

ENTERPRISE ZONES: THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981

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AUTHOR:

Charlotte Breckenridge

Economics Division

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ISSUE DEFINITION

"Enterprise zones" as a concept originated in England in the late 1970s. The idea is to free specified urban areas of taxes and Government regulations to encourage private business investment and create new jobs. There is little in the way of direct empirical evidence to indicate whether and how such an approach would work. There is considerable interest in the concept, however, since other Federal urban assistance programs (such as Urban Renewal in the 1950s, Model Cities in the 1960s, and Urban Development Action Grant more recently -- since 1978) have not produced in sufficient amount the desired results in creating jobs for the unemployed in inner cities.

BACKGROUND AND POLICY ANALYSIS

Congress has shown considerable interest in the enterprise zone idea. Among bills introduced in the 97th Congress, the Urban Jobs and Enterprise Zone Act of 1981, H.R. 3824 and S. 1310 is receiving most attention. Introduced June 4, 1981, this is a substantially revised version of H.R. 7563 introduced in the 96th Congress. The bills authorize local jurisdictions (not restricted to urban areas) to establish enterprise zones in high-unemployment, low-income areas. Federal tax cuts for businesses in the zones are the main incentives intended to encourage establishment of new enterprises and expansion of existing ones, thereby creating new jobs for the unemployed. Refundable tax credits for workers are also a feature of the bills. The legislation authorizes the creation of up to 25 enterprise zones a year for three years. Jurisdictions would compete for the limited number of zones by means of local incentive packages, such as relief from taxes or regulations, or improved services or infrastructure.

Three other bills containing similar provisions for Federal tax incentives in distressed areas are S. 1240, Urban and Rural Revitalization Act of 1981; H.R. 2965, Enterprise Development Act of 1981; and H.R. 2950, Targeted Area Revitalization Act. Comparisons of the provisions in these bills and in H.R. 3824 and S. 1310 appear in a report by the CRS Economics Division: Comparison of 97th Congress Bills Proposing Enterprise Zones or Revitalization Areas, by Charlotte Breckenridge, Apr. 30, 1982. The comparison is in the form of a matrix, with the features of the bills listed as follows: number of zones, length of life of zones, size of zone, eligibility requirements, administering Federal agency, local commitment, definition of qualified business, tax reductions, selection process, sense of Congress, and "other".

Two bills proposing rural enterprise zones exclusively also have been introduced. H.R. 4576, the Rural Zone Development Act of 1981, was introduced in September 1981; S. 1829, Rural Enterprise Zone Act of 1981 was introduced in November 1981 (these are not companion bills). These bills contain similar provisions to the urban enterprise zone bills, with an additional feature in H.R. 4576 authorizing Federal Appropriations for grants and loans. Features of this bill are an addendum to the comparison mentioned above. Hearings on H.R. 4576 were held by the Subcommittee on Conservation, Credit, and Rural Development of the House Committee on Agriculture, Nov. 16 and 17, 1981.

Federal Tax Incentives for Specified Geographic Areas

Two of the considerations currently receiving attention, that relate to the Federal tax incentives in the bills are (1) their constitutionality; and (2) their ability to leverage private investment. With regard to the first consideration, a legal review of three of the bills states:

The distinction between the standards governing designation used in S. 1240 and those used in H.R. 3824 and S. 1310 could possibly affect their relative constitutionality under Article I, Section 8, Clause 1 of the United States Constitution, which requires that "all Duties, Imposts and Excises shall be uniform throughout the United States." The classification of duties, imposts and excises has been held to include the income tax. See Brushaber v. Union Pacific Railroad Company, 240 U.S. 1 (1916). Therefore, the Federal income tax incentives given to designated areas by all three bills must be evaluated under the rule of uniformity set out by Article I, Section 8, Clause 1. (CRS Division Report, A Comparison of Three Bills in Urban Revitalization Tax Incentives: S. 1240, S. 1310, and H.R. 3824 (97th Congress), by Howard M. Zaritsky, American Law Division, p. 5.)

This review suggests that by providing guidelines basing the tax distinctions on the relative prevalence of poverty and unemployment, the bills (except for S. 1240) "seem to provide adequate assurances of geographic uniformity, in the Constitutional sense...." A report prepared by the Joint Committee on Taxation for the use of the Senate Committee on Finance (Description of S. 1310, Urban Jobs and Enterprise Zone Act of 1981. July 10, 1981. JSC-33-81) cites precedents for targeting special areas under the Internal Revenue Code.

With regard to the second consideration, the Federal Government's ability to use the Internal Revenue Code as a leverage for private economic development investment depends upon the existence of sufficiently high Federal tax rates to permit lowering the rates selectively to offer incentives for specified zones. With the national tax cuts that were enacted during the summer of 1981, this leveraging power would apparently diminish substantially. The Federal tax reductions proposed for enterprise zones have, therefore, probably lost much of their incentive qualities, since the tax code applicable nation-wide offers rates lower than, or comparable to, those proposed for the zones, according to some tax economists. (Whether the Internal Revenue Code is an appropriate instrument for implementing economic development policies for selected geographic areas is still another issue that some observers believe requires attention.)

State and local governments are moving to enact their own enterprise zone legislation, in anticipation of a Federal program such as that proposed in H.R. 3824, which would, in effect, auction to the bidders the right to a limited number of Federally designated enterprise zones.

Administration Stand

Spokesmen for the Reagan Administration have indicated that they favor the concept of enterprise zones, although the Administration has not taken a stand on the provisions in the bills introduced. On the question of deliberate intervention in the market economy (which Federal incentives for

enterprise zones would represent, according to some), an Administration spokesman has said this poses no concern.

Secretary of Commerce Malcolm Baldrige wrote, in a letter to the Chairman of the Subcommittee of Savings, Pensions, and Investment Policy of the Senate Committee on Finance (read at July 13 hearings), that he would favor a bill that "is tightly drafted and precisely targeted, and establishes unambiguously the substantial role which the States, local communities, and the private sector must play in making the concept a reality."

Some Reservations About the Legislation

Sponsors and proponents of H.R. 3824, as well as critics, have noted problems they see in some of the provisions, as well as omissions of elements they regard as important to the program's success. Among these problems and omissions are the following. The bill requires that employers, to be eligible for the enterprise zone benefits, employ at least 40% of their work force from CETA-eligible residents of the zone. A system monitoring possible shifts of residence among the workers has not been specified. Further, there is the question of whether CETA-eligible workers from elsewhere might move to the zone in search of work. This might result in the high unemployment that some areas have experienced when job-seekers arrive from other places, who have heard the areas may offer job opportunities.

One suggested solution to monitoring the residency requirement is to have local community groups and planning boards play a major role. Several proponents of enterprise zones have suggested that the legislation require a local government guarantee that neighborhood groups and local community development corporations play a role in designing and operating the zones. A spokesman for the National Urban Coalition suggests that Enterprise Zone Boards at the local level should monitor moves into the zone by enterprises seeking zone benefits, to reduce the possibility of simple transfers of jobs to the zones, rather than creation of net new jobs.

The tax incentives theoretically are primarily of use to already operating, profitable enterprises with tax liabilities. There is no provision for seed capital for start-up of new businesses.

There is a perceived need for manpower training funds to provide programs for training the potential workforce in the zones. Without such programs, the existing labor is not qualified for employment by the enterprises the zones seek. Some proponents of enterprise zones believe manpower training to be a more central requirement for job creation in distressed areas.

The Conference of Mayors believes at least 100 enterprise zones should be authorized each year to guarantee each State at least two zones. Other proponents, however, prefer a smaller number of zones and increased competition for them.

Critics of the enterprise zone proposal believe it would be impossible for the Internal Revenue Service to monitor the tax incentives, making sure the benefits go only to qualified enterprises and employees. At the same time, some proponents say the proposals as they stand would create another administrative bureaucracy, and that they should be simplified, notwithstanding the risk of abuse or fraud that might be present.

Proponents and critics have noted the possible drag on cities pressed for

fiscal resources, if they must prepare packages of incentives for development that would add to their costs. Administration spokesmen and others have remarked also on the increased challenge to local planners that the enterprise zones would pose.

The AFL/CIO does not support the enterprise zone proposals, with the view that (1) the zones would result simply in shifting the location of firms, and would not result in additional jobs being created; (2) tax benefits are limited to firms within designated zones, and firms outside the zone who employ zone residents would receive no benefits; (3) the elimination of the capital gains tax in the zones could serve as an inducement to sell out and leave the zone; and (4) the tax benefits offer a substantial inducement to establish relatively high-volume, low-income ventures, such as sales office, warehousing and distribution operations, as opposed to more labor-intensive activities.

Aspects of the Proposals That Sponsors and Proponents Say Need Study

Although rough estimates of the costs of the enterprise zone proposed programs have ranged from \$1 billion to \$3 billion, the Joint Tax Committee has not produced an official cost estimate. One of the problems in making an estimate is the lack of size-limit of a zone. Another is the lack of ability to determine which of an estimated 2,500 potentially eligible jurisdictions might apply for a zone designation, and what kind of State and local incentive packages the successful bids might include.

Another area that has not been addressed is the relation of the State and local fiscal policies to Federal policy. Many State and local jurisdictions already offer substantial industrial incentive packages, which have some relation to existing Federal assistance programs. (The relative cost effectiveness of these programs is a subject of some controversy.) The cities have emphasized that they favor the enterprise zone program as an addition to, rather than a substitute for, existing Federal programs such as CETA, Urban Development Action Grants (USAG), Economic Development Administration (EDA), and others.

Administration Proposals

The Joint Committee on Taxation issued a staff pamphlet on Mar. 2, 1982 summarizing revenue measures in the Administration's FY83 Budget, prepared for the Senate Finance and the House Ways and Means Committees. Enterprise zones are listed as item number 7 under income tax provisions:

"Administration Proposal -- the Administration proposes that beginning Jan. 1, 1984 up to 25 small urban areas per year (not to exceed 75 in total) may be designated as "enterprise zones". Special tax incentives and relief from regulation, designed to increase investment and employment, would be provided businesses and individuals locating in these areas. The Administration intends to present the details of its proposal at a later date."

The Office of Management and Budget (OMB) of the Executive Office of the President, in Major Themes and Additional Budget Details, Fiscal Year 1983, discusses enterprise zones on p. 167. Budget authority for the program is listed as zero for each year from 1984 through 1987, with the outlay equivalent (in tax revenues foregone) estimated at \$310 million in 1984, \$620

million in 1985, and \$930 million each in 1986 and 1987. OMB lists four functions of enterprise zones:

- o Providing tax relief at the Federal, State, and local levels.
- o Reducing unnecessary red tape at Federal, State, and local levels.
- o Improving local public services, possibly through experimentation with private provision of some of these services.
- o Involving private, local, neighborhood organizations in the program.

In evaluating applications, the Secretary of HUD would by law consider the contribution of non-Federal governments to tax and regulatory relief; improvement of local public services; and the involvement of neighborhood organizations and private sector groups, OMB says. Basic elements of the enterprise zones should provide the following incentives and opportunities, according to OMB:

- o Incentives for employers to establish or expand business and create jobs in the zone areas.
- o Incentives for people, particularly those currently unemployed or receiving low wages, to take jobs in zone areas.
- o Opportunities for zone residents, including the disadvantaged, to participate in the economic success of the zones.

The Administration's proposal was forwarded to Congress on Mar. 23, 1982, and appears as House Document No. 97-157, "The Enterprise Zone Tax Act of 1982. Message from the President of the United States." The message and accompanying papers were referred jointly to the House Committees on Ways and Means and the Judiciary. On Mar. 30, a bill similar to the Administration proposal, and with the same title, was introduced in the Senate as S. 2298 (Congressional Record, p. S2945, Mar. 30, 1982). (See the table below for a comparison of S.2298 and the Administration's proposals.) On Mar. 31, a bill was introduced in the House, H.R. 6009, containing the Administration proposals and was referred to the Committee on Ways and Means and to several other Committees having jurisdiction over various sections (Congressional Record, Mar. 31, 1982, p. H1342.) The House bill has numerous sponsors, among them Messrs. Kemp and Garcia. Mr. Garcia's office reports that sponsorship of the Administration's bill reflects a desire on the part of the Kemp/Garcia sponsors to provide an area for discussion of changes that might be required in the original H.R. 3824.

Summary of State Activity on Enterprise Zones

According to Edgar E. Vash, Legislative Analyst of the American Legislative Exchange Council (ALEC), the following summary of State activity shows the situation as of mid-March 1982.

Five States have enacted enterprise zone legislation:

- Florida (June 1980) -- 18 areas are being designated. This State has the most experience with enterprise zones, with "significant" business response reported. The legislation was sponsored by the Florida Committee on Tourism.
- Indiana (February, 1981)
- Connecticut (June, 1981) -- No zones have been designated.

Louisiana -- (August, 1981)

Ohio (November, 1981) -- Some zones have been earmarked
for designation.

Six States have bills introduced, that may pass in the near future:

California

Colorado

Illinois -- (A previous bill narrowly missed passage)

Kentucky -- (Most comprehensive bill, according to ALEC)

Maryland

Pennsylvania

Three States have bills introduced that face some political obstacles:

Massachusetts

New York

Tennessee

Some of this legislation is essentially enabling legislation, authorizing local jurisdictions to designate enterprise zones where certain industrial or business incentives will prevail.

COMPARISON BETWEEN S.2298 AND
ADMINISTRATION ENTERPRISE ZONE PROPOSALS

	<u>S.2298</u>
Eligibility and designation. No. of zones.	UDAG eligible, and poverty, unemployment 10 to 25, 1st 3 yr, thereafter unlimited.
Tax breaks for employers.	(1) Refundable tax credit of 5% of wages paid to CETA-eligible employees, no maximum on wages. (2) No capital gains tax. (3) 50% of business income earned in zone is tax exempt.
Tax break for employees.	5% refundable tax credit for wages earned by employee of a qualified business (1 which has 40% CETA-eligible workers.) Maximum wage is \$30,000 (\$1,500 credit).
Cash accounting.	Small business (less than \$2m gross receipts) may elect to use cash accounting.
Loss carryover	Carryover is extended to 20 yr (15 yr is current law).
Regulatory.	Encourages simplification (general language, places qualified businesses under provisions of the Regulatory Flexibility Act of 1980 which allows agencies to rewrite regs for small businesses).
Free trade zones.	Encourages designation of EZ as foreign trade zone.

Administration

Eligibility and designation.	Very similar.
No. of zones.	Up to 25 1st 3 yr, thereafter none.
Tax breaks for employers.	(1a) Nonrefundable tax credit of 10% of increase in payroll for all employees, maximum \$15,000 wage/employee. (1b) Nonrefundable tax credit of 50% of wages paid to disadvantaged workers for 1st 3 yr, no maximum on wages. Beginning in 4th yr, credit phases out at 10%/yr. (2) Same. (3) Additional investment tax credit. (3a) 3% for 3-yr. (3b) 5% for 5-yr property. (3c) 10% on commercial and rental housing, construction or substantial rehabilitation.
Tax breaks for employees.	5% nonrefundable tax credit for wages earned by employee of any zone business. Maximum wage is \$9,000 (\$450 credit).
Cash accounting.	Not included.
Loss carryover.	Carryover extended for longer of life of zone designation or 15 yr.

Regulatory.

Stronger language which allows Federal
bureaucracy to waive regulations which
are not mandated by statute.

Free trade zones.

Same.

LEGISLATION

H.R. 2950 (Rangel)

Targeted Area Revitalization Act. Introduced on Apr. 1, 1981; referred to Committee on Ways and Means.

H.R. 2965 (Nowak)

Enterprise Development Act of 1981. Introduced on Apr. 1, 1981; referred to Committees on Ways and Means; Public Works and Transportation; Banking, Finance, and Urban Affairs; Education and Labor; and Small Business.

H.R. 3824 (Kemp, Garcia, et al.)/S. 1310 (Chaffee, Boschwitz, et al.)

Urban Jobs and Enterprise Zone Act of 1981. Amends the Internal Revenue Code of 1954 to provide certain community development, employment, and tax incentives for individuals and businesses in depressed areas. Introduced June 4, 1981; referred to Senate Finance Committee; to House Committee on Ways and Means, and concurrently to House Committee on Banking, Finance and Urban Affairs for certain portions within its jurisdiction.

H.R. 4576 (Watkins et al.)

Rural Enterprise Zone Development Act of 1981. Amends the Agriculture Act of 1961 to allow the Secretary of Agriculture to provide financial assistance for the economic development of rural enterprise zones; and amends the Internal Revenue Code of 1954 to provide tax incentives for small businesses located in rural enterprise zones. Introduced Sept. 23, 1981; referred jointly to House Committees on Agriculture and Ways and Means.

H.R. 6009 (Conable, et al.)

The Enterprise Zone Tax Act of 1982. Amends the Internal Revenue Code to provide tax incentives to businesses and investors to locate in selected distressed areas. Introduced Mar. 31, 1982; referred to Committees on Ways and Means, Banking, Finance and Urban Affairs, and Judiciary.

S. 1240 (Heinz, Riegel)

Urban and Rural Revitalization Act of 1981. Introduced on May 19, 1981; referred to Senate Committee on Finance.

S. 1829 (Danforth et al.)

Rural Enterprise Zone Act of 1981. Amends the Internal Revenue Code of 1954 to provide tax incentives to investors willing to invest in small towns. Introduced Nov. 9, 1981; referred to Senate Committee on Finance.

S. 2298 (Boschwitz, Chaffee, et al.)

The Enterprise Zone Tax Act of 1982. Amends the Internal Revenue Code to provide tax incentives for business and investors to locate in selected distressed areas. Introduced Mar. 30, 1982; referred to Senate Committee on Finance. Hearings Apr. 15 and 16, 1982.

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Committee on Government Relations. Subcommittee on Intergovernmental Affairs. Feb. 26, 1981.

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