November 18, 1997

MEMORANDUM FOR THE PRESIDENT
THE VICE PRESIDENT

FROM: RON KLAIN
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SUBJECT: **Decision Memorandum On Timing of Second Round Empowerment Zone Designations**

The purpose of this memo is twofold. First, to outline the budgetary and programmatic constraints surrounding the implementation of a second round of Empowerment Zones (EZ); and second, to present options regarding the timing of the second round designations.

I. Background

The premise of the Empowerment Zone Initiative is to provide a holistic approach to revitalizing our nation's distressed urban areas. The first round application process provided communities with incentives to develop a comprehensive community-driven strategic plan. The Federal government supported that process by providing generous tax incentives and a flexible block grant of Title XX funds.

Although the premise of the EZ Initiative has not changed, the grant funding and tax benefit package available for Round II designations has been reduced and does not currently support the holistic and comprehensive approach set forth in the first round.

II. Programmatic and Budgetary Constraints of Round II

The Taxpayer Relief Act of 1997, signed into law by the President on August 6, provides the statutory authority for 20 new EZ designations (15 urban and 5 rural). The statute calls for the new zones to be designated by January 1, 1999. The Act also provides for new tax incentives to support those zones.

1. Grant Benefits Are Uncertain, Less Generous And Not As Flexible

The main difference between Round I and Round II is a reduction in the amount and flexibility of grant funding available at the time of application. Round I was funded through a flexible block grant of $100 million for EZs and $3 million for ECs. This block grant provided communities with the opportunity to develop a comprehensive strategic plan that was tailored to locally driven needs and resources.

Round II grant funding was proposed in the President's budget under a 3 year scenario (1998-2000). Unfortunately, Congress has appropriated only $5 million to HUD for planning and technical assistance and $73 million to USDA for first and second round rural EZ/ECs. In addition, DOL is seeking appropriations for between $100-250 Million in categorical "Out of School Youth" funding for competitive grants. Compared to the first round, this is a significant reduction in the amount of grant funding available to second round zones.

2. Tax Benefits Are Reduced, Yet Their Accessibility Has Been Enhanced

The 1997 Taxpayer Relief Act included a different mix of tax benefits for Round II designations. per zone The major decline in benefits from Round I to Round II is the loss of the Wage Tax Credit. Treasury estimates that the revenue impact of a first round EZ designation to be $30 million annually. For the second round, Treasury estimates that the revenue impact of a new EZ designation $5 million per zone. That is an estimated annual reduction of $25 million in tax benefits per zone.

Note: These estimates are based on economic data; not on actual tax filing data.

Although Round II tax benefits are estimated to have less tax impact than Round I, their accessibility has been enhanced by moving tax exempt facility bonds outside state volume caps and liberalizing small business expensing benefits. In addition, EZ/EC designations are also eligible for the Brownfields Tax Incentive, the Work Opportunity Tax Credit for EZ Youth, Academy Bonds and Welfare to Work tax credits.

not sure what all this means.

3. The Pool Of Potential Second Round Applicants Has Been Increased

During the first round, 520 communities competed for 105 urban and rural EZ/EC designations. One out of every 5 communities that applied won an EZ or EC designation. Potential applicants for the second round Empowerment Zone designation include: 1) 415 Champion communities (applied in 1994 but did not win a designation); 2) 94 Enterprise Communities (eligible for EZ status); 3) "First time applicants" (20% poverty, out migration areas, Indian Tribes, AK and HI)

The second round has a potential applicant pool of +500 with only 20 EZ designations. This creates a potential applicant to awardee ratio of 25:1.

III. Proposed Designation Strategies

Option 1: Modified First Round Approach

This approach follows more closely the spirit of the first round. Supporters of this option, which include HUD, USDA, OMB, and the NEC (?), believe the grants available in the FY98 budget do not support a viable second round of Empowerment Zones. These agencies argue that under the currently available appropriations ($5 million for HUD and $71 million for USDA), it would be difficult to rationalize asking communities to develop the type of comprehensive, locally-driven plan that is the foundation of the Administration's EZ/EC program. Proponents of this proposal recommend the Administration withhold designation until additional funding is secured.

1 Under this approach, the Administration would send out applications in early March. Communities interested in applying would be asked to develop comprehensive strategic plans that would include proposals for spending flexible grants that would be the mandator on the mandatory side of your FY98 budget. All applications would be due by the end of ~~December~~, assuming Congress would agree to your budget request in reconciliation no later than August. You would then announce the twenty EZ designees in December.

Sept.

If Congress chooses not to fund any of your budget submission, we would send out an application clarification and award the tax incentives in late November.

Advantages

- Delineates the Administration's Empowerment Zone program from a "Kemp tax-based" Enterprise Zone program. Reinforces the view that combining tax incentives and flexible grants is most effective in creating economic development in distressed areas.
- Clearly maintains the integrity and comprehensive nature of the program;
- Recreates the comprehensive planning and application process that many communities have identified as one of the most beneficial aspects of the EZ program;
- Creates a large pool of applicants who can pressure Congress to commit to providing flexible grant funds.

Disadvantages

- Raises expectations that flexible funds will be available next Fall by requiring EZ applicants to develop strategic plans that spend funds that do not exist;
- Opens Administration up to criticism from communities and Congress for not making tax incentives available in a timely manner;
- No guarantee the Administration will be successful in obtaining Congressional approval for flexible grants next year;
- The Administration will have to delay "victory" until full grant benefits are secured;

Option 2: Two-Step Application Process

Proponents of this approach, which include the DPC and (?), agree that it is unfair to ask communities to go through the difficult and complicated process of developing a comprehensive strategic plan without the incentive of sizable, flexible grants. On the other hand, they also believe it is mistake to deny communities the opportunity to take advantage of the currently available tax incentives until December 1998. Under this two-step process, the Administration would designate the 20 EZs in the Spring. The EZs would receive the available tax incentives and planning grant funds. Once additional funds were secured from Congress, the twenty designees would compete among themselves for a pool of flexible grants.

Step-one: In December a menu of tax incentives and planning grant money will be made available. The application would be short and focus on asking communities to identify private sector commitments and partners to leverage the tax incentives. Designations would be announced by the end of May 1997.

Step-two: The twenty designated communities, utilizing their planning grant money, would be asked to put together a more comprehensive, strategic plan, similar to the type submitted by first round winners. The plans would include performance goals and measurements. The plans would be submitted in the Fall to HUD and USDA. Assuming the Administration secures funds from Congress, you would announce the amounts awarded to the second round EZs by the end of December. One possible twist on this option would be to allow the first round EZs and Enterprise Communities (EC) to apply for the funds as well.

Advantages

- Insures earliest possible use of tax incentives which are already available to designated communities. Streamlines application process and reduces waiting period for making awards;
- Insures that at least twenty communities would go through the same type of beneficial application/strategic planning process that first round applicants experienced.
- Creates a pool of 40 Senators and 20 Representatives who are vested in obtaining the flexible grant funds.
- Allows the Administration to move through the difficult process of choosing twenty winners out of very large pool of applicants at a quicker pace;

Disadvantages

- Only the twenty designees will develop comprehensive/strategic plans instead of the all the applicants.
- If you announce the winners before going to Congress to seek the additional funds for the grant side of the program, you may decrease the chances for success in obtaining grants from Congress..
- If flexible grants are not approved by Congress, creates association with tax based "Kemp styled strategies;"

IV. Recommendation

The working group on Community Empowerment was unable to reach a consensus. HUD, USDA, OMB, and the NEC (?) recommend Option 1. DPC and (?) recommend Option 2.

V. Decision

______ Option 1

______ Option 2

______ Discuss Further