Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Bruce Reed to the President re: Tobacco Update (5 pages)	09/05/1997	P5

COLLECTION:

Clinton Presidential Records
Domestic Policy Council
Cathy Mays
OA/Box Number: 18517

FOLDER TITLE:

Correspondence and Memos for the President [Binder] [5]

2011-0005-S
rc640

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

TOBACCO

THE WHITE HOUSE

WASHINGTON

September 30, 1998

MEMORANDUM FOR THE PRESIDENT AND VICE PRESIDENT

FROM: Bruce Reed
Elena Kagan

SUBJECT: Federal Tobacco Claims

Over the last few months, we and Bruce Lindsey have had many conversations with Department of Justice attorneys regarding the feasibility of bringing suit against the tobacco companies for Medicare and other losses stemming from the use of tobacco products. We also have asked DOJ lawyers to consult with a number of law professors and trial attorneys who have considered the viability of a lawsuit.

The Department now has concluded that it should not bring suit against the companies. Almost everyone at DOJ agrees that such a suit could be brought consistent with Rule 11 (i.e., with minimum professional standards). Most DOJ lawyers also acknowledge that given the size of the claim and other factors, the companies might well choose to settle the suit (as they are settling state claims) for a substantial sum of money plus public health concessions. DOJ attorneys believe, however, that they should not bring suit unless they would stand a reasonable prospect of actually winning the suit at trial and on appeal (i.e., putting aside all settlement possibilities). The attorneys have concluded that under existing law governing Medicare and other potential federal claims, they cannot meet this standard. The lawyers principally argue that current law precludes the federal government from aggregating (i.e., bringing in a single suit) claims for each Medicare beneficiary's tobacco-related health care costs.

At the same time, most DOJ attorneys appear amenable to settling federal claims against the tobacco companies without bringing a prior lawsuit. (The lawyers reason that although they cannot bring suit against the companies for want of an effective aggregation device, they do in fact have millions of individual claims against the companies, which they could settle all at once.) Under this approach, the government would enter into negotiations with the tobacco companies to resolve potential federal claims; if an agreement were reached, the parties would file in court a settlement agreement and proposed consent decree, which would release federal claims against the tobacco companies in exchange for some combination of monetary damages and injunctive relief. No legislation would be necessary.

We have some reason to believe that the companies -- at least Philip Morris and Lorillard -- would have an interest in entering into this kind of negotiation in the wake of a settlement with the states (which, as you know, is rumored to be in the offing). The principal outside counsel for Philip Morris (Meyer Koplow) recently suggested to Elena that his client wants to resolve all government claims against it, including potential claims by the federal government. He implied that a potential settlement agreement could include money, FDA jurisdiction, and marketing restrictions.

The prospects of actually reaching a good agreement with the companies are uncertain. We know that the companies want to rid themselves of potential government litigation, primarily so they can spin off non-tobacco assets. But without an actual suit against the companies, we would have relatively little leverage in negotiations. Moreover, we could encounter serious legal difficulties in trying to achieve some of our objectives -- particularly, an assurance of FDA jurisdiction -- through a non-legislated settlement.

We believe the Administration should attempt to engage the companies in such a negotiation, but we wanted your approval first. There is always some risk that Democrats will fret that we are letting the companies off too easily. However, they will be reassured somewhat by the Justice Department's involvement in these negotiations -- and the only relief the companies can get out of these talks is from a suit we have not brought. The advantage of entering into negotiation is that we might be able to get something done on tobacco without Congress -- and if not, we could lay the groundwork for legislative action next year.

Approve: ________ Disapprove: ________ Let's Discuss: ________

THE WHITE HOUSE

WASHINGTON

copied
Reed
Jennings
CEN

May 19, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed and Chris Jennings

RE: NGA Agreement on Tobacco Spending

cc: Erskine Bowles, Larry Stein, Gene Sperling, Mickey Ibarra, Elena Kagan

Attached is a one page summary of the agreement we reached with NGA on Friday night regarding the allocation of the Federal portion of the state spending options. Keeping in mind the interests of all the parties, we believe we achieved a strong agreement. It has the support of OMB, HHS, and, of course, DPC/NEC. In short, we agreed to:

- **Commit that states would be allocated $196 billion from the overall Federal settlement.** (The $196 billion figure is viewed as a sacred, inviolable number.) Since we are now assuming a $500 billion (or so) total from the legislation, the 40 percent state investment figure we have been carrying matches well with this number.

- **Use the restricted funds for seven existing programs related to children or health.** Among these, child care is the largest programmatic option. We succeeded in eliminating over 10 categories that the states desired; in so doing, we also were successful in assuring that grant options that could syphon large dollars away from our priorities did not make this list. As the attached table illustrates, we project that states will likely spend at least $5 billion on the Child Care and Development Block Grant over the next 5 years.

- **A 50/50 split between restricted versus unrestricted funds.** We reached an agreement on the 50/50 split because we allowed the states to spend a portion of their restricted dollars (6 percent) on buying down the state portion of the state match of the new Childrens Health Insurance Program (CHIP).

- **Children's health outreach**. The Governors accepted our budget proposals for outreach that, among other things, allow schools and child care referral centers to enroll children in Medicaid ("presumptive eligibility"). These options are critical in light of a new study that shows that 4.7 million children who are uninsured are already eligible for Medicaid.

- **Include strong language prohibiting substitution of Federal for state funds.** This language assures a maintenance of effort for grant options that now have a state match.

The Governors did succeed in taking our class size program off the list. We agreed to remove it only after it became clear that any compromise on this issue would water down our education priorities to the extent that it would be viewed as a loss. The DPC, NEC, and OMB education advisors all concurred with this decision.

The result of our compromise makes it a virtual certainty that significant, new dollars will be invested in child care by the states. Realizing this, the child care staff within the White House are generally quite pleased. We have asked them to try to get some validation in this regard. Unfortunately, and not too surprisingly, the child advocates want more money and more strings than our compromise guarantees. Therefore, they probably cannot be counted on to say anything overly positive in public until the last vote is counted.

Finally, over the weekend, we had a number of conversations with both NGA and the advocates of various Administration priorities. It became clear that we are likely headed towards a difficult predicament on expected floor amendments. On the one hand, if we support expected Democratic amendments (e.g., an amendment that requires more spending and administrative strings on the child care option), we risk being accused of bargaining in bad faith by the Governors. On the other hand, if we oppose these amendments, many on our side of the aisle will criticize us for not even supporting our own budget priorities.

<u>**Legislative Amendment Strategy for State-Based Investments**</u>. Keeping in mind the interest of all parties, we have worked out a position that neither pleases nor totally alienates anyone. Our positioning strategy on all state-based investment amendments is:

1. We oppose any amendment that changes either the overall allocation of the tobacco funds (40 percent for states, not lower than $196 billion over 25 years) or the split between the restricted and unrestricted (50/50) within the state funds.

2. We will oppose any amendment that adds, subtracts, or earmarks options from the restricted share portion of state funds, with one exception: **We will <u>not</u> oppose (nor actively support) amendments that reflect Administration budget priorities.** (In response to NGA's criticism that we appeared to be backing away from the initial agreement, we did agree to oppose amendments that reflect our priorities should any one such amendment be successful in passing the Senate.)

3. We will oppose amendments that totally prescribe (e.g., fixed percentages for each spending option) the restricted share of the state funds, even if one of the options is an Administration budget priority.

Today, before votes begin, we plan on meeting to review likely amendments to the tobacco bill to ensure we have a Administration-wide position on these and other types of amendments.

STATE TOBACCO SETTLEMENT FUNDS
May 15, 1998

- **$196 billion over 25 years** from the legislation will be allocated to states from a trust fund. These grants will be a mandatory, permanent appropriation. Federal spending for new options on children's health outreach will be netted from this amount.

- **50 percent** of the grants may be used by states for any purpose. The remaining 50 percent will be used for specified restricted purposes, described below.

- **Options for restricted funds.** States can use the restricted funds in any amount that they choose (except for CHIP) to add to any one or all of the following options:

    - Maternal and Child Health Bureau's Title V program
    - Child Care and Development Block Grant
    - Child welfare programs (Title IV-B)
    - Substance Abuse and Mental Health Services Administration grant programs
    - Safe and Drug-Free Schools program
    - Professional Development (Eisenhower) grants
    - Match for the Children's Health Insurance Program (limited to 6 percent of restricted funds)

- **Each program's current matching rules** will be used except for an increased Federal match of 80 percent for child care block grant funds above the appropriated amount.

- **Supplement, not supplanting spending**: Funds from the restricted portion of the grants may not be used as state match for Federal programs (except for CHIP). There will be a maintenance of effort on a program-specific basis, that consists of:

    - 95 percent of the FFY 1997 state spending on the programs listed below, trended by the lower of inflation (CPI) or the Federal appropriation growth.

- **Options for the use of restricted funds will be re-assessed every 5 years.** An independent organization (e.g., General Accounting Office or National Academy of Sciences) will conduct evaluations and assessments of spending options every 5 years, and make recommendations on improvements.

SPENDING OPTIONS UNDER THE RESTRICTED SHARE OF THE STATE FUNDS

Additional Federal Funding over 5 Years
If States Increase Spending in Each Program Equally

	Fiscal Year 1997 Federal Spend. $ billions	Percent of Total	5-Year Spending With Equal Increases $ billions
Maternal & Child Health	0.70	10%	1.30
Child Care & Development Block Grant	2.70	40%	5.00
Child Welfare Programs (IV-B)	0.50	7%	0.93
Substance Abuse & Mental Health Adm. programs	1.60	24%	2.96
Safe & Drug Free Schools	0.50	7%	0.93
Professional Dev'l (Eisenhower) grants	0.35	5%	0.65
Children's Health Insurance Program match (6%)*	0.41	6%	0.75
TOTAL	6.76	100%	12.50

* "Fiscal Year Spending in 1997" is a place holder that assures that 6 percent of the total is reserved for CHIP

THE WHITE HOUSE

WASHINGTON

May 12, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Elena Kagan

SUBJECT: Tobacco Negotiations Status Report

Erskine, Larry, and we held a series of meetings today in an attempt to reach agreement with Sen. McCain on a manager's amendment to his tobacco bill. Although we have not yet nailed down a deal with McCain, our discussions with him were very fruitful. In later discussions, Sen. Daschle indicated real enthusiasm for the deal that we believe we can make. As explained further below, however, Sen. Conrad expressed severe disappointment on several issues.

The key features of the manager's amendment under discussion are as follows:

1. Price. As you know, the McCain bill imposes payments of about $65 billion over the next five years. OMB has calculated that these payments, when passed on to price, will increase the price of a pack of cigarettes by $1.10. We expect, however, that CBO will say tomorrow that if the McCain bill becomes law, the price of a pack of cigarettes will rise by over $2 in the next five years. A large part of this price differential reflects disparate assumptions about how much the volume of cigarettes sold will decline in this period. (The more consumption declines, the larger the per-pack price increase necessary to make the annual industry payments.)

To combat the new CBO figures, which will tend to support the industry's recent arguments, we would agree in the manager's amendment to incorporate an explicit "volume adjustment" in the first five years of the McCain bill. (There is already an explicit volume adjustment after year six; prior to this point, OMB's estimates about volume reduction were taken into account in setting the annual payments, but there is no correction mechanism if OMB is wrong.) This volume adjustment would ensure that the price increase attributable to the annual industry payments would not exceed $1.10 per pack, no matter how much volume declines. (CBO assumptions regarding additional factors, such as wholesale and retail mark-ups and state excise tax increases, should bring the total price increase to about $1.50 in five years.) The downside of this approach is that if CBO is right about how steeply consumption will fall, a volume adjustment will bring down the total revenue generated by the bill -- OMB estimates by between $5 and $10 billion in the first five years.

Sen. Conrad is worried that if we go this route, we will wind up with far less revenue than is necessary to fund what people expect from a tobacco bill. It is unclear, however, what Sen.

Conrad would do to respond to the forthcoming CBO estimates. He seems to want to insist on an $1.50 per pack excise tax, but CBO would score that as above $2 as well, rendering this approach utterly impractical.

2. Lookbacks. As you recall, the McCain bill has industry-wide lookback penalties capped at approximately $3.5 billion per year, with no company-specific penalties at all. We have gotten McCain and Hollings to agree to raise the cap on industry-wide penalties to $4 billion. We have also gotten them to add a company-specific penalty wholly outside the cap of $1000 per child for every child by which the company misses its youth smoking targets. This figure represents twice the lifetime profits that a company earns from any youth smoker. Finally, we have gotten McCain and Hollings to agree to strengthen the provision linking a 20 percent miss to the loss of liability protection. Under the current provision, when a company misses by more than 20 percent, the government must show that a company committed affirmative misconduct in order to trigger the loss of liability provisions. Under the new provision, when a company misses by this amount, the tobacco company will have to show both that it did not engage in affirmative misconduct and that it used best efforts to reduce youth smoking in order to escape the loss of liability protections.

Sen. Daschle was supportive of this agreement, but Sen. Conrad thought the provision on company-specific lookbacks is weak. His own proposal would impose far more onerous company-specific penalties, perhaps as much as ten or twenty times higher. We believe penalties of this magnitude would ensure that the companies never return to the bargaining table; we also could not possibly convince McCain and Hollings to accept company-specific penalties of this magnitude.

3. Liability. As you recall, the McCain bill provides for an annual liability cap of $6.5 billion, while avoiding the question of whether this money comes from the annual industry payments or from other industry assets. McCain has now agreed to push the liability cap to $8 billion, the exact amount of the Harkin-Chafee liability cap. (As you recall, you said you would sign Harkin-Chafee.) We have tentatively agreed that (1) half of the upfront payment that the industry makes will go to pay legal judgments and (2) when that amount is depleted, half the amount of judgments will come from the annual payments and half from other assets of the liable company(ies).

Another, perhaps even more tricky set of issues has arisen around other liability provisions in McCain. First, the legislation provides that suits for tobacco related disease can be brought only against a tobacco product manufacturer, and not against a wide variety of other parties, including their parents and affiliates; officers, directors, employees, agents, or attorneys; importers, distributors, wholesalers, and retailers; suppliers of component or constituent parts; growers; and insurers. We have succeeded in removing this liability protection for parents and affiliates. We do not think anyone cares about removing protection for growers, suppliers, or parties down the distribution chain. Conrad, however, has objected strongly to giving liability protection to attorneys, and we are trying to remove this provision. We may also try to remove the protection for officers, directors, employees, agents, and insurers.

Second, the McCain bill settles the Castano lawsuits, which are lawsuits brought on behalf of addicted (but not ill) persons for cessation services. We have succeeded in ensuring that the language in the bill does not at all affect the ability of plaintiffs claiming injury from disease to use evidence of addiction in their lawsuit. (Evidence of addiction generally would come in to these suits in response to the industry's charge that the plaintiff chose to smoke and thus assumed the risk of injury.) As currently written, however, the bill does bar all future claims based solely on addiction. The rationale for this provision is that the legislation itself provides funds for cessation services -- the exact remedy that addicted (but not ill) persons seek. Conrad, however, wants to continue to allow these claims in the future. We do not believe this result can be accomplished while settling the Castano lawsuits, which many Senators would like to do.

Third, the McCain bill provides that no evidence relating to reduced-risk tobacco products is admissible in suits alleging harm from tobacco-related disease. The rationale for this provision, which is very similar to one of the federal rules of evidence, is to assure manufacturers that their development of safer products will not come back to haunt them in a legal proceeding. We have succeeded in narrowing this provision somewhat (so that such evidence, although not admissible at trial, will be discoverable), but apparently not enough for Conrad. We intend to take another run at this provision tomorrow, not because we think Conrad is right, but because we think the liability cap will be easier to maintain if we remove as many objections to other liability protections as possible.

4. Second-Hand Smoke. As you recall, the current McCain bill has a strong environmental tobacco smoke (ETS) provision, but gives states the opportunity to opt out of it entirely. We have tentatively agreed to maintain the opportunity for an opt-out, but only if the state is able to demonstrate to OSHA that it has an ETS standard at least as protective of public health as the federal standard. This compromise, if it holds up, should get us all we need on this issue.

5. International. We think that Sens. McCain, Hollings, and Wyden have agreed to eliminate many of the international provisions in the current McCain bill. (Wyden was their original sponsor.) Under this agreement, the manager's amendment would eliminate the 2 cents per pack export fee, eliminate extraterritorial restrictions on advertising and marketing, and eliminate restrictions on tobacco products in duty-free stores and on military bases. The provisions would continue to fund international tobacco control efforts and would establish a mechanism for multi-lateral negotiations on tobacco marketing and advertising.

6. Spending. We have yet to have a full discussion of spending with McCain, but we believe we can convince him to divide money among (1) the states, (2) public health money (cessation, prevention, counteradvertising, etc.), (3) health research, and (4) farmers. We doubt we can convince McCain to earmark any of the state money to the specific programs we proposed in our budget -- child care and class size reduction. We think, however, that he will

agree that states must use a portion of their money (representing the federal government's share of Medicaid recoveries) on programs appearing on a specified menu. We are currently developing an agreed-upon menu with the NGA; we hope it will include between 8 and 12 health and children's programs, including child care and class size reduction.

7. Bureaucracies. As you know, the industry and other opponents of the McCain legislation have accused it of setting up 17 new federal "bureaucracies." (Charts purporting to illustrate the legislation -- similar to those used in the health care debate -- are appearing all over.) We succeeded today in eliminating all of these 17 supposed bureaucracies, leaving a stripped-down, much simpler bill.

8. Farmers. We agreed to give Sen. Hollings help in ensuring passage of the LEAF Act. Hollings is worried that he will lose a vote on the floor to substitute Sen. Lugar's farming plan for his own. As you know, Lugar's plan would buy out all tobacco farmers and then end the tobacco price support system; Hollings's plan would compensate tobacco farmers for any loss suffered as a result of legislation (through buyouts and/or subsidies), while keeping the price support system in place.

Please let us know if you have any thoughts on, or objections to, what we are doing in these negotiations.

Reed
Kagan
3C 2S

THE WHITE HOUSE

WASHINGTON

April 9, 1998

4-9-98

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed
Elena Kagan

SUBJECT: McCain Legislation

With the overwhelming vote in favor of the McCain legislation in the Senate Commerce Committee and the subsequent announcement of the tobacco industry that it will fight this legislation, we have entered into a new phase of our effort to procure a comprehensive tobacco bill to reduce youth smoking. The Commerce Committee vote last week brought new momentum to this legislative effort. The industry's response should only add to that momentum, by making it even harder for Members of Congress to block legislation, lest they look as if they are doing the industry's bidding.

The broad consensus among your advisors is that we should aim for a strong, comprehensive bill that meets our core public health objectives and that the industry might reluctantly swallow in the end. Without industry consent, some provisions in comprehensive legislation (i.e., the most far-reaching advertising restrictions) would be impossible, while other provisions (e.g., narrower advertising restrictions and lookback penalties) would be in litigation for years. We should not compromise our objectives to secure that consent, but at the same time we should not ask for more than we need to achieve our public health goals and in the process destroy any chance of industry acquiescence. In any event, most of your advisors believe that efforts to push the price too far would be counterproductive, because tobacco-state Democrats will join with Republicans to derail a bill that goes as far as some in the public health community might like. Instead, we should try to address the aspects of the McCain bill that are most important to us and to securing broad Democratic support.

Your advisors also agree that the best way to get this kind of bill is to engage in negotiations with Senators Lott, Daschle, McCain, and Hollings that are designed to produce an agreed-upon bill to go to the Senate floor. The greatest danger we face is chaos on the Senate floor, in which some amendments roll back what we already have achieved (e.g., on FDA jurisdiction), while other amendments make the bill essentially unpassable (e.g., by stripping all liability protections while increasing the overall price of the deal).

We recommend against direct discussions with the industry at this stage; we doubt they would level with us anyway. Assuming Senator Hollings is in the room, we should have a decent sense of the industry's concerns, and of course we have more-than-adequate lines of communication to the public health community.

4-3-98

We list below several aspects of the McCain legislation in which we should seek changes during these negotiations. Note that FDA jurisdiction does not appear on this list; we were able to reach an agreement on this issue with Senators McCain and Frist, prior to the Commerce Committee vote, that satisfies all our regulatory needs and objectives.

I. Youth Lookback Penalties

We already have said that Congress must strengthen the lookback penalties in the McCain legislation, by incorporating some company-specific penalties and raising the cap on the industry surcharge. The incorporation of some company-specific penalties is a core demand of the public health community, and is strongly supported by HHS and Treasury. Such penalties, however, may be unacceptable to the industry, and especially to Phillip Morris because of its disproportionately large share of the youth market. (Unlike industrywide penalties, which can be passed on in the form of higher prices, company-specific penalties come straight out of a company's profits.) Bruce Lindsey has noted that even if we need to make demands in this area, we should not let the issue of company-specific penalties become grounds for vetoing the bill. We agree, but think it is important to try to find a way to address this issue.

agree

A number of approaches are available, and we should not now tie ourselves down to any of them. A company-specific penalty developed by Treasury and HHS would impose a $500 fee for every child by which a company misses the targets (i.e., if a company misses the target by 10,000 children, it would pay a fee of $5,000,000). This per-child surcharge represents the present value of the profits a company would gain from addicting a teenager over his lifetime. Treasury estimates that the total cost of this penalty -- i.e., across all companies -- could reach as much as $500 million a year. Another approach, probably more acceptable to the industry, would be to allow suits between companies for redistribution of the industry-wide penalty. Such indemnification suits would create a potential for transforming the industry surcharge into a company-specific penalty scheme, without increasing the overall cost of the penalty provisions. We will continue to try to develop creative solutions in this area so that we can enter negotiations with a range of proposals.

Raising the cap on industry-wide penalties is obviously an easier matter. We would suggest proposing a change from the current $3.5 billion to $4 to $5 billion if possible.

II. Price per Pack and Spending

Price per Pack

We should not demand any increase in the McCain bill's funding levels in the first five years, because McCain essentially adopted our own budget numbers (while adding a $10 billion up-front payment). We recommend waiting until CBO scores the McCain bill before deciding whether to seek any increase in funding levels in later years. (McCain has asked CBO to score his bill by the time Congress returns.) Congressional scorekeepers may well estimate that the yearly payments in the bill will increase the price of cigarettes not by the $1.10 we estimated, but by the $1.50 that the public health community has most often demanded. The higher figure may result from assumptions by CBO that (1) states will use the opportunity to increase state excise taxes, further reducing the number of packs sold and (2) the bill will significantly increase the black market for cigarettes, resulting in fewer than expected packs sold through the legitimate retail market. By reducing the number of expected packs sold, both of these changes would increase the per-pack price estimate, because the annual industry payment set in legislation would be spread among fewer packs. Once we know the actual per-pack price increase calculated by Congressional scorekeepers, we will be in a better position to determine whether we should push for a small increase in funding levels after the fifth year.

Spending

We hope for bipartisan consensus on much of the spending: we think Members could agree on approximately $10 billion over 5 years for farmers; $10 billion for prevention, cessation, counteradvertising, FDA enforcement, and other public health programs; $10-15 billion for research (the Republicans may want to limit these funds to NIH); and $20-25 billion for states. This distribution leaves about $15 billion on the table, which Republicans will want to spend on Medicare or tax cuts and Democrats will want to spend on programs like child care and school construction.

One issue will concern the use of the state money. Our budget earmarked 57 percent of the state funding for child care, class size, and Medicaid outreach initiatives. As we go forward, we should argue at a minimum for a menu of state programs, such as child care and education, on which states would have to use a significant portion of their funds. For example, in the Harkin-Chafee bill, half of the state funds must be spent on one of 20 listed programs, which include child care, K-12 education, Medicaid, the Child Health Insurance Program, and Head Start.

Another issue, more important in the out-years, concerns the amount of money allocated to paying legal judgments. The June 20th settlement put only a few billion dollars into the tort fund in the first five years, on the theory that lawsuits against the industry would take some time to come to judgment. Congress may well use the same assumption, given competing spending priorities. But once this initial grace period is concluded, Congress must figure out how to fund legal judgments. The June 20th settlement placed a $5 billion annual cap on judgments, with $4 billion coming from the industry's base payments to the government and $1 billion (a kind of copayment) from the defendant companies' coffers. The McCain bill establishes a $6.5 billion cap; McCain contemplated that $5.2 would come from the industry's base payments, with $1.3 as a copayment, but his bill does not actually address this issue. Some in the public health world may begin to call for the entire amount to be paid by the companies, outside of their payments to the government. This change, however, would add an enormous amount to the total cost of the deal and could doom prospects for legislation. Room for a tort fund thus will have to be found in the out-years by squeezing some of the spending listed above.

4-13-98

III. Antitrust Exemption

The McCain bill contains antitrust exemptions for the tobacco industry that are not necessary to achieve the goals of the legislation and may have serious anticompetitive effects. As written, the bill exempts any and all agreements designed to "reduce the use of tobacco products by underage individuals." This exemption could cover (among other things) price-fixing agreements of all sorts. The Department of Justice believes strongly, and we agree, that we should oppose all antitrust exemptions, except possibly for a narrowly-drawn exemption designed to allow companies to agree to restrict their advertising and marketing to children.

IV. International Tobacco Control Efforts

As part of the public health spending noted above, we believe we should include significant funding ($200 million a year) for international tobacco control efforts. These funds should be spent on both governmental and non-governmental efforts to promote public health and smoking prevention efforts abroad.

The McCain bill has several additional international provisions that we would like to change so that they do not interfere with our diplomatic and trade priorities. For example, although we support the bill's effort to prohibit U.S. government support for promotion of tobacco overseas, we need to ensure that the language does not interfere with USTR's ability to negotiate tariff reductions ~~or interfere with treatment of other products~~. In addition, the McCain bill contains a provision that the State Department and HHS consider problematic and unenforceable, which would require U.S. companies to abide by the new labeling and advertising requirements when doing business in other countries. The industry strongly objects to these provisions for a different reason, because it views them as a real threat to its international operations.

V. Environmental Tobacco Smoke

The McCain bill would exempt the hospitality industry (restaurants, bars, casinos, etc.) from its environmental tobacco smoke provisions, which ban smoking, except in enclosed and specially ventilated areas, in public facilities. In addition, the bill would allow individual states to "opt out" of all of the provisions, even if the state had no ETS protections of its own. Although HHS strongly opposes the hospitality exception (workers in the hospitality industry face grave risks from second-hand smoke), we doubt it is politically feasible to remove it. We should, however, try hard to eliminate the state opt-out provision, which could leave many of the nation's citizens without any protection from ETS. Alternatively, we might consider pushing the Harkin-Chafee approach to this issue, which rather than imposing a ban would provide funds to States that progressively reduce exposure to ETS.

VI. Liability Provisions

We believe we should adhere to the basic structure of the liability provisions in the McCain legislation. If we need to make these provisions a bit tougher, we can try to raise the cap from the current $6.5 billion to the $8 billion contained in Harkin-Chafee. Note, however, that doing so only compounds the budgetary issues surrounding the tort fund noted earlier in this memo: to the extent that money for tort judgments come from the industry's payments to the government, that money squeezes out funds for public health and other priorities; conversely, to the extent that money for tort judgments comes over and above the industry's payments to the government, the expected cost of the deal to the industry increases.

Finally, we may want to change the provisions in the McCain legislation that deny the liability cap to certain companies. The current provision, which has received almost no attention, lifts the cap for companies that miss the youth lookback target by more than 20 percentage points if they also have violated the Act or taken action to "undermine the achievement of youth smoking reductions." Because of the vagueness of this standard, the provision may have little or no effect. We should either tighten it (by linking the cap only to objective measures) or discard it entirely. Especially if we try to make the liability provisions tougher in other areas, agreeing to eliminate the provision may prove useful.

VII. Constitutional Issues

The Department of Justice is prepared to recommend changes to the advertising, marketing, and other speech-related provisions of the legislation in the event that the industry does not sign protocols agreeing to these restrictions. The Department also would like us to press for the elimination of all provisions regulating non-commercial speech, such as one that forbids companies from lobbying Congress, regardless whether the companies offer agreement.

Conclusion

In summary, we would recommend seeking these improvements:

Youth Lookback Penalties

- Incorporate some company-specific component in the penalty scheme
- Increase the industry-wide surcharge cap from \$3.5 billion to between \$4 and \$5 billion

Price and Spending

- No change in annual payment amounts in first five years; wait until CBO scores before deciding whether to seek later changes
- Ensure spending on research, public health, and farmers, press for spending on child care and education, or at least a menu including these programs

Antitrust Exemption

- Eliminate the antitrust exemption

International Tobacco Control

- Support funding for governmental and non-governmental organizations
- Narrow provision prohibiting U.S. support for promotion of tobacco overseas to ensure it does not interfere with USTR authority to negotiate treaties
- Remove requirement that companies must abide by new labeling and marketing requirements when operating overseas

Environmental Tobacco Smoke

- Eliminate "opt-out" provision that allows states to adopt weaker laws

Liability

- Retain basic structure of liability priorities
- Consider modifying level of cap and relation of cap to youth reduction targets

Constitutional Issues

- Recommend changes to minimize Constitutional difficulties

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Bruce Reed to the President re: Tobacco Update (5 pages)	09/05/1997	P5

COLLECTION:

Clinton Presidential Records
Domestic Policy Council
Cathy Mays
OA/Box Number: 18517

FOLDER TITLE:

Correspondence and Memos for the President [Binder] [5]

2011-0005-S
rc640

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P3 Release would violate a Federal statute [(a)(3) of the PRA]
- P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

- b(1) National security classified information [(b)(1) of the FOIA]
- b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
- b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Empowerment Zones

CD Banks

THE PRESIDENT HAS SEEN

THE WHITE HOUSE

WASHINGTON

21 P4:08

November 21, 1993

Thanks — it's a big opportunity

MEMORANDUM FOR THE PRESIDENT

FROM: Paul Weinstein (DPC)
Paul Dimond (NEC)
Sheryll Cashin (NEC)

SUBJECT: Community development bank and financial institutions legislation

On Sunday, November 21, the House of Representatives adopted your community development bank and financial institutions initiative (H.R. 3474) by voice vote. H.R. 3474 also includes a package of regulatory reforms designed to reduce administrative requirements for insured depository institutions. No significant changes were made in the bill since its passage out of the House Banking Committee on November 10. As you know, the Senate Banking Committee, by a vote of 18 to 1, agreed to similar legislation on September 21. We are hopeful the full Senate will take up this legislation upon its return in January.

cc: Carol Rasco
Bob Rubin

THE WHITE HOUSE

WASHINGTON

July 14, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING, BRUCE REED

SUBJECT: TOMORROW'S CD BANK/CRA REFORM EVENT

As you know, you are scheduled to announce your CD Bank and CRA Reform initiatives on the South Lawn tomorrow -- two economic initiatives which you approved in late April. The reason we had to schedule this event today is that the Senate Banking Committee had scheduled a hearing for July 15 on your CD Bank Bill, where Secretaries Bentsen and Espy will testify. We were unable to get an announcement date prior to your leaving for the G- 7 trip but were able to get Riegle to move his hearing to this afternoon in order to accomodate you. This event is the culmination of months of planning, drafting, policy development and delicate negotiations with constituent groups and Members of Congress. Frank Newman and Gene Ludwig at Treasury and Bob Nash at Agriculture have been particularly involved in the negotiations with these groups and in developing the final proposals.

These initiatives reflect a fundamental principle of your overall economic plan: to make capital available to enterprising Americans in all communities that want to invest, spur economic growth and create jobs. Whether promoting the G-7 talks or the community development banking bill, the message is the same -- creating new jobs.

The CD Bank and CRA reform initiatives reflect a New Democrat approach to helping distressed communities create jobs and spur economic growth. Across the country, poor communities from South Central L.A. to the Mississippi Delta are reeling from a decade of declining opportunity and rising social and economic isolation. Government cannot do the whole job -- but we can be a catalyst for the private sector and bottom-up innovation in local communities. These two initiatives will result in a substantial increase in lending for distressed, underserved communities -- both by bottom-up community development institutions and by mainstream banks.

The event will include a broad range of groups and Members who are particularly supportive of these efforts. This is an historic occasion in which the major banks, community groups, the CDFI industry, and members of Congress stand together on the same platform.

The CRA Reform will be completed by regulation. Tomorrow you will send a memorandum to the four bank regulators asking them to issue performance-based regulatory reforms by January 1, 1994. Banks and community groups will be invited to participate in the development of this regulation. Three of the bank regulators, including Gene Ludwig, will be at the event. Hugh McColl and other heads of banks with good CRA records will also be on hand to support this effort, as well as supportive community groups.

The CD Bank Bill will be transmitted tomorrow. Key members of Congress who support the bill, including Representatives Flake, Waters, and Rush as well as the Banking Committee chairs will be seated behind you and scores of Members of Congress will be in attendance.

Attached are the following documents:

1) a more detailed memorandum which outlines our negotiations with key constituent groups and Members of Congress;

2) promotional materials that will be handed out to the press and attendees, including

-- a summary of the CD Bank and CRA Reform initiatives;

-- a summary of the problems faced by credit-deprived communities (prepared with the excellent work of Alicia Munnell, Assistant Secretary for Economic Policy at Treasury);

-- highlights of the CD Bank Proposal;

-- description of the CD Banking Industry;

-- success stories;

-- highlights of CRA Reform;

3) a copy of the CD bank bill along with a transmittal letter and a section-by-section anaylsis;

4) a draft of the memorandum that you will send to the bank regulators; and

5) Q & A on both initiatives.

July 14, 1993

MEMORANDUM FOR THE PRESIDENT

THROUGH: GENE SPERLING, BRUCE REED

FROM: PAUL DIMOND, PAUL WEINSTEIN, SHERYLL CASHIN

SUBJECT: BACKGROUND ON CRA REFORM, CDFI INITIATIVE

I. BACKGROUND

You are scheduled to announce your CRA Reform and Community Development Bank and Financial institutions initiatives tomorrow. The NEC and DPC staff, along with senior officials at HUD, Commerce, Agriculture, and Treasury, have engaged in extensive negotiations and coalition building among constituent groups and members of Congress. This memorandum summarizes those negotiations to give you perspective on the various positions and concerns of key groups and officials who will be present at the ceremony.

II. SUPPORT FOR CRA REFORM, CDFI BILL

A. Community and Consumer Groups. When we first met with groups like ACORN, Center for Community Change, Community Reinvestment Coalition, ONE, Consumers Union and Consumer Federation of America, they expressed substantial concern that (1) the CDFI bill would lead to the creation of a separate and unequal system of banking for distressed communities, (2) that CRA reform by regulation could lead to diminution of lending by regulated banks and thrifts in distressed communities, and (3) that we might be contemplating a "safe harbor" from CRA for mainstream banks that invested in CDFI's. Through the careful explanations of Undersecretary Newman, Comptroller of the Currency Ludwig, Assistant Secretary Nash, and the NEC and DPC staff at a series of private discussions and presentations at public forums, these groups generally came to agree with the three principles that you set for reform of CRA by regulation:

- reform the CRA assessment criteria to focus on actual lending performance in the circumstances of the local community and particular bank

- exercise the full array of enforcement sanctions currently available so that full scrutiny and public comment is not limited to go/no-go decisions on acquisitions and mergers

- train a corps of specially trained CRA examiners to focus on lending performance, not on the extent of community public relations and image

The groups eventually expressed a strong preference for reform of CRA through regulation this year, rather than running the risk of seeking legislation in Congress that might lead to weakening CRA. They also came to understand that mainstream banks would get some credit, but not a "safe harbor," for investing in CDFIs. Despite this understanding and support, however, some community groups and some consumer groups are concerned about our rhetoric (e.g., "substitute performance for paperwork") and need constant reassurance that they will be full participants in the development of CRA regulatory reforms with the Bank regulators.

B. CDFIs. At the outset, there was also some concern from non-depository CDFI's (e.g., Community Development Corporations and revolving microenterprise or community development funds) and Credit Unions that they either would be excluded from our CDFI initiative altogether or would be at a disadvantage compared to depository institutions like South Shore or Elk Horn. When we explained that the basic criterion was ability to match the CDFI Fund's investments and then to leverage the resulting public-private investment to multiply the actual loans to community and economic development, they came to understand both how they were eligible and would be challenged to demonstrate their own ability to perform and to become self-sustaining.

Mainstream banks with wholly-owned CDC subsidiaries and state economic development authorities initially expressed some concern because they are not eligible directly for funding in our CDFI bill. Rather, the CDFI bill and CRA reform will encourage local CDFI's to join in lending networks and investment consortia with such mainstream banks and public finance authorities to help them fulfill their own public mission and community reinvestment activities. Although there was not great joy, most mainstream banks with CD subsidiaries came to accept and understand why we targeted resources on "bottom-up" CDFIs.

C. Mainstream Banks. Many mainstream banks originally wanted to support their own investment in CDFI's and a national CDFI fund in exchange for some form of interstate branching or a CRA "safe harbor." But many of these banks have come to accept that no such financial reform is or should be considered this year. Several mainstream banks have endorsed the proposal to reform CRA through regulation, while many more have agreed to participate in the process of developing regulatory reforms rather than run the gauntlet of reforming CRA through legislation. Once you ask the regulators to proceed with this process, mainstream banks and banking interests and the representatives of small banks will participate and, at this time, appear willing to accept a new focus on actual performance in exchange for avoiding paperwork related to community relations. Some mainstream banking interests have even expressed a willingness to consider using "geocoding" -- indexing loans by geographic area -- and "independent testers" to measure their community reinvestment performance rather than the current emphasis on community public relations processes and documentation.

There is a risk, however, that some mainstream banks may lobby Congress for amendments to our CDFI bill that would seek CRA relief or major financial reform in Congress.

D. Congress. The House and Senate Banking Committees have dealt with a lot of bad news over the past decade and there is much pent-up demand by some for major financial reform. No one seriously believes such major reform has any chance of passage this year because of the opposition of non-regulated financial service sectors and because of tensions between mainstream banks and representatives of the small banks and the consumer and community groups. Nevertheless, there are several members, both Democratic and Republican, who might seek to add reforms onto any CDFI bill in hopes of winning broader support. We have been warned that if our CDFI bill becomes such a "Christmas tree," there will be no chance for passage.

We have therefore worked closely with the Banking Committee staffs, key members, Banking Committee Chairs, and Leadership to secure support for a narrowly focussed CDFI bill and reform of CRA by regulation. Subcommittee Chair Joe Kennedy, an early supporter of strengthening CRA by legislation, was the first to embrace your two-part strategy of strengthening CRA by regulation and a narrow CDFI bill. Chairmen Gonzales and Riegle also endorsed this approach early on. Subcommittee Chair Kanjorski, a proponent of new legislation to support secondary markets for small business loans, also agreed to support the narrow approach this year while he sought to build support for his proposed reform for next year.

Representative Waters, a proponent of strengthening CRA by legislation and of a much more ambitious CDFI bill, agreed to endorse your two-part approach, while reserving her right to press for more funding. Representative Rush, who has over 70 co-sponsors for a CDFI bill that is very similar to ours (but with a secondary market, tax advantages for deposits in CDFI's, and much greater funding) came on board after lengthy discussions and extended but friendly negotiations with Howard Paster and Treasury, OMB, and White House staff. There will be a major push from these members, and their supporters, to provide substantially more federal funding for the CDFI Fund beginning in FY 95. They understand that, at this late date in the appropriations calendar, we will be doing well to get the $60 million that you requested for FY 94.

Representative Flake was an early opponent of CDFI legislation of any kind and supported reforming CRA by legislation and rewarding mainstream banks under his Bank Enterprise Act (BEA) for investing in distressed communities by lowering their FDIC insurance premiums on such loans. The BEA was authorized but not funded last year. Gene Ludwig, Frank Newman, and White House staff persuaded him that he could be actively involved in the CRA regulatory reform, including through his Oversight Subcommittee if necessary. Out of his personal respect and support for you, he also agreed to hold off on pressing his BEA funding request, pending completion of the CRA regulatory reform, while we studied the merit and need for the insurance premium subsidy for loans in distressed communities.

Finally, Subcommittee Chair Neal, at a meeting of Banking Committee and House Leadership, agreed to withhold his proposal for interstate branching this year in order to allow a narrow CDFI bill to proceed. With this unusual unanimity among Banking Subcommittee Chairs, Chairman Gonzales proposed a single set of hearings and mark-up before the full Banking Committee, rather than the usual round of separate subcommittee hearings, in order to assure prompt consideration and as narrow a focus as possible for your CDFI bill.

We are now just beginning the process of exploring broader Republican support in the House and the Senate for your two-part approach. All members of the Banking Committees will be invited to your White House announcement. By then, we may have a better handle on which Republicans, whether or not on the Banking Committees, may wish to support your two-part approach.

III. NEXT STEPS AND CONCLUSION

We have come a very long way in putting together a coalition of community and consumer groups, the CDFI industry, major segments of the mainstream banking industry, and important factions in Congress to support your two-part program to strengthen CRA by regulation and to enact legislation supporting CDFIs. Your announcement of both initiatives before all segments of this nascent coalition can solidify support and set the stage for what will no doubt be difficult negotiations between the diverse interests before the Regulators on CRA reform and a challenging but doable legislative session in Congress on the CDFI bill. Because of the highly partisan atmosphere and the narrow Democratic majority in the Senate, there may well be difficult negotiations ahead in the Senate. In addition, we may face challenges in the House to keep the CDFI bill straightforward and clean.

If we do succeed in continuing to build the coalition of support for your two-part strategy, deliver a strengthened CRA through regulatory reform and enact a straightforward CDFI bill, we will have laid the foundation for substantial reinvestment in distressed communities all across America. We will have built a platform for considering greater support for community reinvestment in the years ahead, through mainstream banks and thrifts, a growing network of CDFI's, and even the unregulated financial industry on a voluntary basis. And, you will have succeeded in bringing diverse interests together behind the basic principle of investing in underserved communities.

THE WHITE HOUSE

WASHINGTON

'93 APR 21 P1:09

April 21, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN RER

SUBJECT: **Enterprise Zones and Community Development Banks**

Attached are decision memoranda regarding enterprise zones and community development banks.

Both of these issues have turned out to be far more complex and controversial than had originally been expected, largely because the approaches are innovative and expansive. Consequently, the memoranda are relatively long and pose numerous and not simple issues. Furthermore, despite many meetings and a well conducted process led by Bruce Reed and Gene Sperling, there are still substantial disagreements on many of the issues, especially relating to enterprise zones.

We need decisions on the basic policy issues within the next few days, in order to dovetail with the legislative schedule. Given the limits on your time, one possibility would be that we could have a meeting with you which would lead to decisions on the basic issues, with the subsidiary design issues reserved for decision at a later date or, if you wish, delegated to Carol and me. Either way, we would meet the requirements of the legislative schedule.

Marcia Hale is attempting to fit this into your schedule very late Friday, and you can let us know at that time what decision-making process you would like to have.

THE WHITE HOUSE

WASHINGTON

APRIL 19, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED
GENE SPERLING

SUBJECT: ECONOMIC EMPOWERMENT AGENDA

Almost one year ago, you toured Los Angeles after the riots and predicted that despite all the media attention and Presidential fanfare, a year would pass and nothing would change. You were right. Across the country, poor communities from South Central LA to the Mississippi Delta are still reeling from a decade of declining opportunity and rising social and economic isolation.

Shortly after you took office, Bob Rubin and Carol Rasco asked us to set up a joint NEC-DPC interagency working group on community development and empowerment. We wanted a joint effort spanning economic and domestic policy that could look at the problems of economically distressed urban and rural areas -- not only to prepare specific proposals that could be passed this spring as part of your initial Budget, but to develop a framework that could incorporate other new ideas over the course of your administration.

Our first task was to focus on the economic empowerment portion of your community development strategy. Job and enterprise development are only a portion of what your administration hopes to accomplish in distressed areas, through health care reform, welfare reform, education reform, family policy, Head Start, and so on, but your campaign commitments and your stress on economic growth necessitated that we come forth with these proposals for FY1994.

To create this economic empowerment proposal, our group brought together policy people from half a dozen agencies, and met with members of Congress, community leaders, entrepreneurs, and federal, state, and local government officials. We agreed in principle on a comprehensive, three-part strategy with a strong economic focus:

1. **Enterprise Zones:** A two-tier plan to create 10 resource-intensive Economic Empowerment Zones and 100 less expensive Enterprise Neighborhoods around the country. These 110 communities would be targeted for economic development, reinventing government, community development banking and microenterprise, community policing, and the administration's other empowerment initiatives.

Bill, [illegible]

2. **Community Banking:** A national network of community development banks and other community lending institutions, spurred on by a federal Community Banking and Credit Fund and perhaps by requiring major banks to start community development banks in return for limited interstate branching. We also propose ways to strengthen enforcement of the Community Reinvestment Act and fair lending requirements.

3. **Community Policing:** We included Community Partnerships Against Crime (COMPAC) -- a HUD initia~~tive to improve safety in public~~ housing -- along with nationwide efforts to promote community policing with economic ~~development.~~ Communities will need to demonstrate progress against crime if they are to attract and maintain enterprises.

CONGRESSIONAL OUTREACH:

We have invited the major Congressional leaders in these areas to meet with us and with Bob Rubin and Carol Rasco -- including Maxine Waters, Floyd Flake, Charlie Rangel, Chairman Gonzalez, Bill Bradley, Chairman Rostenkowski, Chairman Riegle, Paul Sarbanes and Chairman Moynihan. We have also received copies of the bills pending in Congress and will continue to see which of their ideas can be incorporated.

By way of example, pursuant to our discussions with Representative Rangel and his staff, our Enterprise proposal includes a comprehensive approach to public and private investment and coordinated provision of government services, a mix of tax targeted tax incentives and Enterprise grants, and a major emphasis on safe streets. We also have included drug prevention and rehabilitation-to-work among the new initiatives which the Agencies are actively exploring for the Enterprise proposal.

With respect to the Community Reinvestment Act, our recommendation to move to performance-based standards for all bank lending (including for small business and commercial loans) adopts much of the direction and emphasis of Representative Waters' bill. In addition, Representative Waters has also suggested exploring the possibility of making the Federal Reserve Discount Window available for Community Development Banking to spur reinvestment in the inner cities. Although this would require a major rethinking of the Fed's long-established policy and practice, we have proposed including the Fed on the Board of the CD Banking Fund so that such institutional issues may be fully considered by the Fund with full input from the Fed.

Treasury and the FDIC are exploring the impact and cost of Representative Flake's proposal under the Bank Enterprise Act to appropriate funds to subsidize a discount in insurance premiums paid by banks (including CD Banks) to the extent of their loans in distressed communities. If you choose to require major BHCs to participate fully in the attached Community Banking proposal, the potential impact will be far greater; and the issue of providing additional support for bank lending in distressed communities can then be addressed more fully in this new context by the Fund and by you.

Finally, our Community Development Banking, Community Policing and Enterprise initiatives incorporate many of central components of the Bradley bills: incentives for personal savings and investment in the community, cops on the block and safe streets, a CD Bank fund to nurture a network of community development financial institutions, true Community Schools, and mobility and access to opportunity throughout the local labor market.

After you have agreed to a preliminary proposal, we will consult with these members of Congress and come back to you with additional ideas of theirs that can be included.

MESSAGE:

The attached memos present the proposals for enterprise zones and community development banks. These memos lay out the options and decisions you need to make for both proposals.

We also wanted to let you know our own view of how these proposals support the themes that you ran on and now form the underpinning of your economic plan.

First, these proposals offer a new, innovative approach. They move beyond the old left-right debate by taking an activist approach to empowering those in distressed areas without assuming that the answer to every problem is more federal spending on the one hand or more tax breaks on the other. They offer real opportunity to real people: a savings account, a cop on their block, an employment voucher that will reward any business for giving them a job, a local banker willing to invest in new jobs in the community. And we believe they represent a new direction for poor communities across the country in several other important respects:

* **Reinventing Government:** The working group makes reinventing government a centerpiece of our enterprise proposal. No community will get help unless they develop a comprehensive strategic plan that involves the private sector, builds on existing community institutions, and coordinates government efforts across program and jurisdictional lines. The solutions to these problems must come from the bottom up, from individuals and communities willing to help themselves. These proposals will change the way government does business -- including the federal government, which will conduct a competitive grant process through a single point of contact.

* **Accountability for Results:** Communities will receive unprecedented flexibility to design their own plan, but will be held accountable for real, measurable results in return.

* **Laboratories of Democracy:** Communities that show the initiative to make the most of these efforts will become natural targets for other initiatives in the administration's agenda. In exploring our proposals with other agencies and major private sector institutions, we've found a number that want to take part.

* **Comprehensive Growth Strategy:** These proposals foster efficient and entrepreneurial government that promotes both private investment and increased public investment in human and physical capital.

* **A Bold New Experiment:** Some will point out that there is no conclusive evidence that enterprise zones work, and that only three community development banks have been created in the history of the republic. They're right on both counts -- because no one has been trying such new approaches with any federal support or leadership. Our proposals are designed to give these ideas a fair test, by targeting resources in a limited number of places and providing clear measures of success or failure. If these new approaches don't work, we can give up or try something else -- but we shouldn't quit before we start just because the old answers have failed.

Whatever options you choose to put forward, we believe that these proposals provide you with a tangible platform to inspire hope and show your commitment to a new spirit of opportunity, responsibility, and community that will empower people from Watts to Mount Pleasant to believe in the promise of America again.

THE WHITE HOUSE

WASHINGTON

April 19, 1993

93 APR 21 P1:09

MEMORANDUM FOR THE PRESIDENT

THROUGH: BRUCE REED
GENE SPERLING

FROM: THE NEC-DPC INTERAGENCY WORKING GROUP ON COMMUNITY DEVELOPMENT AND EMPOWERMENT

SUBJECT: ENTERPRISE ZONES

I. ACTION-FORCING EVENT

The legislative calendar and the continuing distress in many places in rural and urban America call for announcement of the first parts of your economic empowerment initiative.

II. BACKGROUND

Over the last two months, the NEC-DPC Interagency Working Group on Community Development and Empowerment has been considering several elements of an initiative to empower distressed communities to join the economic mainstream. HUD, Treasury, Agriculture, Commerce, Justice, OMB, CEA, NEC, and DPC have worked together to develop a new, comprehensive empowerment agenda which includes enterprise zones, community development banks, strengthening of the Community Reinvestment Act and Fair Lending requirements, and community policing and Community Partnerships against Crime.

This memorandum presents the Enterprise Proposal. While members of the Working Group differed on the merits of particular components, there was general agreement -- except for OMB -- on a two-tier proposal to create 10 resource-intensive Economic Empowerment Zones and 100 less expensive Enterprise Neighborhoods. OMB has proposed a minimal-cost alternative and recommends using the savings in budget authority to pay for other, unfunded priorities, including Campaign Finance Reform and Family Support. (OMB's views and suggested alternative are attached at Tab A.)

In Section III of this memorandum, we summarize the key components of a two-tier Enterprise Proposal. In Section IV we present the key options for your decision, including OMB's alternative option.

III. THE TWO-TIER PROPOSAL

This proposal seeks to go beyond more traditional enterprise zone proposals in three fundamental ways: One, it makes reinventing government a centerpiece of the entire proposal. Two, it seeks to concentrate a combination of resources (tax incentives and public investment grants) in 10 economic empowerment zones, while having a second tier of 100 enterprise neighborhoods which grant considerable flexibility -- and some limited resources -- to areas that come forth with comprehensive proposals for economic development. Zone population is limited to 100,000 persons in order to achieve this focus and to ensure opportunities for demonstrated success. (The objective criteria for eligibility are attached at Tab B.) Three, the zones are designed to be platforms for local experimentation at both the federal and local level. Finally, the proposal takes an expansive view of the need for comprehensive growth strategies -- ones that take account of the need for both public and private investment.

The proposal has three main goals:

1. Increasing business and jobs within the zones so that they become engines of economic growth within the region.

2. Empowering zone residents to join the economic mainstream -- by owning and managing enterprises and assets within the zones and by connecting them to jobs and opportunities throughout the region.

3. Changing the way government does business in distressed areas -- by streamlining regulations and paperwork, encouraging local flexibility and innovation, and targeting resources so we can measure results and learn what works.

CORE ELEMENTS OF ECONOMIC EMPOWERMENT ZONES:

A brief summary of the key and distinctive components of the proposal include:

A. REINVENTING GOVERNMENT

Competitive Grant Process: The proposal is designed to streamline federal rules and regulations that discourage initiative at the local level -- and at the same time, to challenge communities to develop a coordinated, comprehensive strategic plan to spur economic empowerment. Communities will apply for zone designation through a federal challenge grant process. The winners will qualify for tax incentives that encourage job creation, investment, and individual empowerment and will receive an Enterprise Grant they can use in any way that advances the three goals stated above.

Coordinated, Bottom-up Planning: To be considered, an applicant must form partnerships with the affected community and the private sector in the region to develop a comprehensive strategic plan. The plan must detail how the applicant will coordinate all complementary state, local and federal program resources and incentives with private sector commitments and community initiatives to meet the three goals.

One-Stop Federal Responsiveness: An Interagency Council ("Enterprise Board") will develop criteria for selection. In consultation with the Enterprise Board, HUD will designate the urban zones, Agriculture the rural zones, and Interior the Indian zones -- based on the quality and promise of the strategic plan submitted by each applicant. The Designating Secretaries, in cooperation with the Enterprise Board, will serve as a single point of contact to allow local applicants to coordinate federal programs and incentives in the zone.

B. TWO TIERS OF INCENTIVES AND INVESTMENTS. We recommend a two-tier approach that focuses most resources on a limited number of zones where we can measure and achieve results, but gives a larger number of communities an incentive to take part. The larger number of Enterprise Neighborhoods may make it more palatable for members of Congress to support the concentration of resources in the 10 zones.

10 Economic Empowerment Zones will be designated and will be given discretion to use all available tax incentives, a substantial (e.g., $30 million per year) Enterprise Grant, and one-stop federal responsiveness based upon their approved strategic plan. In addition, each Economic Empowerment Zone will participate, based on its approved strategic plan, (a) in a community development banking initiative, (b) in community policing and HUD Community Partnerships Against Crime, and (c) in a DoEd Enterprise School Community initiative to implement the National Education Goals for school readiness, lifelong learning, and competitiveness.

100 Enterprise Neighborhoods will be designated and will receive a few of the tax incentives, a smaller Enterprise Grant (e.g., $3 million per year), and one-stop federal responsiveness. In addition, these Enterprise Neighborhoods will also be eligible to participate in the Community Policing, Enterprise School, and Community Development Banking initiatives.

C. TAX INCENTIVES AND INVESTMENT PROVISIONS

TAX INCENTIVES:

The tax expenditures are designed (a) to reduce the costs of doing business in the zone, (b) to provide incentives for employing zone residents both within the zone and throughout the local labor market, (c) to provide incentives for investment in new equipment and expansion of qualified zones business, (d) to finance new construction and renovation within the zone, and (e) to empower zone residents with the opportunity to work, save and invest, <u>and</u> obtain a real ownership stake in their own communities and economic destiny. The proposal includes:

SUMMARY OF INCENTIVES AND INVESTMENTS

10 ECONOMIC EMPOWERMENT ZONES

INVESTMENTS

- Enterprise Grants ($50-175 million)
- Community Development Banks
- Community Policing
- Coordination and Flexibility with Existing Funds
- Education Enterprise Funds
- Eligible for Participation in a Range of Innovative Federal Experiments

EMPLOYMENT TAX INCENTIVES

- Employment and Training Credits (ETCs) for zone residents:
  - A multi-year ETC for employers located in the zone
  - Targeted Empowerment ETC ("TETC") for all employers
- An ETC Opportunity Card for zone residents

CAPITAL INCENTIVES

- Increased property expensing under Section 179
- Accelerated depreciation for all investments in tangible property in the zone.
- Tax-exempt Private Activity Bonds for investments in tangible property in the zone.
- Expansion of the Low Income Housing Tax Credit

EMPOWERMENT INCENTIVES

- Resident Empowerment Savings
- Resident Community Investment Corporations (CICs)
- Small, Worker Controlled Enterprises (WCEs)
- Zone ESOPs

100 ENTERPRISE NEIGHBORHOODS

INVESTMENTS

- Enterprise Grants ($5-15 million)
- Eligible for Community Development Banks
- Eligible for Community Policing
- Coordination and Flexibility with Existing Funds
- Eligible for Education Enterprise Funds
- Eligible for Participation in Innovative Federal Experiments

EMPLOYMENT TAX INCENTIVES

None

CAPITAL INCENTIVES

- Tax-exempt Private Activity Bonds for investments in tangible property in the Zone
- Expansion of the Low Income Housing Tax Credit

EMPOWERMENT INCENTIVES

- Resident Empowerment Savings Account

Economic Empowerment Zones	FY 94-98 cost in $Billions
Property Expensing	.2
Accelerated Depreciation	.*
Flat Employment and Training Credit (ETC)	1.4
Targeted ETC	.5
Community Investment Corporations	.*
Worker-Controlled Small Enterprise	.3
Zone ESOP	.*
	2.6
All 110 Zones	
Savings Plan	.*
Private Activity Bonds	.1
Low Income Housing Tax Credit	.1
	2.8

(The asterisk means that the cost is less than $50 million.) The Working Group would prefer to use $1.3 billion of the tax incentives funds set-aside in the Budget for investments. Yet, it is important to note that additional tax expenditures might be required if, for example, the population limits of one or more zones were increased (as discussed in Section IV below) or if more tax incentives had to be added to make the 100 Enterprise Neighborhood more attractive.[1]

INVESTMENT PROVISIONS:

- **Enterprise Grants.** As noted, beyond mere tax incentives, the ten economic Empowerment Zones will receive a substantial Enterprise grant, on the order of $150-175 million per urban zone and $50-75 million per rural zone over five years. In addition,

[1] The two-tier proposal calls for approximately $3 billion in tax expenditures and approximately $3 billion in investments through Community Policing and Enterprise Grants (plus investments from several of the Agency budgets.) Your proposed budget provides for $4.1 Billion in tax expenditures, plus $500 million for Community Policing (appropriated in FY93 but not authorized) and $500 million for community investments in FY 94. In addition, HUD and Agriculture have agreed to contribute up to $900 million from their existing budget authority.

Any enterprise proposal you submit will require careful coordination with Congress for purposes of authorization, the Budget Enforcement Act, Budget Reconciliation, and annual appropriations. We will need bi-partisan support to secure the sixty votes in the Senate that will be necessary for approval of many issues, including our enterprise proposal.

matching state and local resources and private sector commitments will be expected for all zones. The second-tier, enterprise neighborhoods will receive $15-20 million for urban zones and $5-10 million for rural zones over five years.

Community Policing: All zones will be eligible for additional support for Safe Streets from the $500 million of the FYs 93-94 baseline which has been reserved to meet your pledge of 100,000 additional cops on the beat. (Our enterprise legislation could address whether these monies will go exclusively to communities with enterprise zones).

Community Development Banks: The 10 Economic Empowerment zones will be given first priority on having a Community Development Bank. The other zones will be eligible to participate in your community lending initiative in order to access private capital, financial services, and support for microenterprises.

Education Enterprise: DoEd has asked to include, and to provide funds for, a comprehensive Enterprise School Communities initiative to implement the National Education Goals. DoEd will provide sufficient funding for Enterprise School Communities in each of the 10 Economic Empowerment Zones, plus up to another 10 to 30 enterprise school communities for Enterprise Neighborhoods.

Eligibility for Participation in Innovative Federal Experiments: The Enterprise Neighborhoods and Economic Empowerment Zones can serve as platforms for experimentation. This experimentation function serves a dual purpose: First, it aids the federal government by giving it laboratories to experiment with new innovations designed and implemented from the bottom up. Several Agencies believe that the designated zones provide a unique opportunity to offer new initiatives that local communities may use to complement their own economic empowerment and community development strategies. Second, it allows the zones and neighborhoods to have an even more comprehensive investment strategy. The 10 zones and 100 neighborhoods will be eligible to participate through the challenge grant process in a range of other economic, human and community development and access-to-opportunity initiatives that are likely to be sponsored by various Agencies during the operation of the zones.

Possible initiatives include: foreign trade centers, microenterprise and venture funding, and entrepreneurial assistance (Commerce and SBA); school-to-work, apprenticeship, youth build, juvenile justice and drug prevention and rehabilitation-to-work (DoEd, DOL, HHS, HUD and DOJ); unemployment-to-work training and support (DOL); time-limited welfare and work supports (HHS); and access and moving to opportunities (HUD and DOT). (A list of possible federal initiatives is attached at Tab C). States, localities, and the private and non-profit sectors will be challenged to add their own initiatives. These human development and access-to-opportunities initiatives, coupled with the Fair Housing and fair lending components of your CD Banking and Community Reinvestment Act proposals, should send a clear message that enterprise zones will not be isolated garrisons but will strive to integrate distressed communities and poor people into the economic mainstream.

D. EVALUATION OF PERFORMANCE AND RESULTS: The enterprise zones will run for ten years. Each year the Designating Secretaries will review the performance and results of the zones in achieving the benchmarks set in the zone's strategic plan. Mid-course corrections will be permitted and encouraged.

At the end of the fourth and seventh years, the Designating Secretaries will conduct a full review of results. Based thereon, they may terminate the designation, withhold or reduce enterprise funds, or require appropriate changes in the comprehensive strategic plan of any zone that is not making satisfactory progress in meeting its benchmarks to achieve the three goals of the enterprise proposal.

The National Academy of Sciences will contract for an independent evaluation of all aspects of enterprise zones. A full report will be given to the President and Congress at the end of five years and again at the end of ten years. We expect to learn what works from the performance and results in both the Economic Empowerment Zones and the Enterprise Neighborhoods. The entire enterprise legislation will sunset at the end of 10 years so that the lessons learned from actual experience can be included in any reconsideration.

In sum, the two-tier proposal seeks to improve the opportunities and competitiveness of both people and places. It challenges affected local communities to reinvent themselves, to join with the private sector in strategic public-private-community partnerships, and to strive to integrate distressed communities and poor people into the economic mainstream.

IV. ISSUES, RECOMMENDATIONS AND DECISIONS

A. TWO-TIER PROPOSAL OR OMB LOW-COST OPTION?

OMB proposes an option that adopts much of the two-tier proposal's emphasis on the coordination and reinvention of government, but without spending any funds beyond what is already provided in the baseline or the other new investments proposed in your overall budget. In particular, OMB's proposal would spend only $110 million of the $4.1 billion included in your budget for tax expenditures.

OMB has serious reservations concerning the use of any tax incentives or new Enterprise Grants. OMB argues that tax incentives will not be very effective in stimulating new business development and jobs in distressed areas or, if successful, will be too costly to be widely replicated in other areas. Or they fear that enterprise zone tax incentives will draw employmentfrom other economically depressed areas. In addition, OMB believes the two-tier proposal focuses too much on moving jobs into small areas that are not very hospitable to business investment, rather than preparing people in those areas for work opportunities. OMB is also concerned that the almost $6 billion that would be absorbed by the two-tier proposal will benefit a very small fraction of the heavy poverty areas in the country.

OMB, therefore, proposes a "low cost" option which, in its view, meets your campaign promise to create enterprise zones while preserving the opportunity to use some of the resources originally committed to enterprise zones for other budget priorities. Attached at Tab A is a summary of OMB's concerns and its alternative, low-cost option.

If you decide to devote additional new budget authority to enterprise zones, as does the two-tier proposal, OMB offers three additional alternative options, as described in Tab A. One of these options does not rely on tax incentives and proposes an increase in the Enterprise Grant instead; the second and third would give localities greater flexibility in choosing between direct spending and a menu of tax incentives.

RECOMMENDATION: With the exception of OMB, the Working Group uniformly supports the two-tier proposal for the following reasons. (There are differences of opinion on certain aspects of the proposal, as described below.) First, we believe that we have tailored and targeted the tax incentives to encourage investments in both places <u>and</u> people. Second, tax incentives form the basis of the enterprise zone concept and have strong bi-partisan support in Congress. If you do not include tax incentives, you will not be entertaining an "enterprise zone" proposal.

Third, we believe that the two-tier proposal will produce some real success stories in distressed areas in rural and urban America. OMB's criticism that the cost of replicating tax incentives is too great may miss the point. We do not have enough money on the discretionary spending side <u>or</u> the tax incentive side to improve every distressed area. Instead, the mix of tax incentives, investments and reinvention of government in the two-tier proposal will challenge public-private-community partnerships to develop effective strategies in the lower-cost Enterprise Neighborhoods as well as the Economic Empowerment Zones. If we are successful, we believe more resources from the public <u>and</u> private sectors will be forthcoming for what works. Finally, we are concerned that OMB's "low-cost" proposal may be perceived as a retreat from your commitment to distressed areas, particularly urban areas.

OMB's three additional alternatives offer ideas for reinventing government and investing in people. The two-tier proposal incorporates both concepts. With respect to OMB's proposal to offer localities a menu of tax incentives, the Working Group considered and rejected such an approach because of its administrative infeasibility and our decision to target tax incentives that would be used to invest in <u>both</u> people (e.g. labor and empowerment) <u>and</u> places (e.g. cost-recovery).

DECISION

___ "Low-cost" OMB Proposal

Leave the $1.3 Billion as —

___ Other OMB Alternatives

✓ Two-tier Proposal

✓ Discuss Further

Make consolation prize bigger — spread
— $1.3 billion ~ over ~ 100 second prize.
— package
— Flexibility ~ w/existing moneys

B. DECISIONS RELATING TO THE TWO-TIER PROPOSAL

If you select the two-tier proposal, a number of other issues must be resolved, as will be described in this section of the memorandum.

1. WHETHER TO NAME THE TEN ZONES IN ADVANCE?

As set forth in Tab A, OMB Director Panetta fears that Congressional expansion of the number of zones may be unavoidable. To limit the likelihood of such expansion, he suggests that you designate in advance the ten communities that would receive the Economic Empowerment Zones. Presumably, you would justify naming these ten by stressing that they are "hardship" communities, e.g., South Central Los Angeles, that warrant targeted attention. Other communities would be reminded that they may compete for Enterprise Neighborhoods and that all communities will benefit from the stimulus package should the stimulus pass.

RECOMMENDATION: The Working Group opposes this suggestion. First, naming the "ten worst" communities in advance undermines central tenets of the two-tier proposal. We want to use the challenge grant process to spur all communities to put forth their best efforts in designing a coordinated strategic plan. We also want localities to make a real effort to reinvent government and involve community residents and the private sector in the planning process. We feel the competition of the challenge grant process is critical to ensuring successful zones. Through the challenge grant, we will have an opportunity to reward innovation and pick the ten communities that have the best opportunity to succeed in achieving the enterprise mission.

Second, naming ten communities in advance may doom the proposal from the outset, either by alienating the 80 senators and 425 congresspersons whose districts will not benefit from these designations or by encouraging Congress just to name additional zones. We believe that we have a better chance of defending the two-tier proposal against congressional expansion.

DECISION

___ Name Ten Zones in Advance

✓ Rely on Challenge Grant Process

✓ Discuss Further

3 w/ 200,000

2. POPULATION LIMITS

The Working Group agreed that we should focus resources (and the energies of the Designating Secretaries) on smaller targeted areas. As a result, we placed a 100,000 population limit on any zone. Los Angeles clearly will be very disappointed with such a limit. California representatives have lobbied hard for larger zones. The issue, therefore, is whether to provide for a different limit for very large population cities (e.g., over 2.5 million persons, New York, L.A., and Chicago).

The following are three options for larger population limits in some of the six urban economic empowerment zones, while keeping the total tax expenditure costs around $ 3 billion.

- One zone with 250,000; four with 100,000; one with 50,000
- Three zones with 200,000; three with 25,000.
- Two zones with 250,000; two with 50,000; two with 25,000.

up to 2 w/ 250 k
up to 2 w/ 100 k
at least one for city of less than 500,000

PPD
- over 2.5 million - maximum of 250,000
- over 1 million - maximum of 100,000
- over 500 k, maximum of 50 k
less than 500 k, 25,000

upto 2 at 200,000

RECOMMENDATION: The Working Group recommends that you apply the 100,000 population limit to all zones but be prepared to compromise during the legislative process if it proves necessary. If we are to ensure some measure of success, we feel it is essential to target our limited resources to a relatively small area.

DECISION

___ 100,000 Population Limit

___ Allow one to three zones with 200,000 to 250,000

    ___ 1-250,000, 4-100,000, 1-50,000

    ___ 3-200,000, 3-25,000

    ___ 2-250,000, 2-50,000, 2-25,000

_✓_ Discuss Further

PPD 2-250,000, 2-100,000, 2-25,000

301-619-3483
~~515-1584~~

3. POVERTY CRITERIA

There is some disagreement among the Working Group as to how we should target the poverty criteria for enterprise zones. H.R. 11, the enterprise zone bill passed by Congress last year (and vetoed by Bush), required only that all of the census tracts in the zone be at 20% or more of poverty level. This requirement would apply to tens of millions of people and perhaps give communities too much discretion in designating zone areas.

The more liberal the poverty criteria, the higher the risk that communities will designate areas that are not most in need of assistance. On the other hand, the Working Group does not wish to hamstring communities by making them pick only hard-core poverty areas that have little chance of being successful in meeting the enterprise goals.

Two options that attempt to address these competing values have been offered.

- Option 1:
  50% of census tracts at 35% or more of poverty;
  90% of census tracts at 25% or more of poverty;
  100% of census tracts at 20% or more of poverty;
  plus limited discretion in Designating Secretary to permit limited variation from criteria to fit existing state-designated enterprise zones.

- Option 2:
  90% of census tracts with 30% or more of poverty;
  100% of census tracts with 25% or more of poverty.

Option 1 has the advantage of being targeted but offering communities a degree of flexibility. It also addresses the possibility that a community may wish to overlay state-designated and federal enterprise zones that have slightly different qualifying criteria.

Option 2 is more targeted but less flexible. It has the advantage of ensuring that only truly needy communities will be designated as enterprise zones. But, this set of criteria could knock out some prime candidates for enterprise zones. In New York City, for example, a budding commercial area in Harlem that would qualify under Option 1 would be excluded under Option 2.

RECOMMENDATION: The Working Group has not reached a firm recommendation on this issue. HUD supports Option 1. Treasury supports Option 2.

applicants that try to involve most poor, integr into jobs —

DECISION

✓ Option 1

____ Option 2

____ Discuss Further

change name

4. MECHANISMS FOR REINVENTING GOVERNMENT

a. New Enterprise Funds. The new Enterprise Grants will be vehicles for reinvention and innovation because localities will have considerable flexibility in using this money to address unique local needs. An issue arises, however, as to how we will ensure that the zone communities adhere to the enterprise mission in developing their strategic plans and in spending Enterprise funds to implement these plans.

There are essentially two alternatives. The first approach is to state general federal objectives and vest the Designating Secretary with discretion to choose among applicants based on the specifics of each strategic plan in implementing the three enterprise goals. The Designating Secretary would make sure that Enterprise funds are not used to supplant existing federal funds and programs and would measure results against the benchmarks established in the strategic plan. This approach may be most in keeping with the objective of reinvention, but it risks providing insufficient federal direction in local planning and too much discretion in the Designating Secretaries.

The second approach is to state specific federal requirements and objectives in the legislation which will guide local spending and plan implementation. Last year, for example, the Senate version of H.R. 11 simply listed all the federal programs that zone communities could spend funds on. However, if the stated criteria are too specific, it could limit a community's ability to innovate, for example, in establishing its own matching venture funds and other public/private economic empowerment partnerships.

The Working Group has no firm recommendation on this issue, which, may have to be resolved in the legislative process.

DECISION

___ Challenge Grant Process and Performance Review

___ State Specific Compliance Criteria in the Legislation

___ Discuss Further

give creativity

b. Existing Federal Programs and Funds. Time and again, mayors and governors have complained that they would be in a better position to meet our enterprise objectives if they were free to deploy existing federal programs and resources to implement their own strategic plan. Former President Carter made much the same point when he visited with you last month about the Atlanta Project: we would not need to invest much more federal money to revitalize urban America if we empowered local communities to apply existing federal funds flexibly in conjunction with State and local resources, and private enterprise.

Although we propose to eliminate all burdensome strings from the new Enterprise Grant funding, such radical deregulation of existing federal programs is a formidable challenge. We believe there are at least three approaches to providing greater flexibility and responsiveness with respect to existing federal programs:

- Broad, Pilot Waiver Authority: seek statutory waivers in the Enterprise legislation that would vest the Enterprise Board with authority to grant any waivers it deems necessary for a specified list of programs relevant to promoting enterprise in each zone. A municipality with an enterprise zone might be allowed, for example, to aggregate all funds it receives from the specified range of programs and spend these funds on a new type of activity to implement the strategic plan approved by the Designating Secretary for the zone.

- Limited Waiver Authority: allow the Enterprise Board to develop one set of categorical criteria that municipalities must meet to receive funding from existing programs that are relevant to promoting enterprise in each zone. The enterprise legislation would specify, for example, 10 to 12 existing programs -- e.g., CDBG, Jobs Training Partnership Act, Job Corps, Youth Apprenticeship, JOBS -- for which one set of categorical criteria will be developed. Municipalities that receive enterprise zones, therefore, would be relieved of some of the burdens of meeting uncoordinated, fragmented program requirements. Municipalities would not, however, have the flexibility to redirect funds to their own spending priorities.

- Expand the Enterprise Grant Program: beginning with the FY 95 budget request, increase the Enterprise Grant by an agreed amount and seek lower appropriations from a range of existing programs. For example, if total federal spending on a range of separate categorical programs averages $25 million per zone, then the budget request for Enterprise grants in each zone could be increased by a proportionate share. At the same time, the budget requests for these categorical programs would be reduced by this amount. This approach approximates the effect of the broad, pilot waiver approach.

RECOMMENDATION: We do not have a firm recommendation with respect to the three options.

The first approach -- pilot testing broad regulatory relief in the enterprise zones -- is most in keeping with our basic goal of reinventing government and would be strongly supported by the mayors and governors. It may complicate passage of the Enterprise legislation. We do not know whether Congress would be as willing to go along with such a radical restructuring. It may also give pause to some of the Secretaries as they work with you to make plans to initiate new national programs. HUD strongly recommends this approach.

The second approach -- limited waiver authority -- will provide substantial flexibility and responsiveness for those programs specified for uniform categorical treatment. Congress should be receptive to such narrower statutory waiver authority as a part of the Enterprise package. But many localities and public-private partnerships will argue that we should go further because the costs of compliance with the multitude of federal requirements ultimately defeats their purpose.

The third approach provides a means to approximate, roughly, the result of the first approach: it increases the enterprise grant by the amount that would be available to focus on implementing the zone's strategic plan if full waiver authority were available. It does so, however, by reducing a range of programs throughout the country by the small amount necessary to achieve this result. It will also require careful budgeting (and negotiation with Congress) each year.

Close consultation and cooperation with Congress and interested constituencies may provide the best approach to resolving this issue. Given the uncertainties and the need for full Congressional cooperation to implement any of the three approaches, it may be prudent to explore this issue fully with Congress and constituency groups before making a final determination.

DECISION

✓ Broad, Pilot Waiver Authority begin w/ Broad pilot authority —

___ Limited Waiver Authority

Pilots [illegible] above. to

✓ Expand Enterprise Grant through Annual Budgeting

✓ Consult with Congress and Constituencies — Tack on in addition

✓ Discuss Further

5. DISAGREEMENTS AS TO EMPOWERMENT TAX INCENTIVES

a. Resident Empowerment Savings. Following on your campaign pledge to establish Individual Development Accounts to empower low-income Americans to move toward economic self-sufficiency, the Working Group recommends a 50-percent tax credit for employer contributions to a Defined Savings Plan ("DSP") on behalf of zone employees. Participating zone residents could also contribute to the DSP on a tax deferred basis. These savings could be withdrawn (or borrowed against) without penalty to pay for education, purchasing a first home, starting a small business, or investing in a Community Investment Corporation.

In addition, the CEA has recommended that you also consider encouraging short-term savings that would help zone residents avoid excessive credit costs on large consumer purchases such as furniture and cars. We could offer a special-issue U.S. Savings Bond with an above-market rate of return and allow this interest to be fully tax exempt to zone residents. These bonds could be purchased through payroll deductions and excluded from taxable income reported by the employer, making tax preparation easier for the saver. Treasury opposes this savings incentive.

While the Working Group generally favors having some form of resident empowerment savings, Treasury is skeptical about whether our limited resources might be better spent on incentives for employment and business activity rather than savings. The tax expenditures for such resident empowerment savings and investment in all 110 zones, however, total less than $50 million over five years.

RECOMMENDATION: We recommend that you include empowerment savings incentives in your enterprise zone proposal.

DECISION

____ Resident Empowerment Savings Accounts

____ Add Resident Empowerment Savings Bonds

____ No Resident savings incentives

✓ ____ Discuss Further

b. Community Investment Funds or Corporations. Owned 51% by zone residents, CICs could be spurred through tax advantages to lenders for loans made to CICs for purchase of qualifying zone tangible assets and firms. The CIC would be a for-profit, resident-driven community investment fund or developer which could, for example, invest in a number of zone businesses or acquire and develop land and buildings within the zone. The CIC would provide a way for zone residents, as shareholders, to accumulate assets, invest in zone businesses, share in profits from development, and gain control of their communities and their economic destinies. Although Treasury and CEA are concerned that zone residents should diversify their investments, most members of the Working Group support the CIC concept as an essential means to give zone residents a real stake in their own economic futures.

The tax advantage for investment in CICs could be provided either (a) through the exclusion of interest from the income of banks and other lenders who make loans to finance CICs or (b) through the issuance of special CIC tax-exempt bonds. Such tax exempt bonds could also be made available through local banks or community development lenders who will then make loans to a CIC based on their own underwriting criteria, including the requisite technical, accounting, and management assistance and expertise. Such Enterprise Zone Tax-Exempt Bonds could be exempt, either in whole or major part (e.g., 75%), from state volume caps. Treasury believes that existing rules for review by a local bond authority would help assure compliance with applicable law, prevent abuse, and involve the local community, without requiring the creation of a new set of anti-abuse rules for a new interest exclusion.

RECOMMENDATION: We recommend that tax incentives for CICs be included. Such tax expenditures for the ten Economic Empowerment Zones would total $140 million over five years. No tax advantaged loan would be made unless the underlying asset, whether a business or land, supports the loan. Making such character loans to CICs should be among the financing mechanisms that banks have to economically empower zone residents.

DECISION

____ Interest Exclusion on CIC qualifying loans

____ Tax Exempt Bonds only for CIC financing

____ No CIC Financing

____ Discuss Further

c. Small, Worker Controlled Enterprises -- Owned 51% by zone resident employees, worker controlled small businesses (less than $5 million in gross annual receipts) could also be encouraged through tax incentives. First, interest on loans to permit resident workers to start or to acquire WCEs could be excluded from taxation to a lender. Second, repayment of principal and interest on the loan could be a deductible business expense to the WCE. With full disclosure, full voting rights, worker control, annual reporting of individual share values to each zone shareholder, and deferral of taxes to the worker until a sale of shares, the WCE will empower resident employees with a full ownership stake in their own businesses, while curbing abuses common to ESOP's.

Secretary Espy strongly supports incentives that empower residents to gain an ownership stake in the businesses in which they work. Others in the Working Group join Agriculture in supporting such employee stakeholding. Treasury and CEA are concerned that WCEs are risky investments for zone residents and are subject to tax shelter abuse in which the benefits go to outside investors rather than to zone residents. As with CICs, Treasury therefore proposes that the tax advantage be financed only through tax exempt bonds, issued by an independent State or Municipal Bond Financing Authority, which can be exempted from State private activity bond caps. As with CICs, these tax exempt bonds could finance loans made by CD banks and other lenders based on their own underwriting criteria, including the requisite technical, accounting and management assistance and expertise.

RECOMMENDATION: We recommend that tax incentives for WCEs be included. Such tax expenditures for the ten Economic Empowerment Zones would total $300 million over five years. No tax advantaged loan would be made unless the underlying small business being started or acquired supports the loan. Making such character loans to WCEs should be among the financing mechanisms that banks have to economically empower zone residents. If successful, WCEs could effectively implement the Grameen bank, microenterprise lending approach in distressed communities throughout rural and urban American.

DECISION

____ Interest Exclusion on WCE qualifying loans

____ Tax Exempt Bonds only for WCE financing

Tax exempt bonds

avoid tax shelters

____ No WCE Financing

____ Discuss Further

d. Employee Stock Ownership Plans (ESOPs). Secretary Espy also strongly supports a modified ESOP structure for larger zone businesses. He recommends providing enhanced tax incentives for special Zone ESOPs. Under current law, eligible lenders may exclude 50% of the interest income they receive on certain loans to an ESOP from taxable income, provided the ESOP has the requisite stake (more than 30%) in the sponsoring employer. The interest exclusion would be raised to 100% for loans to Zone ESOPs which have a 30% stake in the company. In addition, the sale of existing stock to Zone ESOPs would qualify for tax deferred rollover status provided the proceeds are reinvested in securities of other domestic companies. To meet concerns about abuse, all participants in Zone ESOPs would be entitled to the same voting rights on all matters voted upon by other stockholders possessing the highest voting rights.

The Treasury Department opposes any increased tax incentives to Zone ESOPs. Treasury reasons that ESOPs are inherently risky for employees because of lack of diversification of the plan assets. It also argues that traditional ESOPs have not been effective in transferring to low-income employees a significant voice in management decisions or a significant share of the economic appreciation in the value of the employer's stock. It believes the Defined Savings Plan incentive, together with qualified zone private activity bonds (that could be used to finance CICs and WCEs), provide appropriate empowerment incentives for zones.

RECOMMENDATION: Attached at Tab D is Secretary Espy's defense of Zone ESOPs. It is possible that the Treasury proposal for using tax-exempt bonds to finance empowerment incentives could also be used here to alleviate concerns about abuse of Zone ESOPs. Such tax expenditures for Zone ESOPs in the ten Economic Empowerment Zones would total less than $50 million over five years.

DECISION

√ Interest Exclusion for Zone ESOPs

___ Tax Exempt Bonds only for Zone ESOPs

___ No Financing for Zone ESOPs

✓ Discuss Further

6. "FLAT" vs. "INCREMENTAL" EMPLOYMENT AND TRAINING CREDIT

Employment and training tax credits (ETCs) provide an effective means of lowering the cost of doing business for employers and incentives for hiring zone residents. When combined with a coordinated private sector campaign to secure the acceptance and support of employers, they also empower residents to seek employment, to obtain and hold jobs and to receive training. The two-tier proposal recommends allowing employers <u>outside</u> the zone to take advantage of a one-year Targeted ETC ("TETC") -- 40% of the first $6,000 in the first year of each new zone resident employee's wages and qualifying expenses for education and training.[2]

With respect to the ETC, you must decide whether to adopt a flat or incremental approach. The flat ETC provides employers <u>within</u> the zone with a credit of 25% of the first $20,000 in qualified wages and training costs for each zone employee. The credit would remain at 25% for the first six years and then be phased out proportionately over the remaining life of the zone. This credit applies to all resident zone employees.

By contrast, the incremental ETC is applicable only to <u>increases</u> in employment of zone residents (where total employment also increases) over a stated base. It therefore costs

---

[2] The TETC is substantively identical to the Targeted Jobs Tax Credit (TJTC), which will preclude the administrative burdens of having separate criteria and credit amounts. However, we believe we should distinguish the TETC from the TJTC, where certification of eligibility in one of the 10 categories by DOL has too often operated to stigmatize prospective applicants as inferior in the eyes of employers. An education campaign for prospective employers is therefore essential with respect to the Enterprise TETC. The extent of private employer commitment to participate should be one of the factors used by the Secretaries in the Challenge Grant Process to judge the merits of any zone applicant's strategic plan.

Every qualified zone resident will receive an empowerment card in the mail which can be presented to a prospective employer to qualify for the ETC or TETC once place of residence has been verified. The same card will allow zone residents to open a Resident Empowerment Savings Account and a checking account with the nearest Community Development Bank. It also could be used in future experiments with electronic delivery of food stamps, AFDC and job-training and with providing rewards for zone residents who succeed in finding and keeping a job.

substantially less in tax expenditures than the flat ETC.

The flat ETC is simpler for zone employers to use and more effective in lowering total costs of doing business for a zone firm. Though less expensive, the incremental ETC is much more complicated to use and is often ignored by small employers. In addition, the incremental ETC would give a competitive advantage to new businesses over existing zone businesses.

RECOMMENDATION: For the above-stated reasons, the Working Group unanimously favors the flat ETC, but believes this is a close call.

DECISION

_✓_ Flat ETC

____ Incremental ETC

_✓_ Discuss Further

The members of the NEC-DPC Enterprise Zones Working Group include:

AGRICULTURE	Robert Nash Ron Blackley Mike Alexander	CEA	Joe Stiglitz Kevin Berner
COMMERCE	Johnathan Sallet Larry Parks	DPC	Bruce Reed Paul Weinstein
HUD	Andrew Cuomo Bruce Katz Jacquie Lawing	NEC	Gene Sperling Paul Dimond Sheryll Cashin
TREASURY	Maurice Foley Val Strehlow Edith Brashares	OMB	Chris Edley Ken Ryder Steve Redburn
V.P.	Greg Simon		

We have also received important contributions from:

DoEd	Mike Smith Anita Estelle Tom Fagan
HHS	David Elwood
LABOR	Larry Katz Carolyn Golding

OMB Views and Suggested Alternative Approach

OMB supports the two-tier approach to Enterprise Zones but has reservations about the proposed incentives. These concerns are briefly summarized below, and a more flexible alternative is suggested that OMB believes deserves careful consideration.

Concerns About the Proposed Approach

The Enterprise Zones approach to urban and rural development proposed by the NEC would spend $5.5 billion over five years, one-half of this for tax incentives to stimulate new business investment and jobs, primarily in 10 designated zones. This may not be the best use of our limited Federal budget for an urban and rural development initiative.

First, we are concerned that the proposal relies too heavily on apparently costly and largely uncontrollable tax incentives. The emphasis on labor-side as opposed to capital-side incentives is an improvement over previous versions of Enterprise Zones. Nevertheless, using the Treasury's assumptions about revenue losses and job growth in the Zones, it will cost the Treasury about $80,000 in revenues for every job added in that period in the 10 super-zones. *This is four times the cost per job created in the Urban Development Action Grant program.* Previous research on tax incentives to stimulate jobs and development also suggests that, compared to spending approaches, they are expensive and less likely to work. Tax incentives are a blunt instrument, but there may be ways to increase their flexibility as discussed below.

A second concern is that, because the tax approach is so costly, the high costs of extending the proposed approach beyond 10 areas to any significant share of distressed communities may be prohibitive. This is just not the time to be investing very limited budgetary resources in an idea that has a limited chance of payoff <u>or</u>, if it succeeds, could not conceivably be extended to reach more than a small percentage of distressed communities.

An even more fundamental problem with the proposed approach may be that it focuses too much on moving jobs into small areas that are not very hospitable to business investment rather than preparing people in those areas for the work opportunities offered by the regional economy. After all, relatively few people both live and work in the same neighborhood. The most effective strategies to address chronic poverty and urban distress may be those that invest in human capital and in linking people to jobs through transportation, opportunities for relocation, and other means.

One choice would be to save the $2.8 billion now proposed for tax expenditures to fund other critical priorities that the Administration has proposed but are not funded, such as family preservation and campaign finance reform (see Attachment 3 on the final page of this Tab). In that case, the 110 communities could still receive the following:

- In the 10 economic empowerment zones, substantial challenge grants from a pool of $2 billion created by earmarking two percent of planned spending over five years in a number of relevant domestic discretionary programs;

- Grants to plan and reorganize services in the 110 zones (these can be funded from the already appropriated $500 million in 1993 Community Investment Program funds);

- Money to promote community policing and put more cops on the beat in the zones ($500 million in Community Investment Program funds);

- Waivers of CDBG, HOME, and other Federal program regulations to facilitate coordinated, more flexible service delivery;

- Priority for Community Development Banks, provided they meet other qualifying criteria; and

- Designation as "difficult to develop" areas where the eligible basis for computing the value of the Low-Income Housing Tax Credit would be 130 percent of the cost basis.

However, if the President feels that now is the time to put forward a major urban and rural development program, the following is probably a better approach.

<u>An Alternative Approach</u>

OMB supports the component of the NEC's plan which proposes a competitive process for planning grants and other limited assistance to 100 "Enterprise Neighborhoods." If the $4 billion in resources ($2.8 billion in tax expenditures and $1.2 billion in spending) now proposed for the 10 economic empowerment zones is retained, then we suggest the following approach:

A. <u>Designate the 10 superzones up front</u>. Rather than undertaking a lengthy review and selection process, the Administration could identify 10 superzones and could work closely with State and local officials in the designated areas to develop attractive plans quickly. Naming the superzones has political pluses and minuses. Those not named will be disappointed, but the ability to point to a defensible selection of distressed areas and well-conceived action plans will be a plus. The key point is that we want to defend the proposal against dilution. An amendment to add an 11th superzone will have a more apparent cost -- either in terms of the price of the package, or the erosion of assistance to the 10 we have designated. It's not an easy sell, but it may be our best chance of holding down the number of zones and focusing the resources.

B. Provide communities with maximum flexibility. (1) To give communities maximum flexibility to fit local needs, across both the mandatory and discretionary spending elements, the funds could be provided as a single new comprehensive grant with a broad range of authorized uses. (2) If some part of the funds must be used as tax expenditures, then OMB would prefer an approach that gives the communities flexibility to choose a mix of tax items that they believe best supports their own development strategy. (3) A third option would allow communities to vary the mix of spending and tax expenditures as well. More information on how we think these options would work is provided in Attachment 1.

While preserving flexibility, we also may want to suggest to the communities (but not require) that they emphasize the development of human resources in the zones. In that case, we believe that there are at least two promising emphases, as reflected in Attachment 2.

Whatever the approach, OMB supports the proposal for a strong, independent evaluation of the experiment so that, whatever the result, we capture insights that can be used for the next round of efforts to address these very difficult problems.

Attachment 1: **Flexible Funding Options for Enterprise Zones**

Option 1: A Capped Mandatory Entitlement

Reduce $2.7 billion (5 year) tax expenditure component for the 10 Economic Empowerment Zones (superzones); use these "savings" for a mandatory spending program targeted to 10 distressed cities. This program would authorize spending of the funds in the zones for a broad purpose (economic development) by combining the general authorities now provided under HUD's Community Development Block Grant program, HHS's AFDC waiver authority and Headstart, Education's chapter I, Labor's JTPA and other training and employment programs, and others. Communities would submit plans for use of the funds identifying a coordinated development strategy and the planned mix of programs the community intends to pursue in the zone. Plans would be subject to approval by the Federal government, which could encourage a substantive focus such as those outlined in Attachment 2. Funding for the superzones would be spread over 5 years and could be allocated by on a zone-by-zone basis annually (reflecting both need and relative strength of the zone strategies).

Option 2: A Capped, Flexible Tax Expenditure Pool

In contrast to Option 1, Option 2 preserves the $2.7 billion in tax expenditures. However, the ten superzone communities would be given broad flexibility in using the $2.7 billion earmarked for tax expenditures (in addition to the spending component). Each locality could then shape a tax preference package best suited to its objectives: some might emphasize wage credits to encourage labor-intensive businesses; others might emphasize capital incentives to promote construction, rehabilitation, and equipment modernization.

Each community could be given a tax expenditure "budget" or overall cap and a menu of individual tax preferences with "price tags" attached. It could choose its unique mix of preferences, subject to the zone's overall cap. To ensure that the cap was not exceeded, the community would need to suballocate tax expenditure vouchers to the targeted economic activities of firms and individuals (hiring, construction, other capital spending) qualifying for each tax preference. This is similar to the way the Low-income Housing Tax Credit program works at the State level (i.e., an overall cap and individual project prior review and approval). It would allow a locality to target preferences to a particular job category (e.g., no credits for dead-end jobs), approved training, or socially preferred capital investments (e.g., worker-owned firms, high technology companies).

Option 3: A Capped Blend of Mandatory Entitlement and Flexible Tax Expenditures

This option would establish a $4 billion pool of resources, which the 10 superzones could use either for spending authorized under the mandatory grant program or to award selected tax expenditures, as under option 2. This option would still be consistent with the budget resolution that allows Ways & Means and Finance committees to reallocate up to 20 percent of their reconciled spending and revenue increase targets between the two categories. This would be scored by making an initial estimate of the mix of spending and tax expenditures that the 10 communities would be expected to choose. Even though actual decisions may result in a different mix, so long as the aggregate spending total stays within the capped amount, there would be no adverse deficit effect.

Attachment 2

Focus 1: **Education/Personal achievement**

Rationale: Excellent schools can be the institutions that focus community renewal, attract new people and investment.

Essential elements:

- Systemic reforms (Schools 2000) reinforcement
- facilities, systems retrofitting
- teacher training
- foster program integration between school districts, local communities
- school-to-work demonstrations
- "Do the Right Thing" vouchers
- support rigorous education/training opportunities/requirements for AFDC recipients

Discussion: The President's proposed systemic reform (Schools 2000) is about to be launched but is in some trouble with traditional liberal advocacy groups. They argue that imposing national standards on city/rural schools that lack resources to meet the standards is unfair. Not all localities will receive a share of States' funding allocation. An initiative that concentrated aid for facilities upgrading (computers, lab equipment, security), retrofitting electrical and telecommunications systems to support the hardware, and released time (teacher substitutes) for training all-curriculum teachers in software applications would be one answer to these critics. States/localities can be required to include zones' schools in the systemic reform process. To foster program integration between local governments and independent school jurisdictions, both can be given incentives to coordinate their services to protect children outside the school and support the education process. School-to-work demonstrations are in the budget and can be done under current law; some would be targeted to zones. The Administration's major 1995 school-to-work initiative is being drafted, will emphasize minimum competencies, choice at 10th grade level of college or vocational prep., apprenticeships. "Do right" vouchers (which would offer a significant financial reward to all high-achieving high school grads with clean records and no kids, which they could use to go on to college or for rigorous job training) also complement this focus. The current education requirements for AFDC mothers are not fully enforced; grants to States for enforcement in zones would require additional AFDC spending.

Focus 2: <u>Job creation/employment/capital investment/mobility</u>

Rationale: Jobs and income are keys to stabilizing families and normal community life. Closest to original Enterprise Zones concept in focus and political support.

Essential elements:

- wage supplementation (current authority or strengthened)
- guaranteed jobs, training, supportive services to noncustodial parents (Boren Amendment to H.R. 11)
- last resort public service jobs for AFDC recipients
- wage credits to contractors hiring community residents for public construction in the zones
- extra Job Corps slots/other training
- job search assistance for AFDC recipients
- capitalize microenterprise loan funds
- housing rehabilitation; Youthbuild; LIHTC
- infrastructure investments
- reverse commuting

Discussion: The goal is maximizing residents' access to existing private sector employment opportunities. Wage supplementation programs can be conducted under current law by States without triggering PAYGO. However, experimenting with longer duration (max. now 9 months) or Federal enrichment would require new AFDC spending and may or may not have PAYGO consequences depending on details. AFDC or other funds could be used to pay absentee fathers for community service, on the condition that they pay child support. AFDC JOBS participation requirements for job search and employment would be reinforced by new AFDC spending for last-resort community service (housing rehab., child care) and by reverse commuting subsidies. Wage credits would reduce the cost of hiring zone residents and allow contractors to reduce their bids on public projects, would leave a long-lasting public works legacy. HUD could target some public housing modernization, other rehabilitation funds to zones.

Administration Priority
Unfunded/Mandatory Programs
(in millions of dollars)

04/19/93
02:34 PM

	1994	1995	1996	1997	1998	1994-98
OUTLAY INCREASES						
1. Family Support* Proposal in 94 Budget..........	48	91	260	538	597	1,534
2. U.S. maritime industry initiative 1/ DOT proposal to subsidize 90 ships over ten years............	340	340	315	265	220	1,480
3. Medicare premiums Loss in savings since Feb.....	0	0	1,145	1,720	1,990	4,855
4. Campaign Finance Reform*......	50 - 100 2/	50 - 100 2/	50 - 100 2/	50 - 100 2/	50 - 100 2/	250 - 500 2/
Outlay Increases Subtotal.............	438 - 488	481 - 531	1,770 - 1,820	2,573 - 2,623	2,857 - 2,907	8,119 - 8,369
REVENUE LOSSES						
1. Proposal assumed in OMB baseline (but not CBO): Uruguay round 3/.................	0	313	795	1,267	1,694	4,069
2. Proposals endorsed:						
NAFTA...............................	333	476	521	562	607	2,499
GSP 4/...............................	529	501	526	548	564	2,668
Revenue Losses Subtotal...............	862	1,290	1,842	2,377	2,865	9,236

Memo Entry

	1994	1995	1996	1997	1998	1994-98
1. Urban enterprise zones Proposal in 94 Budget and Budget Resolution................	73	347	772	1,228	1,699	4,119

* Possible candidates for funding with some/all of enterprise zones tax expenditures. Both of these spending programs have reserve funds in budget resolution.

1. Low estimate would subsidize based on defense needs only (25 ships for 7 years); 5 year costs total $286 million.
2. These are estimates only; numbers still being developed.
3. Budget resolution based on CBO baseline; revenue offset therefore needed.
4. GSP also has $158 million paygo cost in 1993.

ELIGIBILITY CRITERIA
ECONOMIC EMPOWERMENT ZONES
ENTERPRISE NEIGHBORHOODS

Minimum Population		
Urban	15,000	change?
Rural	5,000	omit
Maximum Population	100,000	lesser of 200,000 or 10%
Maximum Area in Square Miles		
Urban	20	
Rural	1000	
Maximum number of non-contiguous areas		
Urban	3	
Rural, if within state	3	
Rural, if multi-state	0	
Maximum number of States		
Urban	2	
Rural	3	
Minimum % of Households in Poverty		
In 50% of tracts	35%	
In 90% of tracts	25%	
In 100% of tracts	20%	

Additional Poverty Rules:

1. CBD may be included if at least 35% poverty rate
2. 0 population tract may be included
3. Tract with 2000 or fewer residents may be included iff zoned 75% or more commercial or industrial (unless CBD)
4. Secretary discretion to waive if substantial compliance with criteria and targeted area boundaries coincident with state enterprise designation prior to January 20, 1993

LIST OF EXAMPLES 0F FEDERAL CHALLENGE GRANTS FO ENTERPRISE ZONES MAY BE ELIGIBLE TO APPL'

Community Development Banking

Cops on the Street and Community Partnership against Crime (DOJ and HUD)

Enterprise School Communities (DoEd with HUD, DOL, HHS, Commerce)

Youth Fair Chance, YouthBuild, and School-to-Work Transitions--link youth apprenticeship, job training and education to economic and community development projects in the zone and job-apprenticeship partnerships throughout the local labor market (DOL, HUD, HHS, DOJ, National Service and DoEd)

One Stop Shopping and Opportunity Cards for job search, retraining and other services (DOL)

Access to Opportunties, including transportation, job matching throughout labor market, and Moving to Opportunities (HUD, HHS, DOT)

Foreign Trade Zones and Technical Assistance (Commerce)

Minority Business, Small Business, Microenterprise and Venture Funding (SBA and Commerce)

HOME and PHA Tenant economic empowerment, management, ownership (HUD and HHS)

McKinney Homelessness Act, Personal Development and Training (HUD and HHS)

JOBS Make Work Pay--earnings supplement, medical protection, child care and transportation, like New Hope Project (HHS, Treasury, DOL)

JOBS Distressed Area Demonstration--intensive, longer term training and community support, job matching throughout labor market, with many more immediate benchmarks, like Project MATCH (HHS)

Drug education and rehabilitation-to-work (HHS, DOL, DoEd, DOJ)

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

April 16, 1993

To: NEC/DPC Enterprise Zone Working Group

Fr: Secretary Mike Espy

Re: Why we need ESOPs in Enterprise Zones

In 1985, White Pine, Michigan, an isolated copper-mining town of 1200 people, teetered on the edge of economic collapse. To keep the last working mine in Michigan's Upper Peninsula open, employees agreed to wage cuts in a $9 a share employee buyout of Copper Range, Co., owner of the mine.

According to the Wall Street Journal, "the timing couldn't have been better." In 1989 a West German concern paid $80 a share for Copper Range - putting $83 million into the hands of area residents. The 1017 employees of Copper Range pocketed an average of $60,000 each... Overnight, White Pine was transformed from one of Michigan's poorest places into one of its richest."

I relate this story because it demonstrates the unprecedented possibilities available to working Americans via ESOPs. Certainly every ESOP company is not bought out and workers don't accumulate $60,000 in assets overnight everyday. There are far more examples of ESOP companies where workers steadily accumulate assets. To be sure, there are also others where the ESOP is only a tool for the "real" owners to exploit tax breaks.

But when one considers the economic distress that characterized White Pine, Michigan, with scores of people on welfare, small businesses collapsing, families breaking up, and then comprehend the resulting resurgence, this kind of growth potential cannot easily be dismissed.

The essence of the White Pine, Michigan story is that average working Americans were empowered through an ESOP to become equity owners in a free market economy. Like all successful owners, when the value of their holdings increased (in part through their own sweat equity) they made a handsome profit. As we work to craft legislation that can really empower other Americans in communities where the economy collapsed long ago, White Pine, Michigan is powerful example and a success story waiting to be replicated. Within this success story are lessons that we should not ignore.

The ESOP allows hourly wage workers to participate in an aspect of the economy that is foreign to the vast majority. In the best run ESOP companies workers not only have significant stock holdings, they have full voting rights, enjoy access to financial data, and the companies rely on the workers' knowledge and input in the decision making process. In the best ESOP companies workers are empowered in every sense of the word.

In these companies workers not only become part owners, they are educated to think like owners. Most importantly they begin to act like owners. In his book, Paying for Productivity, Alan Binder observes, "It appears that changing the way workers are treated may boost productivity more than changing the way they are paid, although profit sharing or employee stock ownership combined with worker participation may be the best system of all." This is why 43 out of 100 companies on the Inc. Magazine 100 list have ESOPS.

Though ESOPs are not widely popular - there are only 10,000 in the United States - business pages have many examples of companies where shared ownership and responsibility with workers has greatly boosted productivity, profits and income.

For example, ConSonics, a high tech firm in the Shenandoah Valley with 119 employees, recently grew by 269 percent over a five year period. The reason: an ESOP set up over a decade ago under which employees have acquired about 45% of the stock and a system of participatory management that encourages all employees to help solve company problems.

Or take the example of the Michael Baker Corp., an engineering company in Pittsburgh. The company's ESOP, which kept the company from going under, was born in 1984 when Baker was piling up a $2 million annual loss. Since then, the company has turned around in a move the Chairman attributes to the ESOP. Between 1985 and 1991 Baker's revenue surged an average of 20% annually. Employment increased almost ten fold since 1984 to 2,040. More than 1,000 workers have interest in the ESOP which owns 61% of the company.

In June 1992 Inc. Magazine reported on another tremendously successful ESOP. In 1983 Springfield Remanufacturing Corp, in Springfield, Missouri, then owned by International Harvester, faced an uncertain future. IH was cutting loose operations like SRC in a desperate attempt to stay afloat. That's when the managers and 119 workers used an ESOP to buy the company - with stock worth 10 cents a share. The new management's philosophy was that the most efficient, most profitable, way to operate a business is to give everybody a voice in saying how the company is run and a stake in the financial outcome, good or bad.

From 1983 to 1986, sales grew by 30% a year. SRC went from a loss of $60,500 to a pretax earning of $2.7 million. The workforce increased to 650. The stock's value soared to $18.30, an increase of 18,200% in eight years. Hourly workers who had been with the company from the beginning had holdings in the ESOP worth as much as $35,000 per person - the price of a home in Springfield.

Yet another example is Oregon Steel. According to an April 1992 article in the Commerce Business Daily, employees doubled productivity after using an ESOP to purchase 16% of the company. In 1991 their share of company profits came to about 40% of base salaries. In the early 1980s the same company was saddled with high labor costs, outmoded technology and increased competition from foreign companies. Today, it is one of the most profitable companies in the industry.

Another example is Weirton Steel where an ESOP saved 8400 jobs and revitalized the town of Weirton, West Virginia. At Avis, 12,500 workers acquired 100% of the company in a $1.7 billion buy out. They are ahead of schedule at paying off the debt and may have already passed Hertz as the number one rental car company.

There are many similar success stories of companies rebounding, jobs saved, workers empowered, and distressed communities revitalized through employee stock ownership combined with creative management.

Of course there are also risks: some ESOPs replace conventional pension plans so workers risk losing everything if the stock becomes worthless. However, most small companies don't have pension plans anyway. Others are closing them down. We should protect against abuses by giving workers control over their own assets by requiring full disclosure and voting rights.

But the risk factor should not be a deterrent. Our goal is to put residents of distressed areas in position to take risks. At present, they have nothing to lose. I believe strongly that the potential benefits of ESOPs for residents of distressed areas far outweigh the risks. These workers typically have no jobs, no pension plans, and no assets. Diversification is not an issue because there are no savings to diversify. To forsake a financing tool that has proven successful because of risk or the possibility of abuse is tantamount to throwing the baby out with the bath water.

The key issue is whether or not the 100% interest exclusions we have proposed for special Zone ESOPs, coupled with the ESOP provisions already in the law, will attract sufficient capital investments to create jobs and equity ownership opportunities for residents of Enterprise Zones.

Experience already demonstrates that a 100% interest exclusion, coupled with other benefits for ESOPs already in the tax code, is a powerful tool to attract capital investments. The 100% interest exclusion has the same tax benefit as a tax free municipal bond. Bankers and other commercial lenders would make loans directly to Zone ESOP companies. However, unlike trickle down approaches, the expanded growth would be financed through a mechanism (ESOP) that creates ownership opportunities for employees.

Investments in Zone ESOPs will also be attractive because with financing through ESOPS workers know they will gain more take home income through productivity gain and increases in profits - therefore reducing pressure to increase labor costs. As shareholders, workers can increase their income levels through profit sharing and dividends without increasing fixed labor costs. When workers share equity growth and profit sharing companies can produce at lower costs and therefore become more competitive in the global marketplace.

Moreover, if workers have a substantial equity stake in their companies, they are unlikely to agree to the transfer of operations outside the community and more likely to do whatever is necessary to keep the company viable. The result would be a reduction of capital flight.

Clearly, if distressed areas are to reverse their economic decline and enter the economic mainstream sufficient capital must be attracted into those areas. Relying on microenterprises, mom and pop stores, and only small businesses, while helpful, simply won't get the job done. Further, there is simply no way government can spend enough money to "fix" all of the problems. Government can, however, utilize the tax code to direct capital to distressed areas in a way that truly empowers zone residents.

We must create an atmosphere where viable companies, especially our best run companies, will want to invest within enterprise zones - rather than abroad. That means reducing the cost of credit, lower than average market wage rates, a crime free environment (with community policing), and a highly motivated workforce - motivated by a real ownership stake and profit sharing in their jobs and communities.

Government can creatively utilize tax breaks (which almost universally benefit those who already have sufficient capital) to empower those who do not. The ESOP is not perfect. However, it has proven to be the best financial tool to marry capital with workers and, in the best cases, improve productivity, promote growth, and most of all enhance the incomes of working Americans.

There are too many places like White Pine, Michigan and Weirton, West Virginia that are still locked out of the economic mainstream to just ignore what has already happened in those communities. These are success stories waiting to be replicated.

I am convinced that a genuine empowerment strategy must focus on helping people acquire real ownership opportunities. People don't burn what they own. They do their best to protect and enhance it. The fundamental problem within distressed areas is that residents do not have enough opportunities to become owners - real stakeholders - in our society.

With enterprise zones we have an opportunity to start reversing this trend. ESOPs are not the total solution, but an important piece that, in many, many cases, has already succeeded in promoting economic growth, empowering people and revitalizing distressed communities.

Reinventing Govt

THE WHITE HOUSE

WASHINGTON

FEBRUARY 4, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: Bruce Reed

SUBJECT: Campaign to Reinvent Government

I. ACTION-FORCING EVENT: On Tuesday, February 9, you are tentatively scheduled to announce a series of executive orders and other actions designed to streamline the Federal Government. We have prepared a working draft of legislation to create a board with broad statutory authority to reinvent government. This legislation is entitled the "Campaign To Reinvent Government Act Of 1993," and would do the following:

♦ Establish a board of 7 members (4 Democrats and 3 Republicans), appointed by the President, that would lead a campaign to reinvent government. The board would have nine months to conduct a performance audit of the Federal Government. With your approval, it would then submit legislation to consolidate, streamline, or eliminate Federal departments, agencies, commissions, and programs; devolve responsibilities from the Federal Government to the States and establish criteria for awarding performance grants and federal grant waivers; implement civil service reform; reduce red tape; and implement performance-based budgeting.

♦ Require Congress to vote up or down, with no amendments and limited debate, on the recommendations of the board.

♦ Assuming passage of the legislation, direct the Office of Management and Budget, in association with the heads of all affected agencies and departments, to implement the recommendations of the board.

II. BACKGROUND/ANALYSIS: This legislation would give you broad authority to cut spending, reduce bureaucracy, and eliminate unnecessary layers of management -- and demonstrate that you will do everything in your power to make government work better before you ask the middle class to work harder. The review board is based on John Sharp's highly successful performance audit in Texas, and enjoys broad bipartisan support. Senators Glenn, Roth, Lieberman, and Campbell have prepared similar legislation.

In proposing this legislation, you will need to decide who should head it. John Sharp, Phil Lader, and David Osborne are obvious candidates. Warren Rudman could be considered for one of the Republican slots.

III. RECOMMENDATION: We recommend that you announce next week that you will be sending to Congress legislation to create the Campaign to Reinvent Government.

IV. DECISION:

_____Approve _____Approve as amended _____Reject _____No action

FEBRUARY 8, 1993

MEMORANDUM FOR JOHN PODESTA

FROM: **Bruce Reed** BR

SUBJECT: **Reinventing Government Decision Memos**

I am sending along decision memos for the executive orders and Presidential memoranda you should have received from OMB:

1. Executive Order to Reduce the Bureaucracy by 100,000
2. Executive Order to Cut Administrative Costs
3. Executive Order to Reduce Advisory Commissions by 33%
4. Memorandum to Restrict Use of Government Aircraft
5. Memorandum to Reduce Use of Government Vehicles
6. Memorandum to Reduce Various Perks

I have been working under the assumption that the White House staff cuts would be announced on Tuesday, and that these other measures would be announced on Wednesday. Let me know if that has changed.

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Executive Order Reducing the Bureaucracy by at Least 100,000 Positions

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in the federal bureaucracy on Wednesday, February 10, 1993.

II. BACKGROUND\ANALYSIS: This Executive Order seeks to satisfy your campaign pledge to cut the federal bureaucracy by at least 100,000 positions through attrition, as a way to eliminate unnecessary layers of management and improve productivity.

One of every six dollars we spend on domestic programs goes to wages and benefits for federal workers -- not counting administrative costs. Eliminating 100,000 positions in the bureaucracy would save $3-4 billion a year by FY 1996.

This measure will reduce the government's civilian workforce of 2.2 million people by four percent over the next three years. It orders OMB to issue detailed instructions directing executive departments and agencies with over 100 employees to achieve 25 percent of the cuts in FY 1993, 62.5 percent by the end of FY 1994 and 100 percent by FY 1995. At least ten percent of the reductions would come from management (Senior Executive Service, GS-14 and GS-15). Independent agencies are requested to make similar reductions voluntarily.

III. RECOMMENDATION: This action will help fulfill one of your most visible campaign promises. I recommend that you approve the proposed Executive Order.

IV. DECISION:

___Approve ___Approve as amended ___Reject ___No action

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Proposed Executive Order To Cut Administrative Costs

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in executive branch administrative costs on Wednesday, February 10, 1993.

II. BACKGROUND\ANALYSIS: This proposed Executive Order is intended to satisfy your campaign pledge to cut administrative costs in the executive branch by three percent. The Order directs executive agencies and departments to break out administrative costs (to be defined by the Office of Management and Budget) as a separate line item category in their budget requests to OMB. The Order further directs that future budget requests must reflect reductions in the agencies' and departments' administrative expenses of one percent in FY 1994, three percent in FY 1995, six percent in FY 1996, and eleven percent in FY 1997 off the 1993 baseline. Independent agencies are requested to reduce their administrative expenses by the same amounts.

OMB estimates that these cuts would save $2.4 billion a year by FY 1997.

III. RECOMMENDATION: I recommend that you sign the proposed Executive Order.

IV. DECISION:

___Approve ___Approve as amended ___Reject ___No action

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Proposed Executive Order Reducing Advisory Commissions

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in unnecessary advisory commissions on Wednesday, February 10, 1993.

II. BACKGROUND/ANALYSIS: This Executive Order seeks to eliminate unnecessary executive branch advisory commissions. There are over 1,100 advisory commissions, approximately 700 of which have been created even though they are not required by statute.

These commissions issue 1,000 reports a year, cost taxpayers approximately $150 million per year, and are spreading like kudzu. The State Department has an Advisory Committee of the International Commission on the Conservation of Atlantic Tunas <u>and</u> an Advisory Committee to the Inter-American Tropical Tuna Commission. The Transportation Department has a Commercial Fishing Industry Vessel Advisory Committee, a National Boating Safety Advisory Committee, a National Offshore Safety Advisory Committee, a Navigation Safety Advisory Council, and a Towing Safety Advisory Committee.

This proposed Order directs the Office of Management and Budget (OMB) to ensure that executive agencies and departments terminate not less than one-third of those advisory commissions not required by statute. Within 90 days after the date of the Order, executive agencies would be required to submit to OMB: 1) a justification for the continued existence or a recommendation for the termination of each nonstatutory committee and 2) a recommendation to Congress to continue or to terminate any advisory committee required by statute. Agencies and departments would be prohibited from creating or sponsoring any new advisory commission except in compelling circumstances and only with the approval of the Director of OMB. Independent agencies are requested to comply voluntarily.

III. RECOMMENDATION: It is time to clean house in Washington. I recommend that you approve the proposed Executive Order.

IV. DECISION:

___Approve ___Approve as amended ___Reject ___No action

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Restricted Use of Government Aircraft

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in government perks and privileges on Wednesday, February 10.

II. BACKGROUND/ANALYSIS: This Memorandum limits use of government aircraft to select officials (Secretary of State, Secretary of Defense, Attorney General, Director of the FBI, and Director of the CIA), and requires that they (1) use the authority only when the particular circumstances require its use and upon approval of the White House Counsel Office; and (2) reimburse at full coach fare. This differs from current practice which allows agency heads to decide for themselves what represents "required use."

This action would make it explicit that you intend only a limited number of officials to have special access, and remove the presumption that every trip by even that limited group must be on government aircraft.

III. RECOMMENDATION: The memory of John Sununu is still fresh. I recommend that you approve issuance of this Presidential Memorandum.

IV. DECISION:

_____Approve ____Approve As Amended ____Reject ____No Action

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Proposed Presidential Memorandum Reducing Use Of Government Vehicles By High-Level Government Officials

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in executive branch perks and privileges on Wednesday, February 10, 1993.

II. BACKGROUND/ANALYSIS: The Presidential Memorandum would reduce the use of limousines by high-level government officials as follows:

Under current law, the President may designate six Executive Branch employees and ten additional officers for daily home-to-work transportation. In addition, each member of the Cabinet is authorized to designate a principal deputy to receive this "portal-to-portal" service.

The proposed Presidential Memorandum would limit portal-to-portal service to Cabinet members, the National Security Advisor and the White House Chief of Staff.

The proposed Memorandum also directs each federal department or agency to reduce the number of executive motor vehicles (except armored vehicles) that it owns or leases by 50 percent by the end of fiscal year 1993.

III. RECOMMENDATION: Portal-to-portal service was one of the most brazen abuses of privilege in the Bush Administration. Reducing home-to-work service will demonstrate your commitment to saving taxpayer dollars (without decreasing government efficiency) and show that you're not going to let your Administration lose touch with ordinary people. I recommend that you approve issuance of this proposed Presidential Memorandum.

IV. DECISION

___Approve ___Approve as amended ___Reject ___No Action

THE WHITE HOUSE

WASHINGTON

February 8, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED BR

SUBJECT: Proposed Presidential Memorandum To Reduce Various Perks

I. ACTION-FORCING EVENT: You are tentatively scheduled to announce reductions in executive branch perks and privileges on Wednesday, February 10, 1993.

II. BACKGROUND/ANALYSIS: The Presidential Memorandum would reduce perks of Executive Branch employees in the following ways:

Executive Dining Facilities - The Memorandum directs departments and agencies to recover costs for meals served in Executive Dining Rooms, including the White House Executive Mess. It also encourages Secretaries to voluntarily close dining rooms if they are not essential for the conduct of government business.

Fitness Club Facilities - The Memorandum ends the practice of paying for employees' membership at private health clubs (except where an employee's official duties require maintaining physical fitness). Agencies are directed to recover operating and equipment costs from employees who use fitness rooms provided by the agency.

Golf Courses - Government-owned golf courses would be opened to the public (except where the Secretary of Defense designates the course as exempted for security purposes in exceptional circumstances). The Memorandum directs that the costs of operation be recovered from users except in certain limited circumstances.

Conferences - The Memorandum requires that decisions on conference sites and employee attendance be based upon cost effectiveness. The Office of Management and Budget will issue further instructions necessary to implement this requirement.

Medical Services - Agencies are directed, to the extent permitted by law, to charge at least a nominal fee for medical services provided to their employees by the Public Health Service. Certain services, such as emergency care and occupational health screening, are exempted. Military personnel and their dependents are also exempted from the fee requirement.

Agency Souvenirs and Gifts - Agencies are prohibited from using appropriated funds for the purchase of agency souvenirs or gifts.

OMB is directed to implement and ensure compliance with the requirements contained in the Memorandum.

III. RECOMMENDATION: I recommend that you approve issuance of this proposed Presidential Memorandum.

IV. DECISION:

___Approve ___Approve as amended ___Reject ___No Action