatement at the local level, wouldn't you have to have less tax abatement at the Federal level? And therefore wouldn't these incentives be a little better than if you had no tax abatement?"

Mayor SCHAEFER. Not from my standpoint, no.

Senator BRADLEY. Why? Could you explain for the record?

Mayor SCHAEFER. I go back to the tax rate again. Tax abatement, continual tax abatement, on a rate eroding our tax base. Last year we retained a tax rate of $5.95, just below $6. We are going to try to maintain that. The more you take away the tax base from the city of Baltimore the higher the taxes eventually are going to go.

That is very difficult for us. So I am just not favorable with tax abatement.

Mayor VOINOVICH. Something else, Senator, that needs to be pointed out is, there was a study that was done a couple of years ago by a committee of the House and the Senate. It was a survey made of some 18 or 19 cities in the country in terms of what it was that caused business to stay and expand and be attracted to those communities.

Quite frankly, it wasn't the local tax structure. It was first, government's attitude toward business. That was No. 1. After that it was the basic city services that were provided.

If you have tax abatement and you don't have the dollars necessary to provide the police and fire protection, snow removal, and those other things—that is the bottom line. No matter what you do here, if I am not providing those basic services in the city of Cleveland, we are not going to get somebody to stay or to be attracted to our community.

Senator BRADLEY. What more do you think has to be offered here in addition to the tax incentive provisions that are included? You say it is not enough. What more? If we were going to add one or two other incentives, which do you think would be the most effective in attracting business to Cleveland or Baltimore?

Mayor VOINOVICH. I mentioned to Senator Chafee that I will be glad to submit a complete analysis of this bill done by our small business people, and medium sized businesses in the city—but it was already mentioned that many of these small businesses need capital.

There has got to be some kind of a provision where they can get their hands on capital and I'm sure you are familiar with small business debenture proposal that the small business groups from all over the country are interested in seeing put into effect. Where they can borrow money and those that they are borrowing from participate in the profits if there are profits.

Senator BRADLEY. Yes.

Mayor VOINOVICH. But there are a series of possible incentives. We recommend that firms of all sizes be eligible for an employment tax credit for the larger of either actual training costs for new CETA hires, or double the current limit of $3,500 in targeted jobs programs.

We recommend that firms of all sizes be allowed a 20 percent investment tax credit on all new investments within the zones and that such a credit be refundable for small businesses.

We recommend that larger businesses be given a 10-year carryback or carryforward. We get into things dealing with the industrial revenue bonds law which would give special kinds of treatment to those firms which locate in an enterprise zone. For example, allow qualified small businesses to use IRA's without dollar limits.

Other firms not meeting SBA size standards should be allowed IRA limits up to $25 million; $35 million for the UDAG. And 6-year investment limits within the zones.

There are a lot of specific things here. I am not a tax lawyer. But I suggest that when you really get into some of these incentives that you get the folks that are out there that are doing business to come in and realistically appraise some of the incentives that you have. And say, "Look, it's not enough." And then, what is enough?

And as Senator Boschwitz said, that they want every thing they can get. And let's face it, a lot of them do. But there is a middle ground there. I think it is important that whatever the incentives are that they be realistic. And that you ask the question: "Mr. Businessman, you are now located in X. If an enterprise zone goes in, if these incentives are in this bill, would you go into an enterprise zone?"

Senator BRADLEY. What about Baltimore?

Mayor SCHAEFER. I think the mayor covered it. I think that saying to the businessman one thing, would you come in? Under what circumstances would you come in?

No, we were in New York and put on all this presentation and at the very end they said, "How many businesses would come in?" None of them raised their hand.

One lady said, "I'll come in if you put up the capital up front." They were all very cautious on what they are going to do.

I think a real discussion with the businessmen who are putting the money up is very important.

We know what we can provide. Mayors can provide X. Everything—the police, the fire, and all the rest and have a good business climate. And I get back to that one thing. There has to be some possibility of profit.

While you talk about your social conscience, I went through that years ago. I really believe that stuff about social conscience of big enterprise. And that was fine. It sounded nice. The bottom line with all that social conscience: Is there a reasonable expectation of being able to make some money in the area? And are we able to employ people that will work in the area?

It is up to us, I think, to train the people through a CETA program, education program, whatever it might be. Give an employer people that can perform a job.

Senator BRADLEY. So you are saying——

Senator CHAFEE. Let me ask one quick question if I might. Mayor Voinovich was very strict on not wanting any CETA requirements.

I would like to point out that I think we would have a very difficult job getting Congress to approve this bill if we didn't have some such provision. Because you could easily have a situation where somebody would come and put a plant there and it would consist of a whole group of suburbanites that drove in and drove home that night. We wouldn't have really done anything to improve the unemployment picture.

I take it that Mayor Schaefer was prepared to go with this 40 percent CETA eligible. I really see great problems, Mayor Voinovich, in the position that you take.

Mayor VOINOVICH. Well, I think that point I made was that if you make the 40 percent CETA eligible, and make this an inflexible requirement, that you are not going to get the small businesses and the venture capital people that you want to go into an enterprise zone that will ultimately become the larger employer in that area. And that if you want this bill to be another bill strictly aimed at the underemployed and unemployed of this country, that I don't think it is going to be successful.

Let me say this, the Congress has spent 15, 20 years trying to reach the unemployed and underemployed. And as I said earlier, the lines are longer in Cleveland because while we were concentrating on this group of people, we had industries moving out of the city.

Our job is to take the industries that we have and keep them and get them to expand. That is No. 1.

No. 2 what we need to do is attract into the city, smaller businesses that ultimately are going to become larger employers.

Senator CHAFEE. Then you think that we need businesses that would pick up the CETA eligible.

Mayor VOINOVICH. Absolutely. And if you want to get them to hire the CETA eligibles and others, you make it worth their while by increasing the targeted jobs credit. And you extend it over a longer period of time than you now have it.

It will happen. And let me say one other thing to you. It is important that we have these businesses in our communities because they provide the tax dollars that allow us to provide the services to the unemployed and underemployed. What has happened is the programs, in my opinion overall, haven't done that much for the underemployed or unemployed, and we have lost businesses. Our tax base has deteriorated. We have less dollars available to take care of the underemployed and unemployed people.

We need enterprise in our cities. We need to create tax dollars.

Senator CHAFEE. Would you subscribe to the criteria that has to be met for the jobs enterprise zone, namely that the unemployment rate over the last 18 months be at least 1½ times the national average.

Mayor VOINOVICH. Sure. I think those are good in terms of where do you put them, that's great. You ought to look at, also, the number of people that have exited out of a community. Maybe Mayor Schaefer won't agree with that because that is self-serving. We have lost 25 percent of our people

Senator CHAFEE. I see you are shaking your head, Mayor Schaefer. What do you say to this?

Mayor SCHAEFER. I always hate to disagree because he is such a great guy. [Laughter.]

But I do totally disagree. Because I think as we see it, the enterprise zone is targeted to the people that can't get the jobs. This is the purpose of it. And if you say to an employer, you don't have to take—you don't have to teach a person. You don't have to tell them they have to be on time. They have to work 5 days a week. Those same people are going to stay unemployed.

It is up to a good CETA program—and we had a suburb CETA program—when we took those people that couldn't get a job, that didn't know what it was to get a job. And we trained them so that they became productive. You don't want to take the unemployed who can eventually get a job as skilled people. You are trying to get those people who have no opportunity for a job.

It doesn't show good on the ledger sheet. But when you train those people and they can get the job, that is what we want to do.

If you get a bottom line, like I mentioned 25 individuals, or 15, or whatever. And then say after that you have to comply with some kind of CETA requirements.

But the main thing I'm trying to get at this morning is that you want to get that small business in there. You want to get that venture capital.

And in the initial stages of the game if you say to the guy, "You have got to have 40 percent of your employees that are CETA eligible." And he's got three employees, you are not going to get him. So that is the point we are trying to get across today.

Senator CHAFEE. All right. Governor Mutz.

Governor MUTZ. OK. The issue is, as far as I'm concerned, an entrepreneur is a person who possesses some management skills and abilities. And the thing that has to be included in this mix is a few of those people. They will employ the people we are talking about. And I think it is absolutely essential that the flexibility to the manager be great enough that he has ability to maneuver.

This business of the 25-employee level might be a good way to do it. I agree.

Senator CHAFEE. Thank you very much, gentlemen, we appreciate you coming.

[Statements follow:]

National League of Cities

1301 Pennsylvania Avenue NW
Washington, D.C.
20004
(202) 626-3000
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STATEMENT BY
GEORGE V. VOINOVICH, MAYOR
CLEVELAND, OHIO

ON BEHALF OF

THE NATIONAL LEAGUE OF CITIES

ON S. 1310

THE URBAN JOBS AND ENTERPRISE ZONE ACT

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY
COMMITTEE ON FINANCE

UNITED STATES SENATE

JULY 16, 1981

Mr. Chairman and members of the Subcommittee, I am George Voinovich, Mayor of Cleveland, Ohio. I am Vice Chairman of the Community and Economic Development Policy Committee of the National League of Cities (NLC). I also serve as Chairman of NLC's Subcommittee on Enterprise Zones.

NLC, represents over 15,000 municipalities through our network of state municipal leagues and nearly 1,000 direct member cities. I am pleased to be here today to express the views of the NLC on S. 1310, the Urban Jobs and Enterprise Zone Act.

NLC strongly supports the basic concept that undergirds the Enterprise Zones legislation of stimulating economic growth and employment in areas of poverty and high unemployment by encouraging business, through federally-targeted tax incentives and local initiatives, to locate, remain or expand in such areas. Although we do not endorse each and every provision of S. 1310, we believe that your bill is responsive to many of the concerns we had with the previous enterprise zones legislation, introduced in the 96th Congress and co-sponsored by Senators Chafee and Boschwitz.

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As Chairman of NLC's Subcommittee on Enterprise Zones, I participated with a number of city officials from around the country in reviewing the previous version of this bill in March. At that time, we agreed to certain criteria and concerns that we wanted any revision of the bill to address. As I indicated earlier, many of those concerns and criteria have been dealt with in S. 1310. Our Subcommittee will be looking carefully at this legislation, especially the tax incentives, and I hope NLC will have the opportunity to submit further comments on these and other provisions. Some of my testimony today, therefore, aims more at raising questions and suggesting further analysis than at endorsing or opposing specific provisions.

The following comments represent our views on what we believe are the major provisions of the bill:

Eligibility and Designation

NLC generally supports the eligibility and designation process contained in the bill, which requires that all zones be in Urban Development Action Grant (UDAG) cities or pockets of poverty, and establishes certain levels of distress that must be met by the designated enterprise zone.

The UDAG eligibility criteria were agreed to after considerable debate by the Congress during the reauthorization of the Community Development Block Grant Program in 1977 and 1979. They have acquired legitamacy as an extremely eff ctive mechanism for targeting limited public resources to econom cally distressed

COMMUNITIES. IN ADDITION, USE OF THIS ESTABLISHED SET OF CRITERIA WILL FACILITATE THE COORDINATION OF ENTERPRISE ZONES WITH UDAG AND OTHER DEVELOPMENT PROGRAMS.

UNDER S. 1310, A STATE GOVERNOR WOULD BE ALLOWED TO VETO A LOCAL GOVERNMENTS' ZONE APPLICATION, WE ARE NOT PERSUADED THAT THE GOVERNOR SHOULD HAVE THIS POWER. SIMILARLY, WE BELIEVE THAT, IF A STATE IS TO SUBMIT AN APPLICATION ON BEHALF OF A LOCAL GOVERNMENT, THIS SHOULD OCCUR ONLY AT THE SPECIFIC WRITTEN REQUEST AND WITH THE FULL APPROVAL OF THE LOCAL GOVERNMENT RATHER THAN MERELY WITH THAT LOCAL GOVERNMENT'S "CONSENT."

IN ADDITION, THE LEGISLATION PROVIDES THAT THE HUD SECRETARY MAY REVOKE A DESIGNATION IF THE LOCAL GOVERNMENT IS NOT SUBSTANTIALLY COMPLYING WITH THE "COURSE OF ACTION" IT HAD COMMITTED TO UNDERTAKE. WE THINK SUCH A PROVISION MAY BE NEEDED BUT IT SHOULD INSTRUCT THE SECRETARY, PRIOR TO REVOKING A DESIGNATION, TO NOTIFY THE AFFECTED LOCAL GOVERNMENT AND TO EXHAUST ALTERNATIVE REMEDIES, INCLUDING PERHAPS AMENDING THE "COURSE OF ACTION." (SUCH AN AMENDMENT MIGHT BE RELEVANT ANYWAY IF CHANGING CIRCUMSTANCES IN A SUCCESSFUL ZONE RENDERS A PART OF THE "COURSE OF ACTION" IRRELEVANT OR EVEN DETRIMENTAL.) FURTHERMORE, POTENTIAL REVOCATION RAISES THE QUESTION OF WHAT WOULD THEN HAPPEN TO BUSINESSES' ELIGIBILITY FOR TAX INCENTIVES DURING THE PERIOD OF TIME THAT THEY WOULD OTHERWISE HAVE BEEN IN EFFECT.

LOCAL COMMITMENT

NLC STRONGLY SUPPORTS THE FLEXIBLE PACKAGE OF ACTIONS BY WHICH LOCAL GOVERNMENTS CAN DEMONSTRATE THEIR COMMITMENT TO THE SUCCESS OF THE ZONES AND REDUCE SOME OF THE BURDENS BORNE BY EMPLOYEES AND EMPLOYERS IN THE ZONE.

WE BELIEVE THAT IT IS CRITICALLY IMPORTANT TO ENCOURAGE LOCAL INITIATIVES THAT BEST REFLECT LOCAL CONDITIONS. IN SOME JURISDICTIONS, LOCAL SALES, CORPORATE, OR INVENTORY TAXES MAY FREE UP MORE BUSINESS CAPITAL AND THUS BE GREATER INCENTIVES TO INVESTMENT THAN PROPERTY TAX REDUCTIONS. THE WAIVING OF LOCAL REGULATIONS OR REQUIREMENTS, TECHNICAL ASSISTANCE PROGRAMS, "ONE-STOP" OFFICES FOR CITY LICENSES, CODE COMPLIANCE, AND SO FORTH WOULD ALL PROVIDE VALUABLE INCENTIVES TO ENCHANCE THE ZONE'S EFFECTIVENESS.

EMPLOYMENT TARGETING

I CANNOT, ON BEHALF OF THE NATIONAL LEAGUE OF CITIES, SPECIFICALLY ENDORSE THE 40 PERCENT CETA ELIGIBLE JOB TARGETING REQUIREMENT. NLC WOULD LIKE TO MAKE THE POINT THAT ANY NATIONAL REQUIREMENT MAY BE TOO RESTRICTIVE AND INAPPROPRIATE IN SOME LOCAL SITUATIONS, DISCOURAGING FIRMS FROM ENTERING THE ZONES OR ATTRACTING ONLY FIRMS WITH DEAD-END JOBS. IN A VERY DISTRESSED LOCALITY, FOR EXAMPLE, WHERE UNEMPLOYMENT IS RELATIVELY HIGH EVEN BY THE STANDARDS OF THIS BILL, A SOMEWHAT LOWER PER-

CENTAGE OF CETA ELIGIBLE EMPLOYEES -- SAY 25 PERCENT -- MIGHT BE MORE APPROPRIATE TO THE PERVASIVE JOBLESSNESS OF THE AREA. PERHAPS SUCH A COMMUNITY SHOULD BE ALLOWED TO PETITION THE HUD SECRETARY FOR A WAIVER THAT WOULD REDUCE THE REQUIREMENT FROM 40 PERCENT TO 35 PERCENT, DEPENDING ON THE LOCAL CIRCUMSTANCES. I DO NOT THINK THE REQUIREMENT SHOULD EVER DROP BELOW 20 PERCENT AND PROBABLY THE NUMBER OF SUCH WAIVERS SHOULD BE SEVERELY LIMITED.

I MUST EMPHASIZE THAT THIS SUGGESTION IS NOT MEANT TO UNDERCUT THE PERCENTAGE JOB TARGETING REQUIREMENT. NLC BELIEVES THAT ONE OF THE MAJOR PURPOSES OF THIS PROGRAM SHOULD BE JOB CREATION FOR THE UNEMPLOYED, THE UNDEREMPLOYED AND FOR LOW AND MODERATE INCOME PEOPLE. WITHOUT SOME SUCH REQUIREMENT, EFFECTIVELY ENFORCED, THE ENTERPRISE ZONE PROGRAM WOULD LOSE ONE OF ITS MAJOR THRUSTS. THIS PROPOSAL MERELY PROVIDES GREATER FLEXIBILITY FOR EXTREMELY DISTRESSED LOCALITIES TO ADDRESS THEIR LOCAL EMPLOYMENT NEEDS.

TAX INCENTIVES

NLC SUPPORTS GENERALLY THE USE OF TARGETED TAX INCENTIVES TO CREATE JOBS, ATTRACT INVESTMENT, AND ENCOURAGE LOCAL ENTREPRENEURSHIP. FOR THE ZONES PROGRAM, WE BELIEVE TAX INCENTIVES SHOULD BE PROVIDED THAT ARE RELEVANT TO THE NEEDS OF A VARIETY OF SIZES AND TYPES OF BUSINESSES AND THAT ARE SUFFICIENTLY ORIENTED TOWARD EMPLOYMENT TO ACHIEVE THE JOB CREATION GOALS OF THE PROGRAM.

THE SPECIFIC TAX INCENTIVES USED MUST BE ASSESSED AS TO, FIRST, THEIR PROBABLE EFFECTIVENESS IN ACTUALLY ATTRACTING INVESTMENT AND CREATING JOBS IN A WIDE VARIETY OF TYPES AND SIZES OF FIRMS AND, SECOND, THEIR EFFICIENCY AS REGARDS THEIR COST RELATIVE TO THE BENEFITS THEY CREATE. THEREFORE, THE TAX PROVISIONS IN THIS BILL MUST BE LOOKED AT IN RELATION TO THE CHANGES IN THE TAX CODE THAT WILL RESULT FROM THE BASIC TAX LEGISLATION THAT IS CURRENTLY BEFORE THE CONGRESS. MOREOVER, WE NEED FINANCIAL ANALYSES DONE FOR NUMEROUS AND VARIOUS HYPOTHETICAL FIRMS IN DIFFERENT SITUATIONS IN ORDER TO BE ABLE TO SEE EXACTLY WHAT EACH INCENTIVE DOES AND HOW IT INTERACTS WITH OTHER TAX PROVISIONS. OTHERS WITH MORE TECHNICAL EXPERTISE WILL COMMENT ON THESE AND RELATED ISSUES AND WE LOOK FORWARD TO STUDYING THEIR TESTIMONY AND ANALYSES.

THE MEMBERS OF NLC'S SUBCOMMITTEE ON ENTERPRISE ZONES WERE TROUBLED BY THE FACT THAT, IN ORDER TO BENEFIT FROM A TAX REDUCTION, A FIRM MUST OF COURSE HAVE A TAX LIABILITY. WE ARE TOLD THAT MANY SMALL FIRMS AND CERTAINLY MOST NEW FIRMS HAVE LITTLE OR NO PROFIT AND THUS LITTLE OR NO LIABILITY AND THUS WOULD NOT FIND THE TAX REDUCTIONS RELEVANT. THE PROPOSAL BEFORE US INCLUDES A REFUNDABLE TAX CREDIT FOR BUSINESSES WHICH WOULD CIRCUMVENT THIS PROBLEM. WE THINK THIS IS AN IMPORTANT PROVISION AND SHOULD BE RETAINED.

TECHNICAL ASSISTANCE AND EVALUATION

IF THE ENTERPISE ZONES PROPOSAL IS TO BE AN IMPORTANT ADDITION TO FEDERAL URBAN POLICY, WE WANT TO ENSURE THAT ITS CHANCES OF SUCCESS ARE MAXIMIZED AND THAT WE LEARN ALL WE CAN FROM THE EXPERIENCE WITH THE PROGRAM. THUS, WE SUGGEST THAT, IN ADDITION TO PROVIDING FUNDS FOR HUD TO ADMINISTER THE PROGRAM, THE BILL SHOULD AUTHORIZE MONIES FOR HUD TO PROVIDE TECHNICAL ASSISTANCE TO LOCALITIES. FURTHERMORE, HUD SHOULD ESTABLISH MEANS FOR MONITORING WHAT HAPPENS IN THE ZONES AND FOR EVALUATING THESE OPERATIONS SO THAT IMPROVEMENTS CAN BE MADE AND ALL CITIES CAN LEARN FROM THE EXPERIENCE OF ZONE CITIES.

RELATED FEDERAL PROGRAMS

ALTHOUGH THE BILL INSTRUCTS THE SECRETARY OF HUD TO COORDINATE THE ENTERPRISE ZONES PROGRAM WITH OTHER FEDERAL PROGRAMS, IT FAILS TO TAKE INTO CONSIDERATION THE ADDITIONAL COSTS THAT A CITY WILL PROBABLY INCUR IN A DESIGNATED ZONE. THESE MAY INCLUDE INFRASTRUCTURE EXPENDITURES THAT MIGHT NOT OTHERWISE HAVE BEEN NEEDED, ESPECIALLY THOSE ASSOCIATED WITH THE NEEDS OF A PARTICULAR PROJECT; INCREASED POLICE, FIRE, OR OTHER PUBLIC SERVICES RESULTING FROM GREATER ECONOMIC ACTIVITY; AND COSTS ASSOCIATED WITH PROMOTING THE ZONE TO FIRMS, ADMINISTERING CODES, ZONING REGULATIONS, OR PROVIDING TECHNICAL ASSISTANCE TO FIRMS.

WE URGE THE COMMITTEE TO KEEP IN MIND THAT WHILE ENTERPRISE ZONES MAY BE A USEFUL ADDITION TO EXISTING PROGRAMS, IT MUST AND CANNOT BE A SUBSTITUTE FOR THEM. WITHOUT ADEQUATE FUNDING FOR OTHER ECONOMIC DEVELOPMENT AND LABOR PROGRAMS, THE ENTERPRISE ZONE PROGRAM WILL BE FAR LESS SUCCESSFUL THAN OTHERWISE. PROGRAMS LIKE EDA'S PUBLIC WORKS GRANTS COULD PROVIDE THE INFRASTRUCTURE FUNDS NECESSARY FOR INCREASED ECONOMIC ACTIVITY; HUD'S UDAG GRANTS COULD SUPPLY THE NECESSARY FRONT-END ASSISTANCE FOR NEW FIRMS; AND THE CETA PROGRAM COULD PROVIDE THE TRAINING NECESSARY FOR THE STRUCTURALLY UNEMPLOYED.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU AND PRESENT THE VIEWS OF THE NATIONAL LEAGUE OF CITIES.

THANK YOU.

National Governors' Association

George Busbee
Governor of Georgia
Chairman

Stephen B. Farber
Executive Director

TESTIMONY OF THE HONORABLE JOHN M. MUTZ
Lieutenant Governor of Indiana

Before the

Subcommittee on Savings,
Pensions and Investment Policy
Committee on Finance
United States Senate

Regarding

The Urban Jobs and Enterprise Zone Act

July 16, 1981

HALL OF THE STATES • 444 North Capitol Street • Washington, D.C. 20001 • (202) 624-5300

SUMMARY

- The experience with urban development programs during the 1960's and early 70's has shown the limitations of direct fiscal assistance as a "solution" to the problems of distressed cities. Complex urban problems cannot be solved by government above or by simply throwing money in the general direction of deteriorated inner city areas. The creation of the UDAG program in 1977 recognized the importance of private sector involvement in efforts to revitalize distressed cities. Enterprise zones carry this emphasis a step further by providing major new incentives for private firms to expand or locate in severely distressed areas.

- While the enterprise zone concept can be a valuable tool for community revitalization, it should be tried initially on a demonstration basis prior to full-scale implementation. The effectiveness of these zones will depend on their success in attracting new entrepreneurs, increasing business formation rates, and encouraging expansion of existing small businesses in distressed areas. It is the small business sector which holds the key to job creation and economic growth in these areas.

- Although NGA has not taken a formal position on specific tax measures contained in this bill, we believe the elimination of the capital gains tax and provisions for refundable targeted jobs tax credit will particuarly benefit small firms in enterprise zones. In addition, consideration should be given to allowing firms to buy and sell tax loss carry-forwards, as a way of converting a tax loss into badly needed cash from the private sector, not from government.

- State and local governments have a major role to play in packaging complementary services and investments in enterprise zones, and in supplementing federal tax incentives. Because of unique state constitutional requirements governing local powers and authorities, state governments need to be heavily involved in designating eligible zones, structuring state and local incentives, and overseeing the administration of zones within their jurisdictions.

- States around the country are gearing up for implementation of enterprise zones. There are now over 60 state bills, pending or enacting, to target special tax advantages to distressed areas and complement federal zone incentives. Indiana has recently enacted a series of targeted economic development measures that provide a statewide framework for enterprise zones, and has established a new commission to explore the feasibility of a state enterprise zone program in Indiana.

- While the federal tax incentives contained in S.1310 and H.R. 3824 would provide greater benefits to new, small business than did earlier enterprise zone bills, there are a number of refinements that should be considered in the tax provisions. Our testimony suggests a number of possible improvements in some of the other federal tax incentives contained in the bill.

I am pleased to appear today on behalf of Governor Orr and the State of Indiana, as well as the National Governors' Association, to discuss proposed enterprise zone legislation. I would like to commend you, Mr. Chairman, for arranging these hearings to explore fully the concepts embodied in S.1310 and H.R. 3824. As I have observed the evolution of this legislation over the past year, I have been highly impressed by the openness of both the Senate and House authors to constructive advice and new ideas. In order to contribute to the continued refinement and improvement of this legislation, I would like to share with you Indiana's approach to enterprise zones and economic development, and discuss the role which we see for state governments in implementing this concept.

Certainly no development concept in recent memory has generated the interest and debate that enterprise zones have sparked among the academic community, development practitioners, and public officials. Enterprise zones represent a dramatic departure from many of our existing urban programs, which have tended to emphasize the role of the public sector in fostering urban revitalization. The experience with these programs during the 1960's and early 70's has shown the limitations of direct fiscal assistance as a "solution" to the problems of distressed cities. We have learned that complex urban problems cannot be solved by government alone or by simply throwing money in the general direction of deteriorated inner-cities.

The 1977 advent of the urban development action grant program recognized for the first time the importance of enlisting the private sector in the cause of urban economic development. Enterprise zones carry this emphasis one step further by providing major new incentives for private firms to expand or locate in severely distressed areas.

While I am convinced that enterprise zones, properly structured and administered, can be a valuable tool for community revitalization, I support the demonstration approach contained in S.1310 as a preferred alternative to immediate, full scale implementation of this concept in all eligible communities.

In my view, the effectiveness of enterprise zones as a tool for job creation and economic development will depend on their success in attracting new entrepreneurs, increasing the rate of business formation, and encouraging expansion of existing small firms in distressed areas. Various research studies, as well as my own experience with economic development in Indiana, point to the small business sector as the key to job creation and economic growth. The revisions which you have made in the business tax incentive provisions of this bill more closely target tax benefits to young, innovative firms than did last year's bill. In particular, the elimination of the capital gains tax and provisions for a refundable jobs tax credit will be especially helpful to struggling new firms during the early years of their existence.

I would also like to suggest the consideration of allowing firms to buy and sell tax loss carry forwards. This would make it possible for a company to convert a tax loss into badly needed cash which will be produced from the private sector, not from government.

However, tax incentives, in and of themselves, are not sufficient to make this program work. Starting a small business is a risky venture under the best of circumstances; locating a new enterprise in a severely distressed area poses nearly insurmountable odds. Increasing the survival rate of new, small firms in designated zones will require a coordinated package of services, investments and incentives to be provided by state and local governments in conjunction with federal programs and incentives. While specific development needs will vary from zone to zone, such things as improvements in public infrastructure, stepped-up law enforcement, housing, employment and training services, business loans and loan guarantees, and streamlined regulatory procedures can make a critical difference in the success of individual firms and the enterprise zone concept. We are convinced that states have a critical role to play in packaging these complementary services and investments, and in supplementing federal tax incentives.

Evidence of state governments' willingness to play a strongly supportive role in this program can be found in Indiana and in states throughout the country.

In Indiana, we view enterprise zones as fitting into a more comprehensive framework that we have established for statewide economic development. As part of an omnibus package of state economic development initiatives proposed by the Governor and myself, and adopted by the 1981 Indiana General Assembly, we have recently created a new Commission on Enterprise Zones. This Commission is charged with responsibility for exploring the feasibility of an enterprise zone program for Indiana and evaluating alternative approaches to implementing this concept. In addition to developing the criteria for determining which geographic areas should qualify for zone designation, the Commission will conduct a thorough review of the impact on enterprise development of state and local regulatory requirements in such areas as fire and safety regulation, building codes and zoning, environmental regulation, and health and sanitation regulations. The Commission is charged with submitting an annual report by November 1 of each year concerning its activities and recommendations, including suggestions for legislation to accomplish its recommendations.

Indiana is not alone in preparing to implement an enterprise zone program. According to a draft report prepared by the American Legislative Exchange Council and the Sabre Foundation, there are now over 60 state bills, pending or enacted, targeting special tax advantages to distressed areas to stimulate economic development and complement federal enterprise zone incentives. States that have passed enterprise zone legislation include Florida, Connecticut, Maryland, Illinois, Missouri, and Oregon. Similar bills are pending in state legislatures in 17 other states.

While Indiana has not yet adopted a state enterprise zone program, the package of economic development initiatives we passed this year include a number of measures targeted specifically to new, small businesses and distressed areas. These include:

- the creation of a new Corporation for Innovation Development that will channel from $10 to $11 million in private capital into venture capital pools for new, innovative small businesses;

- amendments to our current 10-year property tax deduction for rehabilitation or redevelopment of real property in designated urban development areas to include a five-year property tax deduction for owners of new manufacturing equipment in these target areas;

- expansion of the Indiana Neighborhood Assistance Program that provides state income tax credits to individuals and businesses for investments in neighborhood assistance projects benefiting individuals living in economically disadvantaged areas;

- creation of a $2 million industrial training program designed to provide assistance to new or expanding industries for the training, re-training, and upgrading of the skills of potential employees;

- establishment of a rural development fund that provides direct grants to communities of less than 10,000 population for infrastructure improvement projects tied to economic development;

- creation of new industrial sewer and industrial highway set-aside funds to provide loans and grants for public facilities in conjunction with industrial development projects; and

- modification of the Indiana Economic Development Fund, originally designed to provide matching funds for EDA projects, to allow grants and loans for economic development activities with or without federal matching funds.

These initiatives, together with a wide range of other ongoing state economic development programs and incentives in Indiana, establish a good foundation for our state to play a constructive and meaningful role in implementing an enterprise zone program.

Based on my experience in Indiana, I am convinced that states need to be extensively involved in the designation of eligible zones, in structuring complementary state and local incentives, and in overseeing the administration of enterprise zone programs in their jurisdictions.

Under the legislation you are considering, states would be allowed an effective veto power over local zone applications filed with the Secretary of HUD. States would also be authorized to seek zone designation on behalf of a local government (with local consent), and state commitments to designated zones are considered as one of the priorities for zone selection.

As an alternative to the 21-day "review and objection" process contained in S.1310, I would suggest consideration be given to a more affirmative review and approval process at the state level. The decision to seek zone designation is fundamentally a local decision. In most states, however, the state has certain constitutional responsibilities that bear directly on local taxing, spending, and regulatory powers. In addition, it is essential that local zone designations be consistent with statewide development plans and priorities. State review and certification of local enterprise zone applications would ensure consistency with state legislative and constitutional requirements and statewide development priorities. This state review and sign-off is also necessary to avoid the problem of neighboring jurisdictions competing for zone designation, and to minimize the intra-state "pirating" of businesses and jobs from one locality to another. In order to assure strict geographic targeting, each state could be limited to certifying areas occupied by a small percentage of its total population for enterprise zone designation.

As I have indicated, targeted state programs and incentives can significantly enhance whatever federal incentives are offered in conjunction with enterprise zones. In addition, the states have taken an active lead in structuring innovative development finance programs that provide needed capital to new, small businesses that we envision being the primary focus of the enterprise zone concept. State programs and policies should therefore be given major consideration in the development of a negotiated package of federal, state, and local incentives for each designated enterprise zone.

NGA supports, as a matter of policy, local responsibility for the routine planning, management and delivery of substate development programs. Consistent with this position, administrative responsibility for the day-to-day operation of designated enterprise zones should be vested with local units of government, wherever feasible. At the same time, state governments can play a constructive role in providing needed monitoring, oversight, and technical assistance to local zone authorities. This oversight role for states is particularly essential with regard to coordination, streamlining, and simplification of state and local regulatory requirements and permitting procedures in such areas as environmental impacts, water and sewer permits, construction codes, and zoning and land use regulations.

Mr. Chairman, the bulk of my remarks has focused on the intergovernmental aspects of this legislation. Before I close, however, I would like to briefly discuss the specific tax incentives which this bill would provide to qualified businesses and employees in enterprise zones. To date, NGA has not adopted a detailed policy position regarding tax incentives provided in conjunction with enterprise zones. However, our analysis of this legislation raises a number of issues and questions with regard to the tax provisions for businesses and individuals. I would like to briefly summarize some of our concerns in this area.

First, the creation of a new five-percent refundable tax credit for wages paid by qualified businesses to CETA-eligible workers duplicates, in some respects, the current targeted jobs tax credit and poses administrative difficulties in determining income eligibility for workers already employed by a firm. As an alternative to creating an entirely new jobs tax credit program for enterprise employers, we would suggest making appropriate changes and modifications in the existing targeted jobs tax credit for use in conjunction with enterprise zones. Since the primary objective of this tax credit is to encourage private employers to hire hard-to-employ individuals, we would also question the need for limiting eligibility for the tax credit to firms that employ 40 percent of their workforce from the CETA-eligible population. As I indicated earlier, refundability is particularly important for new, small firms that typically have no tax liability in their first few years.

Second, the five-percent personal tax credit for zone employees (subject to a $1,500 maximum) would benefit not only the so-called working poor, but would provide significant tax breaks for upper-income workers as well. While I recognize this measure is intended to offset a portion of employee-paid social security taxes, I question the rationale for such a broad-based tax credit. If the objective is to minimize the work disincentive effects of our current income maintenance and tax policies on low income workers, it may make more sense to modify the existing earned income tax credit to directly benefit economically disadvantaged zone employees. I do not believe it is anyone's intent to use these zones to create a tax haven for middle and upper level managers of zone businesses, which could be the effect of this provision.

Third, if the effect of the 1978 reduction in the capital gains tax is any indication, the elimination of the capital gains tax in designated zones will serve as a major stimulus for capital investment in these areas. However, to avoid setting off a wave of short-term speculative investments in these zones, we would suggest requiring that an asset must be held for a specified period of time, say three to five years, in order to qualify for capital gains exclusion. While the exclusion of interest income earned on loans to qualified zone enterprises could provide modest incentives for banks to make riskier loans in these areas, it would also provide a major new tax shelter for large commercial banks without necessarily changing their lending practices or reducing interest costs paid by individual firms. I would recommend your close scrutiny of the exclusion on interest income before you adopt this measure.

NGA will be pleased to work closely with the members of the Senate Finance Committee to help refine these specific tax incentive measures as you proceed to consider this legislation.

In conclusion, we believe the enterprise zone concept is a potentially useful tool for fostering entrepreneurship, business development, and job creation in economically distressed areas. We hope that as you continue to explore and refine this concept, you will consider it in the context of a renewed commitment to federalism. State governments can and should play a positive and constructive role in ensuring the success of this program in achieving an economic resurgence of blighted inner city neighborhoods, as well as distressed small and medium-sized communities. We look forward to working with you in a cooperative way during the months ahead to help fashion a workable and successful enterprise zone program.

Thank you.

Senator CHAFEE. Now, the next panel.

Mr. Van Leesten, Mr. Torchia, and Mr. Barrow. If you gentlemen would come right up. We welcome you here.

A PANEL OF: MICHAEL S. VAN LEESTEN, RICHARD TORCHIA, AND WILLIAM BARROW

Senator CHAFEE. Mr. Van Leesten, we are delighted you are here and we know of your excellent record you have achieved in the city of Providence as chief executive officer of the OIC. You have had long interest and experience in this area. Your testimony will be very valuable.

Mr. VAN LEESTEN. Thank you very much, Senator Chafee. It certainly is an honor and a privilege to be here to express my views on this piece of legislation.

I first want to make the point that Mayor Schaefer's comments were similar to mine and took the sail out of my balloon a little.

However, one of the things I think is important is that this piece of legislation be viewed as an experiment. And a lively one at that. Our Founding Fathers talked about our country being a lively experiment. I think if we lose the basic essence of this being a lively experiment, something is going to be lost.

I have heard a lot of pragmatism about business just coming in and doing the job, and we know that is not going to happen. Tax incentives in and of itself will not bring it in and make it happen. In that context I will frame my views.

One of the things that hasn't been pointed out here is that we are talking about a tremendous impact in people. On human beings, that live in these areas. And in some way there has got to be a realization within the thinking and the development of this legislation that the people that live in the areas that will be the designated areas are human beings that have the same kind of hopes and aspirations, fears and anxieties as all of us in this room. I think that is vitally important. I think if we get too pragmatic about this I see it doomed to failure.

Second, I also see the legislation as a real opportunity. Not an opportunity just for businessmen who can capitalize on it and do what they need to do, which is important, of course. But also a tremendous opportunity to get black and minority involvement in ownership and in also job training and placement.

Third, there is a tremendous gulf between the private sector and the public sector. That has been going on for years. In Providence we have got a number of experiences that lend themselves to how private and public partnerships can make urban kinds of things happen.

I hear too much discussion about things that don't happen. All the negatives about social welfare program, etc. The fact of the matter is that around this country there has been some significant things that have happened by virtue of private and public partnerships. And I think that those ought to be investigated. Those good things ought to be investigated and incorporated in this piece of legislation.

I have a prepared statement that will take about 6 minutes, Senator Chafee. So I would like to relate to that.

Senator CHAFEE. I think what would be most helpful to us is your suggestions on how we could improve this, or how, from your vast experience, you think it will work.

I think your comment about keeping it a lively experiment is interesting. Would you stick with the 25?

Mr. VAN LEESTEN. I would stick with the 25. Twenty-five maximum.

Senator CHAFEE. Fine.

Mr. VAN LEESTEN. Let me just say this, just to give you an indication of what can happen. Because I have to drum this point in. I can recall we were planning to build a major facility in the city of Providence. That facility was a $6 million project. We said that we wanted a 40-percent black involvement, or minority involvement in constructions and the subcontracts let.

Everyone said we were crazy. The building is up. Thousands of people are utilizing those services annually, as you well know, Senator Chafee. And it was built with an excess of 40-percent black involvement in the construction and the subcontracts let.

Everyone said it couldn't be done. It was done because it was planned cooperatively between a community-based organization, between city and State and Federal Government, and between the people in the community.

It is not a theoretical kind of a feeling that I am expressing here. It is something that has actually happened. And this kind of setting exists in every single one of our communities. And I just think that we need more work done on pulling these partnerships together to make things happen.

Second, in terms of the ownership question, there is a distinct feeling, I submit, that black people or minority people aren't ready yet—I think that still pervades in our society—to get involved in the ownership question.

We have to have a piece of the rock. This is a free enterprise system but we can't be in the supportive ends of it at all times. Proportionately, at some point, a noble goal for this society of ours should be for the kind of proportionate mix of blacks and minorities owning businesses and participating fully in the free enterprise system in our country.

Anything short of that makes us not reach the kind of ultimate goals, in my judgment, I think we ought to be reaching for.

In that regard we have, in Providence we have set up a development company in concert with our nonprofit company. We own an aerospace shop that produces small precision parts for the aerospace industry. Douglas Johnson, who is sitting in the back, is running it. He is as black as I am.

We are only 8 months in the doing. Maybe in a year or 5 years from now we will be able to show what we can do. But we feel that we have every opportunity to participate and to grow and to expand and involve more minority people. To make money, to increase the tax base, to do all of the things that are essential to economic renewal. I can't help but really believe that listening to the mayor of Cleveland I was very much in disagreement with the position that he took in terms of this is not a social welfare kind of a situation.

The manner in which he said social welfare, I think that we all know that the nature of our free enterprise system, our economic system and the nature of the kinds of people that are here in our country today—never ever will we have people fully participating in our system, in our economic system. It is always going to be a gradual bringing into the system people I think, as long as we are a society in existence.

For that reason there is always going to be a need for social welfare. Social welfare is an important part of the fabric of our society. I think that we can joint venture social welfare programs and economic development programs for the good of the whole. And not take away at all from what the end objectives of profit are. There is a feeling, and an erroneous one at that, that poor people do not want to work, do not know how to go about working, aren't interested in goals and objectives and some of the higher ideals that we all aspire for.

That is erroneous. The great majority of black and minority and poor people in our inner cities are fine people that just need some opportunity rungs to get their feet on.

Senator CHAFEE. Mr. Van Leesten, I don't think the Mayor was against social welfare programs. I think what he was saying is that what he was trying to do is to have this thing work. And as I heard his testimony, if too many obstacles are placed, or if the system is too rigid, with CETA requirements for example, you are not going to get the business to come in.

The mayor's point, as I understood it, was get the businesses in the cities. By hook or by crook, get them there. Then once they are there, rely on their need to hire people to lick the unemployment problem rather than have a requirement of the 40 percent such as we have in the act now.

Mr. VAN LEESTEN. Well, I am all in favor of requirements, Senator Chafee. I am all in favor of regulations and laws that protect people who don't have access to decisions and what not.

I submit to you right now that I wouldn't be sitting here now, and many other black people who are in this room wouldn't be here now, if it wasn't for the Federal Government's assurance in certain areas.

I submit that there has to be—well, I know everyone wants to strip away the Federal Government from its role and involvement because that way private enterprise will be able to flourish without the restrictions, but that will not protect the goal and objective of bringing poor and minority people into all areas of the development of this enterprise program.

Senator CHAFEE. Fine.

Mr. VAN LEESTEN. And, Senator Chafee, just let me make this point.

I am also speaking from the vantage point of spending a great deal of my life being involved in social welfare programs. But on the other side of the coin, I am also involved—have been involved in business for quite a while. In fact, I am a director of one of our local banks. So I have my feet in both camps. And hopefully, bring to you a balance that has been struck through both experiences.

Senator CHAFEE. Fine. Well, thank you very much. I have, obviously, some questions I would want to be asking you.

What we are going to do now is interrupt briefly. I see that Representative Jack Kemp is here. The Representative has been the principal proponent of this legislation. Starting last year, he has pressed it vigorously.

And so, Representative, why don't you come right up and present your testimony now, and then I will get back to the panel.

We welcome you here.

STATEMENT OF HON. JACK KEMP, U.S. REPRESENTATIVE, STATE OF NEW YORK

Mr. KEMP. Thank you, Senator. It is a pleasure to be here and particularly a pleasure to have you chairing this committee and taking what I think is an extremely important step toward bringing about the conditions in our inner cities that are absolutely imperative if this Nation is to move forward, in the 1980's, toward what I perceived to be the number one goal of economic policy and the No. 1 need in this country, which is full employment and no inflation.

We cannot rest until the prosperity that was once the hallmark of the American dream is not only restored nationally and across the board, but also is a widely shared prosperity. We need a policy that reaches out toward all people and reaches toward those areas of the country, geographically, that heretofore have been left outside the mainstream of our economy, that is the inner city.

I noticed that the previous—or the current witnesses, really—have expressed concern that somehow there might be some hidden agenda. Somehow, Congressman Garcia, from the South Bronx, or Kemp of Buffalo, or Boschwitz or Chafee or the administration have a surreptitious goal in mind—which is to reach some state of nirvana in the inner city in which there are no government regulations, no government taxes, no social programs, no UDAG grants. That is a strawman. I hope there is no hostility in my voice, because I don't feel any. I simply want to put to rest, put to bed once and for all, the notion that Kemp and Garcia and, I know I speak for the gentleman from Rhode Island as well as the Senator from Minnesota, both of whom are good friends of mine, are trying to hide an agenda. To use enterprise zones to replace those social welfare, economic development programs that are working or that have potential for working in a utilitarian way to alleviate the distress economically and socially in the inner city.

I can't say it often enough, but the issues keep reappearing. This is not an attempt to go backward to some laissez faire 18th-century approach to a Darwinian market in the inner city.

We are simply recognizing that, while we have other programs, and other Federal involvements, in the inner city that we can use a new tool. This tool is tax policy aimed in a compensatory way at reestablishing not only nationally, but in the inner city where we are desperately in need of new jobs, and new enterprises an incentive for the small, independent, entrepreneurial business community as well as employees to take the jobs that ultimately, I think, will be created. We must create a program which can exist side-by-side with the other programs that the American people, through their elected representatives, want to see continued.

We would be foolish not to use the very best tool that we can. This may not be the best tool. But I think the gentleman from Rhode Island has offered his panel, and these hearings; as has Congressman Garcia; not only in Washington, but around the country, to offer a forum for the debate to take place. It is a very helpful climate.

The President has suggested, not only to me personally, but through the press conference that Mr. Chafee and I had with Congressman Garcia, and Senator Boschwitz as well as with Vernon Jordan of the Urban League, that this is the beginning not the end. This is a road map, not necessarily the end.

So I just wanted at the beginning, Mr. Chairman—and it is a pleasure to call you Mr. Chairman—to at least put to bed, put to rest at least, that mythology.

Second, I'm not going to go into all of the technicalities of the tax proposals because that has been labored and belabored and of course will be subject to all the vicissitudes of the legislative process as it goes forward. But what you have started, Mr. Chairman, is a dialog and a discussion.

The President is absolutely committed, both publicly and privately, to seeing enterprise zone legislation passed in this Congress. That ought to be good news for the American people. That ought to be good news for the inner cities. That ought to be good news for people who are desperate for some sense that life can get better. We must show that we can restore, once again, the jobs that are so very needed in cities from Buffalo to East St. Louis, to Liberty City, Miami, to Baltimore and New York City, and the South Bronx, and New Jersey and throughout this country.

One other thing I would like to discuss, Mr. Chairman. We have been criticized for not providing up-front money; that is, seed capital. A lot of people want to get the Federal Government back into the business of providing seed capital for new enterprises.

Mr. Chairman, I don't think I'm departing from your hopes or, really, Boschwitz's hopes for this bill. But I believe there ought to be at least one single program at the Federal level in the United States of America that rewards the entrepreneur and the working men and women who go to work in those businesses or small businesses—which I think ultimately our tax incentives are aimed at—without having it subsidized.

There is a place for subsidies. We have other programs. But this is one program in which we are saying to the small business men and women, those who want to take a risk, those who want to go out and start a new business—that here is a place where if you go out and make it, whether it is a mom and pop grocery store or an electronics firm—you will get a reward for investing in the part of the country that is designated by the zone.

We will decide cooperatively between the local, State, and Federal level, that an enterprise zone is an area where we are in a compensatory way, as I said earlier, trying to target these new jobs in the private sector. I believe seed capital, and venture capital and equity capital in this country will once again be available if there is a potential for that business to earn a profit. Which ought not to be a nasty word in our economy.

In fact, I would think it axiomatic that rather than talking about profits in an pejorative sense we ought to talk about losses in a perjorative sense.

I come from Buffalo, N.Y., as the gentleman from Rhode Island knows, and to me it has been a tragedy to see what has happened to the small business community and the business community as a whole. Above all, the people who are employed in those companies have seen the steady deterioration of the economic climate of our area and our State and the Northeast—indeed, of the country.

You could make a case that the lack of profitability of American enterprise, coupled with the lack of profitability for working in America industry, has been one of the saddest and most tragic stories of the last 10 years.

Retained earnings—that is real capital generated by enterprises in America over the last 10 years available for investment in new machinery, equipment, technology, expansion, new jobs—has been steadily eroded.

And the labor profit of course is the wage. Steadily the wages in this country have been reduced, even though nominal wages have gone up. As you know, Mr. Chairman, the after-tax real purchasing power of American labor has gone down.

I find it unbelievable that an organized labor union could possibly oppose an attempt by the gentleman from the South Bronx and myself, or you from Rhode Island, to restore in those areas of the country in which they have such a great stake, a measure of profitability not only to capital but to labor.

Maybe we will get some testimony as to why they find themselves, at least in part, at odds with the purposes of the enterprise zone bill.

One of the distinguished people of this country, a researcher who has had a big impact on my views, Mr. Chairman, as well as those of my staff, and who I think is going to testify later today, David Birch of MIT, has made a point that I think probably has been made already in this committee. I would just like to enunciate it one more time. The point is that the most labor intensive industry in America is the small startup company.

The Fortune 1,000 over the last 10 years have not really created any net new jobs in America. With all due respect to the Fortune 1,000, the level of competition comes from the bottom.

And a society is renewed and revitalized and resuscitated, if you will, when there are thousands of new businesses starting up. That has historically been part of the inner city. Yet today we see this small business sector contracting. It has been strangled by excessive regulation and excessively counterproductive tax policies of the Federal Government; and in no small degree, States as well.

I think one of the things that I like most about this bill, I would say to my friends on the panel, is that this bill envisions a process whereby communities and States would compete. They would compete to receive the designation of the zone, and the competition would not be how high they can raise the taxes, and how many more regulations they can impose upon their community or their businesses, but quite the reverse.

I think it might be fair to say, parenthetically, Mr. Chairman, that one of the mistakes we made in our revenue-sharing legislation, of which I was a coauthor and which I continue to support—was that we predicated the formula, not only on population, but on tax effort.

In other words, revenue sharing was predicated upon the idea that the higher the tax that is raised at the local level, or at the State, the more the Federal Government will share its revenues.

And in effect, it has in many instances driven industry and businesses out of the area. In creating competition for Federal largess, we have spawned a counterproductive Federal program of State and local tax increase. Mayor Koch is one of the most distinguished mayors in this country and certainly a good friend of all of ours on a bipartisan basis. He has made the point over and over and over again that many of the pieces of legislation that he voted for when he was in Congress, not all of them—not maybe even many of them—but some of them have had an adverse impact upon his city's ability to meet the social and economic needs of the people.

Birch makes the point that about two-thirds of all the new jobs created in America in the last 10 years have been in those areas of the economy that foster small, independent businesses. That is an area which is not only labor intensive, but also very difficult to assist directly. If the Federal Government gets into the business of trying to subsidize failures, or take marginal businesses and make sure that they are not going to sink in the competitive stream; that in effect is a terrible misallocation of capital. Ultimately you have to have some failures in order to have a dynamic, growing economy. Enterprise zones can encourage new, small businesses, but they can also accommodate failure.

Incidentally, Mr. Chairman, one of the statistics that Birch points out is that in Houston, Tex., last year there were proportionally more business failures than there were in New York City.

There are also a lot more businesses starting up in Houston, Mr. Chairman. This is a manifestation of a healthy economy—that there are lots of new enterprises.

Someone attacked our bill, Mr. Chairman, by suggesting that we are interested in fly-by-night operations. I am disappointed, Mr. Chairman, that that type of terminology would be used to attack what I think is at least a progressive idea that ought to be discussed on its merits and not in such ominous terms.

But who is to say what is fly-by-night? Who is to sit up here in Washington, D.C. and say to Mom and Pop or to a small businessman or woman or a black entrepreneur or a hispanic entrepreneur or anybody, that what you are doing in that franchise or what you are doing in that grocery store or what you are doing with that little machine shop or what you are doing with that little auto repair shop is fly-by-night.

Who is to say that we should claim, in our infinite, omnipotent wisdom up here in Washington, that we know what is going to succeed? Because we don't, Mr. Chairman, and that is one of the principles underlying the enterprise zone legislation. What we're trying to do is to restore to the cities that climate of competition and entrepreneurship that ultimately our social programs absolutely depend upon.

Now, my goodness gracious, Mr. Chairman, how is it possible that anybody could oppose trying to encourage people to go into business on the principle that if they can make it, fine; and if they can't they are going to try again. Who is to say that they ought to be subsidized or protected from the competitive process?

There ought to be at least one program in the United States in which, if a man or woman makes it, there is going to be a reward. And I would suggest, Mr. Chairman, that that reward would not only be individually attainable and reflected in their lives; but also would redound to the benefit of the people who would get the jobs, the widgets that would be produced, and to the city's economy that would have a broader tax base.

So, frankly, I just find it inconceivable that anyone could oppose something as progressive as attempting to do, for our country and our inner cities what Israel is doing, what the Sri Lanka is doing. Mr. Chairman, I'm sure you recognize that Sri Lanka, a tiny little country in the Indian subcontinent, has enterprise zones. Hong Kong has an enterprise zone.

Senator CHAFEE. Well, I have not been following Sri Lanka lately, but I'll put you down as strongly favoring this legislation. [Laughter.]

Mr. KEMP. And in conclusion, I apologize if I have trespassed on anybody's time.

Senator CHAFEE. No, no, we're——

No one has been more involved with this legislation than you. I think it is fair to say, without contradiction, that you are the one who—conceived of this. Whether you got it from Sri Lanka or——

Mr. KEMP. I stole the idea, Mr. Chairman. I stole it from those experiments and those places in the world where this type of an entrepreneurial capitalism has worked in the past.

It is kind of fun, though, to be involved in this, as you know.

One last point, Mr. Chairman, that I would like to make, and then maybe could join you up there?

Senator CHAFEE. I certainly expect you to, and hope you will.

Mr. KEMP. I think it should be pointed out, Mr. Chairman, for at least the record that we have a broad consensus. It is incredible.

Several members of the Black Caucus, our good friend Bobby Garcia, who is one of the most eloquent spokesmen on this bill; Democrats, Republicans, Conservatives, Liberals, blacks and whites, Northeast and Sunbelt all support enterprise zones. I mean, it is really thrilling to see a bill take off in such a way as to achieve a consensus like this.

I just wanted to finish by saying that the inner city is existing today at the margin. People are hanging on by their fingernails, if at all. It is a tragedy if this Congress does not respond to the cry, the pleading for help. And part of that help must come from the Federal Government in terms of social programs, and economic programs that compensate for the problems that people have had by virtue of the poor economic performance recently.

So we have an obligation to do whatever we can. I believe that. Maybe I have changed my views over the years in some of those regards.

Nonetheless, the cities are a place where I think we can have an impact if we will target dramatic changes in tax policy. People say to me, often, hey Kemp, how do you know people are going to respond? Why do you think it will work?

I am convinced, Mr. Chairman, that people do respond to rewards—that they are entrepreneurs. It is the height of elitism to sit up here in Washington, and suggest that not only do we have all the answers, but that somehow we can pick out and choose who is going to be the next entrepreneur or whether entrepreneurship is the special quality of the middle class, white, Wall Street men and women of America. It is just not so.

Everybody daily calculates what is in their own rational self-interest. American people, in fact people as a whole, calculate arbitrages taking place daily across the face of this Earth.

The inner city poor are just as capable of making up their minds and making decisions predicated upon that rational self-interest. And they have the entrepreneurial skills if we didn't suffocate those, or strangle them, by our economic policies.

I believe that sound economics, Mr. Chairman, would result in people responding to that climate. I also think enterprise zones would also be very good politics for those men and women in both Democratic and Republican parties who once again want to see this country grow and thrive and prosper.

I know that is what the President wants. I know it is what you want and it certainly is what I want.

I appreciate the time, and——

Senator CHAFEE. Well, thank you very much, Congressman Kemp. I know that the mayor of your largest city will be along shortly. And that you will be interested in questioning him.

Won't you come up and join us here?

Mr. Torchia, you are next and we appreciate your permitting Congressman Kemp to intervene.

Mr. TORCHIA. I want to thank you very much, Senator, for giving me the opportunity to express my views on the enterprise zone bill.

First, a little background of my involvement in the city. I worked for the city of Providence over 20 years. I started off as a planner in urban renewal. I since became the director of model cities and went the full term with that program.

I also directed the CETA program since its inception in 1974. And I am currently the director of economic development in the city of Providence.

What this all basically means, is that the experience I have gained from all of these programs places me in an advantageous position at least to express my views on the proposed enterprise zone legislation.

Now, in each of these programs, the Federal Government subsidized very heavily the urban centers to perform activities mandated by these programs. The lessons learned from these programs have been absolutely instrumental either in avoiding past pitfalls, or playing on the successes that led to the effective cures of some of the urban problems.

Now, although the critics may argue that programs such as urban renewal with its emphasis on slum clearance were most disruptive and ineffective, I submit to you that at least in the city of Providence, redevelopment activities were quite successful in that it opened sufficient space in otherwise congested centers and provided much needed uses such as commercial, industry, better housing for its citizens notwithstanding.

And, of course, we did benefit by having additional revenue accrued to the city which is, as you know, is in financial restraints.

Now, the model cities program was a demonstration project to increase the quality of life for people residing in the very specific area which the zone in many ways is attempting to do.

This program taught many of us lessons otherwise that would not have been detected if it were not for the infusion of Federal funds. Conceptually, the program was to deal with a comprehensive approach to both the social and physical needs of its citizens in that particular area.

It also dealt very highly with the employment problem. As a matter of fact, the program itself hired over 750 neighborhood residents at its peak. The unfortunate problem with this program is that it was short funded. The timing was too short. And, of course, the results were insufficient to evaluate. It certainly got bad press but it did have an impact on the various areas that model cities actually performed.

Then came the CETA program and the purpose of this was to train the both unemployable and retrain the employable. Now, this basic program focused on the human element as a resource to the economy of a given locality.

Conceptually, the program does serve the need. However, through a great deal of paper work that is bogging that program down, and a heavy interference by the Federal Government, and a rather distortion of the basic objectives of the program through the introduction of the public service employment component; much criticism which eventually led to many of the cutbacks is probably now being made on the CETA program.

I related in general terms to several of the programs, certainly, that I have been involved in over the last 20 years. Now, the Federal Government is basically attempting to put another program into effect. Quite honestly, the Government has helped many of the problems, or has cured many of the problems in urban centers. It has identified many other problems.

But keeping in mind that much of the Federal involvement can also be the demise of the cities. One of which has also been a demise is putting the Federal freeway in various cities during the 1950's and causing a heavy exodus of people from the inner cities as well as the urban areas into the suburbs.

This caused a problem, meaning a polarization of population, leaving the elderly and the poor remaining back in the urban centers. This, coupled with a dwindling tax base, is causing the city a great deal of financial burden in terms of public services and assistance.

The essence here, of course, as I understand the enterprise zone bill, is that employment has become a high priority. Through the attainment of these goals, families could therefore maintain themselves, reduce dependence upon the Federal Government to provide services that most inner city residents have become accustomed to.

Now, the achievement of these three objectives may fall far short of its mark in that to have industry locate in certain select areas based upon tax incentives may not be enough. To employ strictly neighborhood people, and thirdly to eliminate or to reduce Federal spending for social services, may also not work at all.

I must admit to you that I am a proponent, or better still an advocate, of the enterprise zone bill. Any program that is designed to help its citizens, and more importantly the disadvantaged, has many indirect benefits.

I have read with great interest many articles written by various individuals both in support and against the enterprise zone bill. Although those stated to be against it are basically not opposed to the objectives of the bill. They are more concerned, however, about the process to achieve the objectives.

Based upon my knowledge and experience, I would like to offer my views on the process to achieve the objectives of the enterprise zone bill.

I have broken it down into some problematic areas which I think you should at least be aware of, and then a solution and strategy which I would like to lay forth. Not, again, opposed; but to supplement the existing bill.

In the city of Providence, like most New England cities, or for that matter any city throughout the Nation, its characteristics of industrial or business space is depicted by multistory deteriorated and obsolete buildings. Especially for today's modern production and goods and services.

The availability of space sufficient in size to house the modern industry or commercial building is almost nonexistent. Access to highway and rail through heavily congested streets is devastating. The lack of space and parking for employees and clientele is inherently becoming an irritating problem.

Just recently, Narragansett Brewery has announced that it is going to reduce its operation from 12 to 3 months per year due to energy problems and the cost of energy in urban centers.

We can go on with a multitude of different problems. One of the things, because the time is running, I will just offer——

The private sector, in its location anywhere, and some of the things that we have taken surveys, would prefer an estheticly pleasing environment. The location of which should be enhanceful. And it is amazing how many people actually are all for that sort of thing.

We would like to see that, in the enterprise zone, the opportunity to create kind of an industrial park situation. I don't think one business will survive. I think there has to be a grouping and a series of them.

To that degree we would like to see an industrial park perform. But industrial parks are expensive. That essentially means that

UDAG has to come to play. Now, there is a problem with UDAG which necessitates revision. And that is that they will leverage private capital with public funds only at the time of application; that is, when you do have a company ready to go in.

Now, in the meantime, a city generally has to acquire, has to demolish, has to put the infrastructure, streets, and so on. And it spends a considerable amount of money.

The Federal Government ought to at least allow, if the city does put that money into it, that it ought to get reimbursed as industry starts to move into those particular sites created for that purpose.

Senator CHAFEE. Mayor Koch has arrived. We promised we would put him on at 11:30 and so Mayor, why don't you come right up to that microphone if you would.

Mayor, you have a very distinguished gentleman who wishes to introduce you. A former compatriot from—and of course, a fellow citizen from your State. So Congressman, won't you go ahead.

STATEMENT OF HON. EDWARD I. KOCH, MAYOR, CITY OF NEW YORK

Mr. KEMP. Thank you, Mr. Chairman. I would like to welcome to the hearings today, one of the most engaging personalities in America today. Someone who has captured the imagination, not only in the city of New York, but in many cities. I was in Jerusalem recently and Mayor Teddy Kolleck said that the only mayor in the world who is more recognizable in Jerusalem than he is Ed Koch, which is no small distinction. That comes from a great mayor himself.

It is a pleasure as a Republican to recognize the distinguished and bipartisan mayor of New York City, Ed Koch; and I say that not only with friendship but with a high degree of respect and regard for what he has done. I think there is a great deal of admiration from many in America as well as in New York.

And even in Buffalo, N.Y., we think a lot of you. So thank you for appearing and we appreciate your interest and support of the concept Bob Garcia and I and Mr. Boschwitz and Mr. Chafee have coauthored.

Mayor Koch.

Senator CHAFEE. Thank you, Mayor. We are delighted. I don't know whether you consider that an endorsement for your reelection or not, but it came awfully close to it.

Mayor KOCH. I will use it that way. [Laughter.]

Mr. Chairman, Senator Chafee; Jack Kemp, a good friend; it is a pleasure to be with you.

I would like to introduce, if I may, Tony Riccio, who is the director of policy analysis for the N.Y.C. Office of Economic Development who is also our expert on the enterprise zone bill. If during the questioning I don't have the answer, I will turn to him.

When Jack Kemp and Bobby Garcia came to see me at City Hall some time ago to elicit support for this legislation, they already found someone who was very desirous of being supportive. We thought, and still think, on the city level, that this is a very innovative proposal and that it should be employed for the purposes of employing people.

We have several areas of our city, as does every city in the country, that are underemployed. But we made the point that if you simply had a piece of legislation that applied to the whole country, all you would be doing is engaging in revenue sharing; and that is not the purpose of this legislation.

So, they understood, and already have taken that into consideration, and we wanted to reemphasize it. The criteria in this bill have to drawn so as to limit where these enterprise zones could be. Otherwise you would have one in every city, and that would make no sense and would defeat the purpose of this bill.

We came up with a number of recommendations which related to the entire bill. We are very pleased that four of the matters that we discussed with Jack Kemp and Bobby Garcia have already been considered and adopted in the new bill. But I would just like to mention them because we think that they do, in fact, improve the legislation.

The area designation requirements have been expanded to include population decline, abandonment of commercial and industrial properties, and tax arrearages. We think that is very important. Previous requirements, measuring only unemployment and poverty levels, focused primarily on residential areas, rather than areas with adjoining industry.

The second recommendation that we had, was to eliminate the local property tax reductions of 20 percent across the board which had been in the bill. That has been dropped in favor of local commitments, including tax incentives, improved services, and job training.

The third change that we approved of, was that the period of zone designation should be lengthened, as it has been from 10 to 20 years.

And finally, the last recommendation that we had at the time, which was adopted in the new bill, was that the income tax provisions be expanded to include those who make loans to businesses in the zone.

So those are the four recommendations we made that we are very pleased went into the bill.

There are two other new provisions that we support that we hadn't considered. We are just delighted that they went in as well, as a result of the author's own decision to improve the bill.

That is a refundable employment tax credit has been added, and an investment tax credit has been extended to low income housing.

There are still some problems with the legislation which we would like to mention, and hope that they will be changed in the bill. That is the purpose of the hearings to point out these matters.

The tax incentives, for the most part, are weaker than those prepared last year. Last year the city recommended deeper incentives.

Now, the tax incentives provide little incentive to existing businesses to retain existing jobs. The focus of incentives is on creating new jobs only. The original bill applied incentives to all businesses. We hope that will be considered.

Just five more little references, and then I will stop and file my full speech.

The rapid depreciation provision has been eliminated. We believe this is an important physical development incentive and should be restored.

The capital gains tax now applies only to new investment. We think that is too limiting.

There is no accounting provision for large corporations to locate a plant or business division within a zone, and we think that should be addressed.

Senator CHAFEE. I think we have handled that. In other words, if General Motors puts a plant in the area, General Motors would be able to get the benefit of this by the profits that flow from this plant in some manner. Well, certainly that is our intent.

Mr. KEMP. Could I just make a comment about that? I think there is a big debate, as you know, Ed, in the Ways and Means Committee between Democrats and Republicans, Rostenkowski and Conable and Reagan on depreciation. No matter what happens, no matter what emerges, whether it is the expensing provision in the Democratic bill or the 105-3 rapid rates of accelerated depreciation in the Conable-Hance bill; one thing we do know, that nationally, across the board, there will be a liberalization of the depreciation rates which will help, it seems to me, the Northeast.

Excuse me to those who are in the Sun Belt, but generally speaking, the aging plant and equipment of America is in the Northeast.

I represent Buffalo. We have Bethlehem Steel built in 1921, outrageous. What we do to Bethlehem Steel when they put in a new blast furnace, they write it off over 16 years. Canada writes off their investment in 1 year.

So anything that liberalizes will enhance the country, but particularly the Northeast, because that is where the aging plant and machinery is.

If you target it you are simply going to get into almost a zero sum game. We removed it because there was a national consensus as to what was going to happen in the tax reform bill. But I am certainly willing to consider it, and I think Rudy and John are as well.

Mr. KOCH. We have just two other items. First we believe that there should be a provision for adequate job training if a 40 percent CETA hiring requirement is to be met. It is a high requirement. We are not opposed to it, but adequate training therefore would be required in order to have that effective.

Finally, we see no need to have the Governor's veto power in the bill. Since the State isn't required to make any contribution at all, there shouldn't be any gubernatorial involvement.

Senator CHAFEE. That is the same point that Mayor Voinovich made earlier when he testified.

But we did have a representative from the National Governor's Association that, oddly enough, thought that the power should be kept there. [Laughter.]

Mayor, what do you think about the limited number of designations that we have in this bill? We say not less than 10 nor more than 25 in 1 year. Do you think that is good, or do you think it is too small an attempt?

Mr. KOCH. No, I think it is a very appropriate range for a couple of reasons.

The first one is: to see if it works. If there are so many competing cities you are going to defuse the energies and you may just prevent the project from working. That is No. 1.

The second is that it is just an extension of the first comment on my part. The program will have no meaning, if in fact the thrust of it is to put one in almost every city.

Senator CHAFEE. Well, you still have the eligibility criteria.

Mr. KOCH. You are right. But I still believe that you ought to build upon success. I would suggest that you keep the limitation.

Senator CHAFEE. With the limitation you would probably get one.

Mr. KOCH. I understand. We are not piggish.

[Laughter.]

Mr. KOCH. But a big one.

Senator CHAFEE. Just one, but a big one. OK.

Jack, do you have——

Mr. KEMP. Insofar as the training goes, it is my understanding in the budget bill that the CETA program with regard to CETA training is preserved.

So the cities will still have those aspects of the CETA program that are involved with training and that can be used.

Parenthetically, when talking about the States' role it is important to recognize that it would be obligatory that a State have some role in the, I don't maybe want to use the word competition, but at least in the qualification to designate the enterprise zone. It would be helpful to have a governor and a mayor working to see what are the impediments to starting up and expanding and preserving businesses in the South Bronx or Bed-Sty or Maston-Buffalo.

Mr. KOCH. But the problem, as I read the bill, is the following: it is after all the administration, the Feds, that make the designation in terms of eligibility and then it is the locality, in fact, that does the accepting. You would not want the Feds to designate a city as one place where the enterprise zone should be, the mayor to say absolutely and the Governor, for political purposes or other purposes, to reject the whole project.

Mr. KEMP. I can't imagine any Governor doing that, not cooperating with you. How could a Governor not cooperate with someone like you? [Laughter.]

Mr. KOCH. This bill applies to more cities than New York.

Mr. KEMP. You know, one thing that is important to point out here, and I think John touched on it, and I would like to make it again. It is simply this. We are not interested in experimenting. We think it will work. We believe it will work. We think there is intuitive and empirical evidence to support our contention.

If you create an enterprise zone and you are trying to lead an entrepreneur to make an investment and a person to take a job in that enterprise you must offer some assurance that this is a permanent policy. In effect, if the anticipation is that what one hand gives, another may soon or at some point remove, it seems to me that the expectation that this would work would be reduced. Entrepreneurship would be discouraged, and the "experiment" might be considered unsuccessful.

So we are anxious to put it in place. The President believes it will work. The authors believe it will work. I know that you believe it will work.

Mr. KOCH. I believe it will work.

Mr. KEMP. Fifteen or twenty is a reasonable number given the budget constraints. But, as far as I am concerned, I would ultimately, some day, like to see every city in the United States create a haven for this type of enterprise.

Senator CHAFEE. Mayor, what would you do to meet the requirement of the local effort?

Mr. KOCH. Well, obviously tax incentives include eliminating taxes from that particular area where possible. But, for example we always have a problem changing taxes on gifts and loans under our State constitution.

However, we can give real estate tax breaks as we have in the J-51 program, which probably you have heard about, that relates to our housing program. Also, commercial tax abatements which have been employed very successfully in New York, but generally speaking in the most affluent part of our city.

People in the private sector tend to build in the parts of the city where their investment is most assured of success. Consequently, we have had to reduce our programs and line out—I don't want to call it redline, because redline is pejorative, so we'll call it blueline out investing in areas. What we don't want to do anymore is to allow tax abatements and tax exemptions in midtown Manhattan, so we have excluded whole areas from our J-51 residential program.

We are very careful with tax abatements as it relates to our commercial program, and therefore, what we would seek to do is to apply tax incentives like the J-51 program in heavy concentration in these enterprise zones.

Mr. KEMP. I have got a good word that might replace that pejorative—greenlining. Green line.

In effect, you are trying to attract rather than repel. And certainly, redlining in the past has been an ad hoc response to what was perceived as a problem for the investor in those areas.

And now we are saying you are not being repelled. We want to invite capital, seedcorn, back into that area.

Mr. KEMP. Ed—Mayor Koch, one of the things that I think this bill specifically does that has not yet been focused on—and I am not an expert in tax policy, but I would like to think I have some expertise in incentives—is recognize that there are different taxes that impact in different ways.

The incidence of taxation is different than the burden of taxation. I think that has been proven in many different instances across the board.

Hong Kong has no capital gains tax. The top tax rate on corporations is 15 percent; and the top tax rate on income in Hong Kong is 15 percent.

Incidentally, Hong Kong's growth rate, and with lots of different variables—and I apologize that I am not going to answer everybody's question as to the many different variables that might be introduced in this equation—but nonetheless, for just a simple parallel, Hong Kong is growing at 11.5 percent in real terms per year.

Half of all the residents of Hong Kong in the last 10 years have been moved into subsidized housing.

It is interesting that the tax base of the city has expanded to such a point that the revenues are able to provide a healthy environment in terms of housing. There are lots of differences, and I will not take my analogy any further, but simply say that where there is a reduced burden of taxation on those factors of production that lead enterprises and people to become more productive, in effect, the tax base expands not shrinks.

An expanding tax base is one thing New York City needs desperately. Our panel has mentioned that the tax base of the inner city has been restricted and thus it poses a threat to the very social programs that have provided an infrastructure.

I am worried that the recent tax increase in New York might retard or restrict that tax base, not expand it.

Can you comment on that tax, which seems to me to be counterproductive in our need to increase capital investment in our State?

Mr. KOCH. In a very brief way. The tax that you are referring to consists of several taxes levied in order to provide subsidies for mass transit and to keep the fare from going up to a dollar. We have already raised the fare from 60 cents to 75 cents, which is a 25 percent increase. If we had not received the tax package, which is imposed regionally and statewide, and imposes a tax on gasoline, the fare would have risen even more.

I mean, who can be opposed to a tax on gasoline, except the people who use it?

[Laughter.]

Mr. KEMP. Well, I think there are a lot of people who use it and tax on gasoline is anticonsumer.

Senator CHAFEE. I think we want to be careful not to stray too far from the matter at hand here.

And you think this will work?

Mr. KOCH. Yes I do, and we offer the city of New York as your first enterprise zone.

[Laughter.]

Senator CHAFEE. Thank you. And I want to thank Congressman Kemp for coming here.

Mr. KEMP. Thank you, Mr. Chairman.

[Statement follows:]

THE CITY OF NEW YORK

TESTIMONY OF MAYOR EDWARD I. KOCH
BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
SENATE FINANCE COMMITTEE
U.S. CONGRESS

"THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981"

JULY 16, 1981

83-937 O—81——14

I WOULD LIKE TO THANK SENATOR CHAFEE AND OTHER MEMBERS OF THIS SUBCOMMITTEE FOR THE OPPORTUNITY TO COMMENT ON THE PROPOSED "URBAN JOBS AND ENTERPRISE ZONE ACT." AS YOU MAY KNOW, THE CITY OF NEW YORK HAS BEEN ACTIVELY INVOLVED WITH THE DEVELOPMENT OF THIS PROPOSAL SINCE IT WAS FIRST INTRODUCED LAST YEAR. AT THAT TIME, I APPOINTED A TASK FORCE COMPOSED OF PRIVATE AND PUBLIC SECTOR REPRESENTATIVES TO EXAMINE THE LEGISLATION AND MAKE RECOMMENDATIONS, WHICH WERE THEN DISCUSSED WITH THE HOUSE SPONSORS. I AM PLEASED TO SEE THAT MANY OF OUR RECOMMENDATIONS HAVE BEEN INCORPORATED IN THE NEW BILL.

AS WE HAVE STATED IN THE PAST, THE CITY OF NEW YORK ENDORSES THE CONCEPT EMBODIED IN THIS BILL--PROVIDING FEDERAL TAX INCENTIVES IN ORDER TO STIMULATE JOB GROWTH AND RETENTION IN ECONOMICALLY DISTRESSED AREAS. WE ALSO HAVE STATED, HOWEVER, THAT TAX MEASURES ALONE CANNOT ACCOMPLISH THE GOAL OF ATTRACTING INCREASED BUSINESS INVESTMENT TO DISTRESSED AREAS, BECAUSE TAXATION IS NOT THE ONLY FACTOR IN A BUSINESS'S DECISION ON WHERE TO LOCATE. THUS, THE LEGISLATION SHOULD NOT BE THOUGHT OF AS A SUBSTITUTE FOR EXISTING ECONOMIC

DEVELOPMENT PROGRAMS. FEDERAL AND LOCAL PROGRAMS IN THE AREAS OF INFRASTRUCTURE CONSTRUCTION AND REHABILITATION, SMALL BUSINESS FINANCING AND EMPLOYMENT TRAINING MUST BE LINKED TO THE ENTERPRISE ZONE.

WITH THIS BACKGROUND, I WOULD LIKE TO OFFER SOME COMMENTS ON THE NEW BILL BEFORE US.

ON THE POSITIVE SIDE, WE ARE PLEASED THAT OUR RECOMMENDATIONS FOR AREA DESIGNATION HAVE BEEN INCORPORATED. DESIGNATION REQUIREMENTS IN THE OLD LEGISLATION WERE SIMPLY UNWORKABLE BECAUSE THE DATA CALLED FOR WAS LARGELY UNAVAILABLE, OR, WHEN AVAILABLE, FOCUSED THE BENEFITS ON RESIDENTIAL AREAS, RATHER THAN ON INDUSTRIAL AREAS MORE CONDUCIVE TO JOB GROWTH. THE NEW INDICATORS, WHICH INCLUDE POPULATION DECLINE, ABANDONMENT OF COMMERCIAL AND INDUSTRIAL PROPERTIES, AND HIGH LEVELS OF TAX ARREARAGE, DO A BETTER JOB OF FOCUSING THE LEGISLATION ON DECLINING INDUSTRIAL AREAS.

THE CITY IS ALSO PLEASED THAT THE LOCAL PROPERTY TAX PROVISION HAS BEEN DROPPED, AS WE HAD RECOMMENDED, IN FAVOR OF A PROVISION THAT WOULD SUBSTITUTE OTHER KINDS OF LOCAL

COMMITMENTS SUCH AS TAX INCENTIVES, SIMPLIFICATION OF REGULATIONS AND SERVICE IMPROVEMENTS. WHILE WE HAVE NOT YET COMPLETED OUR PLANS FOR THIS LOCAL MATCH, THE CITY DOES HAVE ONGOING PROGRAMS IN THE AREA OF INDUSTRIAL SECURITY, TAX ABATEMENT AND EXEMPTIONS, AND JOB TRAINING, ALL OF WHICH QUALIFY IN THIS LEGISLATION. OUR OWN EXPERIENCE SUGGESTS THAT THE ROLE OF MUNICIPALITIES MAY BE MOST IMPORTANT IN THESE AREAS, PARTICULARLY SECURITY. FEAR OF CRIME IS ONE OF THE GREATEST DETERRENTS TO LOCATING IN DISTRESSED AREAS.

NOW LET ME COMMENT ON THE MOST IMPORTANT ASPECT OF THE BILL-- THE TYPES OF FEDERAL TAX INCENTIVES PROVIDED TO ATTRACT INVESTMENTS IN ENTERPRISE ZONES.

THE TAX INCENTIVES IN THE CURRENT BILL HAVE BEEN IMPROVED IN SEVERAL RESPECTS:

- THE PERIOD OF TIME IN WHICH THE INCENTIVES ARE IN EFFECT HAS BEEN LENGTHENED FROM 10 TO 20 YEARS.
- THE INCOME TAX PROVISIONS HAVE BEEN EXPANDED FOR ALL KINDS OF BUSINESSES, NOT ONLY CORPORATIONS. BUSINESSES MAY NOW EXCLUDE 50 PERCENT OF THEIR ZONE INCOME FROM THEIR GROSS INCOME FOR THE FIRST 17 YEARS, AFTER WHICH THESE INCENTIVES ARE PHASED OUT TO EASE THE TRANSITION

TO FULL TAXATION. MOST IMPORTANT, THIS INCOME TAX EXCLUSION EXTENDS TO THOSE WHO LEND TO BUSINESSES IN THE ZONE. THIS WILL PROVIDE AN INCENTIVE FOR FINANCIAL INSTITUTIONS TO FINANCE ENTERPRISE ZONE BUSINESSES.

. A REFUNDABLE EMPLOYMENT TAX CREDIT PROVIDES AN ADDED INCENTIVE FOR BUSINESSES TO HIRE DISADVANTAGED WORKERS: THE REFUNDABILITY OF THE CREDIT WILL ASSIST SMALLER AND NEWER FIRMS WHICH MAY NOT HAVE TAX LIABILITY. THE NEW BILL ALSO CONTAINS A 20-YEAR TAX LOSS CARRY-FORWARD, WHICH SHOULD ESPECIALLY HELP SMALL START UP FIRMS.

. THE INVESTMENT TAX CREDIT HAS BEEN EXTENDED TO INCLUDE LOW-INCOME RENTAL HOUSING. THIS IS A WELCOME ADDITION. HOWEVER, THIS COMPONENT CAN ONLY BE SEEN AS A COMPLEMENT TO, AND NOT A SUBSTITUTE FOR, OTHER HOUSING PROGRAMS THAT ARE DESPERATELY NEEDED IN CITIES LIKE NEW YORK.

UNFORTUNATELY, FOR THE MOST PART THE TAX INCENTIVES IN THE NEW BILL ARE CONSIDERABLY WEAKER THAN THOSE PROPOSED LAST YEAR. THIS IS A DISAPPOINTMENT TO US BECAUSE OUR MAJOR COMPLAINT WITH

LAST YEAR'S BILL WAS THAT THE TAX BENEFITS IT CONTAINED WERE NOT STRONG ENOUGH TO ATTRACT SIGNIFICANT NEW INVESTMENT.

- TAX INCENTIVES IN THE OLD BILL APPLIED TO ALL BUSINESSES IN THE ZONE. EXCEPT FOR THE EMPLOYER'S REFUNDABLE TAX CREDIT, THE INCENTIVES IN THE NEW BILL ARE RESTRICTED TO FIRMS THAT INCREASE JOBS. SINCE RETAINING JOBS IS A PRIMARY GOAL OF ANY URBAN ECONOMIC DEVELOPMENT PROGRAM, WE STRONGLY BELIEVE THAT THE BILL SHOULD BE AMENDED TO INCORPORATE THIS GOAL. WHAT IS THE NET GAIN FROM JOBS CREATED BY A NEW FIRM WHEN AT THE SAME TIME WE LOSE EMPLOYMENT FROM EXISTING BUSINESSES?
- THE PROVISION FOR RAPID DEPRECIATION OF ENTERPRISE ZONE PROPERTY HAS BEEN ELIMINATED. THIS WAS A KEY INGREDIENT OF THE ORIGINAL BILL; IT IS A VERY IMPORTANT PHYSICAL DEVELOPMENT INCENTIVE FOR AREAS, SUCH AS THE SOUTH BRONX, THAT HAVE EXPERIENCED MASSIVE DISINVESTMENT OVER THE LAST 20 YEARS. WE URGE YOU TO INCLUDE A RAPID WRITE-OFF IN THIS BILL.

- THE ELIMINATION OF THE CAPITAL GAINS TAX APPLIES ONLY TO BUSINESS INVESTMENTS MADE AFTER THE DESIGNATION OF AN ENTERPRISE ZONE. WE FEEL IT IS UNFAIR TO EXCLUDE FROM THESE BENEFITS PAST INVESTMENTS THAT HAVE WEATHERED THE STORM IN THE MOST DISTRESSED AREAS OF OUR NATION.

- THERE IS NO PROVISION IN THIS BILL FOR VERY LARGE CORPORATIONS TO LOCATE A PLANT OR DIVISION WITHOUT SETTING UP EXPENSIVE (PERHAPS PROHIBITIVE) SEPARATE ACCOUNTING PROCEDURES. SUCH ENTITIES SHOULD BE ALLOWED A TAX CREDIT EQUIVALENT TO THE BENEFITS FOR BUSINESSES ELIGIBLE UNDER THE CURRENT LANGUAGE. THIS CREDIT WOULD BE TAKEN AGAINST THE PARENT CORPORATION'S TAX LIABILITY AND WOULD APPEAR ON THE CONSOLIDATED TAX RETURN.

AT THIS POINT I WOULD LIKE TO STRESS THE NEED FOR AN ADEQUATE EMPLOYMENT TRAINING COMPONENT IF THE CETA HIRING REQUIREMENT IS TO BE SUCCESSFUL. I ALSO URGE THE COMMITTEE TO EXAMINE WAYS TO MAKE

THE 40 PERCENT REQUIREMENT FLEXIBLE ENOUGH TO ATTRACT THE WIDEST ARRAY OF INDUSTRIES.

ONE LAST POINT CONCERNING THE VETO POWER GIVEN STATE GOVERNMENTS IN THIS LEGISLATION. SINCE THE INCENTIVES AND COMMITMENTS ARE SOLELY ON THE FEDERAL AND LOCAL LEVELS, WHY HAVE A PROVISION GIVING GOVERNORS THE RIGHT TO FILE AN OBJECTION TO A LOCAL ENTERPRISE ZONE DESIGNATION? THIS SECTION OF THE LEGISLATION SHOULD BE DELETED. PERHAPS THE COMMITTEE SHOULD CONSIDER A MORE POSITIVE ROLE FOR STATE GOVERNMENTS. ADDING STATE INCENTIVES TO THE PROGRAM WOULD ENHANCE ITS ATTRACTIVENESS AND ADD TO THE SUCCESS OF AN ENTERPRISE ZONE.

IN SUMMARY, LET ME RESTATE MY EARLIER COMMENT THAT THIS LEGISLATION IS NOT, BY ITSELF, A CURE FOR THE NATION'S URBAN ILLS. WE NEED OTHER FEDERAL PROGRAMS TO SUPPORT THESE EFFORTS. WE CANNOT EXPECT TO MEET ECONOMIC DEVELOPMENT GOALS BY STIMULATING INVESTMENT IN AN ENTERPRISE ZONE, WHILE WE LET LAPSE OTHER VITAL PROGRAMS FOR DISTRESSED AREAS SUCH AS CETA, UDAG, EDA AND FEDERAL CRIME INSURANCE.

FINALLY, I URGE YOU TO LISTEN CAREFULLY TO THE MEN AND WOMEN IN PRIVATE BUSINESS FROM FIRMS LARGE AND SMALL. WHILE THE CITY OF

NEW YORK IS WILLING TO CONTRIBUTE ITS SHARE IN ORDER TO MAKE THIS PROGRAM A SUCCESS, IT IS ULTIMATELY PRIVATE INDUSTRY THAT WILL PUT AREAS LIKE THE SOUTH BRONX BACK TO WORK; SO PRIVATE INTERESTS WILL BE THE BEST JUDGES OF THIS LEGISLATION.

AGAIN, I THANK YOU.

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TESTIMONY OF THE HON. JACK KEMP (R-NY)
ON THE URBAN JOBS AND ENTERPRISE ZONE ACT
BEFORE THE SENATE FINANCE COMMITTEE
THURSDAY, JULY 16, 1981

Mr. Chairman and members of the committee, I would like to thank you for this opportunity to testify on behalf of the Urban Jobs and Enterprise Zone Act, which Representative Robert Garcia (D-NY) and I have also introduced in the House of Representatives, as H.R. 3824.

Several witnesses have already testified in support of the concept behind our legislation. I welcome this emphasis on enterprise zones as an idea--even when it's followed by a long string of "buts". Ideas are important. If we are really going to make a difference to the people of America's inner cities, we will have to base this proposal on a sound understanding of how people tick economically, of how jobs are created and why cities prosper or decay.

Many witnesses have also offered specific proposals for revision. These are welcome too. By now even the most skeptical observer must be convinced that Rep. Garcia and I meant it when we asked for suggestions. After months of discussions with literally hundreds of interested groups and individuals, I believe we have come a long way toward workable enterprise zone legislation. The incentives are deeper and more significant, the state and local role is more important but also more flexible, and the provisions are more closely tied to the needs of disadvantaged workers. Still, I'm certain that together we will make this bill even better.

What worries me, all the same, is that the whole debate about enterprise zones is in grave danger of bogging down over issues which in fact are mere straw men. So rather than review the history of the enterprise zone concept, or the details of the Urban Jobs and Enterprise Zone Act, I would like to try to lay to rest certain misconceptions about enterprise zones.

First of all, I agree with a whole string of witnesses that enterprise zones are not a substitute for current programs. How many times must we say it? The bill has no hidden agenda. When Bob Garcia and I first introduced enterprise zone legislation in the summer of 1980 there was no question of changing programs like CETA, UDAG, or

EDA, and the cutbacks in the current budget have been made without any reference at all to enterprise zones. If anything, our revised bill makes the role of Federal spending programs more explicit, by confirming that Federal money can be used for projects included in a state and local zone contract.

But there is an even more important reason why enterprise zones should not be considered as a substitute for direct spending programs. They provide a very different tool, and are aimed at reaching problems that direct Federal programs, by their very nature, cannot address in the same way.

Above all, enterprise zones are designed to attract private capital. Now, I know that our proposal has been criticized for not providing "up-front" Federal seed money. Yet even if we tripled FY 81 Federal capital assistance programs--and there seems little public or Congressional support for such a move--these programs would still provide less than one-tenth of all start-up business capital. By far the greatest part--89%--of this capital comes from personal savings. Seventy-five percent of all new businesses start without using any outside debt or equity at all; and even when they receive outside funds these are more likely to come from family or friends than from financial institutions.

What makes a person decide to put his or her savings into a new enterprise instead of, say, a house, or money-market funds, or a yacht? The entrepreneur surely isn't looking for immediate profits. Most new small businesses don't make money for their first five years, if they beat the odds and survive at all. Instead, entrepreneurs choose the highly risky course of starting their own business because they calculate that, in the long run, they will reap a greater personal and financial reward.

This is why future-oriented tax incentives make capital available in the present. By reducing capital gains and income taxes, in particular, the Urban Jobs and Enterprise Zone Act promises a greater reward to those who succeed in their initial risk-taking investment. In this way we can tap the greatest resource available for our inner cities: the huge pool of private savings seeking a significant after-tax rate of return in these uncertain and inflationary times. In addition, by excluding half of all interest income on loans to zone enterprises from taxation, the bill will help these businesses attract loan capital, whether from formal institutions or from the informal, but more significant network of family and friends.

Enterprise zones also provide a unique tool for assisting the kind of business most likely to provide new jobs in the inner city. As the M.I.T. Program on Neighborhood and Regional Change discovered, two-thirds of all new jobs nationwide were created by businesses employing twenty people or fewer. Closer to 80% of all the new jobs taken by blacks and other disadvantaged workers were provided by small businesses, and 100% of the net new jobs in my own region of the Northeast, and in almost all of our declining central cities, come from businesses with twenty or fewer employees.

Yet these are the very businesses that development grants, loan guarantees, and public job training programs by their very nature are least likely to reach. As M.I.T. researcher--and witness before this committee--Dr. David Birch has pointed out:

> "The job generating firm tends to be small. It tends to be dynamic (or unstable, depending on your viewpoint)--the kind of firm that banks feel very uncomfortable about. It tends to be young. In short, the firms that can and do generate the most jobs are the ones most difficult to reach through conventional policy initiatives. . .The very spirit that gives them their vitality and job-crating powers is the same spirit that makes them unpromising partners for the development administrator.

In fact, these smaller businesses tend to resist direct government succour. When thousands of small businessmen and women came together for the White House Conference on Small Business in January, 1980, they voted not for more Federal grants, for loan guarantees or development assistance. Of their top 15 recommendations, the top 5 all proposed changes in the tax code, while 4 more advocated reduced government regulation. None of the top 60 recommendations favored direct economic assistance.

This doesn't mean that direct Federal programs don't have an important role to play in economic development. When it comes to large-scale projects, or infrastructure development, Federal assistance is often essential. In my own city of Buffalo, for instance, I have supported Federal aid for constructing a downtown mall, which will enhance our light rail rapid transit system, and for building a major banking and commercial complex. But, as Dr. Birch points out,

> "A problem arises when the target population consists of thousands of small businesses. They are difficult to reach. They are expensive to aid--the set-up costs are high relative to the magnitude of assistance provided. They can be very

embarassing--they fail often, and agencies cannot tolerate very many failures. . .

What the data do suggest is that those cities that wish to capitalize upon the job-generating powers of the smaller businesses within their boundaries are going to have to complement the traditional economic development vehicles with a broader approach. They must come to understand the special needs of the entrepreneur. They must work with their state legislatures to develop indirect tax and regulatory strategies that foster the 'percolation' of thousands of small businesses at the same time that they work on the politically more satisfying task of handing out money directly."

On this note, let me make a political point about the complementary roles of direct spending programs and enterprise zones. Whenever the Federal governments seeks to assist new, small firms directly, it runs up against the fact that 4 out of 5 new firms fail in their first year. The number is sure to be even higher in the risky environment of the inner city. Eventually pressure for a decent success rate leads to a conservative strategy for aiding sure winners, rather than encouraging risk-taking and entrepreneurship.

This problem won't be solved just by better Federal oversight. It is inherent in the process of economic growth. If Dr. Birch will indulge just one more quote from his ground-breaking study:

"if we look at the rate at which establishments go out of business, we find that the fastest growing area (Houston) is actually losing a higher percentage of its establishments each year than declining ones like New Haven and Boston. This is not a paradox. It simply reflects the fact that the healthier an economy is, the more active it is and the more its corporate population is turning over. Turnover is a natural consequence of entrepreneurial activity. Those who would reduce deaths as a way of improving the health of an economy clearly misunderstand the processes that lead to job creation."

Not every entrepreneur who responds to the incentives offered in enterprise zones will be able, ultimately, to take advantage of them. Some will fail. So even as the tax incentives affect the risk-reward calculations of all enterprise zone entrepreneurs, the rewards themselves go to the successful. Thus enterprise zones fit the nature of our economic marketplace, and can adapt to change, risk, and failure. This is not only efficient--it will help insure the program's political survival as well.

We need to keep this in mind, too, as we consider the possible tax "cost" of the Urban Jobs and Enterprise Zone Act. The more successful enterprise zones are, after all, the more expensive they become in <u>static</u> revenue terms. Suppose we had a wildly successful enterprise zones, with hundreds of new businesses and thousands of new jobs. Is the revenue loss equal to the additional taxes these workers and businesses are not paying? But then, would these businesses or jobs have otherwise existed? What other government costs would be reduced? I think any fair estimate of the cost of enterprise zones must take these questions into consideration.

And, of course, should enterprise zones not succeed, we would be no worse off than before. That is more, perhaps, than could be said for some of our earlier efforts at urban renewal.

The final "straw man" in our current debate over enterprise zones is, I believe, the notion that this proposal would somehow be diluted by the economic recovery tax act recently reported by this committee.

Just the opposite is true. Our inner cities, more than any other area, exist on the margin. Their people, and their enterprises, are hurt the most by economic stagnation, and they have the most to gain from economic growth. It is no accident that black and white income in this country converged for the first--and up till now, at least, the last--time in the late sixties, when the Kennedy marginal income tax rate cuts led to unprecedented economic growth. When the entire economy is growing businesses seek out new workers, and new opportunities for expansion. In a stagnant economy it is unlikely that even the enterprise zones' considerable incentives would attract new enterprises, because new enterprises would not be starting up. But in a buoyant economy, when entrepreneurs are seeking new opportunities and new workers, the marginal advantages of enterprise zone incentives will become far more significant.

Let us try, in summary, to examine enterprise zones on their own merits. We should recognize that they can't simply substitute for existing direct assistance programs. But we should also recognize that they bring important <u>new</u> tools to help us meet our old challenge of restoring jobs, economic vitality, and hope to America's poorest communities.

Senator CHAFEE. Now back to Mr. Barrow on this panel that has been extremely patient.

Mr. BARROW. I would like to thank you for this opportunity to present the views of the American Association of MESBIC's. The American Association of Minority Small Business Investment Companies represents MESBIC's throughout the United States who were created administratively in 1969 and through legislative mandate in 1971.

Our purpose, and we specialize in the areas of four profit venture capital vehicles, we are licensed by the SBA and our mission is basically to invest in small businesses—small business concerns owned by minority entrepreneurs.

By late 1980 there were approximately 129 licensed MESBIC's representing over $187.4 million in investments.

I have summarized the major points of our testimony and I would like to proceed.

The greatest potential for private enterprise participation in the proposed urban jobs and enterprise zone programs with small businesses and especially minority small businesses—two greatest problems for the success of minority enterprises in the central cities are the inability to obtain capital and inadequate managerial skills. The major importance in this legislation should be placed on the capital generating provisions of the bill so that there would be available capital to expand in these areas.

We feel that the key in this bill is the help to the infrastructure in the one. And to basically leave the community in a stronger, more self-sufficient condition.

We also feel that the bill helps to draw skilled managers and workers back into the city and encourage investment in the training programs. As experienced investors in the target community, we feel that MESBIC's should be used extensively in establishing small businesses in the urban enterprise zone.

We feel that extensive State and local government participation in the zone is necessary and should be encouraged.

And finally, we would like to see some of the—something to take the place of other programs that may not be operational, such as EEA and UDAG, to assist in the leveraging as an additional tool.

That basically is the summary of our presentation.

Senator CHAFEE. You said you would want to make sure that it does not replace these other programs.

Mr. BARROW. Well, I think the tools have to be used in conjunction.

One of the problems that I have in looking just at the tax incentive side is not taking into consideration the fact that these particular programs have assisted in terms of many of the acquisitions, the mergers, and the prospering small businesses that we have in the inner city.

People that were basically taking the risk in an area where there was very little economic return based on the ordinary financial scenario in reviewing the acquisition or the merger or the company.

Senator CHAFEE. You mentioned in your testimony here that you think that the MESBIC's should be used as a principal instrument in establishing small business in the urban enterprise zone. There is nothing here that would prevent that.

Mr. BARROW. No, I'm not saying that there is. The point that I am trying to stress is, and bring to light is, that there are vehicles—there are groups—that basically have an experience in working with businesses in the inner city.

We have had an opportunity to work with the OIC program. We have had an opportunity to work with HUD. We have had an opportunity to work with UDAG and we have had an opportunity to work with the banking community, the insurance companies, and the pension funds.

You name the city. Mr. Kemp pointed to East St. Louis, New York City, Philadelphia, Detroit, and Cleveland. We have businesses that are operational, that are performing quite well, and they are in the growth industries.

So we are saying we have a track record and we would like to make certain that they know that there are vehicles that are available, that are private source, that can leverage the dollars and bring these resources to bear.

The other tools that I was referring to in terms of the program such as UDAG and EEA expand the capital base and help our dollars to go farther in terms of the involvement.

We proposed, for instance, last year basically $48 million in projects through a certain Government program. There were a number of time delays, but of that about $25 million in programs were honored.

These businesses are still operational and we felt that based on our track record—the rocky history that the MESBIC's have had at some point in time in the 1970's—and based on our improved formula in terms of determining success or failure of a business opportunity has given us an opportunity to look at the proposed Urban Jobs and Enterprise Zone Act and we can place ourself in there and give you some insight into some of the problems that they have.

Senator CHAFEE. What do you think about this legislation as far as providing an adequate incentive for companies to locate in distressed areas? I noted what you said about compared with last year you think that this bill is stronger on encouraging investment.

Do you think this will do the trick?

Mr. BARROW. I think small, minority businesses will continue to locate in these areas. I think some of the incentives that have helped, for instance on the State and local side, have been the availability of some land. City-owned land where the city was willing to sell it at basically a bargain price which would help to strengthen the balance sheet. Or would basically contribute that property as part of the total project cost, which would basically bring down the amount of money that one would have to have to buy into or get established in there. And at the same time reduce the amount of private capital that would have to be invested.

For instance, if you had a project where the land was half the total project cost, let's say $1 million, you are only basically financing $500,000. You basically have collateral and the banking institutions, or the private sector, which basically are maximizing profits, basically has something to collateralize the loan.

So in that sense with the partnership involvement, you are basically able to lever additional private dollars through lines of credit for working capital or other things.

I might add, also, that in these deals generally, unless the MESBIC's is basically financing the whole deal—and when you get too much above certain numbers—$3 to $5 million is syndication and pooling is what we do, it is very difficult for us to do this.

These outside resources, whether they are government or other private sources, are welcomed. And we are further down the line in terms of our position. In other words, we take after the bank and after many of these programs. So we are not in the first or second position. Often we are in the third or fourth position.

I do think there would be growth in there with this bill. I would like to see, though, some of those other tools maintained. I hate to use the word grant, but we found that the grants can basically help us to strike bargains that we otherwise would not be able to and make projects cost effective and efficient.

Senator CHAFEE. I know you share the concern that Mr. Van Leesten voiced about need for increased minority participation in small business, or minority ownership.

Now, in Rhode Island, for example, where there is no MESBIC, could a minority businessman use an outside MESBIC?

Mr. BORROW. MESBIC's are not—some are restricted geographically—for instance, the District of Columbia has one that they basically keep within the boundaries of Washington and not the metropolitan area.

But by and large the MESBIC's can invest in other parts of the country. Anything in the United States and its territories. The—we basically suggest that the investment be made primarily with the MESBIC'S that are established in a certain locale because of the experience factor and they are closer to their investments.

But there is nothing to prohibit MESBIC's from California, say, investing in Rhode Island. We have a group in East St. Louis in which we had the MESBIC's from California, New York, Philadelphia, and Virginia all involved in this particular acquisition. So it is not unusual and that is the nature.

It is very hard for us in an investment of over $250,000 or larger than that for a MESBIC to basically invest in there. They have to basically syndicate the deal.

Senator CHAFEE. Let me ask Mr. Torchia a question. How optimistic are you that this would work in the areas you are familiar with? You are not a mayor, but you certainly are very, very familiar with one difficult urban area. That is the inner city of Providence.

Do you think this will fly there?

Mr. TORCHIA. Not as currently established, Senator. I think you are going to have to continue the low-interest loans. I think you are going to have to continue the loan guarantees, whether it is performed by EDA or whatever organization.

That is for cash flow as well as for capital and machinery and equipment. SBA now does this on the debentures at 50 percent. The IRB's which are currently being discussed in this administration may start cutting back, which I think would be disastrous. We

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take advantage of IRB's in the State of Rhode Island, and more specifically in the city of Providence.

Senator CHAFEE. Mr. Van Leesten, I take it that you would subscribe to the view that there should be the 40-percent requirement for the CETA eligible employees.

Mr. VAN LEESTEN. Yes; very much so. It is pretty much in line with the comment that you made earlier about it could be just a basic ripoff for companies to find a good piece of surf—of turf—in the designated area and bring their whole labor force.

Presently, outside of that urban zone designated area, presently in many of our urban areas we will find companies in existence in areas that could be designated as zone areas that have all-white employment forces.

That is in existence and a lot of people aren't aware of that. And I think that would be subject to abuse.

Senator CHAFEE. Thank you very much, gentlemen.

[Statements follow:]

TESTIMONY OF MICHAEL S. VAN LEESTEN BEFORE THE SENATE COMMITTEE ON FINANCE, SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY (CONCERNING SENATE BILL S-1310, THE URBAN JOBS AND ENTERPRISE ZONE ACT) ON THURSDAY, JULY 16, 1981, WASHINGTON, D. C.

Good Morning, Ladies and Gentlemen. I am grateful for the opportunity to offer my thoughts on the proposed Enterprise Zone legislation. I want to express my appreciation to Senator Chafee and his staff for their interest and desire for input from those of us concerned about the problems of the inner city.

Being Black in America provides me with a special perspective on these inner city problems. My work in the civil rights movement of the 60's and my uninterrupted 15 years since as staff person and Executive Director of OIC of Rhode Island has provided additional opportunities for me to formulate some very definite opinions about our society and how best to work to improve it. During the past few years, I have served as National Convenor and presiding officer of OIC's national organization of Executive Directors.

As you know, Reverend Sullivan founded OIC in Philadelphia in the 60's as a means of assisting disadvantaged people to enter the mainstream of our economic system. Jobs and job training was then and remains now the keystone of the OIC effort.

This early job development effort of OIC has been augmented recently by a strong interest in economic and business development,--especially in the distressed inner city areas.

Coming at the problem with that sort of background and concentration, I can't help but applaud any effort designed to draw attention and resources towards this issue. However hopeful some of the supporters of this legislation may be, I think we all must accept the complicated realities we find in the inner cities. We are dealing with a high level of unemployment, lack of skills, lack of education among the potential work force, and not enough quality jobs for all of those who are willing and able to work.

Our inner cities are desperate for employment opportunities. Our challenge in this regard is twofold -- how to attract new jobs to inner-city communities and how to keep the ones that we have while assuring equal employment opportunity to all segments of our workforce. The question here today is whether or not the Enterprise Zone Bill will significantly affect our ability to meet this awesome challenge?

I do not believe that tax incentives alone,-- which are at the heart of the Enterprise Zone Bill, will do much to attract new jobs to inner city areas or to limit the outflow of jobs from distressed to non-distressed communities.

To improve the general quality of life and to make a more attractive enrironment into which the plant itself, its management people, customers, suppliers, service people and employees can feel comfortable in,--much, much more must be invested into these areas. More municipal services, better police protection, better schools, better lighting, better recreation, better housing.

Don't misunderstand me,-- I am not opposed to this Enterprise Zone legislation, I am in support of any effort to improve the dire straights in which our cities find themselves. I don't want us to feel that much if anything is going to happen by this legislation alone. It must be coordinated with other federal programs; supported by muoh other private and public commitment; and organized and followed up by many local community-based organizations.

Too often the discussion about opportunities for minorities in programs such as these centers around entry level, job training, or middle management aspects of the programs. There is a growing movement of which OIC is an integral part, that looks towards and indeed is working towards a significant involvement of minorities in business development; business, that is, beyond the service-oriented family operated enterprise; manufacturing and high technology firms that generate high quality jobs that pay decent wages.

To the extent that the Enterprise Zone effort can encourage and indeed encompass a strong element of Minority Business Development,-- it will have that much more of a multiplier effect on the subject community. Currently, the legislation makes no effort to stimulate minority business development or ownership. Increasingly, Blacks, Hispanics and Asians dominate our inner-city communities. Unless we are conscious of the desire of these individuals to own and share in the redevelopment of distressed areas our cities of the future will be more like the present than not.

Minority businessmen represent an untapped resource of the enterprenurial American ethic, the new wave of risk-takers reaching out for the brass ring. Within the Federal government, and in the private sector as well, there are programs and policies that will enhance this potential MBE development if they are meshed properly with the broader-based benefits envisioned by the Enterprise Zone legislation. Programs such as MESBIC's, set-asides, special fellowships and interships, OMBI, etc. can be coordinated to stimulate MBE interest and involvement in these targeted zones.

There are unique opportunities for large corporations to develop joint ventures in real estate development, construction and ownership and management of significant manufacturing entities in these zones. Taking a lesson from UDAG programs, minority participation in a proposed investment could be given additional points in the review process. This is certainly true when evaluating the manner in which local cities and towns plan to coordinate and manage enterprise zone activities. Certainly a peer-group, community based organization with a track record of concern and involvement with community needs would be a vital part in effective management of these zones.

Of course, while we look forward to large employers making a dent in the targeted zone unemployment rates, we must not overlook the needs and rights of those businesses that have struggled and survived in the neighborhoods in question.

Too often in the past, an urban renewal program swept away everything in its path,--including the small neighborhood store or restaurant.

In the 1980's it is probable that this neighborhood store is an Hispanic variety store or a black-owned barber shop or similar modest business enterprise.

These small enterprises represent years of heartache and struggle; they must be protected at all costs, almost in the same way we protect the historic buildings we cherish so much.

Another aspect of the inner city jig-saw puzzle is the need for job training,--entry level as well as upgrading of skills to match the needs of the increasing office and plant technology. The largest group in need of job training remains, as it has for years, the inner-city black. Beyond that the job training system must respond to the needs of newly arrived immigrants,--South East Asian, Carribean, South American and others. Then, of course--in high tech areas,--word processing, computer, electronics, etc. There is a well experienced, mature network of community based job-training organizations that came out of the 60's,--OIC being one of them. These organizations have developed a high degree of sophistication in being able to work in advance with industry to plan for and guage their needs, develop the specific curricula to meet their personalized requirements,-- to select the proper person for the proper training course. It goes beyond that into counseling, paying attention to cultural differences, changing courses and curricula when necessary. It fills an educational and training need in the inner city that is fundamental to meeting the ultimate objective of getting unemployed and underemployed people to the point where they are productive contibuting members of society. Attracting the plants to the inner-city by tax incentives is only the start. Putting people to work is the goal.

As a Black, and as a Black active in the movement for social and economic justice, and as an American certain that this lively experiment is the best, and maybe the only experiment worth its salt,--I tend to look at this Enterprise Zone legislation, the inner city problem,--and the role of federal government,--I tend to look at all of this on a larger time scale.

I look at the past 300 years of the period of Black Slavery, Black Oppression, and the American Black attempting to seek economic and social justice. I look at the past 50 years as a period when the Federal System,--the judicial, the executive and the legislative branch began to realize their respective roles in righting the wrongs of the past 300 years.

On a shorter time scale, I look at these past several months as a time when the pressures to balance the Federal Budget are beginning to eat into many social programs that served and still serve as necessary income supports for people most in need.

During these past 300 years, and certainly during these past 50 years we Blacks, along with most other Americans, realized that we did not enjoy our full share of the American way of life,--but we did enjoy our full share of the American dream. We always look ahead with hope for a better life for ourselves and our children.

And a great deal of that hope rested on the basic fairness and goodness of the American people, coupled with the power and prestige of the Federal government and the Constitution.

But now the present danger is that the hope is being swept away along with the various federal programs being cut out of the budget.

In my appearance before you today, Senators, I must implore you, for the sake of America, don't take that hope away.

Whether this Enterprise Zone bill is enacted in the fashion presented here,--or whether it is enacted at all is of little consequence if the total result of your Federal budget cutting is to cut away the hope of the future,--for Blacks and others in our society who don't share fully in it.

I would like to close by quoting from an opinion written by Supreme Court Justice Marshall in 1978 in the case of University of Californiz vs. Allan Bakke:

> "In light of the sorry history of discrimination and its devasting impact on the lives of Negroes, bringing the Negro into the mainstream of American life should be a state interest of the highest order. To fail to do so is to ensure that America will forever remain a divided society."

Thank you Senators for your kind attention.

CURRICULUM VITAE

Michael S. Van Leesten
11 Belair Avenue
Providence, Rhode Island 02906
331-8515

PERSONAL:

Married - Andrea Goins Van Leesten, Esquire
3 Children - Jill, Michael and Christopher

EMPLOYMENT:

Executive Director (1968 - Present)
Opportunities Industrialization Center of R. I., Inc.
One Hilton Street
Providence, Rhode Island 02905

President (1980 - Present)
Opportunities Development Corporation
122 Bacon Street
Pawtucket, Rhode Island

EDUCATION:

Rhode Island College, Providence, RI, Bachelor of Education, 1967; Managerial Skills Course, Wharton School of Finance, University of Pennsylvania, Philadelphia, PA, 1969; Advanced Courses, Community Planning, University of Rhode Island, Kingston, RI 1973.

EDUCATIONAL ACTIVITIES:

Gubernatorial appointee to the State of Rhode Island Board of Regents for Education (1973-1977).

BUSINESS AND INDUSTRY ACTIVITIES:

Chairman of the Board, Peerless Precision Company; Director, Industrial National Bank; Incorporator, Citizens Savings Bank.

AWARDS:

Distinguished Service Award, Providence Junior Chamber of Commerce, 1968; Rhode Island College Alumni Award, 1969; Honorary Doctorate, Roger Williams College, 1976; Honorary Doctorate, Rhode Island College, 1979.

THE BUSINESS REINVESTMENT DECISION AND URBAN REVITALIZATION

by

DOUGLAS H. JOHNSON, Ph.D

for

ATLANTA UNIVERSITY INSTITUTE FOR URBAN AFFAIRS

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THE BUSINESS REINVESTMENT DECISION AND URBAN REVITALIZATION

OVERVIEW

The management of our modern economy is a tricky and very complex business. While I am convinced that we no longer understand our economy very well, the drive continues relative to identifying a management philosophy or technique that would net us sustained economic growth in concert with tolerable inflation and acceptable employment levels.

Virtual full employment without overburdening inflation would undoubtedly enhance our ability to improve the social, physical, and economic conditions of our urban communities in general and those of distressed communities in particular. This is not to say, however, that full employment and economic growth would necessarily result in significant revitalization of distressed urban areas. History reveals mixed results on this score. But few would disagree that our chances for revitalization are reduced considerably when we are experiencing massive unemployment and high rates of inflation. Thus, in this era of stagflation -- high inflation, high unemployment, and no economic growth to speak of --, the establishment of a long-range national goal of jobs for all of us who are willing and able to work, coupled with the availability of a decent and safe living environment, appears more evasive than ever.

Though it may sound a bit elementary, it is worth noting that without a job, few of us are able to provide for ourselves or our families. The upshot of this inability to provide is frequently expressed in social and psychological disorders among individuals and their families. Urban revitalization, therefore, must be anchored securely on a national economic policy which emphasizes getting America back to work. Jobs, as Neal Peirce pointed out recently, come first in a city revival strategy. "Private (and public) sector jobs; how to attract them, develop them, hold them for a city, to provide a more certain way through uncertain times"[1] remains the fundamental prerequisite to any meaningful urban revitalization effort. Accepting this fact helps us to focus very quickly on one of the major problems facing distressed inner city communities -- how to enhance the probability of retaining existing inner city jobs, of attracting new ones through expansion of present employers and of generating a mix of employment opportunities that are compatible with the skills of the existing and future labor force.

While I may have my own way of neatly packaging what I see as the crux of the urban revitalization problem, unfortunately, the same is not so where solutions to the problem are concerned. What is clear, however, is that the solution or solutions to the problem will not be found within the confines of the geographical or municipal boundaries of urban places.

Joblessness and declining employment opportunities in distressed communities require national attention. From about 1940 - 1960, large cities lost jobs to smaller ones and both eventually lost jobs to the suburbs. It was also in the decade of the 1960's that we began to notice considerable interregional and international mobility of capital. These trends have continued through the 1970's and remain with us today. During the 70's, for example, the City of Chicago alone lost more than 200,000 jobs, most of which were in manufacturing.[2] Just recently, General Motors announced that it would build a $100 Million engine plant in Mexico, not in Detroit, a City that it helped to build and now destroy. On a similar note, General Electric announced that it would stop production of black-and-white TV sets at its Suffolk, Virginia plant by 1983 and shift production overseas thereby joining other companies such as Zenith and Motorola, who have long since shifted production out of the country.

The point to be made here is that few cities have been able to escape being affected by the movement of jobs to warmer regions or to countries outside the United States. The flight continues, and some economists are beginning to conclude that such massive movement of industry and jobs from the frostbelt to the sunbelt and to foreign territory is symptomatic of the mobility of capital and the neverending desire of its owners to realize the highest possible returns on their investments.

The highly volatile state of labor markets in distressed communities is obviously dramatically affected by plant closings, plant relocation, and plant reinvestment decisions. Poor communities are in a tenuous position under the very best of economic conditions. And, until we are willing to consider those exogenous forces such as the ones noted above, we will again come up short in our policies and programs that are aimed at revitalizing urban places.

The jobs issue is directly linked to the topic that I have been asked to address here -- the business reinvestment decision in the context of the revitalization of the city. In the remaining space, a review of the relevant aspects of the firm's investment decision as it affects, and is affected by, distressed inner cities will be offered. This review and analysis will serve as a backdrop for an in-depth discussion of the Reagan Administration's urban revitalization strategy -- the Enterprise Zone -- which allegedly looms as the central element of our next Urban Policy.

BUSINESS INVESTMENTS IN DISTRESSED AREAS

In a competitive marketplace, the business investment decision would appear to be a rather straightforward process. However, in reality, as observed by Bennett Harrison, "economic theory probably has met with its least amount of predictive success in trying to understand the dynamics of the investment decision."[3] Nonetheless, according to the theory, the typical entrepreneur will make an investment if the expected profit is adequate to compensate him for his efforts and the risk associated therewith. Seldom, however, does the investor operate with a complete fix on all of those factors which determines the overall profitability of his investment. Outside of major corporations, few small businesses can afford sophisticated market research or to maintain a capacity for formally analyzing supply and demand for their products or services at some future time.

It is important to recall that our economy is comprised primarily of small firms, those employing less than 20 workers each. As the much heralded work of David Birch has concluded, two-thirds of all net new jobs in the United States are created by firms with fewer than 20 employees. In addition, such firms tend to be less than five years old.[4] Investment decisions in these firms are perhaps more a reflection of short-run circumstances, "crystal balling," and hunches than of rigorous long-run market forecasting.

Regardless of the technique employed to arrive at the investment decision or the size of the firm involved, several factors are thought to be considered along the way. The availability and cost of capital, real estate, labor, and energy provides the initial basis for considering a potential investment. Cost and availability of these factor inputs, in varying degrees, are thought to directly affect the investor's ability to maximize profits or returns on their investments. Since we are primarily concerned with business investments in distressed inner city communities, we need to note that the social and physical environment also weighs heavy in the decision to invest in employment-generating activities.

On the basis of the foregoing observations, our task is primarily that of creating and maintaining an environment where owners of small firms and new entrepreneurs are willing to risk going into business and, one that encourages existing firms to remain and invest -- clearly, a most challenging task.

Our alleged understanding of investment decision-making has served as a springboard for a variety of Federal and State policies and programs geared towards attracting investments to otherwise unattractive areas.

At the Federal level, we have had a variety of employment and training programs whose primary objective has been that of transforming unskilled workers into skilled and semi-skilled, and facilitating the movement of workers from labor surplus areas to locales where labor is in short supply. Programs under the Manpower Development and Training Act, along with Counter-Cyclical Public Works activities, are cases in point.

Historically, the basic rationale behind these initiatives has been that they influence the investment decision by converting relatively unproductive labor into productive resources and that they shorten the learning curve, thereby enhancing the immediate productive value of the worker to the firm. These programs give priority to individuals living in distressed communities -- investments in people as opposed to investments in place. Theoretically, if these programs realize their objectives, participants would eventually be able to move from the ranks of the unemployed and secondary labor market jobs into full-time primary labor market employment.

In an attempt to encourage existing firms to expand and to hire workers from distressed areas, numerous states, including Rhode Island, Massachusetts, and South Carolina, to name a few, have leveraged their Federal job training dollars with other public and private sector funds to form extensive on-going labor development and training programs for private industry. Subsequently, in 1980, the Federal government established its Private Sector Initiatives Program in an effort to bridge the gap between employer needs and job training program priorities at the local level. Job tax credit programs were also introduced during this era. Employers could earn credits against their Federal and, in some instances, State taxes by employing the unemployed poor.

Despite the various activities mentioned above, the relative unemployment conditions of the urban poor have not improved significantly over the past several decades. During the decade of the 1970's, for example, the unemployment rate among Blacks who constitute the bulk of the inner city poor, was consistently twice that of whites and never under 8 percent.[5] Moreover, manufacturing firms continued to leave inner cities of the Northeast and Midwest, thereby further aggravating the problems associated with the transformation of the national economy from one dominated by manufacturing to one dominated by services. Perhaps of greatest importance here is the fact that none of these job training or related programs have had any appreciable impact on attracting firms to, or retaining firms in, distressed communities. The inability of these programs to significantly change the employment conditions of the unemployed in the aggregate is perhaps as much a factor of budget allocations as it is of overall program design.

In addition to the labor training and development programs, State governments throughout the country have established a host of incentives aimed at influencing the investment and location decision. Tax credits and forgiveness, loan guarantees, submarket rate loans, and industrial development bonds constitute the incentive package offered by virtually every state in the union. Evidence to date suggests that though abundant, tax incentives have had little or no effect on investment decisions. According to Stephen Davidson and Paul Pryde of the Policy Project on Development Finance,

> . . . reducing a firm's tax burden in order to entice placement of a branch plant only influences the location decision when the alternative sights are equally appealing in all other respects. In general, state business taxes have very little impact on location and expansion decisions. This is logical since state taxes represent a small portion of total business expense . . . 4.4 percent of total expenses . . . labor costs, the major expense of most firms, comprise 66 percent of each dollar of value added . . . Access to growing markets and labor skills, availability and cost are more important determinants of location.[6]

In their research on the role of tax incentives on the investment and location decision of firms, Bennett Harrison and Sandra Kanter arrived at conclusions

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similar to those noted above. Firms of all types, writes Harrison and Kanter,

> "are more likely to increase output and therefore employment if there is an increase in demand for their goods and services; but at the state level, business tax incentives do virtually nothing to stimulate the demand for goods and services . . . . The decision to invest depends . . . on expectations about the likely "returns" to the investment through sales. Almost anything that the government can do to reduce uncertainty about sales is more likely to induce business people to go ahead and build or expand a plant than any other kind of public action -- including the granting of incentives."[7]

Programs established to reduce the cost of capital in given locale apparently have no appreciable impact on the decision of a firm to expand or make significant capital investments.[8]

Several other Federal initiatives administered by the Economic Development Administration, the Community Services Administration, the Department of Housing and Urban Development, and the Small Business Administration have been developed to aid business growth and redevelopment in distressed communities. While it is beyond the scope of this document to discuss these various programs at any great length, a few observations regarding their impact on central city revitalization are in order.

Since 1965, the Department of Economic Development (EDA) has administered several programs targeted at business development in poor communities. The basic purpose of the initial EDA Act was that of increasing a community's overall attractiveness for industrial development. This objective was to be achieved by significantly stepping up public works construction activities in communities experiencing temporary economic stagnation.

Although the first efforts by EDA resulted in a series of isolated projects rather than a comprehensive economic development strategy for distressed areas, corrective legislation later in 1965 eliminated many of the deficiencies of the earlier Public Works and Economic Development Act. Furthermore, the legislation added several loan and loan guarantee programs for both public and private sector projects. Loans could be used to purchase land, buildings, machinery, and equipment to establish job-generating facilities in distressed communities. EDA also encouraged business development by guaranteeing working capital loans made by private lending institutions. In essence, the agency sought to remove some of the private sector risks associated with capital investments in poor communities.

More recent programs administered by EDA placed special emphasis on assisting minority-owned businesses. The Local Public Works Capital Development and Incentive Act of 1976 (LPW), for example, authorized the spending of several billions of dollars for counter-cyclical public works programs. LPW I authorized $2 Billion, and LPW II authorized another $4 Billion.

Of particular importance to this critique is the fact that under LPW II, at least 10 percent of each grant was to be expended with minority business enterprise. While the jury is still out on the full impact of the program on job creation and business development among minority groups, as of July, 1980, it was estimated that at least 16 percent of the LPW II funds had been channeled to minority-owned firms.[9]

Given that an overwhelming majority of minority-owned firms are located within the major metropolitan areas, it is reasonable to conclude that by requiring minority business involvement, LPW II funds made a positive contribution to business development in economically poor communities. To be sure, the fact that the physical infrastructure received many overdue repairs could not help but improve conditions for firms already located in depressed areas. Whether such improvements were strong enough to attract outside firms to these sites, however, is another matter.

In its Spring issue of "Report to the People," the Congressional Black Caucus estimated that if the Reagan Administration's proposal to eliminate the Economic Development Administration becomes law, the $865 Million earmarked for grants and loans to small businesses would nullify the creation of 239,000 jobs in the most depressed areas of the country.[10]

While one might question whether or not these EDA initiatives have had any major impact on a firm's location decision, what is clear is that their use is restricted to development projects in distressed communities. By definition, therefore, EDA programs can be considered viable instruments in the business reinvestment process. Many community-based development organizations such as the Harlem Commonwealth Council and the Bedford-Stuyvesant Restoration Council have used EDA loans and grants to leverage major job creation projects in areas of our cities that have long since been forgotten by conventional private enterprise.

The Small Business Administration (SBA) also offers a variety of loan programs to small business. SBA's regular 7(a) Loan and its Economic Opportunity Loan program are, by far, the most popular. The 7(a) program represents more than two-thirds of SBA's lending activity while the Economic Opportunity Loan program is narrowly focused on assisting businesses owned by individuals from socially or economically disadvantaged groups.

In a review of the urban impact of two of the SBA's major programs, this author found that, "on the average, distressed communities appear to be receiving less than their per capita share of loan approvals. There is little evidence that the SBA is attempting to target its . . . resources to firms in cities with serious poverty and unemployment, indeed, current figures suggest that funds are flowing more to communities with healthier economies."[11]

Without any meaningful targeting capacity, SBA lending programs as they presently stand do not appear to represent any significant impact on business reinvestment decision in distressed communities. Firms can obtain loans at submarket rates without making any commitment to reirvest in distressed neighborhoods; and, as we have already pointed out, the availability of "cheap money" does not carry much weight in the reinvestment decision-making process.

Finally, the Department of Housing and Urban Development (HUD) administers a variety of programs designed to influence the investment decision. The Urban Development Action Grant (UDAG) program represents the major business investment activity presently being pursued by HUD. The goal of UDAG is to "stimulate the private sector to create employment and to improve the fiscal viability of distressed local economies."[12] To achieve this goal, UDAG makes it possible for private firms to use small amounts of their own capital to leverage significant amounts of Federal dollars. The program is specifically aimed at stimulating private investment in the target areas.

How effective has UDAG been in achieving its objectives? In an early assessment of the program, Susan Jacobs and Elizabeth Roistacher found that though UDAG programs favor central cities over suburbs, and more distressed over less distressed cities, central cities were least able to leverage private funds with UDAG dollars, private funds with local dollars, and UDAG funds with local dollars.[13] Further,

> "[A]lthough central cities committed 90 percent of all local funds flowing to UDAG projects, . . . they leveraged 14.85 dollars from all over [Sic] sources for every dollar of local funds. This compares to 49.3 dollars and 62.5 dollars for suburbs and nometropolitan areas respectively."[14]

Perhaps the most important find registered by Jacobs and Roistacher is that a majority of the projects undertaken under the disguise of UDAG would have taken place in its absence.

While I have made no attempt here to present a comprehensive review of the many Federal and State programs established with the explicit objective of influencing the business investment decisions, the evidence offered should be sufficient to substantiate the general conclusion that attracting firms and spawning new ones in distressed communities requires more than cheap money and tax concessions.

None of the foregoing critique should be interpreted to mean that firms will not utilize low interest money or tax concessions should they be available. The point is, however, that such factors alone are not sufficient to trigger reinvestment in economically distressed areas where (1) the probability for acts of crime and vandalism exceed that in more healthy communities, (2) the physical infrastructure is in advance stages of dispair, (3) the housing stock is frequently inadequate, and (4) the quality of public services has probably reached its lowest level in modern times. Remember, our strategy has been that of trying to get outsiders to come into the poorest sections of the country and to undertake job creation investments. Similarly, we are trying to sell distressed areas to those 450,000 entrepreneurs who annually decide to take the giant step and establish a business. Since 90 percent of these firms are surely to fail, rest assured that the investor is going to reduce the probability of failure by selecting the most attractive site for his investment.

To date, our menu of urban-oriented programs has not been capable of stimulating significant investment in the subject areas. Studies have shown that the preferred way to meet new sales demands is to increase productivity within existing facilities. Firms will explore multi-shift operations, overtime, as well as the possible acquisition of new machinery before even considering a new location.[15] This being the case, firms that have already relocated to sites outside of the inner city are not likely to be candidates for resettlement in distressed areas. Again, we must devote our energies towards attracting entrepreneurs who are considering undertaking a new business development project.

We find ourselves at a critical crossroad. With the apparent lack of success of the existing mix of Federal and State programs in stirring business investments in distressed cities, is a new series of programs warranted, or should we spend our energies fine-tuning existing ones? The present political regime may have already determined our fate in this regard. As is well known, the Reagan Administration has advanced its own version of a national urban policy for revitalizing poor communities. The proposal is modeled after the Enterprise Zone program initiated by the British government in 1980. On the basis of the foregoing observations, let us examine the primary aspects of the proposed legislation and its potential impact on business reinvestment decisions in distressed urban areas.

THE URBAN ENTERPRISE ZONE PROPOSAL

The Reagan Administration's supply-side solutions to the problems of unemployment and inflation are about to rekindle the class war in America. And some observers are warning of "explosive possibilities where the economic establishment pursues a class war against the poor."[16] Somehow, the Administration has forgotten, as Arthur Schlesinger, Jr., pointed out, that

> "Capitalism has survived because of a continuing and remarkably successful effort to humanize the industrial order, to cushion the operations of the economic system, to combine pecuniary opportunity with social cohesion. It has survived because of a long campaign, mounted by liberals, to reduce the suffering -- and thereby the resentment and rebelliousness -- of those to whom the accidents of birth deny an equal chance."[17]

David Broder, national political correspondent for the Washington Post, adds fuel to Mr. Schlesigner's fire. He noted that in order to support Mr. Reagan's programs, we must believe that

(1) Federal taxes and regulations are the main barriers to economic growth;

(2) There is a natural harmony between the interest and inclinations of business managers and their employees, customers, and neighbors. Freeing the owners from government restraint will automatically work to the benefit of everyone who deals with them;

(3) State and local governments are more efficient and equitable in their distribution of public funds and services than the national government; and

(4) In this new environment, individual families and private organizations can be relied on to replace government in a wide variety of roles ranging from support of the arts and scholarships to financing of retirement.[18]

It is precisely the lack of validity of these underlying assumptions that have given rise to the need for massive Federal intervention in our economy. We know that the old trickle-down approach does not respond very well to the needs of poor people or poor municipalities, particularly distressed inner city areas. Yet, it is this route that the Reagan Administration has selected as it settles in on an urban strategy for the 1980's.

The heart of the Administration's urban policy is based on the British concept of an Enterprise Zone -- Britain's latest attempt at solving its urban problems.. As initially conceived
The basic strategy permits laissez faire development in declining urban areas. Britain has selected nine zones of up to 500 acres each for its experiment. Within these areas, firms would be (1) exempt from any development land tax, (2) entitled to capital allowances of 100 percent -- eliminating the tax on commercial and industrial buildings, (3) exempt from local property taxes, (4) permitted to use land with a minimum degree of government interference, (5) exempt from industrial development certificates that have been used in the past to direct industrial development to those areas where unemployment was the highest, (6) exempt from industrial training requirements, (7) received of levies on customs processing, and (8) would have their government required statistical information reduced considerably.[19]

As with any new program, seldom does the end results resemble what its proponents prepared initially. Critics of the British model observed that in the end, the concept suffered from the "But Mister" syndrome.

> "But, Mister, we cannot relax labor legislation, the closed shop, or conditions of employment. We'll have the unions about our neck!"
>
> "Oh very well, leave out the union stuff."
>
> "But, Mister, we cannot exempt from health and safety regulations or we'll be wiping out 15 years of protection, and have every professional safety officer up in arms."[20]

The upshot of these exchanges is a program that offers little more than some mild tax concessions along with "a trivial relaxation of local regulations governing building and use of property."[21]

Here in the United States, legislation has been proposed by members of the House and Senate which would make it possible to establish Enterprise Zones in distressed areas. The Kemp-Garcia bill, the first attempt at applying the concept in the United States, was first introduced in the 96th Congress. Another bill was introduced by Representative Ron Paul, while Senator John Chafee and his colleague, Mr. Boschwitz, introduced yet another version of an Enterprise Zone proposal.

The primary ingredients of each of these bills include some form of Federal tax subsidy. This is in essence the crux of the legislative proposal -- provide tax relief to firms willing to locate in distressed urban communities. These firms will, in turn, hire local workers and thereby reduce inner city employment and trigger greater consumption of consumer goods and investments in inner city housing and other real property. In short, the old trickle-down approach to solving the problems of unemployment and disinvestment.

Specifically, firms agreeing to locate within the zone would be eligible for a reduction in their Federal corporate income and social security taxes. Accelerated depreciation and reduced capital gains taxes would also be available. Real estate tax reductions and duty-free foreign trade would represent yet additional benefits available to firms agreeing to locate in the zone. Municipalities would have to agree to a permanent reduction in property taxes of 20 percent under Kemp-Garcia. Social security tax cuts would be worth between $800 and $2,000 per worker per year. Corporations' capital gains taxes would be trimmed by 50 percent while their corporate tax liabilities would be reduced by 15 percent. It would appear that some form of straight-line accelerated depreciation allowance will be incorporated in the Enterprise Zone programs as well.

How effective is the Enterprise Zone concept likely to be in attracting industry to distressed urban communities? Although the program has not been operational long enough to generate sufficient empirical analysis, what is clear is that tax incentives are not very effective instruments for attracting industry and commerce to poor areas. Enterprise Zones, as presently proposed, will not generate significant investment in poor communities. Tax concessions do little to improve the cash flow in small firms or newly-organized ones. We know that new firms usually have smaller tax liabilities and do not show a profit for several years after they are established. Therefore, in the absence of a long-term carry-forward provision, tax relief will have virtually no impact on reducing the risk of going into business. Moreover, since the primary objective of any tax policy is that of stimulating capital investment, capital market access to small firms may be considerably more important than any form of corporate tax forgiveness. Yet, in the context of the Reagan Administration's philosophy, this dimension of a firm's success is of little or no importance. Any policy aimed at stimulating the growth and development of small businesses must reflect their basic cash flow needs over the short-run. In the absence of a sound cash flow, reinvestment decisions are seldom entertained.

Without massive public investments in distressed urban communities, their deterioration is more likely to continue than not. Our cities are still starving for massive capital improvements in public transportation and sewerage and water systems. Expecting private enterprise to resettle in our inner cities in mass represents little more than wishful thinking at the moment. If these areas are to be revived, Federal and State governments will have to assume the lead role. Furthermore, mechanisms must be established to help ensure that small businesses already anchored in inner cities are able to obtain capital for expansion when required, and this expansion capital must be targeted to firms based in distressed areas. Though congressional enthusiasm for the expansion of EDA business financing programs has subsided, the proposed changes represent the type of development initiatives needed in distressed areas.

Our cities are becoming increasingly Black and Hispanic. Unless these individuals have some clearly defined roles in the revival strategy, we will be creating conditions which will further contribute to the class warfare noted above. None of the existing proposals for creating Enterprise Zones have any meaningful programs to ensure that residents of the area have an opportunity to directly participate in revitalization through ownership. As the National Center for Employee Ownership put it, "Only by making zone residents the real beneficiaries of the increased economic activity can the multiplier effects of zone development stay within the area and lead to general revitalization."

Proponent of the Enterprise Zone concept appears to have completely overlooked the desire of local residents to participate in those planning and development processes that affect their lives. We have utilized considerable economic and psychological resources over the past decade developing a network of community-based organizations that are just maturing to the point where they are capable of planning and implementing large-scale development projects. We have already mentioned such organizations as the Harlem Commonwealth Council, the Bedford-Stuyvesant Restoration group, and we can add the more than one hundred Opportunities Industrialization Centers across the countries, as well as an array of Community Development Corporations. These organizations are anchored in some of the most economically distressed areas of our cities where they have stimulated new levels of interest and participation in urban revitalization efforts. Yet, in the context of Reagan's urban policy, they have no apparent role to play.

Another major concern is that the Enterprise Zone proposal attempts to solve the problems of unemployment and underemployment within the confines of the city. That is to say, proponents of the program are placing a great deal of dependency on firms locating within the zone to significantly reduce unemployment among area residents. Yet, there is no attempt to structure the type of jobs that would be attracted to the zone. Are we likely to end up with firms that pay low wages and generate unstable employment? Are zone residents going to be given priority for employment? Although the Kemp-Garcia version of the Enterprise Zone legislation would require businesses to hire 25 percent of their employees from the zone, there is no requirement for the types of jobs that firms would be required to fill with local residents. Given the chronic level of unemployment in these areas, by permitting firm to reap the proposed benefits even if they fill 75 percent of these jobs with non-residents of the zone will not do much to reduce unemployment within the zone. Clearly, these are primary concerns in any job generating scheme.

Finally, it should be pointed out that even with a successful Enterprise Zone program, the fact remains that many inner city residents must depend on maintaining accessibility to jobs throughout the metropolitan economy. Consequently, it is of utmost importance that the progress that we have made in establishing equal employment opportunity not be abandoned in the wake of a half-baked strategy to revive the most depressed areas of the country.

SUMMARY

To be sure, the most casual observer of our urban condition would undoubtedly conclude that whatever we have done to arrest deterioration and to generally improve the environment of our inner cities has not worked very well. But, at times I think that we are too quick to overlook the fact that concerted efforts at urban revitalization are relatively few and far between. What is more, we are just getting to the point where we are beginning to understand the process of deterioration and conditions which lead to urban distress. Our cities are poor because we have "milked" them by subsidizing the development of the suburbs through a variety of housing assistance initiatives to middle-income families, by not attending to our schools, our streets, and other elements of their physical infrastructure. We cannot escape the fact that our cities are still in need of massive public investments. Until these conditions are corrected, it is foolish to expect any significant turn around in the level of private investment in our poorest neighborhoods.

The mix of programs presently available through the U.S. Department of Housing and Urban Development, the soon-to-be-eliminated Economic Development Administration, labor training, and development assistance programs are potentially important public sector instruments for infrastructure revitalization. Furthermore, there is considerable room for improving the yield from these various programs. Proposals for more carefully allocating existing program resources should not be dismissed lightly. We have made some progress towards improving conditions in distressed communities. Progress will continue to be slow, for we cannot expect to reverse in a few years trends that have been in motion for nearly four decades.

We can also help to usher in the revitalization process by continuing our efforts to insure that small business people, especially minorities, have access to capital. This is of critical importance when we consider that it is precisely these individuals who are perhaps most familiar with the problems of doing business in distressed urban areas. The combination of minority business people and community-based organizations represent an important link in any urban revitalization program. As many small business people with inner city based firms retire, they often leave behind successful enterprises that represent potential acquisitions by minority-owned firms or community-based corporations. Our chances for obtaining such companies probably exceeds our ability to attract new ones.

Clearly, the decision by businesses to invest is highly dependent on increased demand for products or services. Until we have devised a scheme for getting America back to work and for reducing the movement of jobs from the United States to other countries, we are a long way from realizing any positive shift in urban revitalization processes.

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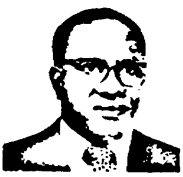
ECONOMIC PERSPECTIVES



By Andrew F. Brimmer

Can Enterprise Zones Work?

Enterprise zones are being advanced by the Reagan Administration as instruments of urban economic development. The idea also has support in Congress. Considerable confusion prevails, however, regarding their scope and function, the economic goals to be sought, and the tools needed to carry out the task.

Some form of federal government tax incentive is the foundation of all versions of the proposed enterprise zones. Yet, careful assessment of the schemes suggests that the costs may be exceptionally high while the benefits may be scrimpy, at best.

It is also clear that enterprise zones could not substitute for other federal programs to improve economic conditions in urban areas.

The modern idea of enterprise zones originated in England in early 1980. The British government established several experimental zones wherein a variety of traditional zoning regulations were eliminated, and tax reductions were provided. The program has not been in place long enough to evaluate its effectiveness.

In the United States, at least two bills have been introduced in Congress which would permit the creation of enterprise zones. In the 96th Congress last year, Rep. Jack Kemp (R-NY) and others introduced the "Urban Jobs and Enterprise Zone Act of 1980." The bill is being redrafted for reintroduction in the present Congress. It is expected to include the following salient features. City and local governments in severely depressed urban areas would be allowed to establish enterprise zones. Within each zone, businesses which qualify would be able to take advantage of several kinds of tax reduction. The conditions of eligibility are not fully defined, but one standard would require that the company employ at least half of its work force from among persons living within the zone. The incentives provided would include a 15 percent cut in the federal government corporate income tax. Social Security payroll taxes paid by employers and eligible employees would be cut by 90 percent for workers under 21 years of age and by 50 percent for all other eligible workers.

Depreciation rates would be accelerated to allow a faster write off of expenditures on capital equipment. Capital gain taxes would be reduced by 50 percent. The bill would encourage local governments to cut effective real property tax rates by at least 20 percent. Other incentives included in the bill would permit the establishment within enterprise zones of duty-free foreign trade zones within which firms could manufacture or otherwise fabricate internationally-traded products.

In July 1980, a second bill was introduced in Congress by Representative Ron Paul. This version contains many of the key features of the bill described above. However, it would liberalize the specific tax rates and relax the criteria for designation of an enterprise zone. This second bill would exclude from enterprise zone benefits any businesses which participated in any other federal, state, or local government programs. This version of the proposal would exempt qualified businesses and employees from all federal, state, and local regulations. These exemptions would include those which apply to the minimum wage, occupational health and safety standards, land use, and zoning rules.

In general, supporters of the proposal visualize that, through tax incentives, private businesses will be attracted to depressed urban areas. These firms will grow and provide jobs to unemployed residents.

Unfortunately, some of the goals set for enterprise zones may be incompatible. For example, one aim is to promote the growth of businesses in the inner city in the hope that they will create jobs. Many of these are small, minority-owned firms concentrated in retail trade. These are not high-growth fields and many of the existing firms are seeking ways to move into more promising lines.

If enterprise zones are to be successful, they will probably have to attract high technology businesses with considerable potential for growth in output and sales. However, firms with these characteristics are likely to employ fewer workers in relation to sales than are found in older more labor intensive industries. Nevertheless, they would bring additional jobs, and lift the overall level of economic activity. As a result, the city would gain additional revenue.

There may also be a conflict between the development of minority-owned business enterprises and the provision of jobs for inner-city residents—particularly young people with few skills. These are both laudable goals, but they are different. As existing small firms try to grow—or as new ones attempt to get started—they will find it difficult to offer a significant number of jobs to essentially unskilled workers. Many of the latter may not be able to produce enough to offset the statutory minimum. This is another reason why fairly large firms would have to be attracted to enterprise zones.

Tax incentives alone would not be sufficient to promote existing businesses or to attract the right kind of new firms to enterprise zones. It will also be necessary to improve the overall business environment. To achieve the latter, increased outlays for transportation, sanitation, and other public services will be required. This is especially true in the case of police and fire protection. Cutbacks in federal government grants which support those services at the local level would pose another obstacle to the development of enterprise zones.

The proposed tax incentives to encourage enterprise zones would have to be blended with other urban development programs. For example, the Economic Development Administration (EDA) in the US Department of Commerce makes loans for business development and grants for public works. Urban Development Action Grants made by the US Department of Housing and Urban Development serve similar purposes. Job training under a variety of manpower programs would also have to be integrated into the overall schemes for enterprise zones.

In conclusion, enterprise zones—standing alone (although sheltered by tax incentives)—are unlikely to be a viable means of rescuing depressed urban areas. Tax incentives would undoubtedly benefit existing firms, but special care would have to be taken to assure that businesses with high growth potential and a capacity to create jobs were attracted to the zones. Other types of programs would still be needed if urban areas are to get genuine assistance to develop their economies. □

American Association of
Minority Enterprise Small Business
Investment Companies

915 Fifteenth Street, N.W.
Suite 700
Washington, D.C. 20005
(202) 347-8600

STATEMENT

by

BILL BARROW,
Director of Business Investments,
American Association of MESBICs

Before the

Finance Subcommittee on Savings,
Pensions, and Investment Policy

United States Senate

July 13, 1981

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The American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC) represents MESBICs throughout the United States. Created administratively in 1969 and through legislative mandate in 1971, 301(d) SBICs, commonly known as MESBICs, are specialized for-profit venture capital vehicles licensed and regulated by the Small Business Administration to invest in small business concerns owned by minority entrepreneurs. MESBICs are a unique private-public sector partnership instrument utilizing the preferred stock and debentures purchased and issued by the Small Business Administration to leverage the financing capacity of minority deals.

By late 1980, there were approximately 129 licensed MESBICs representing a total of over $178.4 million in investments. In 1980 MESBICs made 547 financings totalling $42.2 million. The average firm financed employed twenty people with gross sales of $800,000.00. Approximately 50% of these firms are located in the inner city. As a trade association representing investment companies which invest heavily in inner-city businesses, we are very interested in the Urban Jobs and Enterprise Zone concept.

The greatest potential for private enterprise participation in the proposed Urban Jobs and Enterprise Zone program is with small businesses and especially with minority small businesses. Large corporations, even if they are in sympathy with the program, would have difficulty in setting up a manufacturing division in the targeted area for many reasons, among them being the increased wage costs; they have found a better haven in rural and small town locations. Small businesses, and especially minority owned small businesses, have successfully avoided these increased wage costs and have a better record in working with residents of the Central City who will form their primary work force. Historically, small business has been the primary source for new jobs, especially those jobs that can be filled satisfactorily by the work force that occupies the Central City.

In a recent book on financing minority economic development, it was clearly demonstrated that two factors pose challenges to the success of minority-owned enterprises in the central city: the inability to obtain capital and inadequate managerial skills.

Since the Urban Jobs and Enterprise Zone concept was first introduced, the American Association of

MESBICs has stressed the importance of the capital-generating provisions of the bill. Our association views such items as the elimination of capital gains taxes on investments within the zone, the exclusion from taxation of 50% of all earned income and income on interest earned on loans within the zone, and the extended 20-year loss carryforward as steps in the right direction.

The original version of the Urban Jobs and Enterprise Zone bill, as introduced in the last congress, was geared more toward providing incentives to attract entrepreneurs to the zone, with less emphasis on capital generation and sources to help finance the entrepreneurs. We are happy to see that this year's revised version has stronger capital generating provisions. These will help fulfill the need to build those investment vehicles which have already exhibited their commitment to creating successful businesses that will employ, and thus build the infra-structure in the inner-city. The key to the whole Urban Jobs and Enterprise Zone concept is to leave the community in a stronger, more self-sufficient condition. This is where most other urban revitalization programs have failed.

In terms of managerial skills, the 5% refundable tax credit for wages paid to CETA-eligible zone employees and wages earned by zone employees up to a cap of $1500, would help draw skilled managers and workers into zone businesses. This, combined with the stipulation that the credit applies only as long as the worker remains with the business, encourages a higher degree of investment in training programs for workers within the zone.

Although, as stated above, AAMESBIC supports the provisions of the proposed bill and sees them as steps in the right direction, we would like to make the distinction that even more will be necessary to make businesses within the zones a success. Many of the entrepreneural candidates will be less experienced businessowners than entrepreneurs in other areas. For this and the following reasons, we believe that MESBICs should be used as the principal instrumentation in establishing small businesses in Urban Enterprise Zones.

Most MESBICs have established good communications and good working relationships with all segments of the private and public sectors in the cities in which they are located. These include large industrial corporations, Chambers of Commerce, financial institutions, insurance companies and foundations in the private sector, and city, state and federal agencies on the public side, especially those involved in business development. MESBICs in their day-to-day operations routinely put together deals involving the private and public sectors and would have no difficulty in using such sophisticated tools as industrial revenue bonds, local development debentures, Urban Development Action Grants and Community Development Block Grants.

The MESBIC industry has a ten year experience base involving a working partnership with the federal government and the private business establishment in developing small business companies in the Central City. Because of this experience MESBICs are the only organizations in place in the whole system which could expect full cooperation from both the government and private sector in the financing and monitoring of small businesses in Urban Enterprise Zones.

In addition, a large amount of emphasis should be placed on local and state involvement in the zones. One way to achieve this would be the contributions and/or sales of land at low costs by the local government to the small businesses. Besides helping to cut the costs for the entrepreneurs, this measure would also help attract more capital to the deal as an additional asset. This has been done successfully before in other programs.

Another local effort would be the targeting of local development corporation's and/or similar financial group's resources to businesses in this area in terms of technical assistance, loans and/or grant funds.

We appreciate the opportunity to comment on the Urban Jobs and Enterprise Zone Act and hope to see its successful implementation in the near future, with the MESBIC industry acting as an integral part. Thank you.

MAJOR POINTS OF AAMESBIC TESTIMONY ON URBAN JOBS AND ENTERPRISE ZONE ACT

The American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC) represents MESBICs throughout the United States. Created administratively in 1969 and through legislative mandate in 1971, 301(d) SBICs, commonly known as MESBICs, are specialized for-profit venture capital vehicles licensed and regulated by the Small Business Administration to invest in small business concerns owned by minority entrepreneurs. MESBICs are a unique private-public sector partnership instrument utilizing the preferred stock and debentures purchased and issued by the Small Business Administration to leverage the financing capacity of minority deals. By late 1980, there were approximately 129 licensed MESBICs representing a total of over $178.4 million in investments.

- The greatest potential for private enterprise participation in the proposed Urban Jobs and Enterprise Zone program is with small businesses and especially with minority small businesses.
- The two greatest problems for the success of minority-owned enterprises in the central city are the inability to obtain capital and inadequate managerial skills.
- Major importance should be placed on the capital-generating provisions of the bill.
- The key to the bill is to help build the infrastructure in the zone and leave the community in a stronger, more self-sufficient condition.
- The bill helps to draw skilled managers and workers back into the city and encourages investment in training programs.
- As experienced investors in the targeted community, MESBICs should be used extensively in establishing small businesses in Urban Enterprise Zones.
- Extensive state and local government participation in the zone should be encouraged.

A PANEL OF DR. STUART BUTLER, DR. DAVID BIRCH, RONALD KYSIAK, AND IRVING HAND

We have the last panel here, Dr. Butler, Professor Birch, and I have asked Mr. Irving Hand and Dr. Schwartz if they would join in this panel.

Dr. BUTLER. Thank you very much, Mr. Chairman. I am very pleased to be here to testify on this measure. And particularly so, because I think that this bill is likely to be a very effective instrument to the creation of enterprise zones in the United States. I believe it is a significant improvement on the bill that was offered last year.

I want to just touch on a few reasons why I believe that.

I think that the emphasis on the smaller businesses, as Dr. Birch, I'm sure, will point out, is extremely important in terms of the creation of jobs. Also, as some other witnesses have mentioned, there is the importance of creating local entrepreneurs and getting people from the neighborhoods into businesses as well as just merely providing jobs.

Hence the emphasis more on incentives to investors I think is particularly important in that regard. That, I think, is a significant improvement on the last year's bill.

The encouragement of local governments and the States to become involved is also crucial to the success of an enterprise zone. Many States are contemplating or have passed legislation that would provide for enterprise zones. I think it is important to build on that rather than trying to replace it with a purely Federal program.

The encouragement given in the bill for local governments to bring community organizations and other more locally based groups into the enterprise zone is also important.

The local commitment does allow a great deal of innovation to take place at the local level. Some emphasis has been given on the tax mechanisms that could be applied, but I think there are many other elements, including regulations, at the local level.

Senator CHAFEE. Do you have any constructive suggestions? When you say local regulations, what do you mean by that?

Dr. BUTLER. Well, I think that many small businesses would say that the biggest thing that they face as a problem is not so much taxes, but building codes and other kinds of permits that are required before they can even set up business. There is no point in giving tax incentives if somebody can't even start because of local restrictions.

I do think that there are one or two other things that could be improved in the bill, although I do strongly support the measure. I think the qualified business requirement of 40 percent CETA eligibles does pose many problems, particularly for small, startup businesses that may only have a work force of two or three people. You are saying specifically they must hire 40 percent of CETA eligibles.

I think it is much more important to get these businesses started before we start applying requirements on them. I would certainly favor some bottom limit on the number of employees before that requirement would come in—maybe 5 or 10 employees.

I think, also, there is a danger that the lack of any capital limit on the total tax savings that can be taken through the 50-percent allowance from outside investors or capital gains elimination may well encourage paper companies to be set up for the benefit of outside investors, rather than for the benefit of people within the zones.

I think, in your discussions later on, you might contemplate the idea of some limitation on the total amount of investment that would apply for that allowance.

Senator CHAFEE. Particularly when it goes for 20 years.

Dr. BUTLER. Exactly so.

I think that there is a lot of danger. I understand that Mr. Canter from the AFL-CIO brought up this point, and I—somebody from the Heritage Foundation—hate to agree too much with him—but I think he may have a point in saying that you may find all kinds of well-paid Wall Street accountants seeking means of setting up companies purely for the interests of outside investors. So I think a cap on that would be very important.

I think it may be sensible to look at some other incentives related to the idea of trying to get investments into smaller businesses.

Senator Heinz introduced a bill a little while ago which would have extended subchapter S coverage, allowing 100 people rather than 15 to be involved. I think that is something that maybe ought to be looked at as an inclusion in this bill, particularly as that may well encourage local small investors to take part in enterprise zone businesses and enjoy some of the tax credits and other benefits that may not be available to the loss-making business itself.

So I feel in conclusion, that the measure itself is an important step forward. And I don't want in any way to suggest that the reservations I have about one or two elements of it would contradict my general enthusiasm with the whole approach.

Senator CHAFEE. Thank you for your thoughts.

Dr. Birch—Professor Birch.

Dr. BIRCH. I would like to comment briefly on some of our research findings that are in support of what you are trying to do. And then I would like to talk just briefly about the bill, which I know less about.

We have built up a file of some 5.6 million businesses that we have been following over time. And in 10 cities we have actually taken our location for those businesses down to the neighborhood level so we can see what is happening on a neighborhood-by-neighborhood basis. That is what I would like to comment briefly on.

One of the first things we have found is that the movement of businesses is very localized. One of the criticisms of the bill is that it may pirate firms moving from other parts of the metropolitan area and other areas into a zone.

From the evidence we have seen there is very little likelihood of that, given the nature of moves, which are very local. They don't even cross city and suburban boundaries for the most part.

The other thing we have found is that the losses are very high, the losses due to a firm going out of business or contracting. And they do tend to be higher in the more growing areas than a declining one.

I noticed Congressman Kemp mentioned that fact, and you looked somewhat dismayed. Houston does, in fact, lose a greater percentage of its jobs every year, as does Charlotte, as does, say, Wooster, or New Haven, or Boston.

The reason being there is more entrepreneurship, more risk taking, a more volatile economy, more dynamism in the economy. And one of the consequences of that is a greater loss rate at the bottom, more than compensated for by a much higher replacement rate.

The key to it all is really the replacement of the losses, not the variation in the losses themselves. Regarding replacement, we found that the older a city, the more industrial a city, the more central a neighborhood, or the more minority a neighborhood; the greater the extent to which the replacement jobs are created by smaller and mostly service-sector businesses.

We have also found that in the extreme case of the very old, very declining cities in the very central neighborhoods, all the jobs are being created, in fact 150, 130, 140 percent of the jobs are being created by smaller service-sector businesses compensating for the losses in the larger companies and the manufacturing companies.

This requires, I think, a major rethinking on the part of many economic developers who for the past 150 years have based their growth on large manufacturing plants. But I see a lot of that thinking taking place and I certainly wouldn't turn my back on a large one if it walked in the door.

All the evidence we have suggests, however, that the odds of one walking in the door are dropping fast. The odds of a smaller one walking in the door are quite substantial.

The bill, I think—I would agree with Dr. Butler—shows considerable progress from last year, from my point of view. I think many of the objectionable features have been removed. I think the residency requirement was one and that is gone. The property tax rebates, which Mayor Schaefer points out are illegal in his State and many other States, are gone. The focus on bricks in mortar and the fiddling around with the social security system are gone.

I think in their place a lot of incentives that are aimed at individual investors looking at small companies—I have in mind particularly the heftier capital gains tax cut, and the heftier tax cuts generally. The extension of the tax loss carry forward for 20 years, I think, is a major step and a good one.

The labor cost credits and the tie to the regulatory flexibility act are all, I think, very positive steps. They are all consistent with what we are finding in our research and what other people are finding as the needs of many interest groups that have come before you.

I think, actually, it is an extraordinary example if I may compliment you—not that you need one—of congressional listening. I have seen you listen up in Boston. I have seen Congressman Garcia listen. I have seen many Congressmen listen. This bill represents to me a tremendous amount of listening and I think it is a great thing.

There is only one thing I find missing that I might comment on. That is that—nobody has mentioned this—you are conducting an extraordinary experiment here, of rather large proportions. It is in an area that you have no previous experience in, and it is an area in which there will be substantial variation from city to city due to the contracts that each city will draw up with whichever cabinet officer ends up assuming responsibility for the bill; presumably the Secretary of HUD.

There is no indication anywhere in the bill, that I can see, that there be any effort to learn very much from what happens. The bill does not incorporate in any way a learning process. It seems to me there ought to be some built-in attempt to monitor who creates jobs, for whom they are created, how many are created. What happens—what works, what doesn't work.

The bill makes no mention of that. I think it is a tremendous opportunity to have a monitoring system where you might learn from what happens so we are smarter next time around.

I know when the housing allowance experiment, which was the most analogous thing I can think of several years ago, was instituted a monitoring system was built in and a tremendous amount was learned from the monitoring of the housing allowance experiment as it was taken.

I think this is an analogous situation and I think it would be of great benefit to incorporate some provision that requires cities who engage in this enterprise to report back in some considerable detail what happened. As the bill now stands I see none of that, and I think it would be a major addition.

Thank you

Senator CHAFEE. Thank you very much, Mr. Birch.

Mr. Irving Hand, president of the American Planning Association.

Mr. HAND. Thank you, Mr. Chairman.

I very much appreciate the opportunity to speak this morning in connection with this legislation as the President of the American Planning Association.

I would like to refer to, perhaps, one or two points in the early pages of that statement and emphasizing some remarks that have been made.

Our membership and particularly those serving in local planning organizations have a special interest in this legislation.

I might, parenthetically, say that in addition to my own professional interest, a reference to New York City and more particularly the South Bronx, brought forward a very personal interest on my own part. I spent a lot of my growing up years and early adult life as a resident of that community. And I know the kinds of experiences that it has had and indeed this legislation can be very instrumental in dealing with the issues that are confronting areas of that kind.

Planners, I think, will have a key role to play in advising the chief elected officer and members of city councils on the city's enterprise zone option. Some of the testimony that you heard earlier today, I think, was evidence of that fact. The experience that we had in Baltimore, I think, illustrates it very well.

Local planners will actively participate in defining potential enterprise zones and in compiling information to meet elegibility requirements. In short, planners will be very much involved in putting together the local package of incentives required by the legislation. Planners will be heavily involved in relating enterprise zone objectives to locally adopted development plans and city-wide objectives.

For these reasons, we have carefully examined the legislation as it has been introduced in the past, and at the current session of Congress. As professionals, we support this bill; and believe that its implementation will have positive results. We must point out, however, that it will take very careful planning and, as Professor Birch has mentioned, very skillful monitoring and a very dedicated control in order for enterprise zones to succeed where earlier experiments have missed their mark.

Above all, we must be keenly aware of the constraints within which enterprise zones must operate; particularly, in relation to essential supporting governmental actions.

First and foremost, and this is a point that has been made by others as well, I understand, aside from those commenting today; the act should not be viewed as a panacea which will, by itself, solve economic development problems of depressed urban areas.

It is, however, a very important tool which, used in combination with other actions, has the potential for positive impact. Cities must provide physical improvements and a high level of public safety and other services needed in such zones.

Sites must be assembled, existing buildings acquired for new employers, loans, grants, technical assistance must be available to assist businesses to get their start. Job training programs must be targeted within such zones to help residents to qualify for the new jobs to be created.

All of these actions, concentrated and coordinated within the designated zones, can help bring about the desired economic turnaround.

In this regard, we believe that HUD, as the designated lead agency in the bill, and as the agency responsible for developing the congressionally mandated President's report on urban policy—the next one due in 1982—has a unique opportunity for fitting enterprise zones into an urban policy that coordinates Federal programs and interrelates economic development, energy, housing, and environmental quality with other pertinent national interests.

We feel that that kind of a policy context is absolutely essential in connection with whatever may happen with respect to the application to the enterprise zone legislation.

Let me ask Dr. Schwartz to——

Dr. SCHWARTZ. Senator, I think I could make a couple of points that others have not made.

The reason I have been asked to testify, I believe, for the American Planning Association, is that my professional experience involves every possible aspect of what you are trying to do, which is take one more stab at bringing together economic development programs designed to help places and economic development programs designed to help people. We have tried this in different ways for 25–35 years, and we have failed every time.

I helped design one of the most radical business tax incentive programs ever designed by a city, when I worked in the City of New York for two of Mayor Koch's predecessors, Mayor Lindsay and Mayor Beame. I was instrumental in giving very deep tax

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incentives to corporations in the most devastated part of New York, Bedford-Styvesant.

I now, having spent 4 years as an advisor to State and local government, and to small business, I know all of the problems, I think, that any of us could anticipate.

I would like to make four points, trying not to repeat any of those very excellent points which I think have already been made.

The first one of these is that the course of action that the local government is required to take must include, at least, 6 major elements. It must include the provision of capital, as many witnesses have said. Without capital this program will be bound to fail. What they have not said is that there is a certain type of small business—a business doing less than $5 million per year of business—that has no access to equity capital under our present system, with the possible exception of through MESBIC's. And MESBIC's, with all due respect for their success, provide a very small amount of capital.

A firm doing $5 million or more can get into the venture market, but firms below that are hampered because they have a very high debt-to-equity ratio. And that is a critical ingredient of any local plan.

Second, as others have said, there must be a labor training program. The hard-core unemployed will not get the jobs if they can't fill them. I won't dwell on that.

There must be a critical mass. A community must be sure that they have encouraged enough firms so that they can provide the necessary security and services to an enterprise zone. There must be attention to markets so that firms are not encouraged to enter zones if there are no markets.

And finally, there must be management.

Since you have turned on the yellow light, I am going to skip the second point and get to the third.

Senator CHAFEE. Oh no, don't leave us hanging here. Do the second point, briefly.

Dr. SCHWARTZ. The second point, you have asked others what they think about the limitation on the number of zones. The American Planning Association does not believe there should be a limitation on the number of zones. Twenty-five zones would be 10 percent of all the major SMSA's in the country, but there are 39,000 State and local governments.

We feel that if a locality meets all the designation criteria and could get its act together in a sufficient way so that the designated agency, which would be HUD in this case, approves it there is no reason to stop it.

Even if enterprise zones were allowed anywhere, and they increased jobs in the Nation by about 3 percent, which would be a tremendous achievement, the theoretical loss to the Treasury would only be in the neighborhood of $1.1 billion; and that isn't even a loss because, presumably, it is a net gain.

So, we see no economic reason, or revenue reason, to limit the number of zones.

Point No. 3, which is a point that no others, I believe, have made, is that there should be an option, at least, for localities to limit the types of industries which are elegible for the tax breaks that the Federal legislation creates.

This speaks to the competitive inequity problem. Particularly for the so-called mom-and-pop stores. Take a dry cleaner establishment, for example.

If Sam and Sally are dry cleaning on one side of the enterprise zone and Molly and Mo come into the other side of the enterprise zone and are in it and get a tax break, then they can sell their service at a much lower cost——

Senator CHAFEE. Across the street from each other? Is that the point that you are making?

Dr. SCHWARTZ. Yes. That certain kinds of activities that deal with local markets primarily—it would generally be in the nature of retail and service activities that sell their services to a very narrow trading area; these may not be good candidates for these types of tax breaks, because they cannot really generate an economic multiplier and bring new business to the community at large. But they will just be competing with each other and basically eating each other up.

So we think some consideration should be given in the legislation to limiting the types of firms, either by writing it into the bill itself or by specifying that localities make that decision.

Senator CHAFEE. I think that is a good point. You can see all kinds of horrible problems coming up in that you do this to Sally and Sam and they are outraged because somebody down the street is getting special treatment.

OK, point No. 4.

Dr. SCHWARTZ. Point No. 4 is one which Dave Birch also mentioned and we would like to stress very strongly. That is the ability to evaluate this very innovative program.

Senator CHAFEE. No argument with that.

Point No. 5.

Dr. SCHWARTZ. That's it.

Senator CHAFEE. Those are good points.

Now we have Mr. Ronald Kysiak, who is president for the Council for Urban Economic Development.

Mr. KYSIAK. Mr. Chairman, I appreciate you giving me just a few minutes.

The Council for Urban Economic Development represents about 400 cities and about 1,500 professionals in the business of economic development, but really I am just speaking to you primarily as an individual. I am director of economic development for the city of New Haven, Conn. Before that I was director of economic development in the city of Milwaukee, Wis.

So I have done it for 12 years and I know pretty much what seems to work and what doesn't seem to work. I must, however, disagree with a very good mayor, Mayor Koch, when you asked him, "Do you think this will work, of and by itself?" I don't think it will.

I can't remember, in the 12 years I have worked, of any business that has either moved into or out of a city in which I worked, solely because of the tax situation. Oh, they may have said taxes but they meant labor costs. They may have said taxes but they meant a black neighborhood. They may have said taxes but they meant a lot of other hings.

So I think philosophically the problem I have with the enterprise zone bill—which, by the way, is much better then when it was first proposed—is that there are really other pieces that need to be plugged into it.

In many cases what you are giving, in effect, is the frosting and you are going to ask a lot of the cities to bake the cake. And it is going to be a very expensive cake. You are taking away a lot of the ingredients from us with EDA and UDAG and IDB's, and so on.

Senator CHAFEE. We are not taking UDAG.

Mr. KYSIAK. Well, you are holding it constant which, in effect, means there will be less and less.

But my point is that you need site improvements, infrastructure, financing, and job training to go with the taxes and those are functions of CDBG moneys and EDA moneys and SBA and so forth.

Now, we know how to do those things and how to put them together, but it is going to be more and more difficult. As you know, the States are going to be backing away more and more because their moneys are being shut down, so it is going to be a tough row to hoe for everyone.

I think the enterprise zone concept is a good one. I think it makes sense to attempt to create this environment, but I just want to make the point that there are more parts of the environment than just the tax incentive.

Secondly, the State approval question. I think Mayor Koch made a good point. Why should the States be involved?

In Connecticut it doesn't make much difference. We have an urban jobs program. The State has been very helpful for cities. As a matter of fact, you may have read recently in the New York Times that the State of Connecticut passed its own enterprise zone legislation. It provides 7-year assessment freezes, 80-percent property tax abatements for industry, $1,000 job tax credits—cash credits—directly for those who hold State vouchers as CETA elegible. A 50-percent State income tax forgiveness over 10 years. A $1 million venture capital fund. All good things.

The city, in turn, contributes to part of that. You asked that question before. We give up 20 percent of the property taxes, for example. We provide half of the money for site preparations and we provide a development corporation for 503's as well as direct financing. So the city is going to provide special assistance to enterprise zone areas.

But the reason it works in Connecticut is because the State picks up 75 percent of that abatement. The State picks up the income tax forgiveness. The State provides many, many incentives. Many States don't do that. Many States are neutral toward cities. In some cases they are downright hostile to cities.

Senator CHAFEE. When you say it works, in Connecticut, does it work?

Mr. KYSIAK. Well, it has worked for us, in the sense that the city of New Haven, for example, has been able to do industrial parks without going to EDA or to HUD, because the State will share half of the cost of that park development with us.

Right now we can afford to do that. Next year and the year after we will be unable to do that because our bond rating has now fallen to A–. We are going to need some other kind of help.

The problem we have, Senator, is that resources are drying up all over. The enterprise zone seems to me to be being put forward by the administration as their urban policy.

Senator CHAFEE. This isn't being put forward by the administration. The administration hasn't even come in with a bill.

This is being put forward by the four of us. Congressmen Kemp, Garcia, Senator Boschwitz, and myself.

Don't target the administration for good or evil here.

Mr. KYSIAK. I stand corrected. I would like to just make the point that it should not be considered, if at all possible, the one and only solution to the urban economic problems of our country. They go far deeper. They are far more complex.

Senator CHAFEE. I think everybody has made that point. As Congressman Kemp was saying, we are not suggesting this as in lieu of other efforts.

Mr. KYSIAK. Would you consider, in the bill, for example, allowing or requiring that UDAG's be given special consideration in enterprise zones?

In other words, for those development assistance programs at the Federal level there would be a special connection made available. A reduction in ratio. An increase in competitiveness. Some way in which to integrate the rest of the Federal development system into the enterprise zone concept. I think that would be very helpful.

Senator CHAFEE. I think your points are good ones except that if we said that, and we have a very limited number of areas receiving special zone treatment with also, tailing along with it, those additional UDAG funds, the other cities really might scream.

Mr. KYSIAK. I accept that. But just as a point, I think there is a way to integrate them as we go along.

I like the idea of the zones. I don't think they are enough. However, I think it is a good start and I appreciate the work you have done on it.

Senator CHAFEE. Thank you.

I would like to ask a couple of questions.

Dr. Butler. How have these things worked in Britain?

Dr. BUTLER. Well, with mixed results. Of course, it is a very early stage in Britain. The first two zones, I think, have just been opened.

But it is important to realize that in the British case, the incentives are really quite different. They are very heavily associated with building. Construction of new facilities. Therefore, they tend to be much more of interest to branches of established companies rather than to new businesses. I don't think you will see new businesses starting up in the British enterprise zone.

Also, their setting is rather different from that contemplated in this country. One site, for example, in Britain is 7 miles from the nearest major city.

So they should not be seen as primarily inner-city neighborhood development areas in some way. The track record on Britain has yet to be seen, and I think the experiment is quite a bit different from that which is occurring in this country.

I think the bill you have before you is far better than the bill that was passed in the British Parliament.

Senator CHAFEE. Professor Birch, I think your point about the report is good; and we will put that in. I think we have to monitor these things and see if they are working. That is the same point Dr. Schwartz made in point 4?

I assume you agree, Professor Birch, that we should press the CETA training at the same time?

Dr. BIRCH. Yes. I don't think I would agree with Congressman Kemp that this shouldn't be a substitute for something else. You do have to get people who will work.

I am ambivalent, I think, on the 40-percent requirement just as I was—not ambivalent, but against—the residency requirement. I think I am a little more inclined to agree with Mayor Voinovich from Cleveland that the major thing is to get businesses going and started and any impediment or any restriction against that, I think, may cause more harm than good.

Maybe a cutoff, which Dr. Butler suggested——

Senator CHAFEE. You know the problem with that. Take a look at Washington, for example. There is tremendous building going on and everybody is pouring into these insurance companies or whatever from the outside, parking their car in some garage and leaving that night. It hasn't helped the employment in these cities one iota.

The idea is, as Mayor Voinovich said that if you attract factories that are employing people, then eventually they will employ the people who are nearby.

Dr. BIRCH. Well, I think it depends upon which sort of a business you get going. We both listened to Mrs. Moss up in Boston talk about her plate glass company.

Quite an extraordinary woman. Her point was that if this enterprise zone were to encourage her, she would be hiring mostly people from her community. If it were to require smaller businesses of the sort that she had in mind, then they would hire everyone from the local community. That would take care of itself.

So maybe, in fact, it is not an imposition at all. That is why I am ambivalent at all. Maybe if the right kind of people are in there the 40-percent requirement won't bind them at all and it won't be a restriction. If it helps get it through the Congress, then maybe that is a good thing.

On the other hand, I am a little hesitant about somebody who might have come in from outside who might not otherwise do so because of that restriction.

It is a toss up in my mind. I guess I would go for the thing that would help it get through the Congress.

Senator CHAFEE. One of the things that bothers me, I must say, is the 20 year zone life; 20 years is a long time.

Dr. BIRCH. For the loss law carry forward, or for the duration of the zone itself?

Senator CHAFEE. For the duration of the benefits.

Dr. BIRCH. Oh, yes.

Senator CHAFEE. Also, suppose General Motors has a plant here. And they put one into South Boston. I suppose it would take a platoon of accountants, of IRS accountants, to figure out how much of General Motors profits came from the zone plant.

Dr. BIRCH. If General Motors would make that information available to you, which it doesn't always do.

Senator CHAFEE. Well, it would have to in order to get the benefits.

Dr. BIRCH. They would have to, and that is an issue. They tend to consolidate their accounting to a rather extraordinary degree, and I think you have a big problem figuring out exactly how much profit is attributable to a GM branch in that enterprise zone. That is an issue the accountants can deal with.

On the other hand, I guess I favor that extension, because, some of the statistics that I have seen is that the average small business that gets through the first 2 or 3 years rarely becomes profitable before 5, 6, 7, 8 years.

If you are really going to hold out a hand to the entrepreneur in the startup phase, if you don't give them 8 or 10 years to get going, you are not really giving them a running chance. You will cut off the benefit at just the time when they become profitable, and that is not a very attractive option, I don't think.

Senator CHAFEE. Mr. Hand, you stressed job training.

Mr. HAND. Yes, sir.

Senator CHAFEE. And Dr. Schwartz talked about capital formation, which presents a very difficult problem. If the local community can get the banks there to somehow provide capital for one of these zones, that is one thing. But for the Federal Government to get into it, is a real hill with landmines.

Dr. SCHWARTZ. That's true, Senator. But I think there are some Federal programs that have been effective and it is a matter of encouraging States to piggyback upon them. Loan guarantees, for example. But I think the real problem, as I said, is the equity problem. Some States are beginning to experiment with State-backed legislative appropriations and equity corporations.

Senator CHAFEE. Well, that's the kind Connecticut had.

Dr. SCHWARTZ. That's right.

And California has just put forth a new proposal to allow public pension funds to be invested up to a limited amount in small business equities. I can see a lot of problems with that.

Senator CHAFEE. I think that is great. That is the kind of thing that we would chalk up as a plus under a local effort.

Dr. SCHWARTZ. Exactly.

Senator CHAFEE. I really am very, very leery for the Federal Government to get into that under this legislation.

Dr. SCHWARTZ. Well, if I may take a moment to elaborate on the comment that I had wished to make if time hadn't been so short. Part of the problem seems to be in the potential rules and regulations, which as the present legislation drafts exist leave a great deal of discretion to the lead agency to draft the rules and regs.

If the rules and regulations are written in such a way that they don't take cognizance of the level of effort that a locality already makes in giving incentives to new business, then we can foresee a situation where one State or one community, which already gives tremendously deep and broad incentives, is disadvantaged in the review process and the qualifying process as against another community that suddenly adds a whole host of incentives.

Senator CHAFEE. OK. Your point is well taken.

Traditionally around here, we punish the people who have been doing a good job.

Dr. SCHWARTZ. Exactly.

Senator CHAFEE. On that high note, I want to thank everyone for coming.

Dr. SCHWARTZ. Exactly.

Senator CHAFEE. And that is fine. But I really am very, very leery for the Federal Government to get into that under this legislation.

Dr. SCHWARTZ. Well, if I may take a moment to elaborate on the comment that I had wished to make if time hadn't been so short. Part of the problem seems to be in the potential rules and regulations, which as the present legislation drafts exist leave a great deal of discretion to the lead agency to draft the rules and regs.

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Senator CHAFEE. OK. Your point—we'll make sure that that is taken care of.

Traditionally around here, we punish the people who have been doing a good job.

Dr. SCHWARTZ. Exactly.

Senator CHAFEE. On that high note, I want to thank everyone for coming.

[The statements of the preceding panel follow:]

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THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981 (S. 1310, H.R. 3824)

INTRODUCTION

The Enterprise Zone concept has made solid progress on both sides of the Atlantic since it was unveiled in a 1978 speech by Sir Geoffrey Howe, MP, now the Chancellor of the Exchequer in Mrs. Thatcher's Conservative government. A means of stimulating economic development in depressed urban areas by encouraging local entrepreneurs through tax and regulatory relief, the approach marks a radical departure from the government expenditure programs of the 1960s and 1970s.

In Britain, legislation to create eleven experimental zones was enacted by Parliament in November 1980, and a number of these sites will be operating by the end of this summer. The British zones are, however, a specialized version of the basic concept, designed primarily to reactivate deserted industrial areas, and they are not likely to be an accurate guide to the way in which American zones would affect neighborhoods.[1]

In the United States, the Enterprise Zone has become a central issue -- if not the central issue -- in the national urban policy debate, and legislation is being considered at both the state and federal levels to create versions of the concept. In the District of Columbia and several states, such as Illinois, bills have been passed or are pending which would reduce state and local taxes, and regulatory burdens, in distressed neighborhoods. Although these measures are designed to establish state Enterprise Zones, they are generally constructed in a manner that

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[1] For an analysis of the British Enterprise Zones, see Stuart Butler, "Enterprise Zones in Britain: The Experiment Begins," International Briefing #8 (The Heritage Foundation, 1981).

would allow the zones to fit within the criteria being discussed at the federal level. In some other cases, the measure establishes a commission or similar body to investigate possible sites and to examine state burdens which could be relieved in federally-designated zones.[2]

President Reagan gave strong support to the Enterprise Zone idea during his campaign. In particular, in his speech to the National Urban League in August 1980, he argued that taxes and regulation should be relaxed in such inner city zones. He explained that the purpose of the Enterprise Zone, in his view, should be to encourage entrepreneurs to start new businesses, and to put local people to work. "Those who view poverty and unemployment as permanent afflictions of our cities," he concluded,

> fail to understand how rapidly the poor can move up the ladder of success in our economy. But to move up the ladder, they must first get on it. And this is the concept behind the Enterprise Zones.

After the Reagan Administration took office, the White House began a detailed examination of the idea, and a cabinet council was set up under Commerce Secretary Malcolm Baldrige to seek ways of turning the concept into reality. Although, as yet, no firm proposal has emerged from the Administration, Secretary Baldrige issued a statement in June, stating that

> The Administration supports the establishment of Enterprise Zones to help create new jobs and enterprise in our nation's poorest communities.
>
> ...It is a top priority of the Reagan Administration that Enterprise Zone legislation be enacted in this Congress.

CONGRESSIONAL ACTION -- THE URBAN JOBS AND ENTERPRISE ZONE ACT (MARK I)

In June 1980, a bill to create Enterprise Zones was introduced in the House (H.R. 7563) by Representatives Jack Kemp (R-NY) and Bob Garcia (D-NY), and in the Senate (S. 2823) by Senators John Chafee (R-RI) and Rudy Boschwitz (R-Minn.).[3]

Known generally as the Kemp-Garcia bill, the measure laid down poverty and unemployment characteristics that would have to

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2 For information on state legislation dealing with Enterprise Zones, contact the American Legislative Exchange Council, 418 C Street, N.E., Washington, D.C., 20002, tel. (202) 547-4646.

3 For an analysis of the bill, see Butler, "The Urban Jobs and Enterprise Zone Act," Issue Bulletin #62, (The Heritage Foundation, 1980).

exist for an area to be considered for Enterprise Zone status. In addition, the proposed zone would have to contain at least 4,000 people, and the local government would have to agree to a reduction in property taxes in the zone amounting to at least 20 percent within four years. If these requirements were met, the Secretary of Commerce would accept the application from a local government and declare the area an Enterprise Zone.

Once the designation had been made, the bill authorized the following incentives, in addition to the property tax reduction. They would apply for a minimum of ten years:

1) For individuals owning property in the zone:

   - An increase in the capital gain deduction from 60 percent to 80 percent on property used predominantly for business purposes within the zone.

2) For employees who complete most of their work in the zone:

   - A 90 percent reduction in the employee's and employer's social security tax for employees under 21 years of age, and a 50 percent reduction for other workers.

3) For businesses who recruit 50 percent of their workforce from among the zone's residents ("qualified businesses"):

   - A 15 percent reduction in corporate income tax.

   - Three year straight-line depreciation for all property, other than land, used for business purposes in the zone, up to $500,000 in property per year.

   - Loss carryforward for up to ten years.

   - Cash method of computing taxable income available for businesses with gross annual income below $1.5 million.

4) For corporations in general:

   - A reduction in capital gains tax from 28 percent to 15 percent on property (other than land) used for trading purposes in the zone.

REACTIONS TO THE 1980 ACT

When the Urban Jobs and Enterprise Zone Act of 1980 was presented to the Congress, it was intended by its sponsors to be a discussion document rather than a bill intended for passage. The sponsors urged both supporters and critics of the Enterprise Zone idea to make their views known, so that a remodeled bill could be offered at a later date.

The Kemp-Garcia bill did, indeed, provoke considerable national discussion. In the year following the introduction of the bill, there have been many conferences and meetings, and much media coverage devoted to discussions of the concept and the legislation. While the Enterprise Zone gained wide support as an approach, however, certain specific features of the 1980 bill did attract criticism. The principal objections may be summarized as follows.

1) Targeting

The criteria for selection of areas were said to be imprecise and too coldly statistical. Some areas which might seem to be perfect candidates for a zone could not meet the requirements, while less deserving locations managed to fit the demands. Some critics also questioned the wisdom of what was, in effect, the automatic designation of eligible areas. They argued that there should be some discretion and a limit on the number of zones, at least until the performance of the initial zones could be analyzed and necessary modifications made.

2) Regulation

The absence of any provisions serving to streamline federal or local regulation came under attack. Many small businessmen, and some neighborhood groups, argued that red tape -- particularly at the local level -- is a greater obstacle to enterprise and innovation than taxes and other tangible costs.

3) Small Business

Small business spokesmen maintained that although the Enterprise Zone was supposed to stimulate the creation of new firms, and in particular small, local enterprises, the tax incentive package was heavily geared towards larger, established companies. While the loss carryforward, social security tax cuts, and property tax reduction might offer some help to struggling new businesses, they conceded, most new firms show little or no taxable profit in their early years, and so depreciation and other tax allowances would have very limited impact.

4) Social Security

The reduction in social security taxes proposed by the bill was to be reimbursed to the fund out of general revenues. This was viewed by some as a dangerous precedent in light of the controversy over the future of social security. Also, it was pointed out, the incentive might well be designed to help low-income employees, but it would also benefit highly-paid executives in Enterprise Zone firms.

5) Depreciation

A major criticism of the bill was that the rapid depreciation allowance appeared to be the most significant incentive in the package. This might lead to companies deciding to install a great deal of equipment, while employing very few local people.

6) Residency Requirement

The requirement that at least 50 percent of a company's workforce be zone residents for it to enjoy the principal incentives was seen by the sponsors of the bill as a mechanism to ensure that local residents would be the chief beneficiaries of the Enterprise Zone. However, objections to this provision did emerge. The requirment did not specify any category of resident, such as CETA eligibles, and so skilled workers or highly-paid executives would fulfill the criterion if they moved to the zone -- or established convenience addresses. In addition, critics charged, the requirement was precisely the kind of red tape that the zones were supposed to reduce. If it remained as a feature of the zones, it was said, it would only have the effect of dissuading new entrepreneurs from setting up in the Enterprise Zone. Some even predicted dawn raids on zone businesses by government agents checking for "illegal non-zoners," much as agents now search for illegal aliens.

7) Property Tax

Perhaps the most vociferous criticism voiced against the bill centered on the requirement that property taxes had to be reduced by at least 20 percent. In certain states, it was pointed out, differing property tax rates are unconstitutional, meaning that no site could comply with the requirement. Even in states where there was no constitutional problem, mayors argued that it would be impossible to adopt further reductions in city revenues already cut by tax referendums.

8) Thrust of the Bill

There was general concern that the goals of the Enterprise Zone would not be achieved by the package of incentives in the bill. Certain minority and neighborhood organizations, in particular, feared that although the zones probably would lead to increased economic activity, local people would be passed over in the process. There was also some concern that residents, and even existing small businesses, would be displaced by newcomers. If the purpose of Enterprise Zones is to stimulate the creation of local entrepreneurs and to help poor inner city residents, it was argued, then the incentives must be aimed at small businesses. Similarly, the emphasis should be on reducing the disincentives that persuade unskilled inner city people to stay on the welfare rolls rather than taking entry level jobs. The Enterprise Zone, in other words, should provide a "trickle up" mechanism in depressed neighborhoods.

A second reservation often expressed about the broad thrust of the bill concerned the question of relocation. While some advocates of the Enterprise Zone seemed unconcerned where new jobs might come from, providing they came to the inner cities, others maintained that the approach could only be justified if it led to new economic activity. It should not be a mechanism to reallocate economic activity, it was argued, but to expand it in the cities. Like those emphasizing the importance of local activity, people who took this position stressed the need to have incentives which would lead to new entrepreneurs entering into the market, rather than incentives which would cause businesses to move to the inner cities.

THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981

Many of the criticisms of the 1980 bill were accepted by its sponsors, and led them to refashion the measure. The modified bill was introduced in the House (H.R. 3824) and Senate (S. 1310) on June 3, 1981. The House bill was referred to the Committee on Ways and Means -- although elements touching on other federal programs were also referred to the Committee on Banking, Finance and Urban Affairs. The Senate bill was referred to the Committee on Finance. The principle co-sponsors were once again Kemp and Garcia in the House, and Boschwitz and Chafee in the Senate.

The bill has impressive support. National Urban League President Vernon Jordan joined the co-sponsors at their June press conference introducing the new legislation. In addition, the NAACP, the National Urban Coalition, the National League of Cities, and many other organizations have endorsed the Enterprise Zone concept.

Congressional support for the new bill has been growing. The measure picked up sixty-one House co-sponsors within one month. The forty-five Republican co-sponsors include House leaders Bob Michel (R-Ill.) and Trent Lott (R-Miss.). The Democratic support is particularly impressive. Garcia is joined by fellow Bronx member Mario Biaggi. Black Caucus members Gus Hawkins (D-Cal.) and Bill Gray (D-Pa.) are also co-sponsoring the measure. The Senate bill collected fifteen Republican co-sponsors in the first month, but only one Democrat, Quentin Burdick (D-ND).

PROVISIONS OF THE BILL

1) Designation

a) Method of Designation

The initiating body must be a state government (or possession) or a local government. If the state applies on behalf of a local government, the latter must consent to the application. The governor of a state may block a local application within twenty-one days.

The Secretary of HUD, after consultation with the Secretaries of Commerce, Labor, and the Treasury and the Administrator of the Small Business Administration, may approve applications for zones in eligible areas. The designation would last until the year 2001. Designations may be made by the HUD Secretary until 1996, but in the first three years of the program, no more than twenty-five zones, and no fewer than ten, may be made in any one year.

The bill requires the Secretary to give priority to areas with the highest levels of economic distress, areas in which state and local government is making the "greatest effort to remove impediments to job creation" (see Local Commitment), and

> areas which have the widest support from the government seeking designation, the community, residents, local businesses, and private organizations, especially in meeting local commitment....

b) Eligibility

To be eligible for designation as an Enterprise Zone, an area must be characterized by "pervasive poverty, unemployment and general distress." Sites must meet the eligibility requirements of the Urban Development Action Grant Program (including Pockets of Poverty -- designed for poor neighborhoods within generally prosperous neighborhoods). The areas must also meet at least one of the following criteria of distress:

* Unemployment for the most recent eighteen-month period is at least one and a half times the national average.

* At least 20 percent of the population is living in poverty, as defined by the Bureau of Census.

* At least 70 percent of area residents have incomes below 80 percent of the median income for the area as a whole.

* All census tracts within the area suffered at least a 10 percent decrease in population between 1970 and 1980 and are characterized by chronic abandonment or substantial property tax arrearages.

To be eligible, the area must contain at least 4,000 people (at the time of the most recent census) if it is within a metropolitan area of 50,000 or more; or 2,500 in any other case; or be an Indian reservation.

2) Local Commitment

The government seeking the Enterprise Zone designation must also agree, in writing, to follow a course of action "designed to reduce the various burdens borne by employers and employees" in the area. This local commitment may involve the participation of private and/or public entities, and may include the use of federal programs. The bill suggests the following:

* Reductions in tax rates or fees.
* Improvements in local services.
* Streamlining of business and employment regulations.
* Commitments from private entities to provide training and other assistance for zone residents.

The HUD Secretary may revoke the Enterprise Zone designation if he determines that the applicant government has not substantially complied with the local commitment. This is the only circumstances in which the designation may be terminated prior to the date specified in the bill.

3) Federal Commitment

The HUD Secretary is directed to expedite and coordinate all federal housing, development, financial assistance, and employee training programs within the zone. The federal government must also disregard any reduction in taxes, resulting from the local commitment, in determining the eligibility of the state or local government for federal assistance programs.

4) Sense of Congress Provisions

The bill states that it is the sense of Congress that local governments should attempt to facilitate "to the greatest extent possible" the employment of poor and unemployed zone residents. But in choosing the sites for consideration, the impact of an Enterprise Zone on neighboring areas should be examined.

The IRS is urged to simplify the administration and enforcement of the tax incentives contained in the bill. The Foreign Trade Zone Board is also urged to expedite applications for foreign trade zones within Enterprise Zones, and to take into account future development likely to result from Enterprise Zone incentives in determining the economic viability of the site under consideration for foreign trade zone status.

5) Tax Incentives

a) Refundable Credits for Employers and Employees

An employer may take a tax credit equal to 5 percent of the wages paid to a "qualified employee." A qualified employee is defined as a CETA eligible person who performs at least 50 percent of his service within an Enterprise Zone. The credit is refundable if the total credit exceeds the employer's tax liability.

Any employee of a "qualified business" may also take a credit against his or her personal federal income tax equal to 5 percent of the income received from services performed for the business within an Enterprise Zone.[4] The credit is limited to $1,500 in any taxable year and only covers the first 36 months of employment. Like the employer's credit, it is refundable.

b) Capital Gains -- Corporations and Non-Corporate Taxpayers

Taxpayers are not required to pay any capital gains tax on tangible property installed after an Enterprise Zone is designated, providing the property has been used for business purposes. Such property would include an interest in a qualified business, and both new and substantially rehabilitated low-income rental housing. The exemption from capital gains tax extends to the first sale or exchange made after the zone designation ends. Capital gains on such property would not be taken into account as a preference for assessing minimum tax.

c) Taxation of Business Income

A 50 percent tax allowance is available to any qualified business for income received within a zone. The same allowance is available for any income received by any taxpayer from loans, mortgages and other financing provided to a qualified business for business purposes within the zone.

The full 50 percent allowance will operate only until the year 1997, after which date it is to be reduced in increments of 10 percent until it is phased out by 2001.

6) Other Financial Incentives

A qualified business may use the cash method of computing taxable income, providing its total receipts do not exceed $2 million in the tax year.

The bill also specifies that new and rehabilitated low-income rental housing in an Enterprise Zone is eligible for investment credits.

7) Regulatory Flexibility

A qualified business is to be considered as a "small entity" for the purposes of the Regulatory Flexibility Act. A not-for-profit enterprise operating within an Enterprise Zone would be treated in the same manner. Rules affecting the administration

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[4] A qualified business is defined as a business in which at least 50 percent of gross receipts come from trade within an Enterprise Zone and at least 40 percent of new hirings are qualified employees. In the case of a firm already in existence, the business will be considered as a qualified business only if the average number of full-time employees for the taxable year is at least 10 percent greater than for the year immediately before the area's designation as an Enterprise Zone.

of an Enterprise Zone will also be subject to the Regulatory Flexibility Act.

COMMENT

General

The 1981 Urban Jobs and Enterprise Zone Act is a substantial modification, and improvement, of the 1980 bill. It does much to meet the criticisms raised against the earlier measure.

The new bill lays much greater stress on small business development within the Enterprise Zones, and breaks entirely new ground in providing a means for streamlining both federal and local regulation. A much greater emphasis on the provision of low-income housing can also be seen in the new bill.

Designation

The 1981 bill differs in important ways from its predecessor concerning the selection of sites. The designating authority has been moved from Commerce to HUD, and the Secretary of HUD has been given the task of coordinating other federal programs within the zones. These changes reflect the fear expressed by some that the Enterprise Zone might become a replacement for other programs, rather than a supplement to them.

The 1981 bill also seeks to extend the Enterprise Zone mechanism to small towns, rather than restricting it, in practice, to large urban areas. States and local governments are also brought more into the picture than was true in the 1980 version. This indicates a greater emphasis on the idea of Enterprise Zones as a local program, and conforms with the Administration's strategy of devolving development planning as far as possible to the states through such means as the block grant system.

The limit on the number of zones which can be designated in any one year is an extremely important change. Even some of the most enthusiastic supporters of the Enterprise Zone concept have become concerned that what is still a very experimental approach to inner city revitalization has gradually acquired the status of _the_ urban policy of the 1980s, and the panacea for all urban ills (it might be added that the reason for this situation stems largely from the lack of alternative urban initiatives). A limit on the number of designations has the advantage that the incentives may be examined very closely in the first set of cities before they are applied more extensively. This limit and priority system should also ensure that the cities acquiring the zones will be those prepared to do most at the local level to help the Enterprise Zone idea to succeed.

There is a negative aspect to the limitation on numbers, however, when compared with the automatic designation process in the earlier version. Critics will no doubt charge that HUD discretion only opens the door to political pressures and favoritism. While this problem cannot be eliminated, it obviously must be addressed.

The Local Commitment

The property tax reduction required by the 1980 bill has given way to a new provision requiring state and local governments to put together a package of changes within the zone, designed to encourage enterprise and development. This is another very important feature of the 1981 measure, and removes a major criticism of the previous bill. It allows local flexibility and should stimulate innovative mechanisms by local governments. It also further emphasizes that the Enterprise Zone is very much a local device for revitalization, not a blueprint from Washington.

The bill awards priority in selection to areas where the local government can demonstrate strong neighborhood support for a zone. Community support is crucial to the success of an Enterprise Zone. One cannot achieve development based on grassroots organizations and entrepreneurs if there is no enthusiam for the approach in the neighborhood. The bill correctly stresses this. Only by motivating and mobilizing a community will the "trickle up" process embodied in the concept be achieved.

An Enterprise Zone Contract?

Although the local commitment must be in writing, there is no provision in the bill for it to be modified in the light of experience. An improvement might be to require the federal government, and the state and local governments involved in any zone, to draw up a formal Enterprise Zone contract, specifying the agreed local commitment and the federal programs and projects which would be provided in the zone. The contract could be modified during the lifetime of the zone, but only by the agreement of all parties. Such a contract could lead to additional incentives being offered by both "sides." The federal government, for example, might offer to test a new housing or development program in the zone if the local government agreed to a greater relaxation in its housing regulations or if it would contract out city services to neighborhood groups. In short, the Enterprise Zone contract could become a vehicle for innovative ideas to be tried out with the agreement of all concerned.

The Business Tax Incentives

The tax incentives in the bill represent a significant shift from devices that would encourage branching by larger firms to incentives which are more likely to meet the needs of new, independent businesses. Small firms of this kind generally pay very little tax, and find access to capital a bigger obstacle than their tax burden. The bill seeks to improve the flow of finance to these new companies by the elimination of capital gains on investments made in such firms, and by the 50 percent allowance on income from loans made to the businesses. It remains to be seen whether this will be sufficient to overcome the risk and other disincentives accompanying investment in small, inner city firms; but the provision is based upon the valid assumption that the best method of encouraging the growth of new firms in depressed areas, as elsewhere, is to provide incentives for investors, rather than tax breaks for the firms themselves.

No limit is placed on the tax saving that can be obtained under the capital gains tax or the 50 percent allowance. This is a shortcoming. Enormous tax savings would be possible under the provision. If it remains in the final legislation, it is likely that "paper" companies will form, sharing large profits channeled from corporations outside the zone. Without some limit on the total investment that would be eligible for these generous concessions, the Enterprise Zones could offer considerable opportunities for corporate accountants and yet have little impact on the poor.

The tax incentives in the bill might be improved considerably by incorporating a measure suggested by Senators Heinz (R-Pa.) and Riegle (D-Mich.) in their Urban and Rural Revitalization Act of 1981 (S. 1240), introduced in May. The Heinz-Riegle bill would change the rules covering Subchapter S corporations by expanding the number of persons who could be shareholders of such corporations, in depressed areas, from 15 to 100. Subchapter S corporations can "pass through" tax benefits and operating losses to their investors, who may then utilize them for tax-saving purposes. The investors are treated as shareholders, yet retain the advantages of limited personal liability. Given the low tax burden common in new firms, Subchapter S treatment would make these firms more attractive to investors who were seeking ways of reducing their tax burden, rather than obtaining immediate income. The greater number of investors permissible under Heinz-Riegle might also stimulate more investment in local firms by zone residents with modest savings, and could encourage employee stock ownership plans (ESOPs).

The new Enterprise Zone bill drops the three-year straight-line depreciation allowance for capital equipment that was a feature of the 1980 bill. Although some critics argued that the allowance was too strong, others now contend that removing it completely may go too far in the other direction. There are many, such as Ed Logue, Director of New York's South Bronx Development Office, who fear that if the 10-5-3 depreciation system passes Congress, something will be necessary to offset the even greater encouragement there will then be for inner city businesses to leave for new suburban sites.

While there is merit to this argument, the emphasis on small, new firms in the Enterprise Zone concept does mean that the other tax mechanisms in the 1981 bill are likely to be more important than a depreciation allowance. In considering depreciation as an element in an amended bill, it would be sensible to examine the idea of Congressman Henry Nowak (R-NY), contained in his Jobs Expansion and Urban Development Act (H.R. 390). Nowak's bill would increase the amount of used machinery and rehabilitated buildings eligible for an investment tax credit. Not only would this be particularly useful for small businesses with limited capital, but it would also provide a greater inducement for new inner city entrepreneurs to acquire facilities abandoned or being sold by companies moving out of the city.

Refundable Employer and Employee Tax Credits

A refundable tax credit for employing CETA eligible workers is an improvement on the social security tax reduction in the earlier bill, although it is not without its shortcomings.

The credit would offset at least part of the disincentive of the payroll tax and would target the kind of person the Enterprise Zone seeks to assist. The refundable nature of the credit would extend its effect to new companies with small tax burdens. Since the credit is merely a reduction in payroll tax payable, it does not constitute a new outlay by the government. Even when a firm receives a refund, it is only the reimbursement of tax already taken.

The social security tax reduction in the 1980 bill was, however, simpler and easier to administer than the new provision. Furthermore, experience with the Targeted Jobs Tax Credit suggests that small companies are reluctant to deal with all the red tape needed to obtain employment tax credits.

The credit available for employees is an important step towards reducing the effect of the "poverty trap." Because certain welfare benefits are withdrawn when a recipient obtains paid employment, the worker faces, in effect, a much higher rate of tax than the normal income tax -- in some cases the worker actually faces a net reduction in after-tax income by taking a low-paid job! The credit will not eliminate this effect, but it will improve the situation, and so make paid employment a little more attractive for those on welfare.

Qualified Businesses

In order to obtain the most important tax incentives, a business must show that at least 40 percent of its new employees are CETA eligible workers. This is certainly an improvement on the 1980 bill, in that it targets the requirement more effectively, and will allow low-skilled people to benefit from the zone, even if they do not live there.

The problem with the new requirement is that although the paperwork necessary may impose only a small burden for major corporations, it may be just the kind of restriction which would stifle a new firm in its early days. If a printer decided to start a business in an Enterprise Zone and hire three people, for instance, he would need to ensure that two of them were CETA eligibles to be treated as a qualified business -- irrespective of skills he needed to get the printing firm established. When a business is very small, a precise range of skills is often necessary. When it begins to grow it can build on this nucleus and hire less-skilled employees.

In order to combine the goal of creating jobs for low-skilled people with that of reducing the obstacles to small business start-ups -- so that they can employ such people -- it would be sensible to place a minimum workforce size for the CETA requirement. If a business had fewer than five employees, for example, it should be considered as a qualified business without a certain proportion having to be CETA eligibles: the 40 percent requirement should only come into play for workers hired beyond the minimum.

Foreign Trade Zones

The foreign trade zone provision in the 1980 bill has been retained; it would encourage the Foreign Trade Zone Board to consider future development likely to result from an Enterprise Zone, as well as the current situation, when evaluating an application for a trade zone.

The sponsors see foreign trade zones as potential cores of economic activity in appropriate Enterprise Zones, around which a local economy could develop. Foreign trade zones around the world have been remarkably successful in stimulating growth in this way -- Hong Kong and Taiwan are examples of what can be achieved.

Within a foreign trade zone imported goods are not liable for customs duties until they leave the zone for the domestic market, and they are totally exempt if they are re-exported. In addition, goods which are assembled or finished within the zone are relieved of duty on the added value. This makes the foreign trade zone very attractive to foreign suppliers of goods, who have an incentive to establish assembly plants, hiring local workers, in order to escape part of the customs duties. Since assembly plants tend to offer a high proportion of jobs for low-skilled workers, they are particularly suitable for depressed urban neighborhoods.

Regulation

A major criticism levelled against the 1980 bill was that it failed to include any mechanism to reduce the burden of regulation on businesses and organizations in an Enterprise Zone. Yet many people feared that the relaxation of regulation would mean an unacceptable reduction in safety and other protections for those working and living in the zones.

Defining Enterprise Zones as "small entities" under the terms of the 1980 Regulatory Flexibility ACt (P.L. 96-354) would seem to be an effective method of relieving unreasonable regulation without in any way removing protections desired by Congress. The Act, which was passed with strong bi-partisan support, recognizes in its preamble that:

> Laws and regulation designed for application to large scale entities have been applied uniformly to small businesses, small organizations, and small governmental jurisdictions even though the problems that gave rise to goverment action may not have been caused by those small entities.
>
> The failure to recognize differences in scale and resources of regulated entities has in numerous instances adversely affected competition in the market place, discouraged innovation and restricted improvement in productivity.

The law goes on to argue that in the case of such small entities,

> alternative regulatory approaches which do not conflict with the state objectives of applicable statutes may be available which minimize the significant economic impact of rules on small business, small organizations, and small governmental jurisdictions.

If a proposed regulation is considered to have a "significant economic impact" on a number of small entities, the agency is required to seek an alternative regulation, or grant an exemption, for the small entities -- providing the objective of the relevant statute is observed. Agencies are given ten years to carry out the same procedure for existing regulations.

Treating Enterprise Zones, and the qualified businesses and non-profit organizations within them, as small entities means that if the economic development of an Enterprise Zone is adversely affected by an existing or proposed regulation, the agency will have to make every effort to find some alternative rule which would accomplish the intent of Congress.

The Regulatory Flexibility Act has not been on the statute book long enough for any judgment to be made regarding its effectiveness, but it appears to be the best mechanism available for relieving businesses and organizations in an Enterprise Zone from many of the regulatory burdens which stifle rather than protect. In conjunction with the required local commitment, it should help to remove the rules which are irrelevant to conditions in the blighted inner city.

CONCLUSION

The 1981 Urban Jobs and Enterprise Zone Act is a significant improvement on the 1980 version of the Enterprise Zone, and would seem to be an effective piece of legislation to establish Enterprise Zones in the United States. The bill deals with most of the objections raised against its predecessor, and has helped to widen the coalition supporting the concept. The emphasis on small business and regulation should win support for the bill among the inner city entrepreneurs and neighborhood organizations whose talents the Enterprise Zone seek to encourage.

The important role of state and local governments is appreciated in the bill, and the measure is compatible with the Administration's view of federalism. With only minor amendments, the bill should dispel many of the fears of liberal and minority organizations that the Enterprise Zones may become a tax shelter for big business, where the benefits to the community would be confined to a trickle-down effect. While the 1981 Enterprise Zone bill may have its defects, it is nevertheless a bold attempt to set in motion a genuine "trickle up" process in the depressed inner cities.

Stuart M. Butler, Ph.D.
Policy Analyst

Summary of
Statement Prepared for the
Senate Subcommittee on Savings, Pensions, and Investment Policy
July 16, 1981
by

David L. Birch
MIT Program on Neighborhood and Regional Change

Over the past several years the MIT Program on Neighborhood and Regional Change has developed a file tracing the history of 5.6 million business establishments during 1969, 1972, 1974, and 1976. In the interest of understanding job creation within cities, we have, for a carefully selected sample of 10 metropolitan areas (Hartford, New Haven, Baltimore, Boston, Worcester, Rochester, Charlotte, Dayton, Greenville and Houston) identified the neighborhood in which each business is located. By so doing, we have been able to examine how different parts of different kinds of cities have been changing.

As a first step we wished to determine how important the movement of businesses might be to changes in cities and neighborhoods. We found that:

1. Movement between cities and suburbs is relatively insignificant for both;
2. Firms that do move (and there are a fair number of them each year) tend to move very short distances; and
3. At the neighborhood level, these short moves become noticeable, but are frequently counterbalancing -- i.e., in-moves and out-moves tend to cancel each other out.

Another striking feature of our findings is the constancy of the losses due to the deaths and contractions of establishments:

1. Losses (as a percent of the job base) are about the same in all cities each year
2. The loss rates are high, averaging about 8 percent per year, or about 50 percent of the job base every five years
3. Losses are slightly higher (not lower) in rapidly growing areas. The greater rates of innovation and entrepreneurship in these growth centers leads to higher risks and slightly higher losses.
4. Declining economies are not declining because they lose more jobs each year. They decline because they do not compete effectively for jobs to replace their losses the way growing areas do.

Replacement thus holds the key to growth or decline. Areas that compete successfully for births of new firms and expansion of existing ones are the ones that outpace others. In our effort to discover who creates replacement jobs in different parts of different cities, we discovered that:

1. The older and slower growing a city, and
2. The more centrally located a neighborhood,
3. The greater the share of replacement jobs that come from:

   a. Small companies

   b. Companies in the service sectors of the economy

Summarizing the area-wide results, we find:

Rate of Area Growth	% Area Net Growth Due to Manufacturing	% Area New Growth Due to Establishments w. over 100 employees
Fast	16.1%	36.2%
Moderate	-56.3	27.5
Decline	-138.7	-133.9

Minus percents indicate net losses that must be offset elsewhere.

If we perform the same analysis for the central cities of these areas, we find:

Rate of Area Growth	% Area's Net Growth Due to C.C. Manufacturing	% Area's Net Growth Due to C.C. estab. with 100 or more employees
Fast	3.5%	13.7%
Moderate	-64.3	-43.4
Decline	-143.0	-108.8

In other words, it is only the faster growing cities such as Houston and Charlotte that attract the larger and/or manufacturing companies. Other cities appear to be losing jobs in these categories which are offset by gains in the service sector and in smaller companies.

If we look, with even higher resolution, at minority neighborhoods, we find that:

1. Minority neighborhoods in the central city in general do poorly, except in rapidly growing areas.
2. Minority neighborhoods outside the central city in general do as well as any other kind of suburban neighborhood.
3. Central city minority neighborhoods in slower growing (or declining) areas rely entirely on service sector jobs for growth.

In sum, the older slower growing areas, and particularly the central cities of those areas, are undergoing a fundamental shift in the structure of their economies. Their manufacturing bases built up over the past 150 years, are falling apart very rapidly and are being replaced with almost equal speed by service sector economies dominated by smaller establishments. This is part of a nationwide trend in the same direction. But it is happening much faster in the older cities, and must be taken into account in planning for their futures.

JULY 16, 1981

STATEMENT OF RONALD C. KYSTAK
DIRECTOR, OFFICE OF ECONOMIC DEVELOPMENT
CITY OF NEW HAVEN, CONNECTICUT, PRESIDENT
OF THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT

BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE FINANCE COMMITTEE

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

IT IS MY DISTINCT PLEASURE TO BE HERE TODAY TO DISCUSS THE URBAN JOBS AND ENTERPRISE ZONE BILL. THIS LEGISLATION WHICH WOULD TARGET VARIOUS FEDERAL TAX INCENTIVES TO AREAS OF SEVERE UNEMPLOYMENT AND DISINVESTMENT IS OF GREAT INTEREST TO THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT AND ITS MORE THAN 1500 MEMBERS WHO PLAN AND IMPLEMENT ECONOMIC DEVELOPMENT ACTIVITIES IN OVER 400 CITIES AROUND THE COUNTRY. THE BILL'S EMPLOYMENT AND CAPITAL INVESTMENT INCENTIVES HAVE THE POTENTIAL TO BRING NEW ECONOMIC VITALITY TO AREAS WHICH HAVE BEEN WRITTEN OFF AS HOPELESS DUE TO THEIR GRAVE AND CONTINUING SOCIAL, ECONOMIC, AND PHYSICAL PROBLEMS.

BEFORE ADDRESSING SPECIFIC PROVISIONS OF THE ENTERPRISE ZONE BILL (S 1310), I WOULD LIKE TO BRIEFLY DESCRIBE THE RELATIONSHIP OF A TARGETED TAX PROGRAM TO ECONOMIC REVITALIZATION AND EMPLOYMENT - WHICH IS THE PURPOSE OF THIS LEGISLATION.

FOR ECONOMIC DEVELOPMENT TO OCCUR, WHETHER IT BE A SINGLE COMMERCIAL PROJECT, AN INDUSTRIAL PARK, OR AN ENTIRE CITY OR REGION, THE "ENVIRONMENT" MUST BE CONDUCIVE TO INVESTMENT.

THE COMPONENTS OF THIS ENVIRONMENT - EACH OF WHICH MUST BE PRESENT FOR DEVELOPMENT TO TAKE PLACE - INCLUDE:

1. AVAILABILITY OF DEVELOPABLE LAND OR SPACE AT A COMPETITIVE PRICE.
2. EXISTENCE OF INFRASTRUCTURE AND OTHER SUPPORTIVE SERVICES.
3. AVAILABILITY OF LOW COST CAPITAL.
4. EQUITABLE TAX SYSTEM.
5. TRAINED MANPOWER
6. PUBLIC SECTOR CAPACITY TO ASSIST DEVELOPMENT.

MOST AREAS FACING DISINVESTMENT ARE LACKING AT LEAST ONE OF THESE ELEMENTS. TAX INCENTIVES ALONE ARE NOT ENOUGH TO MAKE ONE PROJECT GO OR TO REVITALIZE AN ENTIRE AREA. FOR THAT MATTER, INFRASTRUCTURE BY ITSELF IS NOT A SUFFICIENT STIMULANT TO PRIVATE INVESTMENT. PROVIDING ONE TYPE OF INCENTIVE WITHOUT REGARD TO THE TOTAL ENVIRONMENT IS INEFFECTIVE AND IN SOME CASES COUNTERPRODUCTIVE.

RATHER IT IS A COMPLEX COMBINATION OF THESE PHYSICAL, FINANCIAL, AND LABOR COMPONENTS WHICH MAKE AN AREA RIPE FOR INVESTMENT. IN ASSESSING THE POTENTIAL SUCCESS OF ENTERPRISE ZONES, WE MUST EXAMINE WHAT OTHER ELEMENTS ARE NEEDED FOR PRIVATE INVESTMENT TO OCCUR. LOCAL EXPERIENCE HAS SHOWN US THAT TAX INCENTIVES OR ABATEMENTS WORK ONLY AT THE MARGIN IN STIMULATING PRIVATE INVESTMENT AND ARE NOT ENOUGH IN AND OF THEMSELVES.

IN REVIEWING THE SPECIFIC PROVISIONS OF THE URBAN JOBS AND ENTERPRISE ZONE ACT, LET ME FIRST EXPRESS OUR PLEASURE AT SOME OF THE CHANGES THAT HAVE BEEN MADE IN THIS BILL. THE LIMITATION OF ELIGIBILITY TO UDAG DESIGNATED AREAS INSURES THAT THE BENEFITS OF THIS LEGISLATION ARE DIRECTED TO THE AREAS OF GREATEST

NEED. FURTHERMORE, WE WELCOME THE BILL'S EMPHASIS ON LOCAL DISCRETION AND FLEXIBILITY IN THE DESIGNATION OF THE ZONE AND IN THE SELECTION OF LOCAL RESOURCES TO BE PROVIDED TO THE ZONE. THE UNIQUE PHYSICAL AND ECONOMIC OBSTACLES TO INVESTMENT IN VERY DISTRESSED AREAS OF OUR CITIES NECESSITATES THIS FLEXIBLE APPROACH WITH HEAVY LOCAL INVOLVEMENT.

BEFORE DETAILING OUR SUGGESTIONS FOR IMPROVING THE ENTERPRISE ZONE BILL, I WOULD LIKE TO ESTABLISH OUR OVERALL CONCERNS. FIRST, THE TAX INCENTIVES PROVIDED FOR ENTERPRISE ZONES MUST BE EXAMINED IN LIGHT OF THE GENERAL TAX BILLS PENDING IN BOTH HOUSES. THERE MUST BE A SIGNIFICANT BENEFIT DIFFERENTIAL BETWEEN GENERAL BUSINESS TAX CUTS AND THOSE AVAILABLE TO FIRMS WHICH LOCATE IN ENTERPRISE ZONES, FOR THE ENTERPRISE ZONES TO BE SUCCESSFUL. AS I STATED EARLIER, TAX INCENTIVES WORK AT THE MARGIN. THERE ARE MANY OTHER FACTORS INVOLVED IN A FIRM'S DECISION (TRANSPORTATION ACCESS, FINANCING, MARKET, ETC.) WHICH ARE FAR MORE CRITICAL. HOWEVER, WHEN TAX LIABILITY IS A FACTOR, THE INCENTIVE MUST BE DEEP ENOUGH TO HAVE AN EFFECT.

SECOND, SOME OF THE PREREQUISITES FOR PRIVATE INVESTMENT SUCH AS DEVELOPABLE LAND AND INFRASTRUCTURE ARE TRADITIONALLY THE RESPONSIBILITY OF THE PUBLIC SECTOR. MANY CITIES WHICH NEED ENTERPRISE ZONES HAVE FEW RESOURCES - AND, IN SOME INSTANCES, DECLINING RESOURCES - TO TARGET TO AN ENTERPRISE ZONE. THUS, IT IS IMPORTANT THAT FEDERAL DEVELOPMENT ASSISTANCE SUCH AS HUD, EDA, SBA, AND LABOR BE USED TO FILL THE GAP OR SUPPLY THE MISSING COMPONENT TO PRIVATE INVESTMENT.

THIRD, THE LACK OF START-UP CAPITAL FOR FIRMS LOCATING IN THE ZONE REMAINS A MAJOR CONCERN. THE CONTINUED HIGH COSTS

OF BORROWING AND THE LACK OF AVAILABLE CAPITAL PARTICULARLY TO NEW OR SMALL BUSINESS COULD LIMIT THE POTENTIAL SUCCESS OF ENTERPRISE ZONES.

OUR SUGGESTED MODIFICATIONS TO S 1310 FALL INTO THE FOLLOWING CATEGORIES:

1) INCENTIVES FOR PRODUCTION AND INVESTMENT;

2) INCENTIVES FOR JOB CREATION FOR DISADVANTAGED WORKERS;

3) PROCEDURES FOR SELECTING AND ADMINISTERING THE ZONES.

INCENTIVES FOR PRODUCTION AND INVESTMENT

THE TAX INCENTIVES PROVIDED IN THE BILL COULD HAVE A SUBSTANTIAL IMPACT ON PRIVATE INVESTMENT DEPENDING ON THE COST STRUCTURE AND FINANCIAL DECISIONS OF A FIRM. HOWEVER, WE ARE CONCERNED THAT THE BUSINESS TAX CUTS PENDING IN CONGRESS COULD WEAKEN THE EFFECTIVENESS OF THE ZONE INCENTIVES. OUR SUGGESTIONS ON ADDTIONAL OR DEEPER TAX INCENTIVES ARE AN ATTEMPT TO CREATE A SUBSTANTIAL DIFFERENTIAL BETWEEN THE TWO, FAVORING INVESTMENT IN THE ZONE.

FOR THIS REASON, THE ACCELERATED DEPRECIATION PROVISIONS IN AN ENTERPRISE ZONE SHOULD BE MORE ATTRACTIVE THAN THE GENERAL DEPRECIATION ALLOWANCES PENDING IN CONGRESS. PERHAPS A THREE YEAR STRAIGHT LINE SCHEDULE FOR ALL PROPERTY UP TO $500,000 SHOULD BE CONSIDERED. FURTHERMORE, THE REHABILITATION INVESTMENT TAX CREDITS FOR OLDER AND HISTORIC PROPERTIES CURRENTLY CONTAINED IN THE PENDING GENERAL TAX BILL SHOULD BE CONSIDERED IN DETERMINING THE EFFECTIVENESS OF ENTERPRISE ZONE INCENTIVES.

SINCE ACCELERATED DEPRECIATION IS NOT AN INCENTIVE FOR BUSINESS WITH LITTLE OR NO TAX LIABILITY, A REFUNDABLE INVEST-

MENT TAX CREDIT SHOULD BE PROVIDED FOR ZONE FIRMS. THIS WOULD PARTICULARLY BENEFIT NEW OR SMALL BUSINESSES.

THE EXISTENCE OF SEED CAPITAL TO ENCOURAGE BUSINESS START-UPS AND EXPANSIONS IS CRITICAL TO THE SUCCESS OF THE ENTERPRISE ZONES. CUED BELIEVES THE INCOME TAX REDUCTION FOR INVESTORS IN THE ZONE IS AN IMPORTANT INCENTIVE FOR CAPITAL FORMATION IN THE ZONE. WE WOULD SUGGEST, HOWEVER, THAT THIS INCENTIVE BE DEEPENED, PARTICULARLY IN THE EARLY YEARS WHEN THE RISK TO THE INVESTOR IS GREATEST. THE DEDUCTION COULD BE ON A SLIDING SCALE DECREASING IN LATER YEARS WHEN THE ZONE IS A MORE ATTRACTIVE AND LESS RISKY INVESTMENT.

SINCE FISCAL AUSTERITY PROHIBITS THE CREATION OF NEW SOURCES OF FEDERAL DEVELOPMENT ASSISTANCE, CUED ALSO RECOMMENDS THAT SBICS BE ALLOWED TO INVEST IN ZONE FIRMS AT A HIGHER RATE OF PUBLIC TO PRIVATE DOLLARS. THIS WOULD MAKE IT EASIER FOR SBICS TO OPERATE IN ENTERPRISE ZONE.

INCENTIVES FOR JOB CREATION

USING CETA ELIGIBILITY AS A BASIS FOR QUALIFYING FOR CERTAIN TAX INCENTIVES IS AN EXCELLENT METHOD OF TARGETING AND IS FAR MORE APPROPRIATE THAN A RESIDENCY REQUIREMENT. ALTHOUGH CUED SUPPORTS THE TARGETING OF LABOR INCENTIVES TO CETA ELIGIBLE PERSONS, WE BELIEVE THAT REQUIRING FIRMS TO HIRE 40 PERCENT OF THEIR NEW WORKERS FROM AMONG CETA ELIGIBLE PERSONS MAY, IN SOME INSTANCES, BE TOO RESTRICTIVE. THIS PROVISION COULD DISCOURAGE SOME BUSINESSES FROM ENTERING OR EXPANDING IN THE ZONE. IT COULD ALSO BE PARTICULARLY BURDENSOME ON SOME SMALL BUSINESSES OR FIRMS WITH UNIQUE SKILL REQUIREMENTS.

TO MAINTAIN THE FOCUS ON EMPLOYMENT FOR CETA ELIGIBLE PERSONS BUT TO PREVENT INADVERTENTLY DISCOURAGING CERTAIN FIRMS WHICH MAY NOT MEET THE EMPLOYMENT REQUIREMENT, WE SUGGEST THAT A WAIVER OR A SLIDING SCALE OF INCENTIVES BE USED.

A SECOND CONCERN WITH THE BILL'S EMPLOYMENT RELATED PROVISIONS IS THE REQUIREMENT THAT EXISTING FIRMS EXPAND THEIR WORKFORCE BY 10 PERCENT TO BE ELIGIBLE FOR THE SPECIAL CAPITAL GAINS TREATMENT. WE RECOGNIZE THAT THIS REQUIREMENT IS INCLUDED TO PREVENT WIDESPREAD SPECULATION AND TURNOVER, BUT THE ADDITION OF 10 PERCENT OF A FIRM'S WORKERS COULD BE DIFFICULT IN SOME INSTANCES. MORE IMPORTANTLY, REGULATIONS MAY BE NEEDED TO INSURE THAT IT IS A REAL GROWTH IN EMPLOYMENT NOT SIMPLY A TEMPORARY INCREASE. THIS WOULD AVOID THE HIRING AND FIRING OF EMPLOYEES, PARTICULARLY BY SEASONAL FIRMS, TO GAIN THE TAX ADVANTAGE.

FINALLY, WE ARE CONCERNED THAT THE TAX CREDITS, INCLUDING THE 5 PERCENT REFUNDABLE BUSINESS INCOME TAX CREDIT, IS NOT ENOUGH TO STIMULATE JOB CREATION FOR THE DISADVANTAGED. HISTORICALLY, EMPLOYEE TAX CREDITS HAVE NOT BEEN SUCCESSFUL IN MOTIVATING FIRMS TO HIRE THE HARD CORE UNEMPLOYED. NO TAX CREDIT WILL GET AN EMPLOYER TO HIRE SOMEONE WHO IS NOT ABLE TO DO THE JOB. IT IS JUST NOT GOOD BUSINESS.

JOB TRAINING IS A MAJOR COMPONENT MISSING FROM THIS LEGISLATION. IDEALLY, ADDITIONAL JOB TRAINING FUNDS FOR THE ZONES IN COORDINATION WITH LOCAL MANPOWER AND TRAINING CENTERS OR PRIVATE INDUSTRY COUNCILS SHOULD BE PROVIDED TO THE ZONES.

HOWEVER, GIVEN THE LEGISLATION'S EMPHASIS ON TAX INCENTIVES, WE RECOMMEND THAT THE REFUNDABLE TAX CREDIT BE DEEPENED TO 50

PERCENT OF THE WAGES PAID TO CETA ELIGIBLE WORKERS. THIS WOULD ALLOW FIRMS TO HIRE THE UNSKILLED AND PROVIDE THE NECESSARY TRAINING.

TO ENCOURAGE RETENTION SO THAT THE WORKERS CAN GET THE NECESSARY TRAINING AND EXPERIENCE, WE SUGGEST THAT THE FIRM SHOULD NOT BE ELIGIBLE FOR THE CREDIT UNTIL THE WORKER HAS BEEN EMPLOYED BY THE FIRM FOR 6 MONTHS. THE CREDIT WOULD THEN BE RETROACTIVE TO THE DATE OF HIRE.

SELECTION AND ADMINISTRATION OF THE ZONE

IN SELECTING AREAS AS ENTERPRISE ZONES, THE NEED FOR THE PRIVATE INVESTMENT AS WELL AS THE POTENTIAL FOR ECONOMIC GROWTH SHOULD BE BALANCED. LIMITING ELIGIBLE CITIES TO UDAG DESIGNATED AREAS IS AN IMPORTANT WAY OF TARGETING THE ZONES TO THE AREAS OF GREATEST NEED. IN REVIEWING APPLICATIONS, THE SIX COMPONENTS WHICH ARE NECESSARY FOR PRIVATE INVESTMENT TO OCCUR SHOULD BE USED AS A BENCHMARK FOR POTENTIAL SUCCESS. IF ONE OF THESE COMPONENTS IS MISSING, THE FEDERAL AGENCY, HUD, SHOULD FACILITATE THE NECESSARY ASSISTANCE WITH OTHER FEDERAL AGENCIES, THE STATE, CITY, PRIVATE SECTOR, AND OTHERS. GIVEN THE LIMITED NUMBER OF ZONES PROVIDED THROUGH THIS LEGISLATION, A CUSTOMIZED PACKAGE OF ASSISTANCE AND INCENTIVES SHOULD BE CREATED.

MANY ARE ASKING WHAT ROLE THE STATE CAN PLAY IN AN ENTERPRISE ZONE. CONNECTICUT HAS JUST PASSED ITS OWN VERSION OF ENTERPRISE ZONES SO I AM FAMILIAR WITH THIS ISSUE. THE ABILITY OF THE STATE TO PROVIDE ADDITIONAL TAX INCENTIVES TO ZONE FIRMS AND TARGET STATE PUBLIC WORKS AND JOB TRAINING FUNDS IS CRUCIAL TO THE SUCCESS OF ENTERPRISE ZONES, WHETHER STATE OR FEDERALLY CREATED.

IN CLOSING, I WOULD LIKE TO ADDRESS THE ROLE OF FEDERAL DEVELOPMENT PROGRAMS IN BOTH ENTERPRISE ZONES AND RELATED LOCAL ECONOMIC DEVELOPMENT. THE ASSISTANCE PROVIDED BY HUD, EDA, SBA, AND OTHERS IS AN INVESTMENT. LIKE ANY PRIVATE INVESTMENT, THESE PUBLIC DOLLARS HAVE A MULTIPLIER EFFECT IN TERMS OF ADDITIONAL JOBS, TAX BASE, AND NEW BUSINESS VENTURES. COMBINING THESE FEDERAL DEVELOPMENT PROGRAMS WHEN NEEDED WITH THE ZONE'S TAX INCENTIVES IS NECESSARY IF ENTERPRISE ZONES ARE TO BE ATTRACTIVE FOR PRIVATE INVESTMENT THUS BRINGING JOBS AND TAX BASE TO THE COMMUNITIES AND PEOPLE WHO NEED THEM.

THANK YOU.

American Planning Association
1776 Massachusetts Ave., N.W.
Washington, DC 20036
Phone 202.872.0611

STATEMENT OF

IRVING HAND, AICP
PRESIDENT
AMERICAN PLANNING ASSOCIATION

and

GAIL GARFIELD SCHWARTZ, AICP
ECONOMIC DEVELOPMENT DIVISION
AMERICAN PLANNING ASSOCIATION

On Behalf Of The
AMERICAN PLANNING ASSOCIATION

Before A Hearing Of The
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
COMMITTEE ON FINANCE
UNITED STATES SENATE

ON S. 1310
THE URBAN JOBS AND ENTERPRISE ZONE ACT

July 16, 1981

Mr. Chairman and Members of the Subcommittee on Savings, Pensions and Investment Policy:

My name is Irving Hand. I am Professor of State and Regional Planning, Chairman of the Department of Urban and Regional Planning, and Director of the Institute of State and Regional Affairs of the Pennsylvania State University at the Capitol Campus. In my 35 years in planning, I have been State Planning Officer for Pennsylvania and Planning Director for the Nashville, Tennessee Metropolitan Planning Commission. I am a member of the American Institute of Certified Planners (AICP). I am also President of the American Planning Association, and it is in this capacity that I appear here today.

Joining me on behalf of the APA is Dr. Gail Garfield Schwartz, AICP, President of Garfield Schwartz Associates, economic and development consultants in Washington, D.C. Dr. Schwartz has extensive experience in urban economic policymaking and implementation at the local, state and national levels. She is a former senior fellow in economic and community development of the Academy for Contemporary Problems and is the author of the Economic Development Planning Policy of the American Planning Association, adopted at a national delegate conference in February and ratified by our Board in April of this year.

One element of this policy speaks directly to S. 1310:

APA's policies on Economic Development call for "better links between government and the private sector. . . to plan for long-term profitability of firms in a given area--involving all levels of government as well as the private sector. In this effort, the Federal government should take the lead in working with state and local governments to develop strategies to meet specific needs of industries and sectors."* The Urban Jobs and Enterprise Zone bill is one such strategy.

We welcome this opportunity to testify on behalf of the American Planning Association on S. 1310, the Urban Jobs and Enterprise Zone Act, introduced by Senators Boschwitz and Chafee. We respectfully request that the complete text of our prepared statement be included in the hearing record.

The American Planning Association is a national organization of 21,000 city and regional planners, including elected and appointed officials at all levels of government, professional practitioners, educators, interested citizens and students. Our membership belongs to 46 Chapters covering virtually every state and Congressional district, and to 18 Divisions, such as an Economic Development Division and a City Planning and Management Division, composed of members with special planning interests.

The American Planning Association is the result of a 1978 consolidation of the American Institute of Planners, established in 1917, and the American Society of Planning Officials, founded in 1934.

* Economic Development Policy of the American Planning Association, adopted 1981

The Association's primary objective is to advance the art and science of planning for the unified development of communities, cities, regions, states and the nation. Within APA, the umbrella organization, is the American Institute of Certified Planners, which focuses on professional development and whose members are distinguished by having passed an examination on planning principles and practice.

Our membership, and particularly those serving in local planning organizations, have a special interest in this legislation. Planners will have a key role to play in advising the chief elected officer and members of the city council on a city's enterprise zone options. Local planners will actively participate in defining potential enterprise zones, in compiling information to meet eligibility requirements and in simplifying governmental regulations including zoning. In short, planners will most likely be responsible for putting together the local package of incentives required by the legislation in Section 101. Planners will also be heavily involved in relating enterprise zone objectives to locally adopted development plans and citywide objectives.

It is for these reasons that we have carefully examined enterprise zone legislation introduced in the last and in this Congress.

We would like to commend Senators Chafee and Boschwitz, Representatives Kemp and Garcia, their staffs and the others who worked on this bill. The revised version corrects many of the problems that we had identified with the legislation introduced in the last Congress. S. 1310 improves upon the earlier version in the following ways:

1. Only improved or newly constructed residential property within the zone qualifies for a capital gains tax break, thus encouraging the improvement of the housing supply within central cities.
2. Local real estate tax reductions are no longer required. This requirement would have resulted in conflicts with the constitutions of some states.
3. Only new businesses, or existing businesses which increase employment, qualify for the capital gains tax break, thus reinforcing the job creation purpose of this bill; and
4. A balance is struck between benefits available to labor-intensive firms and benefits available to capital-intensive firms. This bill gives employment tax credits to the employer as well as the employee.

As professionals dedicated to improving the urban environment, we support this bill and believe that its implementation will have positive results. We must point out to the members of the Subcommittee that it will take very careful planning, very skillful monitoring, and very dedicated control in order for enterprise zones to succeed where earlier social experiments have missed their mark. Above all, we must be keenly aware of the constraints within which enterprise zones must operate, particularly in relation to essential supporting governmental actions.

Let me address this last point briefly, and then turn over the testimony to Dr. Schwartz, who will discuss the context of the economic criteria within which firms in enterprise zones must operate to succeed, and make some specific comments and suggestion.

First, and foremost, the Urban Jobs and Enterprise Zone Act should not be viewed as a panacea which will, by itself, solve economic development problems of depressed urban areas. It is, however, an important tool which must be used in combination with other local actions to have its intended positive impact. Cities must provide physical improvements and a high level of public safety and other services needed in such zones. Sites must be assembled and existing buildings acquired for new employers. Loans, grants and technical assistance must be available to assist businesses to get their start. Job training programs must be targeted within such zones to help residents qualify for the new jobs to be created. All of these actions, concentrated and coordinated within the designated zones, can effect the necessary economic turnaround.

In this regard, we believe that the Department of Housing and Urban Development as the lead agency, and as the agency responsible for developing the Congressionally-mandated President's Report on Urban Policy, due in 1982, has a unique chance to address the criticism that "Enterprise zones do not an urban policy make." What better opportunity for fitting enterprise zones, now the "only game in town," into an urban policy that coordinates Federal programs, interrelates economic development, energy, housing, environmental quality and other national concerns, and provides a basis for reexamining the future of many programs that are now being jettisoned?

My colleagué, Dr. Schwartz, will now address the economic criteria for success of this program.

Thank you, Irving.

The success or failure of business and employers within enterprise zones will depend in large part on meeting a range of economic requirements. There must be both risk and debt capital, because, even if debt financing is available, it might not be sufficient to encourage really vital new industries. There must be skilled labor at a reasonable price. There must be a "critical mass" of business to make the enterprise zone system work, that is, a sufficient number of qualified businesses located in the zone and enough private investment for the local government to be able to make improvements and offer services that are economically justified. We believe that, in reviewing applications, HUD should be looking at how communities address these economic prerequisites for success.

The balance of my comments on the specifics of the bill follow the order in which they appear in the bill.

In regard to priority of zone designation (Section 101f), APA advocates giving high priority to communities that have the best plans and the greatest community support. In reality, these are two elements of a single package--a good plan is not a good plan unless you have community support for it. Greatest distress should not be a principal criterion for selecting enterprise zones, because, by definition, any zone that would be eligible in the first place has reached a threshold level of distress. Areas that are the most distressed will have little chance of success, unless the community leaders have dedicated their time and energy to feasible planning.

We have a number of comments to make on the subject of the required local commitment and course of action (Section 101d). We welcome the provision that the course of action can be implemented with any Federal program funds. In fact, localities should be encouraged to designate Community Development Block Grant (CDBG) areas as enterprise zones. This would make it possible for localities to use Federal funds not only for public purposes related to community development but also to assist private firms. This may become an eligible CDBG activity in the Housing and Community Development Amendments of 1981, now under consideration. Tying in Community Development Block Grant areas to enterprise zones brings a degree of rationality and coherence to the local efforts.

On the matter of regulations, our research shows that interested communities can take action to simplify or streamline governmental requirements without jeopardizing the public welfare. In a recently released report by the American Planning Association entitled <u>Streamlining Land Use Regulation, A Guidebook for Local Government</u>, APA describes and evaluates over 35 techniques that communities are currently using to simplify the administration of their zoning, subdivision, environmental and site development ordinances. Some of these techniques result in savings in public and private costs of development. Examples are:

- "permit expeditors" to help get development applications through the interdepartmental maze;
- simultaneous review of multiple permits;
- simplified staff review; and
- advance conditions for approval of routine cases.

APA recommends a slightly more precise definition of a "course of action" to encourage the kind of careful planning that we believe is essential to a successful enterprise zone. We conclude that the local government should be required to include a "development incentive strategy" for any proposed zone as part of its application for designation. That strategy would set forth a three-year commitment for participation in such actions as: local tax reduction; relaxation of local zoning, building and business regulations; public improvements; increased security and other public services; site assembly and building acquisition; and targeted job training and other economic development efforts. Thus, local governments with differing situations and differing resources could prepare different strategies specifically adapted to their unique needs. Local governments should be required to monitor the success of the overall effort, and to update the strategy at least every three years.

APA also recommends that there be no limit to the number of enterprise zones that can be created (Section 101e-2). The loss to the Treasury would not outweigh the benefits to the local economy, particularly because in the first years of doing business new, small firms are not very profitable and would not be paying much Federal income tax.

We wish to make these comments on the subject of qualified businesses:

First, the bill, by excluding firms which are doing less than 50 percent of their business in the zone, effectively precludes the branching of large corporations in these zones. Some of our constituents have questioned this limitation in light of the trend in our economy toward larger and larger units. This means that a larger segment of our economy would be excluded from enterprise zone benefits. We suggest that this provision be carefully monitored, and at some future date, depending on the results, this provision should be reconsidered.

Second, for equity purposes, consideration should be given to excluding certain firms from enterprise zone benefits. Let me illustrate with the example of two dry cleaning establishments located on the same road but on opposite sides of the enterprise zone boundary. The one within the zone, because of the bill's tax benefits, may hold an unfair advantage over the other. It may be able to undersell its competitor and thus drive the competitor out of business and cause a loss of jobs. One way to guard against this occurrence would be for the legislation itself to preclude certain kinds of enterprises from the benefits. To make certain that legislative intent is met, we would prefer that the legislation itself, rather than the regulations, address this problem. Our experience with industrial revenue bonds, for example, has shown that communities have used them to finance shopping centers that helped drain retail activity away from central cities and older neighborhoods. The same could happen with enterprise zones, where the availability of tax breaks will help drain certain kinds of retail activity from one part of the community into another, without a net community-wide benefit.

The condition for qualification of existing business should hinge not on a ten percent increase in the "average number of employees," but rather on a net increase in "qualified" employees only. It does little good if a firm expands employment by ten percent or more but hires no additional qualified residents of the enterprise zone. Another technical point to be considered is that "increases in employment" should be measured in total number of hours worked, rather than in number of qualified employees. This will avoid discrimination against firms that employ fewer than ten persons.

Finally, in closing, the American Planning Association wishes to recommend careful monitoring of enterprise zones. We believe that the bill should require that, before designating any enterprise zones, the Department of Housing and Urban Development should have a clearly defined, written monitoring and evaluation design which will accommodate all conceivable varieties of enterprise zones. By going through this discipline, HUD will know that the rules and regulations it will promulgate are useful, in the sense that the outcome of the program can be analyzed. We need to know precisely what we are going to measure before we start doing it.

In addition, since the Urban Jobs and Enterprise Zone approach is basically experimental, a section should be added to the bill to require the Secretary of HUD to report to Congress each year after the thi.d year of the program on the findings of the monitoring effort and on the measurable benefits of the bill.

In conclusions, we commend the authors of the bill for their careful and thoughtful work and ambitious agenda. We support the legislation, we hope our suggestions are of benefit to the Subcommittee, and we would be delighted to work with the Subcommittee and its staff on this important legislation.

[Whereupon, at 12:48 p.m., the hearing adjourned, subject to the call of the Chair.]

[By direction of the chairman, the following communications were made a part of the hearing record:]

SENATOR DAN QUAYLE

Statement in Support of S. 1310
Urban Jobs and Enterprise Zone Act

Mr. Chairman, I am pleased today to have this opportunity to express my support for the Urban Jobs and Enterprise Zone Act of 1981. As a cosponsor of this bill, I realize that creation of these enterprise zones will not be a panacea for our urban ills. But I also realize that it is only through the creation of incentives to promote new business, jobs, and entrepreneurship that economically depressed regions can be truly helped. Creation of incentives for new enterprise must become a major goal for this Congress.

Whatever plan for enterprise zones is ultimately adopted, I believe it must be managed through the existing framework of local government. Thus, I am particularly grateful to the Subcommittee for the courtesy you have shown John M. Mutz, Lieutenant Governor of Indiana, in your hearings today. Participation by our State and local government officials in the development of enterprise zones is necessary to ensure an effective role for elected representatives of local people. Likewise, involvement of local officials in the operation of enterprise zones is an essential ingredient for their success. The Governor of Indiana recently signed into law legislation which will create an Enterprise Zone Commission. That commission will identify certain local taxes, rules and regulations to be made exempt in designated enterprise zones. With the early participation and dedication of officials like John Mutz, I believe we can bring a workable plan for enterprise zones to fruition. I am certain the Subcommittee will benefit by the views brought by Indiana's Lieutenant Governor, who has a long-standing interest in the enterprise zone concept.

Several key elements of the enterprise zone must be kept in mind: Our goal is to create new economic wealth--not simply to redistribute economic activity away from existing neighborhoods. The enterprise zone regulations must be kept simple, both at the Federal and the State level. Any policy aiming to revive depressed areas must emphasize individual effort and entrepreneurship, and not larger well established operations. Finally, this bill proposes a bold new experiment, and as such provides for not more than 25 enterprise zones to be created each year for a three-year period.

I believe that if the enterprise zone can be constructed in such a way as to create new economic prosperity, rather than just transfering the old, the concerns about possible revenue losses will be unfounded. We cannot tax profits which are not now being earned. Our purpose is to generate new business in depressed areas, not to drain investment and tax revenues from other neighborhoods. Thus to lower tax rates upon new profitable enterprises, which otherwise would not be established, will not result in a reduction of current tax revenues. Further, the establishment of a specified number of zones and a time limit for their creation will work to limit the total revenue costs of this program.

This proposal does not assume that cities have been idle in their attempts to ameliorate urban decay. For decades, resources on an ever increasing scale have been directed toward improving the lot of the urban poor. But with what result? Our States and local governments have long awaited the kind of Federal tax incentives for depressed areas which this bill will provide. With the passage of this Urban Job and Enterprise Zone Act we can embark on a truly unique approach to free enterprise, revitalizing our urban centers, and creating new jobs.

ILGWU

MG

July 24, 1981

Senator John H. Chafee
Chairman
Subcommittee on Savings, Pensions
and Investment Policy
Committee on Finance
U. S. Senate
Washington, D. C. 20510

Dear Senator Chafee:

The International Ladies' Garment Workers' Union welcomes this opportunity to comment on S. 1310, the Urban Jobs and Enterrpise Act. Over the past two decades, tens of thousands of jobs have been lost in our industry as a result of the rapid increase in apparel imports. Many additional jobs have been lost in legitimate shops as a result of the proliferation of employment of undocumented workers, who, because of their status, are forced to work in shops where the basic laws that protect workers are constantly violated.

More than 300,000 members of the ILGWU, many of whom come from minority groups, are, therefore, deeply concerned with the need to maintain present jobs and to create additional ones. We do not believe, however, that S. 1310, as written, will serve its announced purpose of creating additional jobs and revitalizing blighted urban areas.

Detailed criticism of the provisions of the bill is contained in the testimony presented to this Subcommittee on July 13, 1981 by Arnold Cantor and Stephen Koplan of the American Federation of Labor & Congress of Industrial Organizations. We agree with their comments and wish, in addition, to elaborate on some of the criticism of the proposed legislation.

The basic premise of the bill is that incentives to business to invest in economically depressed areas through various forms of tax abatement will lead to the creation of new jobs. Unfortunately,

INTERNATIONAL LADIES' GARMENT WORKERS' UNION, 1710 BROADWAY, NEW YORK, N.Y. 10019, TEL. 212/265-7000

AFL-CIO

Senator John H. Chafee
Chairman
Subcommittee on Savings, Pensions
and Investment Policy

July 24, 1981

this is not likely to be the result in the apparel industry which has been on the decline in the United States. In 1980, employment in the industry was 11.4 percent below its 1973 peak. Three years ago, the Bureau of Labor Statistics projected a growth of less than 1 percent a year through 1990, but even this miniscule growth is probably overoptimistic. As a result, creation of new jobs in any geographic area in this industry must, unavoidably, lead to a decline elsewhere.

There are few ties to bind our industry to a given area. Raw materials and power supplies are not major factors. The chief requirement is an abundant labor supply that can be given the brief training most jobs in the industry require. Small scale and low capitalization make the apparel industry one of the most mobile.

The industry is a key source of employment for members of minority groups, for women and for recent immigrants with language problems. Large numbers of apparel plants already exist in the distressed urban areas the proposed legislation purports to aid. They are there because the labor supply they need is there.

Passage of S. 1310 would, therefore, not create any new jobs but merely shift existing jobs from one depressed area to another and from one minority group to another. The wasteful and often harmful effects of government subsidy to the apparel industry have been recognized for many years. It was for this reason that the Congress and the Executive Branch time and time again excluded industries such as apparel from a wide range of subsidy programs to industry.

In addition, employers with multi-plant operations would be encouraged to use "creative bookkeeping" to maximize profits in areas where tax incentives exist, while concentrating losses in locations elsewhere. This would be particularly encouraged in labor intensive industries, since a firm's tax benefits under the proposed law would relate to its income and not to the number of people it employed or the amount of money it invested.

While we oppose the specific bill under consideration, we are not unmindful of the need to create jobs and to rebuild our inner cities, nor are we against tax concessions in all cases. We are, however, convinced that, to be effective, tax reductions should occur only as part of a national program, one which involves all sectors of the economy and makes use of all of the tools at the disposal of the government.

Senator John H. Chafee
Chairman
Subcommittee on Savings, Pensions
and Investment Policy

July 24, 1981

To this end, we call your attention to H. R. 3218, which would help firms that are suffering from unfair imports and new industries by targeting funds to both types of industries and to areas where the need is great and the cost and risk relatively low.

Sincerely,

Wilbur Daniels

Wilbur Daniels
Executive Vice President

wd/dg
opeiu 153

NATIONAL TAXPAYERS UNION

A NONPARTISAN, NONPROFIT ORGANIZATION DEDICATED TO THE PUBLIC INTEREST

325 PENNSYLVANIA AVENUE, SOUTHEAST WASHINGTON, DISTRICT OF COLUMBIA 20003 TELEPHONE: AREA CODE (202) 543-1300

James D. Davidson
Chairman

George E. Snyder
President

August 3, 1981

Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions, and Investment Policy
Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Senator Chafee:

The National Taxpayers Union would like to take this opportunity to reaffirm its support of the enterprise zone concept. As one of the organizations to endorse the idea after it was proposed last summer in legislation introduced by yourself and Senator Rudy Boschwitz, we remain committed to the belief that the job of rebuilding the nation's cities can best be achieved not by more government expenditures, but by reducing government imposed burdens. However, we would urge caution against passage of any enterprise zone bill that does not make substantial reductions in both taxes and government regulations. In order to fully release entrepreneurial energy in these areas, real relief is needed. Minor tax changes may not do the job.

Enterprise Zones present a unique opportunity to demonstrate the effect of reduced government intervention in the economy. The concept recognizes that the government itself is one of the prime causes of urban blight. Government taxation and economic regulation have frustrated the private enterprises that would otherwise be developed.

Since the introduction of the Enterprise Zone idea to America in 1980, the response has been overwhelming. Support has been voiced by liberals and conservatives alike. State legislatures have also shown enthusiasm for the concept. Five states have enacted enterprise zone legislation within the last year, and as many as fifteen others may soon follow suit. It is estimated that 71 bills are now pending in state legislatures on the topic. Enterprise Zones have caught the imagination of policymakers across the nation.

We believe that S. 1310 is a positive step toward a successful zone program. Several of the revisions made from S. 2823, introduced in the last Congress, are improvements. Particularly important are the total elimination of capital gains taxes on new investment in the zone, and the 50% exclusion for either business profits or interest received from loans to zone businesses. These are welcome additions to the bill, as they will greatly aid the formation of venture capital for new business.

We also applaud the replacement of the Social Security reduction provisions in S. 2823 with corporate and personal income tax credits. Although Social Security taxes are a barrier to employment, we felt the reimbursement to the system from general revenues set an undesirable precedent.

Several changes should be made in the income tax provisions. First, the reduction in taxes would be more effective if it were larger.

Second, we object to the refundability feature of the business and tax credits. When a taxpayer receives a credit worth more than he paid in taxes, it is no longer a tax break but is a government subsidy. This runs counter to the purpose of the program. A subsidy is a return to the policies of the past, where a business receives cash merely for existing, regardless of whether or not it is efficient or has met consumer needs. This feature should be eliminated.

S. 1310 also includes a requirement that zone businesses hire 40% of their workforce from among C.E.T.A. eligible employees. This requirement should be deleted. It is of only doubtful benefit to zone residents, while it could prove harmful to new businesses.

New enterprises in a zone already face great obstacles in maintaining a successful business. Owners of small businesses in zones must contend with high crime rates, unsatisfactory local services, and a deteriorated physical environment. There is no need to impose upon them added regulatory burdens in order to qualify for the zone program. While it may appear that the 40% requirement will provide needed help to semi-skilled workers in a zone, it should be noted that no one would be helped by an enterprise that never gets off the ground. The best way to serve the employment needs of the semi-skilled is to remove as many obstacles to new business as possible and induce strong economic growth in the zone.

One major deficiency in the 1980 bill was the lack of any provision reducing federal regulations. In many instances regulations are a larger obstacle to the founding and operation of a small business than the tax burden. The delay, cost, and general red tape caused by regulation may easily discourage potential small businessmen. The provision in S. 1310 that includes zone enterprises under the provisions of the Regulatory Flexibility Act is a step toward easing this problem. This Act requires regulators to search for alternate, less burdensome regulations and may help reduce some unnecessary burdens. But it does not give clear, immediate regulatory relief to entrepreneurs. We would urge such additional reforms such as the easing of Occupational Safety and Health Act (OSHA) standards, the elimination of the minimum wage requirements, and a drastic across the board cutback in federal paperwork requirements. If the zone concept is to succeed, half-hearted attempts at easing regulation cannot be accepted. The changes must be substantial if enterprise zones are to live up to their potential.

Another major change in this year's Urban Jobs and Enterprise Zone Act is the change in the required local government commitment. Instead of requiring a flat 20% local property tax reduction, a more flexible system has been proposed where each local government will be free to offer its own reforms, including various factors such as reduced taxes or regulations, subject to the approval of the Department of Housing and Urban Development (HUD). In effect, local governments would have to negotiate an acceptable "contract" with HUD in return for zone status. This new and imaginative approach would have two positive benefits. First, it will allow local relief to be tailored according to local conditions, not an arbitrary national standard. Second, it will encourage local areas to take an active role in fashioning local relief. It is hoped that this will lead to competition among localities to determine the best and most effective package.

We are concerned, however, that S. 1310 gives no guidelines to HUD for minimum requirements for a local commitment. Possibly, certain nationwide standards could be set requiring, for example, a ceiling on taxes. This would ensure the integrity of the program, while retaining local flexibility.

Revitalization of an urban area, of course, requires changes in social, as well as economic, factors. Such factors as the crime rate and physical condition of the neighborhood can be deterrent to renewal. Research conducted by Sabre Foundation shows that establishment of neighborhood associations within the zones could help solve these problems. Associations which have successfully activated local residents could be deeded government-owned vacant land inside the zone, thus giving residents an equity stake in the area. As the neighborhood improves, the value of this equity would rise and its lease value would rise. This would give the residents a direct financial incentive to improve conditions in their neighborhood. These associations could provide services to the area ranging from block patrols designed to reduce crime to park upkeep and street lighting. This plan could also benefit city governments, by reducing the cost of municipal services to an area.

The members of the association would also be protected against displacement. The increased income generated from the rising lease values of their land grant and the increased availability of jobs should enable residents to more than afford the rising housing costs in the area. We believe that incentives for the establishment of such associations should be considered in any Enterprise Zone bill.

We believe that adoption of a comprehensive Urban Enterprise Act would provide the best opportunity in years to demonstrate the benefits of relatively free enterprise, under the toughest conditions. We hope Congress will soon pass a measure to implement the concept of enterprise zones.

Please make this letter a part of the Committee's hearing record on the Urban Jobs and Enterprise Zone Act.

Sincerely,

David Keating
Director of Legislative Policy

DK/dg