Statement of

Martin D. Levine

Deputy Assistant Director for
Education, Employment, Housing
and Community Development
Congressional Budget Office

Before the

Committee on Ways and Means
United States House of Representatives

November 17, 1983

Several proposals now pending before the Congress would institute a new approach for addressing the problems of economically distressed areas within cities and other local jurisdictions. These proposals would attempt to induce businesses to locate or expand in designated "enterprise zones" by lowering selected federal taxes and, in some instances, by increasing state and local aid to the areas.

Enterprise zones represent a new concept for spurring economic development in distressed areas. Current federal economic development aid is provided through direct expenditure programs. Jurisdictions--which generally must meet eligibility criteria based on overall conditions--plan specific development projects and apply for federal grants. The federal government thus maintains control over the type and location of projects receiving aid. By contrast, under enterprise zone proposals, a limited number of areas within different cities would be identified, and all businesses within those areas that meet criteria established by law would automatically qualify for certain tax reductions and other benefits.

Enterprise zone proposals raise a number of issues. One basic question is who the intended beneficiaries of an enterprise zone policy would be. Is the policy intended primarily to increase employment among residents of a zone or to stimulate development in areas with abandoned or underused facilities? Another question is what types of incentives would be required to change the locational decisions of firms and whether the incentives required would vary for different types of firms or locations. A third issue is the types of areas to designate as enterprise zones: residential areas with concentrations of low-income or unemployed people, outmoded industrial quarters, neighborhood commercial districts, or downtown business districts, for example.

At the Committee's request, I will address just one of the central issues raised by the concept of enterprise zones--establishing criteria to determine which areas receive aid. I will cover three topics:

- Considerations in designating enterprise zones;
- The criteria used in two current federal programs to target assistance on small areas; and
- Targeting provisions under three enterprise zone proposals now before the Committee.

CONSIDERATIONS IN DESIGNATING ENTERPRISE ZONES

The principal proposals pending before this Committee call for only a limited number of areas to be designated as enterprise zones--from 75 to 205. In each proposal, states or cities would nominate areas that met certain criteria specified in the bills. Then, either the Secretary of Housing and Urban Development (HUD) or the Secretary of Commerce would designate a fixed number of enterprise zones from among eligible applications.

The key questions raised in designating zones are thus: What sorts of areas should be eligible to become enterprise zones? And, what considerations should guide the federal government in selecting zones from among eligible applicants?

Eligibility Standards for Enterprise Zones

The areas that would be eligible to become enterprise zones would depend on three factors:

- o The characteristics used to measure economic distress;
- o The thresholds that distinguish eligible from noneligible areas; and
- o Which governments are allowed to nominate enterprise zones.

Characteristics Used to Measure Distress. The decennial Census is the only uniform, nationwide data source available to measure economic distress in subjurisdictional areas. In 1980, the Census gathered basic information on all Americans, as well as additional income, employment-status, and housing information for about one in every six people. This detailed information is aggregated and made available for areas as small as city blocks, but is more reliable at the census tract level--groupings of blocks that together generally contain between 2,500 and 8,000 persons.

The decennial Census data can be used to measure some but not all types of subjurisdictional distress. The available data report only on area residents and their housing. The decennial Census does not include information on area economic conditions, such as the number and type of jobs, the distribution of employment across occupations, or the relative amounts of commercial and industrial activity. Nor does the Census report on physical characteristics of an area, such as the type and condition of nonresidential buildings.

The specific Census characteristics that could be used to measure economic distress of area residents include: household or family income, the unemployment rate, population loss, and housing-quality characteristics.

--Income. Two types of income measures are commonly used to identify concentrations of persons who lack opportunities to work or who work in low-paying jobs; each is represented in current enterprise zone proposals. One approach is to apply a uniform standard such as the federal poverty guidelines. The official poverty level--although it does not take account of differences in living costs across the country or differences in noncash income--is one threshold below which families are likely to suffer some hardships. At the time of the last decennial Census, the poverty threshold was $8,400 for a nonfarm family of four, and 13 percent of all persons lived in poverty.

A second approach is to compare household incomes to an area average--for example, designating households with incomes below 80 percent of an area median as low-income. This approach is intended to take account of differences in living costs across areas, but it can result in fairly well-off households within high-income cities being designated as "distressed." For instance, under two of the pending enterprise zone proposals, households in Livonia, Michigan with 1980 incomes below $24,000 would be considered low-income.

--Unemployment. Another frequently used measure of economic distress in an area is its unemployment rate. Unemployment rates are available monthly for the nation as a whole, for states, and for cities with populations over 50,000. But estimates are available only once a decade for smaller areas. Because unemployment is highly cyclical, the level and geographic pattern of unemployment reported in the 1980 Census will not hold for long, particularly across areas as small as census tracts. Setting a very high unemployment standard might partially circumvent this problem, because even with changes in the geographic pattern of unemployment, tracts with very high jobless rates in 1980 are likely to continue to be among the more distressed areas some years later.

--Population Loss. Population loss is often regarded as a proxy for disinvestment in an area. While population loss may indeed reflect disinvestment, it may also accompany the replacement of larger families with smaller ones, or the conversion of multi-family housing into single-family dwellings. Measuring decline in the number of households, rather than in the number of people, would take account of changes in family size, but not the loss of dwelling units through conversion.

--Housing Characteristics. The only physical characteristics of subjurisdictional areas recorded in the decennial Census are measures of housing quality, such as the proportion of units lacking complete plumbing facilities, and the proportion of units built before 1940. Although such measures could assist in identifying areas with decaying residential buildings, they are not direct measures of economic distress. None of the current enterprise zone proposals would rely on them.

Distinguishing Distressed from Nondistressed Areas. Once the criteria for measuring distress had been selected, the number of zones that could qualify would depend on the threshold established for each criterion and on the number of criteria zones had to satisfy. Thresholds could be set in either of two ways. The Congress could designate an absolute standard--requiring, for example, that areas have a 1980 unemployment rate at least twice the national average, or above 13.8 percent in that year. Applying this criterion, census tracts containing about 7 percent of the U.S. population would qualify. Alternatively, the threshold itself could be set in such a way as to designate the share of areas that would qualify--for example, specifying that only the 5 percent of all census tracts with the highest unemployment rates would qualify on that criterion. For 1980, this would imply a threshold unemployment rate around 15 percent.

The number of different criteria that zones had to meet would also affect the number of zones that could qualify, with greater numbers of requirements resulting in fewer zones qualifying. If, for instance, a zone had to have either an unemployment rate of at least twice the national average or a poverty rate of at least 20 percent, census tracts containing roughly 20 percent of the population would qualify. If, on the other hand, census tracts had to satisfy both criteria, census tracts with approximately 5 percent of the U.S. population would qualify.

The nature of zones--rather than their number--would depend, in part, on whether each census tract in a zone had to meet the distress criteria, or only the zone as a whole had to qualify. Mandating that each census tract in a zone meet the eligibility requirements on its own would help exclude better-off pockets but could limit flexibility in drawing zone boundaries, possibly excluding some sites well suited for development. Requiring that all census tracts qualify individually, but allowing limited exceptions, would maintain some flexibility while targeting aid on the most distressed areas.

Application Requirements. A third question in establishing eligibility requirements is which governments should be allowed to nominate enterprise zones and what commitments they should make to aid the zones selected.

The Congress could allow all localities to submit enterprise zone nominations or could limit applicants to those localities that are themselves distressed. Since only a small number of enterprise zones would be chosen, limiting eligibility to zones within distressed local governments would direct federal aid to the areas with the fewest resources to help themselves. This would, however, exclude some distressed areas from consideration. A similar concern is whether state and local governments would be required to make nominations jointly. Requiring state cooperation in selecting potential enterprise zones could help limit the number of applications made and could increase state attention on distressed zones. It could also, however, exclude some highly distressed areas if a state government were unwilling to nominate them and localities could not proceed alone.

Another consideration is whether nominating governments should be required to commit their own resources to aid their distressed areas. Such a requirement could increase the total amount of resources devoted to enterprise zones, but could burden fiscally distressed jurisdictions. One way around this problem would be to require that better-off jurisdictions commit a greater share of their own resources to aiding their pockets of distress.

Selecting Enterprise Zones from Eligible Applications

Current enterprise zone proposals would leave the final selection of zones to either the Secretary of HUD or the Secretary of Commerce.

Because the number of eligible applications is likely to far exceed the number of zones to be designated, the Congress might wish to provide instructions to guide the selection process.

Since the enterprise zone concept is untried, the Congress could require that the selecting agency choose a wide variety of areas as zones to evaluate the effects of enterprise zone designation on different types of areas. Zones could be designated, for example, in both urban and rural areas, in jurisdictions of varying sizes, and in communities with different industrial and commercial bases. The zones themselves could also differ: some could be primarily residential areas, some neighborhood shopping areas, others industrial sections, and still others central business districts. Because nationwide data are not available to distinguish zones on this basis, the Congress would have to rely on the administering agency to make such determinations, possibly using locally gathered information.

Finally, the Congress could also require that the Secretary consider such additional factors as: the fiscal condition of the state or locality applying, its willingness to commit its own resources, and the likelihood that the federal incentives would affect the patterns of local economic activity.

TARGETING PROVISIONS OF CURRENT PROGRAMS

Two current federal programs target aid on subjurisdictional areas, but they differ substantially in their targeting provisions. Under the Urban Development Action Grant (UDAG) program--which provides direct grants for local economic development projects--all funds must be spent either in distressed cities and urban counties or in pockets of distress within healthier jurisdictions. By contrast, under the mortgage revenue bond program--which allows the issuance of tax-exempt bonds to finance single-family homes--up to 80 percent of funds may be used anywhere, and only 20 percent are reserved for targeted areas.

While the relative amounts of aid these two programs provide to targeted areas vary greatly, the eligibility requirements for target areas are similar. Under the UDAG program, entire cities or urban counties may qualify for aid if they meet several of a list of distress standards, including measures of income, housing quality, and employment. Jurisdictions that fail to qualify as a whole may be eligible for aid if they have distressed areas within their boundaries--referred to as "pockets of poverty." Subjurisdictional distress is measured by the area poverty rate and the proportion of households with low incomes; funds awarded on this basis must be used within the pocket of poverty. Under the mortgage revenue bond program, target areas include all census tracts with high percentages of low-income families and those areas designated by the Secretaries of HUD and Treasury as suffering chronic economic distress, based on area housing conditions and income levels. Roughly one-fourth of the U.S. population lives in cities or counties that meet the UDAG jurisdiction-wide eligibility criteria, and about the same percentage live in areas of chronic economic distress identified under mortgage revenue bond provisions. 1/ (Eligibility standards are described in more detail in Appendix A.)

TARGETING PROVISIONS OF ENTERPRISE ZONE PROPOSALS

The three enterprise zone proposals that the Committee is considering today--H.R. 1955, H.R. 1735, and H.R. 2375--contain markedly different targeting provisions (see Table 1).

H.R. 1955

Of the three proposals reviewed, H.R. 1955 has the most stringent eligibility standards. The bill would allow only those jurisdictions eligible for aid under UDAG's jurisdiction-wide criteria, or jurisdictions containing UDAG-eligible pockets of poverty, to nominate areas as enterprise zones. To be eligible, a zone would have to be found by the Secretary of HUD to be

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1. Both the UDAG and mortgage revenue bond estimates underreport the total U.S. population living in targeted areas. The UDAG estimate does not include the population in areas that could qualify under the pockets-of-poverty provisions, because such data are unavailable. However, HUD estimates that less than two percent of the cities and counties that do not meet jurisdiction-wide criteria contain areas that could meet pockets-of-poverty requirements. The mortgage revenue bond estimate excludes any census tracts that qualify independently on the basis of low income and are not included in the HUD- and Treasury-designated areas. About 6 percent of all census tracts qualify as low-income, but the overlap with "areas of chronic economic distress" is unknown.

TABLE 1. MAJOR ELIGIBILITY PROVISIONS OF ENTERPRISE ZONE LEGISLATION

Provision	H.R. 1955	H.R. 1735	H.R. 2375
Number of Zones to be Designated	75	205	75
Application Process			
Nominating Government	State and Local	State and Local a/	Local
Other Requirements	State and local governments must develop and follow plan to reduce burdens on employers or employees in area, such as reducing taxes, increasing service efficiency, reducing government regulations, or involving private firms in job training and other activities	Local government must prepare revitalization plan; must establish revitalization management authority; and must consult with area citizens and firms	None
Area Requirements			
Population	Minimum: 4,000 if in metropolitan statistical area of 50,000 or more; 1,000 for others	Minimum: 4,000 for cities of 50,000 or more; 2,500 for others	Minimum: 5,000
Boundaries and Geographic Size	Continuous boundaries. No limit on geographic size	Continuous and include, where feasible, vacant or underutilized buildings. Minimum size of 1 square mile	Continuous boundaries. No limit on geographic size
Other	At least one-third of selected zones must be in jurisdictions with populations below 50,000 that are also rural areas or that are outside metropolitan statistical areas	None	Local jurisdiction must contain at least 10,000 people

(Continued)

TABLE 1. (Continued)

Provision	H.R. 1955	H.R. 1735	H.R. 2375
Distress Criteria			
For Zone	Must be an area of pervasive poverty, unemployment, and general distress, AND Must meet at least one of following: 1) rate of unemployment at least 50 percent higher than U.S. average for specified period; or 2) poverty rate of at least 20 percent in each census tract within area; or 3) at least 70 percent of households with incomes below 80 percent of local government median; or 4) area population declined by 20 percent or more between 1970 and 1980	Must be an area of pervasive poverty, unemployment, and general distress, AND Must meet at least one of following: 1) rate of unemployment for most recent 18 months at least 50 percent higher than U.S. average for period; or 2) each census tract must be low-income poverty area determined by Bureau of Census; b/ or 3) at least 60 percent of area residents with incomes below 80 percent of local government median; or 4) area population decreased by 10 percent or more between 1970 and 1980, and local government can show area has chronic abandonment or substantial tax arrearages	Must have rate of unemployment for most recent 2-year period at least 1 percentage point higher than national average for period; OR Must have experienced or be about to experience sudden job loss that is significant both in terms of number of jobs lost and effect on area unemployment rate
For Overlying Jurisdiction	Must be eligible for aid under the Urban Development Action Grant program	None	None
Selection Criteria for Administering Agency	Secretary of HUD shall consider: extent and quality of state and local plan and other commitments; economic conditions in zones; ability to stimulate new economic activity and minimize unnecessary tax loss; private commitments to plan	Secretary of HUD shall consider: degree of general distress; local government commitment; area's ability to make promised commitments; extent to which area plan conforms to any state plans	Secretary of Commerce shall select zones. No selection criteria specified

SOURCE: Congressional Budget Office.

a. Includes a provision for local governments to nominate zones independently if a state government fails to act on a request for nomination.

b. Low income poverty areas are those with poverty rates of 20 percent or more.

an area of pervasive poverty, unemployment, and general distress--though the legislation does not specify standards for these characteristics. In addition, a zone would have to meet at least one of four specific criteria: an unemployment rate at least 50 percent higher than the national average, a poverty rate of 20 percent or more, an income distribution in which at least 70 percent of area households had incomes below 80 percent of the area median, or a 20-percent-or-greater population loss between 1970 and 1980.

This bill would require that applications be submitted jointly by state and local governments, which would be expected to develop plans for reducing burdens on zone employers and employees through, for example, tax reductions or service increases. In selecting enterprise zones from among eligible applicants, the Secretary would be expected to weigh such factors as the degree of distress experienced in proposed enterprise zones, the fiscal condition of the governments applying for aid, and the willingness of states and localities to commit their own resources to the economic development effort.

H.R. 1735

In many respects, H.R. 1735 is similar to H.R. 1955, but it has less stringent targeting provisions. The principal difference is that under H.R. 1735, any local government could nominate enterprise zones--regardless of whether the locality could qualify for aid under UDAG. As under the first bill, the nominated areas would have to be classified as experiencing pervasive poverty, unemployment, and distress and would have to meet at least one of four specific distress measures. The four characteristics used to measure distress would be the same as in H.R. 1955, but the thresholds established for two of them would differ somewhat. 2/

H.R. 2375

H.R. 2375--which would authorize an enterprise zone program as part of a larger economic development act--would approach eligibility differently than the other two bills, relying solely on employment characteristics. It would allow nominations to be made by any local government, regardless of its degree of economic distress. To be eligible, zones would have to meet one of two criteria based on rates of unemployment and loss of area employment. Unlike the other two bills, H.R. 2375 would not require that nominating jurisdictions commit local resources to aid enterprise zones, nor would it establish selection criteria for use by the federal agency responsible for designating zones.

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2. H.R. 1735 would use a less stringent income requirement than H.R. 1955. It would also use a less stringent threshold for population loss than H.R. 1955, but the areas meeting the population-loss standard would also have to show that substantial tax arrearages and chronic abandonment have occurred in the zone.

Comparisons With the UDAG Program

Another way of viewing these bills is to compare their targeting provisions to those governing UDAG. In one respect, all of the enterprise zone proposals would be less restrictive than the UDAG program. While the UDAG program provides aid only to specific projects within targeted areas, enterprise zone designation would confer tax advantages and other benefits on all qualifying firms within the zone.

With regard to area eligibility criteria, H.R. 1955, which has the most restrictive criteria of the three enterprise zone proposals, would also define eligible areas somewhat more narrowly than UDAG. While H.R. 1955 would allow all cities and counties that meet UDAG's jurisdiction-wide or pockets-of-poverty criteria to apply, it would then limit aid to distressed zones within these jurisdictions. The other two bills--H.R. 1735 and H.R. 2375--are more difficult to compare to the UDAG program. Each of the bills would allow UDAG-ineligible cities or counties to apply--thus broadening eligibility relative to UDAG--but, as under H.R. 1955, each bill would require that within participating jurisdictions aid be limited to pockets of distress.

APPENDIX A. MAJOR ELIGIBILITY PROVISIONS OF THE URBAN DEVELOPMENT ACTION GRANT PROGRAM AND THE MORTGAGE REVENUE BOND TAX PROGRAM

TABLE A-1. MAJOR ELIGIBILITY PROVISIONS OF THE URBAN DEVELOPMENT ACTION GRANT PROGRAM

PART I: ELIGIBILITY CRITERIA FOR WHOLE JURISDICTIONS

STANDARDS FOR DETERMINING ELIGIBILITY:

- o A housing stock with at least 33.98 percent of all units built before 1940 for large cities and 33.81 percent for small cities.
- o For large cities, a net increase of $2,683 or less in per-capita money income for the period 1969 to 1977. For small cities, a net increase of $4,062 or less for the period 1969 to 1979.
- o At least 10.87 percent of the population at or below the poverty level for large cities, and 11.99 percent for small cities.
- o For large cities, a rate of population growth between 1960 and 1980 of 19.82 percent or less. For small cities, a rate of population growth between 1970 and 1980 of 1.13 percent or less.
- o An average rate of unemployment for 1981 of 7.24 percent. (This standard does not apply to small cities.)
- o A rate of growth in retail and manufacturing employment between 1972 and 1977 of 6.75 percent or less for large cities and 6.84 percent or less for small cities. Data for one employment type alone can be used where the other is missing. Where no data are available, the standard does not apply.

NUMBER OF STANDARDS THAT MUST BE MET:

Large Cities and Urban Counties a/

- o Any three of the six standards if the percent of persons in poverty is at least one-half the standard; or
- o Four of the five standards other than poverty if the poverty level is less than one-half the standard.

Small Cities

Cities With 25,000 to 50,000 Population

- o Any three of the five applicable standards b/ if the percent of persons in poverty is at least one-half the standard; or

(Continued)

TABLE A-1. (Continued)

- One other standard if the percentage of persons in poverty is at least two times the standard; <u>or</u>

- The poverty standard and a percentage of older housing units at least twice the standard; <u>or</u>

- All four of the other applicable standards if the percent of persons in poverty is less than one-half the standard.

<u>Cities With Less Than 25,000 Population</u>

- Any three of the four applicable standards b/ if the poverty level is at least one-half the standard; <u>or</u>,

- One other standard if the poverty level is at least twice the standard; <u>or</u>,

- The poverty standard and a percentage of older housing units at least twice the standard.

PART II. ELIGIBILITY CRITERIA FOR POCKETS OF POVERTY

- For cities of 50,000 or more in population or for urban counties, pocket must be groups of continuous census tracts, enumeration districts, or blocks having a population of 10,000 or at least 10 percent of the area's population; and

- At least 70 percent of zone residents must have incomes below 80 percent of city or urban county median; and

- At least 30 percent of residents must have incomes below the federal poverty level.

SOURCE: **Federal Register**, March 1, 1983, June 7, 1982, and February 23, 1982. Section 119 of the Housing and Community Development Act of 1974 (P.L. 93-383).

a. Includes cities with populations of 50,000 or more and cities with populations under 50,000 that are central cities of metropolitan areas.

b. Data limitations constrain the use of the unemployment standard for cities with population under 50,000 and the use of the employment standard for cities under 25,000.

TABLE A-2. MAJOR ELIGIBILITY PROVISIONS FOR TARGETED AREAS UNDER THE MORTGAGE REVENUE BOND TAX PROGRAM

Areas may qualify in either of two ways:

Qualified Census Tract

Any census tract in which 70 percent or more of the families have incomes 80 percent or less of the statewide median family income. Or,

Area of Chronic Economic Distress

A state government may apply to the Secretary of Housing and Urban Development and the Secretary of the Treasury to have an area--census tract, city, or county--designated as an area of chronic economic distress. The area must exceed the statewide average on a majority of items listed under each of four criteria.

1. Condition of housing stock

   - Percentage of units constructed prior to 1940
   - Average age of the housing stock
   - Percentage of abandoned housing units
   - Percentage of substandard residential units

2. Need of area residents for owner financing

   - Per capita income
   - Percentage of families in poverty
   - Number of welfare recipients
   - Unemployment rate

3. Potential for the use of owner financing to improve area housing conditions

   - Percentage of owner-occupied homes that are substandard
   - Percentage of families that are low- or moderate-income renters

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(Continued)

TABLE A-2. (Continued)

4.	Existence of a housing assistance plan which provides a displacement program and a public improvement and services program
	o Must provide the existing housing assistance plan as part of its application

SOURCE: **Federal Register**, July 1, 1981.