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DIGITAL DIVIDE POLICY BOOK [2]

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April 14, 2000

MEMORANDUM

**TO: JOHN PODESTA
 GENE SPERLING
 JACK LEW
 CHUCK BRAIN**

**CC: DAVID BEIER
 SALLY KATZEN**

**FROM: SARAH ROSEN WARTELL
 LISA KOUNTOUPES
 JOEL WIGINTON**

RE: LETTER TO DIGITAL SIGNATURES CONFEREES

ISSUE PRESENTED

Senate Democrats have asked that the Administration send a letter along the lines of the attached draft letter from Secretaries Summers and Daley to the Digital Signatures Conferees. They are seeking the Administration's endorsement of their views, which were reflected in a letter from all 45 Democratic Senators to the Conferees (copy also attached). The Administration letter has completed OMB clearance and does not require formal West Wing clearance; however, we thought this a good occasion to ensure you are comfortable with our current strategy on this legislation.

We would suggest that the letter be sent early next week, while members are out of town. While the conferees will not formally meet until the first week in May, each chamber's conferees' staffs have been meeting and we expect them to all meet together over the recess to try to work out an agreement. As you know, there is serious consideration being given to using this conference report as a vehicle to move the Bankruptcy bill. The Senate Democrats are eager for our letter to arrive soon. The letter has been carefully drafted not to anger bill proponents. Nonetheless, we would warn in advance the House Democrats and the Republicans who appear open to working with us that the letter was coming and why it is being sent.

The letter to conferees indicates the Administration's support for removing legal barriers to electronic commerce. Specifically, it states our support for both: (1) **contract formation provisions** that ensure that contracts shall not be denied legal effect or enforceability solely because electronic signatures or records were used in their

formation; and (2) **appropriate records provisions** regarding the legal validity of electronic records (e.g., notices, disclosures, and other records retained in electronic form). (Recall that, in the House, we supported an alternative without any records provisions, volunteering only to work constructively to develop “appropriate legislation.”) At the same time, the letter makes clear that the legislation should maintain current consumer protections for paper transactions in the electronic world and should not relax or strengthen them. Finally, the letter endorses the five principles set forth in the Democratic Senators’ letter (which were developed in conjunction with the Administration) and notes that **“the legislation produced by the conference must incorporate the principles articulated in that letter in order to gain the Administration’s support.”**

We worked closely with Senator Daschle as the five principles in the Democratic Senators’ letter were developed. Various approaches may work to satisfy these objectives. The principles were reflected in a draft of the bill released by Senator Wyden and Leahy developed with our heavy assistance. We have discussed that draft extensively with industry representatives. While they have raised important technical issues, we believe that final language could be crafted that meets the Democrats’ principals and the industry’s objectives in seeking legislation. We cannot provide assurance, however, that all the Republicans active in the Conference Committee will be willing to met these objectives fully. Moreover, we have reason to believe that many Senate Democrats, notwithstanding their letter, want to support the final conference product regardless of how well it addresses these concerns. Nonetheless, **we believe the letter and principles are drafted to give us necessary flexibility.**

The Senate Democratic letter was developed, in part, to increase the Administration’s and the Senate Democrats’ leverage in conference. They sought to demonstrate Democratic solidarity. Thus, they chose not to include language that some members had sought (especially Senators Sarbanes and Leahy), but which others said reflected too high a bar. **The Senate Democrats believe that a comparable statement from the Administration is now essential to maintain that leverage.**

One of the issues that we decided not to raise in the principles is preemption, which are the primary concern of State Governors, Attorneys General, and Legislatures. Under the Uniform Electronic Transactions Act (UETA), States have the authority to exclude certain consumer protection requirements from their State law’s coverage. California excluded many requirements, especially in the insurance area, and it provoked industry to seek the House bill’s provision preempting State law entirely unless the State adopts UETA exactly in the form adopted by the National Conference of Commissioners on Uniform State Laws. The legislation also would bar States from imposing any record retention requirements (i.e., mandating the form in which firms must retain their electronic records for access by regulators). States have written letters, but have not yet engaged effectively. **We are sympathetic to their concerns, but have limited leverage to protect Federal requirements and, thus, cannot make preemption our fight.**

LEGISLATIVE BACKGROUND

The Conference Committee will be made up of five house members (3-2) and 17 Senate members (10-7). Senator Abraham has had the lead in the Senate thus far and wants an accomplishment this year. He and Senator McCain seem open to at least some of the ideas that are important to us, especially as some in industry argue that they should accommodate our concerns in order to quickly complete this conference. Senator Wyden wants a bill, but the other lead Senators – Hollings, Sarbanes, and Leahy – might seek more changes than the traffic will bear and criticize us for insisting on too little. Chairman Bliley seems open to resolving the legislation amicably, but clearly wants ownership; Representative Markey wants to help us find a way to get changes that are important to us (despite his support for the House legislation in its current form) but will not fall on his sword if unsuccessful. There is no conferee whose interests are perfectly aligned with ours, although Wyden and Markey are closest. Both would put up little resistance if simply presented with the House bill, but both seek improvements aimed at addressing reasonable consumer concerns.

No one is sure what role Senator Gramm will play. Hollings and Leahy staff report that they are working cooperatively with the other Republicans, but Gramm's staff are unwilling to consider some of the ideas that the Senate Democrats are promoting, even where industry seems willing or even enthusiastic. Reportedly, Gramm has chastised lobbyists for even talking to the Democrats and the Administration. Gramm and Abraham have released a set of principles of their own and have drafted a bill. Wyden, Leahy, and McCain are working to see if aspects of that version can be incorporated in order to bring Gramm along. But Gramm's staff's recommendation that he chair the Conference (Bliley will be the Chair) has created an interesting dynamic that may work to our advantage with the House Republicans. However, all should be forewarned that Senator Gramm's concurrence with the approach that we and other Democrats favor may be difficult to obtain.

POLICY OBJECTIVES FOR CONFERENCE

Our policy objectives are described below (in order of priority). We recognize that we will be unable to get all of our concerns met and are already working on alternative language where concerns have been raised by industry. We hope to convince a Republican (ideally Bliley in consort with Markey) to offer much of our revised approach as a compromise. If advanced by a Democrat, it will not survive. In the Senate, there is some hope that Leahy and Wyden will reach agreement with McCain and Abraham on an approach that we would find satisfactory.

1. Enhance legal certainty and avoid unnecessary litigation by authorizing regulators to provide interpretive guidance.

House bill: The bill is self-executing. As such, no agency has the ability to interpret its provisions. Moreover, it is unclear whether agencies can interpret aspects of their statutes that are modified by this bill. So, for example, if a statute requires that a

disclosure be provided at a particular time, in a particular form, and it is now provided electronically, questions can arise whether or not the time and form requirements have been met or were modified in some way by this act.

Proposal: We argued that interpretive authority is essential, both to prevent creative interpretations that allow predatory practices and to provide industry certainty. Without it, they might face class action lawsuits by parties alleging that requirements of underlying statutes were not met.

Industry response: Industry is supportive, provided language is clear that interpretations cannot create exceptions to the Act's requirements. They also seek language to encourage regulators to adopt consistent interpretations. These changes are fine.

2. Ensure Effective Consumer Consent to the Replacement of Paper Notices with Electronic Notices.

House bill: Provides that, if a statute requires that a notice or disclosure be in writing, that requirement can be satisfied by an electronic record (e.g., e-mail, or posting the notice on a website), if the consumer affirmatively consents, after being notified of the hardware and software requirements for access to and retention of the record. Moreover, the House bill creates an affirmative obligation (not imposed in the paper world) for the consumer to notify the provider of any change in their email or electronic location.

Proposal: To ensure equivalent treatment, we propose to eliminate the new duties for the consumer. Moreover, we recommend that the consumer be informed of the specific types of records that they are consenting to receive electronically and the right to receive the record in paper (if they have the right under law and the business gives that as an option). And we propose that the consumer's consent be provided electronically from the same email account or other electronic method of access, so as to demonstrate that the consumer has the capacity to receive notices electronically. For most consumers, a recitation of necessary hardware and software requirements will be confusing; many could consent when in fact they would be unable to access their own records. We also propose that, if the company changes its technology requirements so there is a material risk the consumer will be unable to read the notices, a new consent must be obtained.

Industry Response: While some complain about the burden, most acknowledge this would create a more effective form of consent. However, technical issues have been raised about ensuring this works not only for email accounts but also for web-based transactions. We think we can draft alternative language to resolve that concern. Industry also complains about the burden of obtaining new consents and we are far less likely to get much on that issue.

3. Ensure that Electronic Records are Accurate and Relevant Parties Can Retain and Access them.

House bill: Says that, if a statute requires that contract or record be retained, the requirement can be met by retaining an electronic record, if it accurately reflects the information in the contract or record and remains accessible for as long as the statute requires.

Proposal: We suggest technical changes to ensure the information is accessible to the consumer and others entitled by law, not just to the company. We are also concerned that some technologies may make it impossible to determine whether or not something is an accurate version of the original record, but we recognize that nothing could be guaranteed to be “unalterable.” So we propose a middle ground: the record should be preserved in a form that “provides assurances of the accuracy and integrity of the ... record substantially equivalent” to those assurances provided by a written record.” Thus technology could adapt.

Industry response: Technical drafting issues but no substantive objection.

4. Avoid unintended consequences in areas outside the scope of the bill by providing clear federal regulatory authority for records not covered by the bill’s “consumer” provisions.

House bill: While most of the attention has been given to bill provisions that affect consumer transactions, there are other cases where federal law establishes requirements for notices and disclosures provided between private parties. For example, workplace safety and hazardous waste transportation notices.

Proposal: We propose that federal agencies be able to supercede the bill’s requirements if they affirmatively act, after passage of this law, because they believe that electronic delivery could undermine the intention of the underlying requirement. Thus, OSHA could act issue new regulations requiring that hazard notices be physically posted in certain places, because electronic notice would not suffice for safety purposes.

Industry response: No objection raised thus far, although we expect they may request that there be some standard met before agencies can supercede the bill’s requirements. Alternatively, the Gramm-Abraham draft may address the problem by narrowing the scope of the bill to not cover these types of notices.

5. Avoid facilitating predatory or unlawful practices.

House bill: No specific provisions. Consumer groups are especially worried about predatory lenders and scam artists. They fear they will bring a laptop into the home of a vulnerable person and trick or coerce them into foregoing the right to receive paper records and notices that might warn them against the transaction or at least provide a way to trace the scam after the fact. Too many of these people may not have computers of

their own and will never have the ability to access and retain the records they “receive” electronically.

Proposal: We would take some solace from the availability of interpretative authority and the requirement that the consent be provided using the same email account or other mechanism to which notices will be sent, demonstrating consumer access. The Wyden-Leahy draft also contained a provision that would make a consumer’s consent ineffective if induced in an unfair or deceptive manner.

Industry response: The industry violently opposes the Wyden-Leahy language, which they view as creating new “unfair and deceptive acts and practices” (UDAP) authority. (Under current law, Federal banks and thrifts are only subject to UDAP if the Federal Reserve first determines that a practice is unfair and deceptive. They never have.) We will propose instead a savings clause, clarifying that nothing in this bill affects any existing federal or state UDAP authority. But this will be most difficult to get and we may need to simply argue that the interpretive authority gives us the ability to protect against predatory practices.

6. Other.

Federal Government Interests: We also proposed changes to: (1) ensure that the SEC retains authority to impose requirements necessary to protect investors; (2) exempts federal government contracts; (3) allows the Federal government to impose requirements for contracts that it guarantees; and (4) preserves federal record keeping and other requirements, when implemented by the states, as under the environmental laws. We have received no objections to these provisions, although we suspect that there will be a fight about the SEC issue, in which the SEC will have to engage.

DECISION

Proceed as proposed _____ Let’s discuss _____

Attachments:

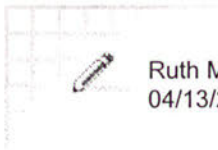
Draft Daley/Summers Letter to Conferees
Letter from Senate Democrats to Conferees

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To: David Tseng/OPD/EOP@EOP, Melissa G. Green/OPD/EOP@EOP, Elliott H. Baer/OPD/EOP@EOP,
Jamie H. Ginott/OPD/EOP@EOP

cc:

Subject: H-1B Fee

I'm looking into a "performance based" fee as per Lofgren's suggestion. Looks like we can both accomodate and give her the credit. INS already agreed to a "premium" processing fee, which would be refunded if they didn't produce as promised. This fee was included in the 2001 budget. So, the model has already been developed and the \$ generated determined sufficient. I think we could come up with a creative design which sets base, unrefundable fee (for training), plus fee contingent on acceptable service.

Premium Processing Fee: This fee which would ensure "premium service" would be voluntary for business-related applications and would not impact family based applications. Improved service includes: guaranteed processing within 15-days for business cases, fax capability for resolution of evidentiary issues and access to an ombudsman to quickly rectify processing errors. The proposed voluntary fee is \$1,000, on top of the existing application fee for business visas.

H-1B Fee Revenue & Distribution

	Current Fee \$500 107,500 cap		Hatch/Abraham \$500 245,000 cap		OLD Smith \$1,000 107,500 cap		Dreier/Lofgren \$1,000/\$500 200,000 cap	
	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue
Job Training Activities	56.3%	47,742,400	36.2%	68,056,000			25%	56,125,000
DOL	56.3%	47,742,400	36.2%	68,056,000				
DOC							25%	56,125,000
Incumbent workers								
Educational Activities	36.2%	30,697,600	56.5%	106,220,000	92.5%	131,350,000	65%	145,925,000
Low-Income (NSF)	28.2%	23,913,600	30.7%	57,716,000			15%	33,675,000
Merit-based (NSF)	4.0%	3,392,000			88.5%	125,670,000		
K-12 Reform (NSF)	4.0%	3,392,000	23.3%	43,804,000	4.0%	5,680,000		
K-12 Grad Teach (NSF)							33%	74,085,000
Loan Forgiveness (Ed)							17%	38,165,000
Upward Bound (Ed)								
Gear-Up (Ed)								
GAANN								
Digital Divide								
Admin./Enf. Activities	7.5%	6,360,000	7.5%	14,100,000	7.5%	10,650,000	10%	22,450,000
INS	1.5%	1,272,000	1.5%	2,820,000	1.5%	2,130,000	2%	4,490,000
DOL	6.0%	5,088,000	6.0%	11,280,000	6.0%	8,520,000	8%	17,960,000
Fraud (INS & State)								
Total	100.0%	84,800,000	100.2%	188,376,000	100.0%	142,000,000	100%	224,500,000
5 year receipts fee time period		248,400,000 1999-2001		599,600,000 1999-2002		305,600,000 1999-2001		913,100,000 1999-2003

	Option 1 \$1,500		Option 2 \$1,500		Option 3 ✓ \$1,500		Option 4 \$1,500	
	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue	2001 Percentage	2001 Revenue
Job Training Activities	35%	137,602,500	45%	176,917,500	50%	196,575,000	56.3%	221,343,450
DOL	20%	78,630,000	25%	98,287,500	25%	98,287,500	56.3%	221,343,450
DOC								
Incumbent workers	15%	58,972,500	20%	78,630,000	25%	98,287,500		
Educational Activities	35%	137,602,500	30%	117,945,000	(25) 23%	90,424,500	36.2%	142,320,300
Low-Income (NSF)	7%	27,520,500	7%	27,520,500	5%	19,657,500	28.2%	110,868,300
Merit-based (NSF)	8%	31,452,000	8%	31,452,000	10%	39,315,000	4.0%	15,726,000
K-12 Reform (NSF)							4.0%	15,726,000
K-12 Grad Teach (NSF)	10%	39,315,000	5%	19,657,500	5%	19,657,500		
Loan Forgiveness (Ed)								
Upward Bound (Ed)	5%	19,657,500	5%	19,657,500	3%	11,794,500		
Gear-Up (Ed)			5%	19,657,500				
GAANN	5%	19,657,500						
Digital Divide								
Admin./Enf. Activities	30%	117,945,000	25%	98,287,500	(25) 27%	106,150,500	7.5%	29,486,250
INS	20%	78,630,000	15%	58,972,500	15%	58,972,500	1.5%	5,897,250
DOL	5%	19,657,500	5%	19,657,500	7%	27,520,500	6.0%	23,589,000
Fraud (INS & State)	5%	19,657,500	5%	19,657,500	5%	19,657,500		
Total	100%	393,150,000	100%	393,150,000	100%	393,150,000	100.0%	393,150,000
5 year receipts fee time period		1,521,050,000 1999-2003		1,521,050,000 1999-2003		1,521,050,000 1999-2003		1,521,050,000 1999-2003

The cap is held constant in each option at 200,000.

The fee level is held constant in each option. It exempts colleges, universities, and non-profits from the fee.

*All of the options assume a cap increase through 2003.

H-1B Legislation

Key Issues

1. H-1B Cap

- X *There should be a limit on the number of H-1B visas, and there should be no exemptions from that cap.*
- X *Set-asides for Master's or Higher Degree.* Include a set-aside within the cap for workers with a master's degree or higher. Phase-in the increase – 40% in 2001, 45% in 2002, and 50% in 2003.

Justification. Currently, approximately 40% of H-1B workers have a master's or higher degree. The set-aside should increasingly target visas towards higher skilled workers.

- X *Set-asides for Higher Education.* If included, should be within the cap (either as a fixed number or a percentage).

2. Registry Date and NACARA Parity

- X Include the Administration's proposals on the registry date and NACARA parity in the bill.

3. H-1B Fee Level and Distribution

- X Increase the fee level to \$2,000 per petition.

Justification. Employers currently pay \$500 per petition. Given the substantial increase in the cap, the requirement for an on-line application system, and the permanent extension of stay for H-1B workers due to the backlogs at INS and DOL, the fee should be increased to adequately fund administration and enforcement, as well as additional training and educational activities for U.S. workers. As structured in current law, the \$2,000 fee would apply to all petitions (initial status, extension of stay, and changing employers) with the exception of colleges/universities, and non-profit and Government research organizations.

- X Revise the fee distribution – 50% for training activities in DOL, 25% for educational activities, and 25% for INS and DOL to cover a portion of the administration and enforcement of employment-based immigration programs.

Justification. The first and primary policy for increasing the availability of high-skilled workers must be focused on increasing the education and training of U.S. workers. The bipartisan Workforce Investment Act (WIA) of 1998, being implemented by DoL, establishes a comprehensive system to provide workers with the information, advice, job search

assistance, education, training and support they need to get and keep good jobs, and that provides employers with skilled workers. The infrastructure for that system is now in place, and the creation of a parallel structure would be duplicative and wasteful.

In addition, given the H-1B program is a “feeder” program for the permanent employment-based program and these programs are operated and enforced by the same staff and equipment, it is appropriate to allow the agencies to fund administrative and enforcement costs related to other employment-based programs with this fee. Without such funding, backlogs will dramatically increase and fraud will go undetected.

4. Extension of Attestation Requirements and DOL Investigative Authority

- X Extend these requirements through the length of the cap increase – e.g., if the cap increase is until FY 2002 then these provisions would be extended until October 1, 2002.

Justification. The Administration fought hard for increased protections for U.S. workers. These protections should be extended through the length of the cap increase. Currently, the provisions sunset in October, 2001.

5. Internet Recruitment

- X Allow Internet recruitment to be an acceptable form of recruitment, but not the exclusive form of recruitment.

Justification. Employers filing a petition for permanent employment must take a number of steps to prove good faith recruitment of U.S. workers. H-2A, H-2B, H-1C, and H-1B dependent employers and willful violators of H-1B must also recruit U.S. workers. Allowing Internet-only recruitment would gut current worker protections by allowing an insufficient test of the U.S. labor market prior to seeking foreign workers. In addition, it would unfairly disadvantage those on “the other side” of the digital divide who seek equal opportunity to apply for these jobs. Lastly, accepting Internet-only recruitment in the immigration context may set a precedent for other employment-related issues such as affirmative action and non-discrimination.

H-1B Legislation Other Issues

1. One-time Protection Under the Per Country Ceiling and Extension of Stay due to Lengthy Processing

- X Limit one-time protection and extension of stay to applications that are filed within the 1st three years the worker is in the country on an H-1B visa; **OR**,
- X Limit one-time protection and extension of stay to H-1B workers that have already applied for adjustment of status as of the effective date of the bill.

Justification. Providing unlimited protection for these workers would create a back-door permanent employment-based immigration program. Recognizing that inadequate government processing has contributed to this problem, providing relief that effectively mitigates the impact on the labor market is appropriate.

2. Technical Issues

- X Include a provision that makes the processing of "failure to select" cases (when a U.S. worker is passed over for a foreign worker) consistent with citizenship status discrimination cases.

Justification. Under current law, a worker must go through a very complicated process. First, the worker must first file a claim with DOJ for a reasonable cause determination. If that is approved, the worker then files with the Federal Mediation and Conciliation Service for findings of fact. If found, the worker is sent back to DOJ for relief. Amending the current law to provide for administrative hearings instead of arbitration is desirable because it would provide consistency in the procedures and evidentiary standard used to resolve these similar causes of action and would be more cost-efficient.

- X Include the Administration's FY 2001 permanent alien labor certification (ALC) fee proposal -- \$1,500 per ALC application.

Justification. Given employers are sponsoring these workers for permanent employment in the U.S., it is appropriate to require a fee to fund additional training and educational activities, as well as administration and enforcement.

- X Application of Internet Based Technologies. If included, provide at least 18 months for INS and DOL to establish an Internet based system.

- X W-2 Forms. A provision requiring employers to provide copies of W-2 forms to DOL creates unnecessary burden on employers and DOL, without providing a benefit.
- X Clarify DOL's current enforcement authority under the permanent alien labor certification (ALC) program.

Justification. This is very important for DOL's re-engineering efforts to be a success.

3. Per Country Ceiling

- X Include a provision to require DOS, in 3 years, to study the impact this provision has on U.S. immigration policy; **OR** sunset this provision with the length of the cap increase.

Justification. Given this provision basically lifts the per country/area ceiling in a calendar quarter, it is important to evaluate the long-term impact this provision will have on U.S. immigration policy.

Revised 4/12/00 8:55am

TO: GENE SPERLING

FROM: ED MONTGOMERY
Acting Deputy Secretary of Labor

Per your conversation with Secretary Herman yesterday, attached is a draft H-1B white paper on innovative training programs and usage of the H-1B fee. Please advise of any comments or concerns.

cc: Ruth Samardick

DRAFT April 12, 2000 8:55am

RESPONDING TO INDUSTRY DEMANDS AND RAPID CHANGE

Introduction

Americans are enjoying the strongest economy in a generation. Given the strong economy, it is not surprising that employers across the country have said that they cannot find enough qualified workers. Soaring demand for technology-related workers in particular has been highly publicized. Americans who want to work and progress need skills to ensure that they can take advantage of the new employment opportunities our economy is creating.

One Key Response: H-1B Technical Skill Grant Program

The American Competitiveness and Workforce Improvement Act of 1998 (ACWIA) was enacted October 21, 1998. It authorized the use of a portion of the employer H-1B application fee that went into effect December 1, 1998 to finance a H-1B Technical Skill Training Grant Program. This training program is designed to help American workers – both employed and unemployed -- acquire the requisite skills in occupations that are in demand, particularly in industries such as information technology and health. These grants provide funds to consortia of business, labor, community-based organizations and local Workforce Investment Boards.

- Fees are deposited on a quarterly basis and credited to the H-1B training account.
 - The first deposit in Treasury by the Immigration and Naturalization Service was January 1999 for funds received in December 1998.
 - Treasury's first distribution to DOL occurred in late January 1999, totaling \$1.8 million.
 - A second distribution in mid-April 1999 added \$12.1 million to the H-1B training account.
 - A third distribution on July 19, 1999 added \$14.4 million for a total of \$28.3 million.
- By July 1999, sufficient funds had accumulated in the H-1B training account so that OMB could approve and DOL could announce the first round of competitions.
- Many H-1B petitions for non-immigrant workers were submitted by employers after the enactment of ACWIA, but before the December 1 user fee start date, in order to avoid paying the fee. This resulted in less funds and a longer waiting period before petitions with user fees were processed.
- Any time a new competitive grant program is set up, DOL consults with interested groups for help in refining the rules and parameters for the competition. The Department of Labor used the time before July 1999 to consult with key stakeholders, including businesses, trade and industry groups, labor organizations, Congressional staff, community- and faith-based organizations, community colleges and others.

- On August 16, 1999, the Department of Labor announced the first round solicitation for H-1B technical skill training, indicating that about \$25 million would be available for grants. (Subsequent competitions will make larger amounts available.) This first round competition closed on November 1, 1999. On February 10, 2000 the Department of Labor announced 9 first-round grant awards totaling \$12.4 million.
- Building on the foundation of the first round of grant awards and incorporating lessons learned and streamlined processes, future rounds are moving more rapidly.
 - The Department of Labor announced March 29, 2000, the availability of an estimated \$40 million for a second round solicitation. Proposals are due June 5, 2000 and awards will be announced in August 2000. The \$40 million includes a current availability of about \$29 million, as well as \$11 million in projected funds.
 - The Department will announce a third round of competition in September. Proposals for this round will be due in October 2000, and awards for this round will be announced in November 2000.
- Additional rounds of competition for H-1B skill training grants will continue as long as funds become available.

Innovative Responses to Skills Shortages in Department of Labor Programs

DOL has funded a number of innovative projects as a result of the first round H-1B Technical Skills Grant competition under ACWIA. They include:

- **The Workplace, Inc. (Bridgeport CT)** - This project proposes a system of employer certified skills centers in southwestern Connecticut to train people in identified occupations that are high skill and in short supply. Workplace Inc. views the current "Emerging Technologies Model" of jobs as very different from the traditional "Business Model". In the traditional pyramidal model, entry-level low-skill jobs at the bottom rung predominated. In the newer model, there are far more high skill jobs with relatively few lower skilled workers to upgrade into the higher levels of employment. The objective is to measurably reduce the need for H-1B visas in the southwest Connecticut area.

The project proposes to use skill standards established under the aegis of the National Skill Standards Board (NSSB) and will formally certify individuals meeting those standards. A number of area businesses, community organizations and educational institutions are involved; in particular, Pitney Bowes will provide classrooms, instructors, materials and equipment.

- **Regional Employment Board of Hampden County, Inc. (Springfield MA)** -The grantee, with twelve core partners – including two One-Stop Career Centers, two

Community colleges, Telitcom Development Corporation (a business-led economic development entity) and Northeast Center for Telecommunication Technology (designed and funded by the National Science Foundation) – is establishing an information and telecommunication technologies workforce development project called IT Squared. Training will occur in IT occupations such as Telecommunications Software Engineers, Cable and Installation (Teledata) High-Level Technicians, and Systems Developers. Creative approaches to the delivery of training will include distance learning via creation of a “virtual” campus for on-demand technical training courses. This method will be combined with campus classroom training and work site internships.

- **NOVA (CA) Private Industry Council (Sunnyvale CA)** - The consortium of business, training, and service organizations includes NOVA, two community colleges, Opportunities Industrialization Center West, University of California Santa Cruz Extension, Joint Venture: Silicon Valley Network, California Employment Development Department, Sun Microsystems, and Cisco Systems. The goal is to equip about 200 individuals with high level technical skills to bridge the “digital divide.” A diverse population from some of the poorest neighborhoods in Silicon Valley, participants will receive one-on-one assistance from counselors/training coaches. A new program called STEP (Systems Administration Training and Employment Program) designed by a team including representatives from Sun Microsystems, Cisco Systems, NOVA and local community colleges will enable individuals to become certified systems administrators in less than one year.
- **The Philadelphia Workforce Development Corp (PWDC)** - In partnership with 60 health care employers, 25 nursing schools, the One Stop Career Center system, and the largest union-based trainer in the country (District 1199C Training and Upgrading Fund of the National Union of Hospital and Health Care Employees, AFSCME, AFL-CIO.), PWDC is launching a comprehensive training initiative designed to address the growing shortage of skilled nurses in the Philadelphia area. In addition to training, the project will offer the full range of supportive services – such as career counseling, testing, assessment, and job placement – provided by the Training and Upgrading Fund and other funding sources.

The Department of Labor has also launched a number of other complementary and creative activities to address the skill shortages issue. They include:

- **Bell Atlantic Multi-state Recruitment for Technical Skills:** The Department of Labor’s partnership with the Bell Atlantic Corporation to recruit employees for technical occupations represents an emerging model of public/private collaboration to address skill shortages. The goal is to recruit as many as 2000 new employees for technical and customer representative jobs across 10 states in the Bell Atlantic Corporation’s New England and Mid-Atlantic regions. The State and local workforce development systems in these regions are the primary recruitment resource for the Bell Atlantic Corporation.

This private/public partnership is based on a mutual commitment to address skill shortages by reaching into the domestic labor market through the public workforce investment system. The partnership is a model of how to meet the challenges associated with a large-scale, multi-State response to skill shortages through building a long-term private/public working relationship. It does not involve a Federal grant to the Bell Atlantic Corporation.

The Bell Atlantic Corporation has rigorous standards for entry level hiring because entry-level employment is the threshold of a career ladder leading to high-paying technical and professional jobs which are supported by extensive employer-sponsored training. A product of this collaboration will be evaluation and technical assistance resources that can be used throughout the workforce development system to serve employers with similar multi-State recruitment needs.

- **Communication Workers of America Military to Work Project** – Military personnel can access this program through the Transition Assistance Program. This Internet program (<http://www.cwajobs.com>) allows transitioning service members and veterans to self-register, take an assessment test, and receive an evaluation of their technical abilities. The program is intended to help users determine the best job match for their skills, interest, and career goals for high technology jobs within the telecommunications industry. Cisco Systems joined the program in January 1999 and provides a sophisticated on-line assessment test.

Many telecommunications companies, including At&T, Lucent Technologies, and PacBell are partnered with CWA and provide CWA information on available jobs. CWA personnel match the service member applications with the appropriate jobs and forward their resumes to the applicable company. Service members who have the aptitude but require additional training are directed to apprenticeship and skill certification programs. In collaboration with Stanly Community College, Cisco Systems also has included an on-line distance learning component that includes assessment and training for computer literacy, computer technology, and to become a Cisco Certified Network Associate (CCNA). Six occupations are available to job seekers: cable installation technician, network technician, personal computer support and applications assistant, local area network/wide area network technician, central office technician, and customer service representative.

- **MetroTech:** On March 23 the Department of Labor announced a \$20 million grant to a regional consortium consisting of Maryland, Virginia, and the District of Columbia to address skills shortages in the Metropolitan region. Known as Metrotech, it is a unique program providing information technology training to 3,300 individuals – primarily dislocated workers – in region. The three jurisdictions collaborate to recruit interested Informational Technology (IT) employers by customizing training and by matching newly skilled workers with jobs. This operational grant builds upon the successful pilot efforts of a smaller planning grant given to the jurisdictions in late 1998, including “repeat business” from local employers.

Metrotech – because it brings together employers, workers, and government – helps meet of both industry and workers and also matches a 21st century challenge with a 21st century solution. It focuses on a coordinated response within in the Greater Washington Metropolitan area – one of the fastest growing locations for technology companies, many with significant workforce needs. By working with technology industry employers to identify job openings and the specific skills needed to meet the demands of those positions, the jurisdictions are better equipped develop recruitment and training strategies to meet these needs. It serves as a model for regions using a multi jurisdictional, public and private sector partnership to meet the training needs of workers while addressing the skills demands of industry.

Working closely with participating employers, curricula are developed by local educational institutions or current curricula are approved by employers to meet a specific the employers' specific hiring needs. Training will provide workers with core competencies required in the high tech field and uses specific training modules geared towards specific employers. Private sector contributions also help finance training, mentoring and other project activities and services. Ninety percent of the trainees are expected to enter employment with the collaborating employers.

- **AOL:** This project -- while still in the developmental stage – will demonstrate the capacity of the public workforce development system to successfully meet the recruitment and initial screening needs of an employer with multiple occupations in multiple locations. Consistent with this goal, the effort will prepare job seekers to meet the needs of high technology occupations that offer solid career and economic potential. The Department of Labor will help State and local workforce investment boards assist AOL as a key source of recruitment. The partnership is expected to focus initially on helping AOL in two call centers across the country and one technical facility located in Herndon VA. Over 1,000 job seekers are expected to be employed through this cooperative effort during the first 12 months of project operations. The Labor Department/AOL partnership will operate with the relevant States and local communities responsible for One-Stop service delivery systems.

AOL will provide detailed information on job requirements and competencies. Local workforce investment boards and One-Stop centers will devise service delivery strategies and referral protocols that make the most sense for both job seekers and AOL. At each local site, the Department of Labor, AOL, and local workforce investment officials will collaborate by identifying "single points of contact" for AOL at the local, State and federal levels.

- **Fort Campbell TN Career Advancement Center (CAC)** - Since 1996, the Fort Campbell CAC has provided employment and training services to over 1,400 soldiers at Fort Campbell,

their dependents and area residents with the goal of providing qualified, well-trained workers for area employers. The Fort Campbell CAC represents a partnership among the North Tennessee Workforce Board, the Department of Labor, the U.S. Army, the National Leadership Institute, the Workforce Excellence Network, and area employers and training providers.

Workforce Investment Act of 1998

The bipartisan Workforce Investment Act of 1998 provided the framework for a workforce preparation and employment system designed to meet both the needs of the Nation's businesses and the needs of job seekers and those who want to further their careers. This system, which will become fully effective July 1, 2000, gives new responsibilities to States and local communities to design and manage training and employment programs at the local level where the needs of customers are best understood. It gives business leaders the opportunity to develop a strategy to address skill shortages through their leadership position on the workforce investment boards. In this capacity, they can play an active role in ensuring that the infrastructure is created that prepares people for current and future jobs. Key components of the Act will:

- Enable customers to easily access the information and services they need through the "One-Stop" system,
- Empower adults to obtain the training they find most appropriate through Individual Training Accounts, and
- Ensure that all State and local programs meet customer expectations.

The bipartisan WIA also provides the authority for a state of the art, quality information system that helps American workers and companies navigate the labor market and exercise informed choice in their workforce decisions. There are several components to this system:

- **America's Job Bank** – the biggest and busiest job market in cyberspace; 1,750,000 job vacancies from every State; new jobs added daily; simple to use..
- **America's Talent Bank** – where more employers find people they need; lists 700,000 resumes; allows job seekers to post resumes electronically.
- **America's Career InfoNet** – the information source for smart career decisions; has national State and metro labor market data; employment trends, wages, and more; millions of employers listed by industry.

- **America's Learning Exchange** – lifelong learning resources at your fingertips; lists 200,000 courses, 5,000 training providers; training, education, technology for career advancement and development.
- **O*Net** – information source for employers, students, job seekers, career counselors and others on job requirements and worker competencies.

In Fiscal Year 2000 roughly \$4.5 billion will be invested in Title I of WIA to support formula-funded services. Congress recognized in ACWIA the need to build a single, unified skill development system under WIA. Thus, it specifies as eligible applicants for the H-1B Technical Skill Training Grants Program Private Industry Councils under the Job Training Partnership Act, local Workforce Investment Boards established under the WIA – or regional consortia of these bodies. As the Department of Labor helps States and local communities implement WIA, it is building and strengthening partnerships among Workforce Investment Boards, businesses, schools, labor unions, public agencies, and community-based and faith-based organizations that can help meet local and regional demands for high-skilled workers.

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by Side Analysis H-1B Legislation

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Views

H-1B Cap

Current Law

FY 1999 = 115,000
FY 2000 = 115,000
FY 2001 = 107,500
FY 2002 = 65,000
FY 2003 = 65,000
FY 2004 = 65,000

S. 2045 Hatch/Abraham

FY 1999 = 115,000
FY 2000 = 115,000 + 80,000 = 195,000
FY 2001 = 107,500 + 87,500 = 195,000
FY 2002 = 65,000 + 130,000 = 195,000
FY 2003 = 65,000
FY 2004 = 65,000

Additional visas provided that are not counted against the cap:

1. visas for institutions of higher education and other research organizations (est. 10,000 visas); and,
2. visas for nonimmigrants with master's or higher degree from a U.S. institution within the period 90 days prior and 180 days following the filing of the petition (est. maximum 40,000).

H.R. 3814 Smith

FY 1999 = 115,000
FY 2000 = 115,000 + 45,000 = 160,000
FY 2001 = 107,500
FY 2002 = 65,000
FY 2003 = 65,000
FY 2004 = 65,000

The 45,000 additional visas provided in FY 2000 are contingent on the employer meeting certain requirements. For example, demonstrating that there was a net increase in total wages paid to U.S. workers during the previous tax year.

H.R. 3983 Dreier/Lofgren

FY 1999 = 115,000 + approx. 20,000*
FY 2000 = 115,000
FY 2001 = 200,000
FY 2002 = 200,000
FY 2003 = 200,000
FY 2004 = 65,000

*Estimate of INS overage.

Within the '01, '02, and '03 caps:
1. 10,000 visas are set-aside for institutions of higher education and other research organizations; and,
2. 60,000 are set-aside for nonimmigrants with a master's or higher degree (or its equivalent).

Increase the set-aside for workers with a master's or higher degree. Suggest phasing-in the increase - 40% in 2001, 45% in 2002, and 50% in 2003. (Change needed in Dreier/Lofgren & Hatch/Abraham)

Delete the cap exemptions for high education and workers with a master's or higher degree, but include set-asides within the cap. (Change needed in Dreier/Lofgren & Hatch/Abraham.)

Add Administration's proposals on late amnesty and NACARA.

Sunset this provision with the length of the cap increase (e.g., in Dreier/Lofgren until October 1, 2003). (Change needed in Dreier/Lofgren & Hatch/Abraham)

Permanent Employment Visas

The annual permanent employment visa cap is 140,000 plus any unused family visas from the previous year.

Per country ceilings

Visas are subject to a limit of 7% per country or 2% per dependent area. For example, the maximum number of visas available for India in a fiscal year is 9,800. In addition, the maximum number of visas issued in a quarter may not exceed 27% of the total available for the year.

Lifts the 7% per country/ 2% area limit in calendar quarters in which the number of visas available exceeds the number of qualified immigrants.

No such provision.

Lifts the 7% per country/ 2% area limit in calendar quarters in which the number of visas available exceeds the number of qualified immigrants.

Limiting fall across for certain countries

The INA provides special rules related to the per country/area limits.

Lifts special rules related to the per country/area limit.

No such provision.

Lifts special rules related to the per country/area limit.

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Side Analysis Legislation

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	Current Law	S. 2045 Hatch/Abraham	H.R. 3814 Smith	H.R. 3983 Dreier/Lofgren	Views
<i>One-time Protection Under the Per Country Ceiling (for H-1B)</i>	The maximum length of stay for an H-1B nonimmigrant is 6 years.	Allows an H-1B nonimmigrant to apply for an extension of stay (beyond the 6 year limit) until their application for a permanent employment visa has been processed.	No such provision.	Allows an H-1B nonimmigrant to apply for an extension of stay (beyond the 6 year limit) until their application for a permanent employment visa has been processed.	Limit this provision to applications that are filed within the 1 st three years the worker is in the country on an H-1B visa; OR, limit the provision to H-1B workers that have already applied for adjustment of status as of the effective date of the bill.
<i>Extension of H-1B Stay due to Lengthy Processing</i>	The maximum length of stay for an H-1B nonimmigrant is 6 years.	Provides an exemption from the 6 year limit to H-1B nonimmigrants who have had a labor condition application or a petition for permanent employment filed on their behalf for at least <u>one year</u> . The AG shall extend the H-1B's status in one-year increments until a final decision is made.	No such provision.	Provides an exemption from the 6 year limit to H-1B nonimmigrants who have had a labor condition application or a petition for permanent employment filed on their behalf for at least <u>six months</u> . The AG shall extend the H-1B's status in one-year increments until a final decision is made.	Same as above.
<i>Recapture Unused Permanent Employment Visas</i>	The annual permanent employment visa cap is 140,000 plus any unused family visas from the previous year.	No such provision.	No such provision.	Beginning in FY 2001, increases the permanent employment visa cap by the number of unused employment visas in FY 1999 (approx. 98,000) and FY 2000 (approx. 40,000 - 50,000). This number is reduced for fiscal years after 2001.	
<i>Internet Recruitment by employers who are required to recruit U.S. workers</i>	Employers filing a petition for permanent employment must take a number of steps to prove good faith recruitment of U.S. workers. H-2A, H-1C, and H-1B dependent employers and willful violators of H-1B must also recruit U.S. workers.	No such provision.	No such provision.	Provides that DOL must accept Internet recruitment efforts and the use of the Internet as an exclusive recruitment tool when determining whether the employer has met the recruitment obligations. The employer must post on a web site designated by DOL (for example, America's Job Bank).	Revise this provision to allow Internet recruitment to be an acceptable form of recruitment, but not the exclusive form of recruitment. (Change needed in Dreier/Lofgren. Hatch/Abraham does not have an Internet recruitment provision.)

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by Side Analysis B Legislation

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	Current Law	S. 2045 Hatch/Abraham	H.R. 3814 Smith	H.R. 3983 Dreier/Lofgren	Views
<i>Application of Internet Based Technologies</i>	No such provision.	No such provision.	No such provision.	Requires, not later than one year after enactment, the AG and Secretary of Labor to establish an Internet web-based system that will permit access to on-line information about the status of a pending application. The AG and Secretary of Labor shall consult with the Technology Advisory Committee (established in the bill) during this effort.	Extend the time period to establish an Internet based system from 12 months to 18 months. (Change needed in Dreier/Lofgren. Hatch/Abraham does not have an on-line application requirement.)
<u>Additional H-1B Provisions</u>					
<i>Increased Portability</i>	An H-1B nonimmigrant cannot move between employers unless the new employer has an approved petition.	Allows an H-1B nonimmigrant to accept employment with a new employer upon the filing of a new petition for the worker. The H-1B nonimmigrant can continue working while the petition is being processed.	No such provision.	No such provision.	Add a provision to extend these requirements through the length of the cap increase - e.g., in Dreier/Lofgren until October 1, 2003. (Change needed in Dreier/Lofgren & Hatch Abraham
<i>Extension of Attestation Requirements and DOL Investigative Authority</i>	Currently, dependent employers and willful violators (as defined by ACWIA) are subject to non-displacement and recruitment requirements. In addition, DOL has investigative authority in certain circumstances.	Extends these requirements until October 1, 2002.	No such provision.	No such provision.	
<i>Recovery of Visas Used Fraudulently</i>		Provides that visas shall be issued in the order in which petitions are filed. In addition, restores visa numbers that have been determined to have been fraudulently obtained.	No such provision.	No such provision.	
<i>W-2 Forms</i>	No such provision.	No such provision.	No such provision.	Requires employers to file H-1B nonimmigrant W-2 forms with DOL. Effective after October 1, 2000.	Delete this provision. (Change needed in Dreier/Lofgren. Hatch/Abraham does not have a V

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2 requirement.)

H-1B Visa Count

INS counts the number of visas based on petition approvals. (Set forth in regulation, not law.)

No such provision.

Requires the Secretary of State to maintain records on the number of visas issued.

No such provision.

Anti-Fraud Provisions

No such provisions.

Requires the following:

No such provision.

(1) specialty workers and fashion models obtain status only via the H-1B program (no other visa);
(2) full-time employment (defined as not less than 35 hours per week);
(3) at least a bachelor's degree or higher in the specific occupation - clarifies that the term "or higher" includes a foreign equivalent degree - experience is no longer counted toward meeting the degree requirement (as is current practice);
(4) an anti-fraud fee of \$100 (as described in the fee section below); and,
(5) that the employer meet additional requirements: the employer must either be a college/university, governmental agency, non-profit, or place of business that it licensed. In addition, the employer must either be a government entity or have aggregate gross assets of at least \$5 million.

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H-1B Fee

Imposes a \$500 per petition fee on employers for: (1) an initial petition, (2) an extension of stay (first time), and (3) changing employers. Exempts colleges /universities and nonprofits from the fee. The fee sunsets on October 1, 2001. The fee is distributed as follows:

- (1) Job training (DOL) -56.3%;
- (2) Low-income scholarships (NSF) - 28.2%;
- (3) Additional NSF Uses - 8%;
- (4) DOL Administration - 6%; and,
- (5) INS Administration - 1.5%.

Extends the current fee for an additional year (expires October 1, 2002). Redistributes the H-1B fee revenue (as reported in Cmte):

- (1) Job training (DOL) - 36.2%;
- (2) Low-income scholarships (NSF) - 30.7%;
- (3) K-12 Grants (NSF) - 25.8%;
- (4) Systemic Reform (NSF) - 2.5%;
- (5) DOL Administration - 6%; and,
- (6) INS Administration - 1.5%.

*Adds to 102.7%.

[Produces an estimated \$351 million in additional revenue.]

Increases the fee to \$1,000. The fee still expires on October 1, 2001. Redistributes the H-1B fee revenue:

- (1) Merit-based scholarships (NSF) -- 84.5%;
- (2) Additional NSF Uses - 8%;
- (3) DOL Administration - 6%; and,
- (4) INS Administration - 1.5%.

[Produces an estimated \$57 million in additional revenue.]

Creates a \$250 expedited processing fee for eligible employers - the revenue is deposited into the Examinations Fee account (not the account with the H-1B fee revenue). [Estimated \$6 million.]

Creates an anti-fraud fee of \$100 - applied to petitions for new workers or petitions to change employers. The fees would be deposited into a separate account. Distributes the fee as follows:

- (1) 20 % for DOJ anti-fraud activities;
- (2) 20% for DOJ to remove deportable H-1B nonimmigrants;
- (3) 40% for State anti-fraud activities; and,
- (4) 20% for DOJ/State joint efforts. [Estimated \$14 million.]

Increases the fee to \$1,000 as of October 1, 2000. It is unclear from the drafting how long the fee is in effect - presumably until 2003. The increased fee only applies to new applications; extensions of stay and change of employers pay \$500 per petition. Redistributes the H-1B fee revenue:

- (1) Job training (DOC) - 25%;
- (2) Low-income scholarships (NSF) - 15%;
- (3) Loan forgiveness for teachers (Educ) - 33%;
- (4) Upward Bound (Educ) - 17%;
- (5) DOL Administration - 8%; and,
- (6) INS Administration - 2%.

[Produces an estimated \$640 million additional revenue.]

Increase the fee level to \$2,000 per petition. (Change needed in Dreier/Lofgren & Hatch/Abraham.)

Revise the fee distribution. See the attached recommended distribution.

Add language that allows DOL and INS to spend the fee on activities related to the administration of the permanent ALC program in addition to the H-1B program. (Change needed in Dreier/Lofgren & Hatch/Abraham.)

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Miscellaneous
Provision

*NSF Study and
Report*

*Miscellaneous
Provisions*

Requires an NSF study to assess the labor market needs for workers with high technology skills over the next 10 years.

Requires NSF to study the divergence in access to high technology ("digital divide") and report on its findings within 18 months after enactment.

No such provision.

No such provision.

Add a provision that stated that D has enforcement authority under a permanent ALC program. (See the DOL draft language implementing the FY 2001 Budget fee proposal. Change needed in Dreier/Lofgren/Hatch/Abraham.)

Add a provision that makes the processing of "failure to select" (when a U.S. worker is passed over a foreign worker) consistent with citizenship status discrimination. (See DOJ draft language. Change needed in Dreier/Lofgren & Abraham/Hatch.)

Add the Administration's FY 2001 proposal -- \$1,500 per ALC application. (Change needed in Dreier/Lofgren & Hatch/Abraham.)



Ruth M. Samardick
04/12/2000 04:49:29 PM

Record Type: Record

To: Melissa G. Green/OPD/EOP@EOP

cc:

Subject: revised House mark-up report

Smith's bill was passed by the Immigrations Subcommittee by voice vote.

Sheila Jackson-Lee offered hers as a substitute, but it was deemed non-germaine due to jurisdiction. (Smith left out all the fee provisions, including only a \$100 enforcement fee, so as to avoid jurisdictional problems.)

Lofgren offered a new substitute. It was different than her last -- haven't seen it but I'm told it included Late Amnesty & Nacara. It was deemed non-germaine as well. In her later remarks regarding her substitute, **she claimed that Clinton commended her on her work on the Dreier/Lofgren bill.** Lofgren's remarks also included sharp criticism of the INS.

A Goodlatte amendment, requiring physical therapists to have qualifications similar to those of U.S. therapists, was adopted.

There was implicit agreement that there will be a full-committee markup.

Several members made remarks in favor of late amnesty and Nacara, including Conyers, Berman, Barney Frank, Shiela Jackson-Lee and Bill McCollum of Florida.

Canady and McCollum both spoke of the need to supplement the agricultural workforce as well, referring to the H-2A program.

Summary of the New Technology Worker Temporary Act

Additional Visas

.. fy 2000, 2001, 2002 No cap on the number of visas available

Conditions

In 2001-02, additional requirements to be met for those visas above current law are as follows:

The petitioning company must demonstrate that it has:

- a) increased its number of American employees over the last year (disregarding spun-off divisions),
- b) increased the total compensation to American employees over the last year, and
- c) increased the average compensation to American employees over the last year.

The high-tech companies that are calling for more H-1Bs visas are growing at a fast rate, hiring all the Americans they can find, and sharing their extraordinary profits with their employees. These companies need additional H-1B aliens in order to keep up these growth rates and to continue to provide new opportunities for American workers. The H-1B quota increase is intended to benefit these companies.

However, companies that are laying off large numbers of American employees or slashing their salaries should not have the opportunity to use an H-1B visa worker.

Final regulations implementing all provisions of the American Competitiveness and Workforce Improvement Act of 1998 must be in effect.

The 1998 compromise H-1B legislation (the American Competitiveness and Workforce Improvement Act) increased the annual H1B cap and at the same time added safeguards for American workers. While the extra visas became immediately

available, the substantive protections have never been implemented because the Administration has never issued final regulations. Thus, the 1998 compromise has not been carried out.

Additional Requirements for All H-1B Visas

H-1B visas will only be available to aliens who will be paid over \$40,000 a year (unless working at universities).

High-tech companies need H-1B visas to employ “the best and the brightest” aliens.

Employers shall provide to the Labor Department in electronic form specified information about each H-1B alien employed (including name, country of origin, academic degree, job title, start date and salary level). The Labor Department shall make such data available on the Internet.

The H-1B program will become completely transparent when information on the use of the program becomes widely available to Americans. This will increase the confidence of the American people in the program. It will also provide information about the demand for technology worker visas.

Fraud Prevention

H-1B aliens must work full time (other than those employed at universities).

Employers currently can petition for part-time workers. Companies doing this may be marginal operations that have trouble meeting the requirements of the H-1B program.

Companies filing H-1B petitions that do not have assets of \$250,000 must provide documentation of their business activity such as a copy of a lease, business contracts, and tax ID numbers.

Under current law, there are no minimum requirements for an employer to file an H-1B petition. H-1B petitions are sometimes filed by questionable companies that have few, if any, assets. These may be “front” companies set up solely to apply for H-1B visas to circumvent the family reunification process or are marginal companies whose level of business activity may be insufficient to pay the

required salary to an H-1B alien.

□ The provision of current law that allows aliens to substitute work experience for a degree is eliminated.

Current provisions encourage overstated and specious claims as to work experience. Assuring that H-1B professionals have college degrees will assure that only well-qualified true professionals will come here to work. The alien of extraordinary skills who does not have a college education can come on an "O" temporary visa.

When an alien applies for an H-1B visa based on a degree from an educational institution outside of the United States, it must be verified by a consular office or its designee located in the country where the degree was granted.

The H-1B program is vulnerable to fraudulent claims of foreign degrees -- counterfeit diplomas from real and fictitious foreign universities and diplomas from institutions not meeting the standards of an American college education. The individuals most able to verify foreign degrees are Department of State officers working in the countries where the diplomas are supposedly or they can consult private credentialing services working for the State Department.

An H-1B petition must be filed on behalf of any alien who is coming to the United States to work in a specialty occupation regardless of the source of the alien's pay.

Current Department of State regulations for "B" visitor visas permit the issuance of visas to certain aliens "normally classifiable as H-1B." Employers who pay aliens from a source outside the U.S. can use this provision to avoid labor attestations and other requirements of the H-1B program designed to protect U.S. workers.

Employers must submit to the Department of Labor each year the "W-2" wage withholding statements for their H-1B employees.

This provision will help enforce current provisions of the law.

H-1B petitioners must pay a special fee (\$100). The funds will be earmarked for H-1B anti-fraud work and split evenly between the INS and the State Department.

The anti-fraud efforts of the Department of State and INS with respect to the H-1B program often falter for lack of resources. The anti-fraud fee would provide more funding for field investigations and joint inter-agency anti-fraud projects. It would also provide funding to pay for deportations of aliens who were admitted to the country based on a fraudulent H-1B application.

State Department Tabulation of H-1Bs

The Department of State would be responsible for counting H-1B visas.

The INS has consistently had problems tabulating usage of the H-1B program. The Department of State, conversely, has been keeping records for the various numerically limited immigrant visa categories for more than 40 years without problems.

Extension of Expiring Provisions

Provisions of the American Competitiveness and Workforce Improvement Act of 1998 that expire after fy 2001 will be extended through fy 2002.

If we are extending additional H-1B numbers through 2002, we should also extend the expiring worker protection provisions from the American Competitiveness and Workforce Improvement Act.

Standards for Issuance of H-1B Visas

Aliens seeking H-1B visas to teach American students must demonstrate proficiency in English.

We should not subject students in college to teaching assistants who cannot speak English well.

Clinton Presidential Records Digital Records Marker

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies the place of a tabbed divider. Given our digitization capabilities, we are sometimes unable to adequately scan such dividers. The title from the original document is indicated below.

Divider Title: _____

**THE U.S. – CHINA WTO ACCESSION DEAL:
A CLEAR WIN FOR U.S. HIGH TECHNOLOGY, GREATER OPENNESS
AND U.S. INTERESTS
*APRIL 4, 2000***

Information Technology Has Helped Transform The U.S. Economy And Fuel Record Growth. Information technology (IT) has made a crucial contribution to the new economy, helping to fuel record growth, higher wages, and changes in the way business is done. IT accounts for only 8% of total jobs, but has been responsible for nearly one-third of U.S. economic growth. Declining IT prices have lowered the overall inflation rate by nearly one percentage point. Wages in the IT industry are 77% higher than the private sector average.

Access To China's Growing Market Is Vital To Maintaining U.S. Global Leadership In Information Technology.

- U.S. high technology industry exports to China have increased over 500 percent between 1990 and 1998. U.S. exports of communications equipment grew over 900% from 1990-1998. China's information technology equipment market is estimated to be growing at 20-40% annually.
- Some analysts predict China will become the world's second largest personal computer market by the end of this year, and the third largest semiconductor market by 2001.
- China is the world's fastest growing telecommunications market. Each year, China installs enough phone lines to replace networks the size of Pacific Bell. By the end of 1999, China boasted approximately 40 million cellular subscribers. Only the U.S. telecommunications market is expected to be larger by the end of 2000.
- In 1999 alone, the number of Chinese Internet users quadrupled, jumping from 2 million at the beginning of the year to 9 million. Growth predictions put Internet users at over 20 million by the end of 2000.

Opening China's Information Technology Market Will Help Integrate China Into The Global Economy And Fuel An Information Revolution In China. The WTO Agreement will make the tools of communication cheaper, better, and more widely available. It will enable Chinese businesses and consumers to connect and integrate with the global economy and advance China's integration into that economy. It will increase the flow and exchange of information among Chinese and between China and the outside world, in ways and such volumes that no amount of censorship or monitoring can totally control. This cannot help but promote the right kind of change in China.

China's Accession To The WTO Will Open China's High Technology Market To U.S. Firms, While Granting Permanent Normal Trade Relations Would Simply Maintain The Market Access Policies We Already Apply To China. China made significant, one-way market-opening concessions across the wide range of high technology products and services. The United States made no market opening concessions. China will eliminate information technology tariffs by 2005, grant trading and distribution rights by 2003, open its internet and telecom markets to investment and services, and provide stronger protection of intellectual property. This will allow the United States to participate in building China's information infrastructure. The Agreement also eliminates distortive investment practices such as local content, forced technology transfer and export performance requirements that can displace U.S. jobs. **The Only Way For Americans to Benefit From This Agreement Is For Congress To Grant China PNTR.**

- **China Will Eliminate Tariffs And Quotas On Information Technology Products By 2005.** Chinese tariffs on information technology products currently average 13%. Upon accession to the WTO, China will adopt the Information Technology Agreement, which eliminates import duties on these products. China will eliminate two-thirds of its tariffs by 2003 and the remaining one-third by January 1, 2005. China will eliminate quotas immediately upon accession.
- **American High-Technology Companies Obtain Trading And Distribution Rights For The First Time.** Currently, U.S. companies' ability to do business in China is strictly limited because the right to engage in trade (importing and exporting), and to engage in distribution services (wholesaling, retailing, transporting, repairing, warehousing, servicing) is restricted to a small number of companies with specific government authorization. China has committed to allow any entity to import most products, including high-technology products, into any part of the country, and will allow U.S. firms to establish, own and operate distribution services within three years of accession. This will allow our businesses to export to China from here at home, and to have their own

distribution network in China, rather than being forced to set up factories there to sell products through Chinese partners.

- **China Will Allow Foreign Investment In All Telecommunications Services For The First Time.** China now prohibits foreign investment in telecommunications. With WTO accession, it will permit 50 percent foreign equity share participation for value-added services (including, for example, electronic mail, voice mail, Internet, on-line information and data base retrieval, and enhanced/value added facsimile services) and paging services two years after accession, 49 percent foreign equity share for mobile voice and data services (including all analogue/digital cellular and personal communications services) five years after accession, and for domestic and international services (including, for example, voice, facsimile, intra-company e-mail, voice and data services) six years after accession. Geographic restrictions will be eliminated for paging and value added services two years after accession, for mobile voice and data services in five years, and for domestic and international services in six years.
- **China Will Adopt WTO Norms For Telecommunications Regulation.** China has agreed to implement the pro-competitive regulatory principles embodied in the WTO Basic Telecommunications Agreement. These include access to the public telecom networks of incumbent suppliers (i.e., interconnection rights) under non-discriminatory terms and at cost-oriented rates, as well as an independent regulatory authority. China has also committed to technology-neutral scheduling, which means that any basic service may be provided through any means of technology (e.g., cable, wireless, satellites).
- **The Agreement Will Provide Strong Protection For Intellectual Property Rights:** China has agreed to implement the Agreement on Trade Related Aspects of Intellectual Property Rights immediately upon accession and with no transition period. The TRIPs agreement is the best vehicle to combat piracy of U.S. software and create a healthy environment for the development of China's software industry. Under the TRIPs agreement, the U.S. software industry will be better able to enforce its intellectual property rights in Chinese courts and administrative tribunals.
- **The Agreement Contains Strong Provisions Against Unfair Or Market-Distorting Chinese Trade.** The Agreement guarantees our right to the special antidumping methodology we apply to non-market economies for 15 years after China's accession to the WTO. China has also agreed to a twelve-year product specific safeguard that ensures that the U.S. can take effective action in case of increased imports from China that cause market disruption in the United States. This applies to all industries, including high technology, permits us to act based on a lower showing of injury, and to act specifically against imports from China. After twelve years, current U.S. safeguard provisions -- Section 201 -- will remain available to address increasing imports.
- **China Will Eliminate Practices That Cost American Jobs And Technology.** China will abolish requirements that U.S. companies transfer their technology in order for U.S. companies to export or invest in China. This will better protect U.S. competitiveness and the results of U.S. research and development. In addition to implementing the WTO's Agreement on Trade-Related Investment upon accession, China will eliminate trade and foreign exchange balancing, local content and export performance requirements and refuse to enforce contracts containing those requirements. China will not condition import licenses and investment approval on performance requirements of any kind, including offset and technology requirements or the existence of a competing domestic producer. All this will make it significantly easier for American companies to export to China from the United States, rather than having to set up in China in order to sell products there.
- **State-Owned And State-Invested Enterprises Will Compete On Commercial Terms.** In this Agreement, China pledged that state-owned and state-invested enterprises will make purchases and sales solely on commercial terms, and will provide U.S. firms the opportunity to compete on non-discriminatory terms. These enterprises comprise a significant portion of the Chinese electronics industry and this Agreement provides rights to combat against discrimination against U.S. companies.
- **The United States Will Continue To Maintain Our Strong Export Control Policies And Laws.** Nothing in this Agreement affects our export control laws or policies, or our ability and conviction to enforce them.

April 8, 2000

MEMORANDUM FOR GENE SPERLING

FROM: TOM KALIL AND JOSHUA WEINSTEIN

RE: INFORMATION APPLIANCES

What is an information appliance -- and how is it different from a PC?

An information appliance is different from a PC in a number of respects. It is typically:

- Cheaper (\$99 - \$300).
- Quicker to turn on and boot up.
- Simpler to use and operate. Some provide a single button for ordering pizza or accessing information on local news and weather.
- Designed to do a few things well as opposed to everything that a PC does. Many information appliances have a focus on providing Internet and Web access - and may come bundled with Internet access.
- Designed to take advantage of the Internet by storing information and programs on the Internet as opposed to storing them locally on a hard drive. This allows people to access their files, calendar, address book, etc. from wherever they are - and is a major paradigm shift from traditional desktop computing.

The post-PC era

The emergence of the information appliance is part of a broader trend that some analysts call the "Post-PC era." It doesn't mean that the PC will disappear. It does mean that there will be an increasing variety of devices that are used to access the Internet, including:

- WebTVs;
- Set-top boxes used for cable and Internet access;
- Cell-phones;
- Personal digital assistants (e.g. the Palm Pilot and its successors);
- Sega and Nintendo games.
- And many, many other specialized devices.

Implications for the digital divide discussion

- The emergence of the low-cost information appliance is used by our critics to suggest that the market will solve this problem. It certainly does underscore the need to repeat to the public that access to hardware is only one piece of the puzzle, and the easiest to solve at that.
- Among the cognoscenti -- talking exclusively about PCs is passe. It's important for us in our remarks (especially before sophisticated audiences) to acknowledge these new trends in industry.

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April 10, 2000

MEMORANDUM FOR GENE SPERLING

FROM: JOSHUA WEINSTEIN

SUBJECT: INFORMATION APPLIANCES ON THE MARKET

The following are information appliances currently offered or that will be coming to market soon.

i-opener

Netpliance's i-opener is a simple, compact appliance. The company promises to have users connected to the Internet within five minutes. The unit connects via a 56 kbps modem. Netpliance preconfigures each i-opener with the owner's ZIP code (for local information such as weather forecasts) and the regional dial-up access number, so there is no software setup. Users plug in the power and phone cords and then let the i-opener configure itself. The interface (the way a user navigates) is more graphic-focused and requires significantly less computer knowledge than does a Windows interface. The device can be purchased for \$99. The monthly fee for Internet service is \$21.95

IBM Internet Appliance

Similar in concept and design to the Netpliance i-opener the IBM unit has a 10-inch screen and a sleek, matte-black case. Unlike the i-opener, the IBM entry is expected to deliver built-in broadband access (DSL or cable modem) right out of the gate. There won't be any local storage (no hard drive, per se, except to help run the Web browser). The device will be co-marketed with broadband service providers and ISPs. A single monthly fee will cover the cost of the broadband access and the use of the device.

AOL-Gateway appliances

AOL and Gateway have joined forces to create a number of non-PC devices with which to access the Internet. The three products that are being developed are small, lightweight tools for accessing the Internet in a variety of ways during the course of a consumer's daily life. Through the appliances' touchscreens, wireless keyboards or traditional keyboards, members will be able to get online quickly and easily with just a touch of a button, and perform online tasks much as they would on a PC. AOL and Gateway will offer:

- ⇒ Desktop appliance: reliable connection and fast access to the features and content of AOL and the Internet. Expected to go on sale by the end of 2000.
- ⇒ Wireless Web pad: an easily portable way to access popular AOL features and content within the home in addition to a wireless connection to a compact base station, enabling the consumer to use the appliance anywhere within the home. Expected to go on sale by 2001.
- ⇒ Countertop appliance: will provide access to a customized version of the AOL service over a device that is small and light enough to be placed in highly trafficked areas of the house such as the kitchen or family room. The device can be mounted on any flat surface to offer the whole family quick and easy "touch" capability in virtually any room of the house. Expected to go on sale by the end of 2000.

WebPC by Dell

For \$999 WebPC has the same specifications as many consumer PCs, but with a smaller chassis. The unit ships with a one-year subscription to Dell's Internet service so users can be online within a few minutes of opening the box. It uses a Windows interface, but the overall set-up/installation is more user friendly.

iPhone

The InfoGear iPhone works as an e-mail station and Web access point for simple tasks (such as checking the news, weather, or stock quotes). This unit looks more like a telephone with a 7.4-inch monochrome touch-screen than a PC or any of the aforementioned Internet appliances. You can use the icons on the touch-screen for navigation and data entry or pull the hidden keyboard from beneath the unit to enter Web addresses and e-mail message. The problem is that this device makes it difficult to view larger web pages; still the iPhone is fine for quick, simple web tasks.

Corporate market: Compaq's iPaq and Hewlett-Packard's e-Vectra

These two units stress corporate features, such as asset tracking and remote manageability. They move away from legacy ports (all the differently shaped slots on the back of your computer) offering USB – Universal Serial Bus – ports, a new, simpler standard instead. The sleek, futuristic design is more approachable than the large desktop computers to which we have become accustomed. Both units start at around \$500.

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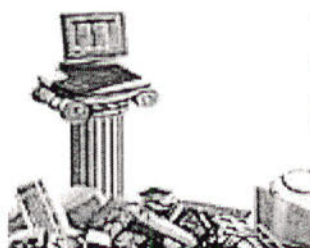
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The Lighter Side Of PCs

Less Is More For Some Computer Users

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Throughout the 1990s, we saw desktop PCs earn their name by occupying entire desks, one box attended by a dozen peripherals, each with its own annoyingly unique cable. As the Web blossomed, we created sites for every idea under the sun and produced an endless series of linked strands that soon grew cumbersome.

Because we could add more, we did. Office suites grew bloated and operating systems added layers like monstrous onions. Computers' threatening complexity is a strong deterrent for most would-be owners. PC vendors are nervous because many of today's sales aren't to first-time buyers; rather, many current PC owners are purchasing second and third systems.

Worried that the existing market may be saturated, manufacturers must either dig in for a sales slump or devise ways to tap into underdeveloped markets.

"Less is more" is the three-word philosophy offering the best hope for a hungry industry. In computing, this idea is embodied by the "appliance," a device that performs a limited set of functions and dispenses with the size, cost, and complexity of traditional solutions.

■ The Easy PC Appliance

In April 1999, Microsoft announced its support for the "Easy PC Initiative," a joint effort with Intel to revamp the ways PCs are built. In essence, Easy PC promotes four ideals: First, instantly available technology, which means little or no boot-up time. Second, reducing setup time to less than 10 minutes and removing common sources of technical support calls. Third, using external Plug-n-Play, which means utilizing Universal Serial Bus (USB) and **FireWire (IEEE 1394)**; a high-speed external bus used for connecting peripherals) for their easy installation capacities. And finally, creating

smaller form factors and more attractive system designs.

These four goals should appeal to every PC user. To reach the end result, however, manufacturers have to make several compromises. In particular, reducing tech support calls and making machines smaller requires eliminating many of the “legacy” systems still present in PCs, namely the Industry Standard Architecture (ISA) and Peripheral Component Interconnect (PCI) slots, diskette drives, and serial and parallel ports. Supporting these older technologies restricts flexibility, adds cost, and creates possibilities for system conflicts.

So the good news is that an Easy PC is more reliable and has a smaller motherboard. But to give a file to your co-worker down the hall without a diskette drive, you’ll either need to be on a network or send it by e-mail. You probably won’t be able to use your year-old laser printer because most laser printers still don’t have USB connections. If you want to pump up the volume with a hot new sound card, put your dancing shoes away. No motherboard slots means the only sound features you get are what’s already wired into the motherboard chipsets.

But vendors believe “power users” are the minority. The average user wants to play music, get online, and do little else. As a result, the market is queuing up to deliver a whole legion of Web-centric PCs, which, because of their narrow application focus, often get lumped into the appliance category.

Consider Avatar Technology’s VBOX Home Theater PC. The VBOX (<http://www.v4me.com>) is designed to nestle comfortably among your entertainment center components, and it includes a 5x DVD-ROM drive, an MP3 player, a surround-sound speaker system, a 56 kilobits per second (Kbps) modem, 10 megabits per second (Mbps) /100Mbps (10/100) Ethernet support, and 14 classic video games. As with WebTV, users interact with the appliance via a wireless keyboard and mouse and use their television for a monitor. Buyers willing to sign a three-year contract for Microsoft Network’s Internet service get the whole system for only \$299.99.

Now look more closely. The VBOX uses a 400 megahertz (MHz) central processing unit (CPU) and Intel’s 810 chipset. It comes with a 4.3 gigabyte (GB) hard drive and 64 megabytes of random-access memory (RAM), and it runs Windows 98. Corel’s WordPerfect 8 is included, along with PC-cillin Anti-Virus and Supervoice Fax. All of a sudden, this “home theater PC” starts to look like an ordinary, low-end computer. This doesn’t mean it’s not a good deal and that it won’t serve the needs of a particular market segment, but be aware of how names and marketing language can be used.

“Popular buzzwords and hot acronyms will get the consumers’ attention,” says Billy Pidgeon, an analyst for Jupiter Communications. “For example, DVD, MP3, and digital cameras are new technologies that have captured the public’s imagination,” he says. “Devices that inexpensively offer technologies widely featured in the press but relatively early in the consumer adoption curve stand a better chance than competitive devices.”

At the higher end of the market, Dell (<http://www.dell.com>) has unleashed its WebPC. Although you might think this is a simple, Web-centered PC, the \$999 WebPC has the same specifications as many consumer PCs. The difference is that the chassis is a bit

smaller. The unit ships with a one-year subscription to Dell's Internet service so users can be online within a few minutes of opening the box.



Hewlett-Packard e-Vectra

To see a true functionality shift conjoined with PC downsizing, take a look at the corporate market and a new wave of PC appliances, such as Compaq's iPaq (<http://www.compaq.com>) and Hewlett-Packard's e-Vectra (<http://www.hp.com>). Both configurations stress corporate features, such as asset tracking and remote manageability. Instead of using legacy slots and connections, the iPaq boasts five USB ports and is one of the first machines to incorporate a MultiBay option, into which users can hot swap CD-ROM, DVD-ROM, or even hard drives.

HP's e-Vectra literally locks out the possibility of end users disturbing their configuration; programmable master locks secure the hard drive. In addition, because the power supply is one of the most likely components to fail on a PC, HP left the power supply outside the chassis. Changing the power supply is just a matter of grabbing a new unit off the shelf and plugging it in.

Some speculate corporate machines may soon turn into true appliances, such as keyboard and display combinations that run their software from a network server. Such a move would likely increase hardware reliability, reduce costs, and eliminate the threat of users clogging their machines with conflict-causing applications. However, HP's Achim Kuttler, marketing manager for business desktops, North America, thinks this shift unlikely.

"I think a lot of customers today are really reluctant to completely change their computing environment," Kuttler says. "To switch that environment, you have to change your operating system and your applications, and this is a big step for many IT users."

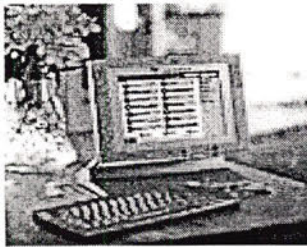
Whether the elimination of legacy hardware makes the VBOX, WebPC, iPaq, or e-Vectra "appliances," "near-PCs," or just regular PCs without certain features is merely a matter of marketing semantics. The point is that these machines provide PC functionality but with the advantages and liabilities of the Easy PC, "less is more" mindset.

■ The Non-PC Appliances

International Data Corp. (IDC), a leading computer industry-analysis firm, doesn't include near-PCs in its assessment of the "information appliance" market. Instead, IDC notes categories such as NetTV, Internet screenphones, Internet gaming devices, and other similar gadgets. Even among these, IDC predicts the worldwide appliance market will top more than \$15 billion in sales by 2002.

When we think of appliances, we think of the kitchen, which actually makes good

sense in this context. The kitchen is where families trade information and make plans, so it's logical that you should find an information appliance on the counter.



Netpliance i-opener

The first such product is Netpliance's i-opener (\$299; <http://www.netpliance.com>), which is little more than a keyboard, mouse, and 10-inch passive-matrix screen. Compact, stylish, and simple to grasp, the i-opener promises to have users on the Internet within five minutes of opening the box. Netpliance preconfigures each i-opener with the owner's ZIP code (for local information such as weather forecasts) and the regional dial-up access number, so there is no software setup. Users plug in the power and phone cords and then let the i-opener configure itself.

We were skeptical of i-opener's appeal, but we were quickly converted. The system still had occasional bugs (we couldn't get any music to play from the i-opener jukebox interface), but they were nothing serious. The hotkeys for areas such as news, weather, e-mail, shopping, and finance are great, and i-opener's simple non-Windows interface made navigating a snap.

The i-opener is simple enough for anyone to use, and the \$21.95 monthly service fee is in line with other Internet service providers (ISPs). The product does exactly what it's supposed to and at a price most consumers can stomach.

If free sounds like a better price, look at the iBrow from Merinta (<http://www.merinta.com>). The iBrow costs \$200 more than the i-opener and is targeted at the corporate market. Specifically, large clients would have iBrows manufactured with their logo on the bezel and the unit preprogrammed to seek their Web site. The companies would then give iBrows out as promotional items to key account end users, complete with one year of free Web access. Virgin Megastores, for instance, recently contracted for 10,000 iBrows, which it plans to distribute to its customers under the name "Webplayer."

The first question that might pop up is: If a business user already owns a PC, laptop, and perhaps one or two other Web-access devices, what is the appeal of an Internet terminal with limited functionality? "The consumer we have in mind is a consumer with a number of household members vying for time on the PC for Internet [and] e-mail," says Kristina Lanuza, associate marketing project manager at Merinta.

As simple as these Web devices are, even simpler options exist. If e-mail is all you want, companies such as VTech (<http://www.vtechworld.com>) and CIDCO (<http://www.cidco.com>) offer plain e-mail terminals for \$100 or less. Manufacturers essentially sell the hardware for near cost, then make their profit on the annual service charges, which run around \$100. Although this may seem steep for a service that most Web portals now give away, the appeal is their simplicity.

On the other hand, Jupiter's Pidgeon sees a limit to how far consumers will simplify. He says there aren't too many users who only need e-mail access and not a Web browser.

■ Looking Ahead

In the future, will we only interact with appliances that are suited for a specific task and let the networks do all the labor? Do desktop appliances signal the end of today's PC?

Not likely, say most industry experts. People will always need one central device that works for a broad range of computing activities. Until the paperless society emerges, we'll always need scanners and printers. The cables may disappear, and the main box may control every electronic device in the building, but the idea of a single machine is here to stay.

That said, these appliances may foreshadow some of the architectural shifts of tomorrow. Because the VBOX and e-Vectra are fully functional, low-priced PCs, the "disposable PC" may not be far away. Or, taking a cue from the iPaq, iBrow, and i-opener, perhaps future PCs will be hardware shells that are designed to support a continual flow of software upgrades from the vendor.

Whether the iBrow succeeds with its premise of promotional goodwill and novel convenience remains to be seen. In examining today's first-generation PC appliances, the influence of marketing is perhaps the most significant harbinger of all. ■

by William Van Winkle

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TALKING POINTS
WALL STREET PROJECT
January 12, 2000

- I. **Impetus for the New Markets initiative:** We have extraordinary economic growth but it is not reaching everywhere -- e.g., parts of Appalachia and inner cities are left behind. As President said in SoTU, if we can't use this opportunity to try to redirect some of the economic engine to address underlying problems, when will we ever be able to do so.
- II. **Goals of the initiative:** Our goals are very similar to those of the ARC's own entrepreneurial initiative. (*See briefing book tab.*) That effort is very impressive and shows that there are ways to address these problems that can get bipartisan support. We tried to build on, and be complementary to, that effort and others similar.
 - A. **Incentives for private investment in communities.** Gov't can't do it alone. We have been more successful in the lending area, at creating incentives for the private sector to lend in underserved communities (CRA and CDFIs, for example). But, there isn't much that we do to prompt the private sector to make equity investments in businesses in underserved communities. As ARC's own study of the capital needs of Appalachia showed, the hardest dollars to find are the first dollars -- equity capital to grow businesses and create jobs.
 - B. **Building relationships.** There is a whole world of venture capitalists who have clubs that meet to hear investment proposals from small businesses. But their contacts and relationships are in suburbs, not necessarily inner cities. On the other hand, we have a small but growing community of community development experts in CDCs and CDFIs and state community development agencies. But never the two shall meet. This program is designed to give the investment community strong incentives to build ties to the community development community because, if they do so, they can get generous gov't-guaranteed leverage and tax credits to enhance the returns on their investments.
 - C. **Building capacity of small businesses.** In addressing the needs of really small businesses and microenterprises in underserved areas, it becomes clear that they need more than just capital -- they need expertise. (E.g., a good CFO, a new accounting system, methods to analyze their costs, etc.) Many have real growth potential but they need not only investment but a helping hand. A central innovation of this initiative is that, for smaller businesses, we marry technical assistance with investment -- having the investors decide how best to apply the technical assistance to yield maximum returns on their investment.
- III. **How we developed the new markets proposal:** With those goals in mind, we looked around the Federal government at tools in the arsenal and found one that had promising potential -- the SBIC program.

- A. Over 40 years, the SBA's *small business investment company* (SBIC) program has provided roughly \$20 billion in equity and debt financing to more than 85,000 different companies, helping them at a critical stage to grow from small businesses to household names, like AOL and Staples. It really helped to create the venture capital market in the United States.

- ***How SBICs work:***

- A private venture capital manager applies to SBA for approval of a new venture capital fund (the SBIC) based on a business plan and their financial management expertise.
- SBA's approval means that for every dollar the fund gets from private investors the SBA will guarantee debt of two dollars, up to _____. (Average size of an SBIC is \$36 million.) So, if private investors put up \$10 million, the government will guarantee debt of \$20 million, creating a fund of \$30 million to invest in growth businesses.
- Because of the government guarantee, the \$20 million in debt demands a lower rate of return, thus enhancing the return available to the private investors on their \$10 million dollars.
- With the fund of \$30 million, the fund manager finds an array of businesses with growth potential and provides them equity capital with which to grow.
- Returns are expected on the debt and the federally guaranteed debt must be fully repaid before returns are paid to the private investors. As a result, our losses have been few and, because guarantee fees are charged, guaranteeing the debt costs the government very little.

- B. But we found that, while it had been successful, only about 20% of its work served underserved communities. That wasn't acceptable. So the VP challenged the SBA to find new ways to retarget the SBIC program to meet the needs of underserved communities. They responded to that challenge with extraordinary creativity and dedication.

IV. Elements of the New Markets Proposal:

- A. ***SBICs for Low-Mod Communities.*** First SBA figured out how to provide incentives to make it more attractive for the venture capital firms created under the SBIC program to invest in low-mod communities.

- Specifically, SBICs making investment in low and moderate income communities will be eligible for a new financing that does not require a return on their investment for the first five years (although interest accrues during that period). *Patient capital* -- allowing businesses time before they have to show a return on the investment.
- In addition, SBA will provide greater leverage -- 3x rather than 2x.
- Finally, SBA will make the investment rules more flexible to better meet the needs of companies in underserved areas.
- *(SBA will be implementing these program modifications this year without legislation.)*

B. *New Market Venture Capital Firms.* Next, SBA realized that SBICs won't work for the smaller firms and those that need expertise as well as capital. So they proposed a new program -- know as New Market Venture Capital Firms -- modifying the SBIC concept to meet the needs of smaller businesses in underserved areas.

- SBA will select 10-20 firms, whose management has a solid track record with community development.
- The equity funds of private investors will be matched (one-to-one) with government debt of guarantees up to \$10 million per fund, creating up to \$20 million dollar investment funds. Interest on this debt will also be deferred for the first five years.
- In addition, investors must provide at least \$1.5 million in technical assistance over the first five years to the target firms. SBA will match that with up to \$1.5 million in federal funds. This \$3 million will not require any rate of return. With this additional investment in the firms not requiring any return, the return produced by the company enhances the return to the investors, making it worth their while to help small firms needing intensive technical assistance.
- *(This will require new legislation.)*

C. *APICs:* But that left us with a challenge. To really make an impact on a community -- to create 100, 200, 400 jobs at a time -- you need to deal with larger firms that are growing and creating new facilities or relocating. So we enlisted the help of HUD and designed a program to create *American Private Investment Companies (APICs)*.

- For years, America has OPIC -- the Overseas Private Investment Corporation -- which has an investment fund program like the SBIC program on a larger scale, to promote growth in emerging markets abroad. We needed a tool to promote growth in emerging markets at home.

- Under this program, fund managers would seek approval for government guarantees for debt of up to \$200 million, to equal private investment of up to \$100 million, to create investment funds of \$300 million. That is large enough to allow investments in significant sized firms that have opportunities to grow.
- The APIC could invest in a corporate subsidiary set up to fund a new plant or back-office operation in an underserved area or become joint venture partners in a business spin-off from an existing firm.
- Unlike the New Markets and SBIC programs, where we rely on the financial incentives of the investors to protect the government's interest, in APICs, the specific investments will be approved by HUD and SBA to ensure they serve public purposes.
- (APICS also require new legislation.)

D. ***Tax Credit:*** Finally, we considered how to ensure that these new great investment vehicles (as well as existing vehicles like CDFIs, Community Development Corporations, and state enterprise funds) have investors rushing to their doors to take advantage. The fact is that large companies and wealthy investors don't want to know the details of SBICs, NMVCs and APICs -- they just want to invest with qualified fund managers who can promise a healthy rate of return. Let the managers then worry about which investments they use. The solution we propose -- *a tax credit*.

- Equity investments in investment vehicles serving underserved communities are eligible for a tax credit worth up to 25% of the equity invested. (The credit is actually 6% a year, which has a net present value of approximately 25% of the amount invested.)
- Credits would be allocated to the targeted investment funds that could use the tax credits to attract investors.
- Eligible investments are in areas with either (a) a poverty rate of at least 20%; or (b) median family income which does not exceed 80% of metropolitan area income (or for rural areas, 80% of the median income of non-metropolitan areas statewide). (*See nationwide map.*)
- This is a very generous definition of underserved -- and we picked it so that these programs will work well with other governmental programs that target areas with greater needs.

E. ***Other pieces as well:***

- Increasing by two and a half times the U.S. commitment to microenterprise, including doubling the level of microenterprise lending and a huge new commitment to technical assistance for microenterprise under a proposal for new legislation known as PRIME.

- A \$30 million increase in funding levels for CDFIs.
- New small business lending firms targeted to underserved markets.
- BusinessLINC -- an initiative of the Vice Presidents to encourage large businesses to work with small business owners and entrepreneurs to improve the economic competitiveness of smaller firms in distressed areas.

V. **Example: flexibility to meet the needs of the investor, the fund managers, and the businesses getting the investment.** Say an investment manager wants to create an investment fund targeted at the needs of Appalachia. Here's what he'd do.

- A. *Develop an investment strategy and a small investment management team (with community development capacity) to create an APIC, for example (or an SBIC-LMI or NMVC firm, depending on the business strategy).*
- B. *Get approval from SBA/HUD, which will provide them with the commitment to guarantee debt to match private investment.*
- C. *Get an allocation of tax credits from the agency that approves the vehicle. (Treasury will allocate credits to SBA, for example, to suballocate to funds.)*
- D. *With tax credit and guarantee in hand, the fund manager then seeks investors, able to provide firm estimate of expected rates of return, knowing effect of tax credit and low cost leverage.*
- E. *APIC manager finds business opportunities.*
- F. *Government pools their debt and places it with investors lowering the cost of borrowing.*

VI. **Or an investment manager could assemble a "fund of funds" that includes an APIC, an SBIC targeted at low-mod areas, an NMVC firm, and other targeted investments, some or all of which would be eligible for the tax credit allocation. Large investors, in particular, may find the "fund of funds" the best way to spread their risk.**

VI. **Bottom line:** This package of programs should leverage \$15 billion in investment in underserved areas with 5 years of program activity (although some of the investment will be in out years).

- Includes \$6 billion leveraged through tax credit
- \$12 billion leveraged through investment vehicles

- Assume 50% overlap of tax credit so to prevent double counting -- estimate \$15 billion.

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THE NEW MARKETS INITIATIVE: BUDGET IMPACT

The New Markets initiative will prompt approximately \$15 billion in new investment in urban and rural areas over five years through:

The New Markets Tax Credit --To help spur \$6 billion in new equity capital for investment in America's New Markets, the New Markets Tax Credit will be worth up to 25 percent for investments in a wide range of vehicles serving these communities, including community development banks, venture funds and corporations, new investment company programs (targeted SBICs, NMVC firms, and APICs -- see descriptions below), and other targeted investment funds. Credits would be allocated to the targeted investment vehicles which could use the tax credits to attract investors. The investment funds would make their own decisions about what investments or loans to make to help create and grow businesses in the New Markets.

A wide range of businesses could be financed by these investment funds, including small technology firms, inner-city shopping centers, manufacturers with hundreds of employees, and retail stores.

Budget Impact: *The New Markets Tax Credit will cost approximately \$980 million over five years.*

America's Private Investment Companies (APICs). For years, America has supported OPIC, the Overseas Private Investment Corporation, to promote growth in emerging markets abroad. Now we must do the same thing in America's New Markets. Under this program, investors will put equity into new private investment partnerships to be known as America's Private Investment Companies (APICs). HUD and SBA working together will provide up to two times the private capital in loan guarantees for each. APICs will make equity investments in larger businesses that are expanding or relocating in inner cities and rural areas. Under the financing structure, the private investors' funds are at risk ahead of the government.

Budget impact: *APICs will cost \$20 million, as appropriated in the HUD/VA Appropriations Bill, in credit subsidy (at a rate of 3.7%, allowing up to \$800 million in government guarantees) and \$1 million for HUD's administrative costs.*

SBICs Targeted to New Markets. Over 40 years, the SBA's small business investment company (SBIC) program has provided roughly \$20 billion in equity and debt financing to more than 85,000 different companies, helping them at a critical stage to grow from small businesses to household names, like AOL and Staples. However, too little of the capital invested has benefited our cities and rural distressed communities. Last summer, the Vice President challenged the SBA to find ways to meet better the needs of minority firms and underserved markets. In response, SBA determined that, under existing legislation, the Agency can offer more flexibility and new financing terms to make it more attractive for SBICs to invest in businesses in low and moderate income (LMI) areas. Specifically, SBICs making LMI investments will be eligible for a new type of federally guaranteed loan to augment their capital for business investment. Interest on the guaranteed funding will be deferred for the first five

years of the 10-year term to give SBICs more time to nurture their investments in small businesses before they must produce a return. In addition, SBA will conduct an aggressive outreach campaign around the country to promote LMI investments.

Budget impact: *No new loan subsidy budget authority is required for this initiative as the SBIC debentures program has a 0% credit subsidy rate. However, the commitment level for the SBIC debenture program must be increased (from \$640 million in FY 99 to \$800 million in FY 2000) in order to ensure that the new targeted activity does not crowd out activity by traditional SBICs.*

New Markets Venture Capital Firms (NMVCs). There are thousands of inner-city and rural entrepreneurs who need both capital and expert guidance to transform their small businesses and great ideas into thriving companies. SBA will select ten-to-twenty NMVC firms whose management has successful records in community-based venture capital. The equity funds of private investors will be matched with loan guarantees of up to \$10 million per NMVC, with interest on the debt deferred. Investors must also provide at least \$1.5 million in technical assistance over five years to the target firms, matching SBA's grants of technical assistance. The program should provide long-term, patient growth capital and facilitate critically needed technology and management skills development for smaller businesses in new markets.

Budget impact: *The NMVC firms will cost \$15 million in credit subsidy for loan guarantees (at a credit subsidy rate of 15%, allowing \$100 million in government guarantees) and \$30 million for technical assistance grants.*

New Markets Lending Companies (NMLC). For the first time in many years, SBA will approve approximately 10 new non-bank lenders -- firms authorized to originate loans under SBA's largest loan program -- the 7(a) General Business Loan Guaranty program. Under the 7(a) program, SBA guarantees up to 80% of a loan that is made by a lender to a creditworthy small business that cannot otherwise secure financing on reasonable terms. The firms selected must have a strategy to target their lending to underserved areas.

Budget Impact: *No additional budget authority is necessary to license these new non-bank lenders.*

Continued Growth for CDFIs. Community Development Financial Institutions (CDFIs), locally-based institutions with expertise in lending and investment in underserved areas, represent an important vehicle for greater investment in new markets. The federal contribution to building these institutions must continue to grow.

Budget impact: *The CDFI Fund will cost \$95 million as appropriated in the HUD/VA Appropriations bill.*

Microenterprise Lending and Technical Assistance. Microenterprise initiatives in the FY 2000 budget include: (1) PRIME, which will provide microenterprise technical assistance and capacity building program to award grants on a competitive basis to microenterprise development organizations and programs that focus on low-income entrepreneurs; (2) doubling support for technical assistance in SBA's Microloan Program, which links loans entrepreneurs with the provision of training and technical assistance; (3) doubling support for SBA lending to leverage over \$75 million in new microlending; (4) doubling funding for Individual Development Accounts (IDAs), to empower lower-income individuals to start a new business, invest in a first home, or save for post-secondary education; and (5) tripling funding for SBA's One-Stop Capital Shops, which offer microenterprise development (including direct access to microlenders), personal finance, and even credit repair services in Empowerment Zones.

Budget impact: *(1) As described above, PRIME will cost \$15 million in FY 2000; (2) SBA's microloan technical assistance and training will cost \$ 32 million in FY 2000 (up from \$16 million in FY 99); (3) SBA's microlending will cost \$5 million in credit subsidy (up from \$3 million in FY 99); (4) IDAs will cost \$20 million in FY 2000 (up from \$10 million in FY 99); and (5) One-Stop Capital Shops will cost \$10 million in FY 2000 up from \$3.1 million in FY 99.*

BusinessLINC. The President's budget provides resources to expand BusinessLINC -- an innovative public-private partnership launched by Vice President Gore and led by Treasury Secretary Rubin and SBA Administrator Alvarez --to new markets in economically distressed communities. BusinessLINC (Learning, Information, Networking and Collaboration) is designed to encourage large businesses to work with small business owners and entrepreneurs in order to improve the economic competitiveness of smaller firms located in distressed areas, both urban and rural. The funds will be used to leverage private sector efforts to spur new BusinessLINC partnerships at the national and local level.

Budget Impact: *BusinessLINC will cost \$3 million in FY 2000.*

Specialized Small Business Investment Companies (SSBICs). The President's budget will expand current tax incentives to increase the amount of equity capital available to economically disadvantaged people by making it easier for Specialized Small Business Investment Companies (SSBICs) to qualify as tax-favored regulated investment companies.

Budget Impact: *This change to tax rules will have a negligible budget impact.*

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DRAFT MEMORANDUM TO GENE SPERLING

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DATE: September 23, 1999

INITIALS: JAM DATE: 5/30/23

FROM: LISA GREEN

2019-0203-F

SUBJECT: CHARITABLE CHOICE and THE AMERICAN COMMUNITY RENEWAL
ACT OF 1999 (H.R. 815) - The Talent-Watts Bill

The purpose of this memorandum is to provide an analysis of charitable choice as it relates to the above referenced Talent-Watts bill.

Background on Charitable Choice

Definition: Charitable Choice permits congregations or religious organizations to receive funds from the government for the provision of social services without forming independent non profit or 501c3 organizations. The term is also used by some as a reference for any legislative proposal that raises issues of church and state, such as the Religious Liberty Protection Act, which affirms the right to exercise faith even in cases where it conflicts with state or local laws. Legislative proposals that allow prayer in school and posting of the Ten Commandments in public buildings have also been associated with Charitable Choice.

Charitable Choice and Welfare Reform: Charitable Choice is closely identified with the provision outlined in Section 104 of the 1996 welfare reform legislation, the Personal Responsibility and Work Opportunities Reconciliation Act (aka the Welfare Reform Act). Conservative Republican, Senator John Ashcroft from Missouri was the primary advocate for Section 104 when the welfare system was overhauled. Section 104, often referred to as the Charitable Choice provision, permits and requires the following:

- Charitable, religious or private organizations may receive government contracts, vouchers or other funding to provide services under Temporary Assistance for Need Families (TANF), Medicaid, Supplemental Security Income and Food Stamps.
- Religious organizations are permitted to receive such funding on the same basis as any other non-governmental provider. In other words, if a state elects to allow independent social service providers to be an eligible recipient of funds for such programs, then it may not exclude providers because of their religious practices.
- If a faith based organization is selected as a provider of government-financed social services, its religious expression and identity may not be censored or otherwise diminished on account of its participation in the welfare program. A series of specific protections are provided to ensure that the religious character of the provider is not impaired as it may relate to
 - 1) employment policy (i.e. exemption from the ban against religious discrimination in hiring);
 - 2) maintenance of religious environment (i.e. religious art, icons, scripture or other symbols); and
 - 3) control over the definition, development, practice and expression of religious beliefs.

Charitable Choice Provisions in the American Community Renewal Act

Summary: As you know, The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for grants numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts.

In addition, the bill provides for Charitable Choice, by allowing religious organizations to:

- 1) be a provider of services for substance abuse programs that receive federal funds
- 2) be designated as award recipients for grants outlined in the bill
- 3) make designated sub-awards to other public or private entities
- 4) provide for the provision of program service (for substance abuse) through the use of voucherized assistance

The bill also includes the same rights for a religious organization that are contained in Section 104 of the Welfare Reform Act, as outlined above.

The Current Debate on Charitable Choice

Opposing Viewpoints: The current debate centers primarily around these two opposing views:

- 1) Charitable Choice weakens restrictions on evangelism by tax-supported charities and allows for discrimination of protected groups. Thus, it threatens the ability of social services (funded or supported by the government) to be equitably distributed to those in need without infringement on their personal beliefs.
- 2) Charitable Choice is a way to encourage and expand the involvement of the independent sector (including faith-based organizations) in the delivery of government supported social services. Religious charities are very effective service providers and their efforts to solve social welfare problems should be supported by the federal government.

Legal Issues: There are several legal issues raised by Charitable Choice. The goal in section 104 of the Welfare Reform Act was to strike a balance between protections for both religious organizations and welfare recipients. Issues include:

- 1) First Amendment. Constitutional and case law deal extensively with the question of whether providing government funding to religious organizations violates the First Amendment. Many hold firm that section 104 complies with the law. However, there have not yet been court challenges to the law.
- 2) Rights of Beneficiaries. Section 104 does include a provision that if a beneficiary objects to receiving social services from a religious provider he or she has the right to receive services from another provider. The state must ensure that alternative assistance is of no lesser value and that beneficiaries are aware of the range of providers. **This provision is not included in the American Community Renewal Act.**

- 3) Preemption of State Law. There are many states with constitutions that restrict the expenditure of public funds by religious organizations. The Supremacy Clause of the U.S. Constitution, provides that rights granted by congressional action preempt any state or local laws to the contrary.

Advocates: Both liberal Democrats and conservative Republicans have supported Charitable Choice. Supporters include some religious organizations that currently provide social services in poor and distressed communities, although the reactions of faith based institutions have been mixed. A poll of 1,200 religious groups showed that while only 3 percent receive government funding now, 36 percent would consider applying for it under Charitable Choice.

Opponents: Critics of Charitable Choice believe that it blurs the separation of church and state and that it allows government funded church programs to practice religious discrimination. Not suprisingly, the American Civil Liberties Union is firmly against Charitable Choice. There are also some religious organizations that believe Charitable Choice threatens their autonomy and the secular nature of state-run agencies. Others are concerned that faith-based institutions will be left holding the bag if government transfers its social service responsibilities and then withdraws financial support when the economy runs into trouble. Charitable Choice is also opposed by gay rights activists who argue that it allows religious organizations to discriminate on a religious basis for employment purposes. As an example, a Catholic social service agency could give certain jobs only to priests or require heterosexual marriage for employees.

States and Charitable Choice

There are many states that have chosen to create their own local versions of Charitable Choice as it relates to funding of religious organizations. Attached is an article that summarizes some of these programs. Texas has been one of the most proactive states in encouraging state agencies to allow Charitable Choice.

Conclusions and Next Steps

I have requested additional information from several Charitable Choice "experts" within the Administration. We will convene a group next week to specifically address the Charitable Choice provisions in the American Community Renewal Act. In addition I have asked Cynthia Rice, from DPC to review the American Community Renewal Act and outline how it compares to Section 104 of the Welfare Reform Act as soon as possible. My understanding is that an interagency working group (which included Justice) underwent a painstaking clearance process for Section 104, prior to the introduction of the Welfare Reform Act. There continue to be mixed opinions among and within agencies about the legal and policy issues presented by Charitable Choice. However, it is noteworthy that in our initial analysis of the American Renewal Act, none of the agencies involved in the New Markets Initiative (HUD, Treasury, and SBA) raised Charitable Choice as a concern. I recommend that I continue to do research prior to our reaching any conclusions on an Administration position on this issue. Please advise.

To: Lisa Green
From: Michael Barry

DRAFT / INTERNAL USE ONLY
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Draft March 5, 1999

SUBJECT: Comments on American Community Renewal Act of 1999 (H.R. 815)

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Summary

This memorandum comments on the tax incentives included in Representative Watts' American Community Renewal Act of 1999. Under this proposal, 100 renewal communities would be designated where the following new tax incentives would be available:

- zero percent capital gains,
- commercial revitalization tax credit,
- additional expensing for small businesses,
- brownfields expensing,
- expansion of the work opportunity tax credit, and
- family development accounts (an IRA-type savings account).

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 2019-0203-F

We have a number of policy concerns with the American Community Renewal Act. Specifically, the proposed incentives would be a costly and relatively inefficient mechanism for assisting distressed communities. Many of the tax incentives proposed in this bill were considered and rejected by the Administration during the development in 1993 and 1996 of tax incentives for the first and second rounds of Empowerment Zones (EZs) and Enterprise Communities (ECs). Indeed, the proposed incentives could lose significant revenue while being relatively inefficient in assisting distressed communities. Federal tax relief is not likely to offset the high cost of crime, low quality of schools, and lack of infrastructure in distressed areas that discourage investment. In particular, while the capital gains and revitalization tax credit are likely to shift some economic activity into the targeted areas, most of this activity will be simply displaced from elsewhere, most of the tax incentives will go to existing businesses, and much of the benefits of the investment incentives will go to existing owners of capital and land. In addition, we are concerned about the precedence of making this proposal exempt from the PAYGO provision before dealing with Social Security. However, if additional tax incentives for distressed areas are to be available, we propose extension of the brownfields expensing and more generous incentives for the Cleveland and Los Angeles EZs as was proposed as part of the Administration's budget.

Below is a summary of our concerns with the specific tax provisions proposed in the legislation.

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The American Community Renewal Act Proposals

Renewal community selection. The process and criteria for selecting renewal communities would be similar to that of empowerment zones (EZs) and enterprise communities (ECs). For example, in general areas would be nominated by local governments and chosen by the Secretary of Housing and Urban Development based on the extent of distress and the quality of plan for redevelopment. Of the 100 renewal communities, 20 would have to be in rural areas.

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In addition, 50 of the renewal communities would have to be EZs or ECs. Areas must have at least 20 percent poverty rates, 1½ times the national unemployment rate, at least 70 percent of households must have incomes below 80 percent of the median income of households in the jurisdiction. Designation would be for 7 years.

While the selection process and criteria is similar to that used with EZs and ECs, tax incentives for renewal communities will not be as targeted. Renewal communities would generally be required to meet more relaxed criteria, particularly with respect to poverty rates, and thus incentives would be less targeted. Less targeted incentives are more likely to be inefficient at encouraging redevelopment of these areas. For example, first round EZs and ECs had at least half of the nominated area consisting of census tracts with poverty rates of 35 percent or more while nominated areas for second round EZs must have at least 90 percent of the census tracts with a poverty rate of 25 percent or more. Similarly, populations are limited in EZs and ECs while renewal communities have minimum population requirements of 4,000 in urban areas and 1,000 in rural areas.

Moreover, the renewal community designation is in addition to EZ and EC designation and is likely to increase administrative and compliance costs of the program. Overlapping designations, such as a renewal community EZ versus an EZ, is likely to make knowing what tax incentives are available in a particular area more difficult than if an area has one designation.

Zero percent rate on certain capital gains. A zero percent rate would apply to capital gains received from the sale of certain business property and assets that are held for more than five years. The assets must consist of property used in, or a partnership interest or stock of, a business that meets certain eligibility requirements during substantially all of the time the taxpayer holds the asset. The eligibility requirements relate to the type of business, where the business operates and who it employs. For example, at least 35 percent of employees must be renewal community residents.

Numerous problems arise from any attempt to use lower capital gains rates as incentives to spur new, meaningful investment in any given geographic area. Generally speaking, a reduction in capital gains rates (even to zero) will not provide an incentive to invest in depreciable property that the business would not otherwise buy since the property is unlikely to increase in value above its original cost. Thus, a zero percent rate on gains is unlikely to prompt the increased investment in machinery or equipment that is so often thought to spur job growth. Nor will there be any benefits to businesses that earn their return through current cash flows that are taxed at ordinary income rates -- whether through sales of inventory or by providing valuable services to their customers. At the same time, however, certain businesses with property in the renewal community could earn large one-time "windfall" profits -- for example, from the sale of property near a site chosen for a large public attraction such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

Finally, the ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970's and 1980's. For example, ignoring depreciation, a taxpayer in the

top tax bracket who borrows \$100 at 8 percent and invests in an asset qualifying for the zero rate would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction of this tax arbitrage could be expected to result in non-productive investments that benefit neither the targeted area nor the country as a whole.

Commercial Revitalization Tax Credit. A commercial revitalization tax credit is an allocated, 20 percent tax credit (or if elected by the taxpayer, 5 percent per year for 10 years) for non-residential building investment in designated areas through 2007. Up to \$2 million in credits per State per renewal community (as is done with the low income housing credit) can be allocated in any year with a maximum of \$10 million in a specific building expenditure being eligible for the credit.

Investment tax credits can result in significant misallocation of investment within and between industries, particularly since the resulting effective tax rates are likely to be negative. In the extreme, taxpayer investment may be purely tax-motivated in order to shelter other income from higher taxes. These tax shelters tend to benefit higher income taxpayers and would do little for residents in the distressed areas.

Additional expensing. The bill expands the current EZ expensing provision, making an additional \$35,000 per year of expensing available for depreciable property used in certain qualified renewal community businesses. This incentive is available to small businesses since the deductible amount phases out as the amount of depreciable property placed in service increases above a fixed amount. The expansion of the amount eligible for expensing includes raising the phase-out range.

Compared to the other tax-based incentives for capital investment, this approach is less likely to be abused. However, capital incentives in general do little to encourage employment of renewal community residents. Moreover, given that some renewal communities will also be EZs, the expensing thresholds will vary among renewal communities and make administrative and compliance costs higher.

Brownfields expensing. The Taxpayer Relief Act of 1997, permits expensing of certain costs incurred in connection with the clean-up of certain qualifying "brownfields" sites. However, renewal communities would benefit from brownfields expensing being available beyond 2000. This provision is a more limited version of the Administration's budget proposal to make brownfields expensing permanent. As a result, we have no objections to extending when brownfields expensing is available, but we do object to its extension to less targeted areas.

Extension of the work opportunity tax credit (WOTC). The bill would create a new target group consisting of renewal community residents who work in a renewal community businesses. The extended credit would be more generous applying to up to \$10,000 of wages and have a 15 percent rate for first year wages and 30 percent for second year wages. Requirements would be similar to those of the EZ wage credit in that substantially all the services provided by the employee must be within the renewal community. Under present law, employers are provided a

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credit of 40 percent of up to \$6,000 in wages paid during the first year of employment of members of certain targeted groups, such as persons receiving TANF. In addition, renewal community youth would receive the same treatment under the WOTC as is available to EZ youth. In particular, the wage credit would be available to renewal community youth who work outside the community.

In order to maximize the credit, renewal community businesses have an incentive to use the regular WOTC for the first year of employment, if possible, and then switch to the renewal community version for second year employment of residents. The relatively loose criteria for defining a community suggests that the hiring incentive is likely to lead to "cherry picking" whereby employers will get the credit for renewal community residents who would have been hired without the incentive.

Family Development Accounts (FDAs). An FDA would be a special savings account for renewal community residents who received the earned income tax credit (EITC) in the previous year. Individuals would be able to make up to \$2,000 per year in deductible contributions to one of these accounts. Earnings would accumulate in the account tax-free, and could be withdrawn tax-free to pay post-secondary education expenses, first-home purchase costs, expenses from starting a business, medical expenses, and qualified rollovers. In 5 of the renewal communities, a 50 percent match for contributions would be available. Tax would be paid on both the individual's contribution and matching amounts when withdrawn.

While the Administration supports the concept of development accounts, we think the general approach proposed by Senator Coats is preferable. Senator Coats proposes a demonstration project for development accounts where qualified entities, state and local governments and nonprofit organizations, would administer the program and provide matches for the saving accounts from Federal grants. This approach is preferable in that it is designed to be a demonstration project and provides the matching grants directly to the administering organization instead of introducing additional complexity to the tax code.

~~DRAFT~~~~CONFIDENTIAL~~as of 9/98 on
last year's bill~~CONFIDENTIAL~~HUD Comments on H.R. 815,
the "American Community Renewal Act of 1999"~~CONFIDENTIAL~~

HUD opposes this legislation for the following reasons:

1. HUD already has an Empowerment Zone initiative in place. There should not be more than one Empowerment Zone program--regardless of its name--operating at the same time. Not only would the operation of multiple programs be confusing to cities, it would also water down efforts to concentrate resources in very distressed areas which have already been designated or are proposed to be designated under the new Empowerment Zone program.

2. Although the tax incentives for the new round of Empowerment Zones in the Taxpayer Relief Act of 1997 may leave something to be desired, it is difficult, based on current information, to assess the impact and effectiveness of the incentives proposed for this legislation. The bill assumes an independent impact of tax incentives on poverty neighborhoods that is still unproven. The interaction of tax incentives with other practical considerations associated with doing business in such neighborhoods is far from straight-forward. HUD suggests that the effectiveness of the bill in targeting the spending of potential tax revenue would need additional analysis.

~~DRAFT~~ HUD notes that the community development research of the last twenty years has demonstrated the need for coordinated, continuing, and concentrated activities to achieve measurable long-term impact: it is on those lessons that the Empowerment Zones initiative is building. Few, if any, of the local participants in the Empowerment Zone program believe tax incentives will, by themselves, improve the economic and social conditions of the nation's poorest communities. Thus HUD suggests that if the bill is considered notwithstanding our objections, it should be reviewed to ensure that the programs set forth by this bill are well-coordinated. In this regard, HUD notes that the course of action requirement contained in title I, section 101, setting forth a proposed section 1400E(d), "Required State and Local Commitments," in Chapter 1 of the Internal Revenue Code of 1986, is too vague and weak to ensure coordinated and reinforcing programs.

4. There are serious flaws with section 201, which would require HUD to transfer to the local government any vacant multifamily property, any substandard multifamily property, or any vacant single family property that (1) is owned by the Secretary; and (2) is located in a renewal community. For example:

❖ The proposal does not take into account that the FHA single family and multifamily insurance programs depend upon the proceeds of sales of property to reduce the overall

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costs of the insurance programs. Single family housing, under the Mutual Mortgage Insurance Fund, is a self-sustaining program; multifamily housing, under the General Insurance Fund, requires annual appropriations to cover losses and to provide credit subsidy for new insurance obligations. Should this proposal be enacted, the budget costs of these programs would increase (since losses could not be offset by sales of the property), which could necessitate an increase in premiums.

❖ With regard to single family properties, HUD already possesses the authority to sell HUD-owned properties to governmental entities and non-profits. In addition, because almost all of the HUD inventory of single family properties are vacant (they are delivered unoccupied) and because of the apparent ease in establishing a locality as a renewal community, HUD might not be able to recover any proceeds of sale on substantial numbers of its inventory. Average sales price on single family properties was about \$55,000 over the last twelve months; interest foregone on such properties would be about \$8.50 per day.

❖ With regard to multifamily properties, current law and regulations provide a right of first refusal to States, localities, and PHAs. This bill would complicate this process and detract from the flexibility given under the Multifamily Housing Disposition Reform Act of 1994. HUD is able to sell or transfer projects to community development corporations now, but is NOT under a mandate to give assets away. It is conceivable that, to reduce holding costs, HUD would want to get vacant and substandard properties off the market quickly. The proposed bill could hinder this effort.

❖ In all cases the local government would be the beneficiary of real estate at no cost, which it could then sell at a higher price (to both community development corporations and to private purchasers, under certain conditions). Although there is a requirement for the sale price to be limited to a cost recovery basis (from the date upon which the local government takes title to the property), HUD notes that the potential for fraud and abuse of this scheme is substantial.

❖ The proposed legislation (section 201(e)) would make HUD responsible for all indebtedness on the properties before transferring them to local governments. This provision would place an unnecessary restriction on HUD's authority, and should be included in the contracts entered with local governments rather than in the statute.

❖ The proposed legislation would limit the Department's discretion with regard to establishing the terms of sales under the Community Renewal program. Community development

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corporations, to which the properties can be sold by the municipalities during a 6 month window, would have the right to pick and choose which properties they would purchase, a procedure which could lessen the effectiveness and impede the purpose of the program.

There are also numerous technical deficiencies in this section. For example:

❖ The provisions of section 201 are written pursuant to the authority of section 204 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997, which only applies to multifamily property. Thus references to single family properties in sections 201(b), (c), and (i)(6) should be deleted, and section 201(i)(9) should be deleted in its entirety.

❖ The last phrase of section 201(c)(1) refers to "1 year after such date". It is unclear as to whether "such date" refers to the date of acquisition by the Secretary or the date on which the area was designated as a renewal community. Therefore, clarifying language should be added to the phrase.

❖ Section 201(d)(2) requires a six-month right of first refusal period during which the local government cannot sell to anyone other than a CDC (unless notified by all CDCs that they are not interested in the property). HUD recommends a shorter period of time for two reasons. First, community groups generally are aware of the status of projects in their area and are capable of making decisions regarding acquisition more quickly than six months. Second, during the six-month period, the local government must pay for property upkeep, security, and other costly items associated with ownership of substandard or unoccupied property. Shortening the period would force the CDC to acquire title more quickly and, thus, renovate, demolish or take other appropriate action to revitalize the community more quickly.

❖ Section 201(e) states that the Secretary shall "satisfy" any indebtedness on the property before transferring ownership to the local government. Subsection (e)(1) states that the Secretary may "cancel" the indebtedness. Reference to the "cancellation" of indebtedness suggests that the debt is a Secretary-held debt--which would not be the case with HUD-owned property. Thus, HUD presumes that reference is to outstanding taxes, sewer charges, the cost of repairs and other costs that might be associated with the property, other than a mortgage indebtedness. Therefore, HUD recommends that in subsection (e)(1) the word "paying" be used in lieu of "canceling".

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❖ There is no language in section 201 which directs how the CDC should develop the property it acquires or ensure that such property is available as an affordable housing resource. The fact that the CDC is defined in section 201(i)(1) as an entity which provides housing to low-income families does not bind the CDC to doing so. HUD recommends that section 201 include a description of how the property may be used by the CDC.

5. The legislation has a number of technical deficiencies when compared with the previously enacted authority for a second round of Empowerment Zone designations under the Taxpayer Relief Act of 1997.

❖ First, the criteria for selection of renewal communities would be less stringent with regard to poverty than the criteria set by the 1997 Act for the designation of new Empowerment Zones (the poverty rate for census tracts would be a minimum of 20%, as opposed to 25% for 90% of the census tracts under the 1997 Act). Thus even though half of the first 50 areas (i.e. 25%) to be designated as renewal communities under this bill would be chosen from areas which are Enterprise Communities or Empowerment Zones, and thus would have to meet HUD's higher EC/EZ standards, the remaining communities would only be held to the lower renewal community standards. In addition, there would be no apparent limitation on the area size of renewal communities.

❖ Second, HUD is not set up to administer a direct entitlement program.

This bill would provide for "Family Development Accounts," where up to \$2,000 in any fiscal year contributed by an individual to a Family Development Account would be tax deductible. The family development account could be used for home purchase expenses by a first time home-buyer, to start a business, for post-secondary education or for qualified medical expenses.

It also contains a demonstration program, to be run by HUD, which would provide matching contributions to Family Development Accounts in certain renewal communities. Five communities could participate in this demonstration. The Secretary would match the deposits made to the Family Development Accounts of each "qualified individual" in the renewal community. In this time of declining resources, it is not clear how HUD could administer this program.

THE AMERICAN COMMUNITY RENEWAL ACT

I. Summary of the Bill

The American Community Renewal Act would provide for up to 100 renewal communities designated through a competitive process similar to that of the current Empowerment Zone and Enterprise Community (EZ/EC) Programs. Renewal Communities would be eligible for numerous tax incentives including zero percent capital gains, commercial revitalization tax credits, expensing for small businesses and Brownfields, expansion of the work opportunity tax credit, and family development accounts. Efforts to create a renewal community program have been underway for several years, and the current bill has evolved from several earlier proposals.

The American Renewal Act contains certain provisions that could not be incorporated into the New Markets Initiative without substantially changing the intent and substance of our proposal for a New Markets Initiative. However, there are a number of other provisions that would be acceptable and could be incorporated into our proposal with little difficult, as outlined herein.

II. Comparison of the American Renewal Act to the New Markets Initiative and the Empowerment Zone and Enterprise Community Programs

CAPITAL GAINS OPENING: One of the major differences between the President's proposal and the Talent-Watts proposal is that their proposal includes a provision for a Zero Capital Gains. The American Community Renewal Act is principally an attempt to create an opening for a capital gains tax through a program that would attempt to improve conditions in economically distressed communities. Objections and concerns raised about this bill include the zero percent capital gains provision for the sale of certain business property and assets held for more than 5 years. Eligibility includes a requirement that 35% of employees reside in the Renewal Community.

Because it is a back-end solution, a zero percent capital gains tax is not a logical incentive for investment in distressed economic communities. Potential investors in these areas may not be motivated by a benefit that comes only upon the sale of an investment in an area where investors are unlikely to experience appreciation in property values. There is a much greater need in poor communities for upfront and ongoing incentives to draw investment into such communities.

A zero capital gains for distressed communities could have the perverse and presumably unintended consequence of encouraging more disinvestment in distressed areas as owners might flip businesses and properties to receive this tax benefit. Additional and well-founded concerns about a capital gains tax for investment in distressed communities include:

- **Unintended Windfalls:** Certain business with property in the renewal community could earn large one-time "windfall" profits --- for example, from the sale of property near a site chosen for a large public attractions such as a sports arena -- without making any new investments related to job growth or spurring the local economy.

- **Negative Tax Incentives:** The ability of taxpayers to deduct interest on borrowing while entirely excluding the gains from the sale of some property, can create negative tax rates like those associated with the tax shelters of the 1970s and 1980s. For example, ignoring depreciation, a taxpayer in the top tax bracket would make an after-tax profit even if the return on the investment were as low as 5 percent, generating a 3 percent before-tax loss. The attraction for this tax arbitrage could be expected to result in non-productive investment that does not benefit the targeted area.

DUPLICATION OF THE EMPOWERMENT ZONE AND ENTERPRISE COMMUNITY PROGRAM: There are several areas of the bill that are duplicative of existing programs or other legislative proposals. However, our primary concern is related to the duplication and overlap of this program with our existing Community Empowerment program. The designation of distressed communities that would receive special tax treatment and coordinated assistance from the local government and the private sector, is an almost identical concept to the EZ/EC initiative. The Renewal Community program would use a place-based approach, similar to both NMI and EZ/ECs. The proposal also allows for overlap between designations as a Renewal Community and an EZ/EC, which could be confusing for taxpayers.

The American Renewal Act would use poverty and unemployment rates to target funding in contrast to the New Markets Initiative emphasis on income levels as well as poverty. The criteria for selection as a Renewal Community are more restrictive than requirements for NMI and less restrictive than those for EZ/ECs. The logic behind NMI was that targeting should be relatively broad (approximately 37% of the country is eligible) giving investors more choice and flexibility in determining where to place their funds, thereby making the program more attractive to the private sector. This issue has been argued both ways --- there is also a benefit to more narrow criteria, which assures that funds reach the most distressed areas. The EZ/EC uses a more targeted approach for this reason.

III. Possible Areas for Agreement and Compromise

A major unresolved issue is how this initiative would be paid for. Obviously this would play into the larger Social Security/Medicare/Tax Cut issues debate. If we could find a way to pay for the initiative the following are some provisions from the American Community Renewal Act that might be open for debate.

- **Family Development Accounts:** Some aspects of the Family Development Account (FDA) proposal mirror the Administration's Individual Development Account proposal. Although, the FDA proposal outlined in this bill would involve a matching program administered by HUD, it requires resources that HUD does not have at this time.
- **Brownfields Expensing:** Renewal communities would benefit from Brownfields expensing. Expensing for small business and Brownfields was provided for in the Taxpayer Relief Act of 1997. The provision in the American Renewal Community Act is actually a more limited version of the Administration's budget proposal to make Brownfields expensing permanent.

- **Commercial Revitalization Tax Credit:** The American Renewal Act includes a commercial revitalization tax credit for projects located in Renewal Communities. Project based tax credits have been used successfully for low-income housing where State Housing Agencies have been able to monitor and administer the program. However it would be difficult for Treasury to monitor credits for commercial properties, as there are no similar state or local entities equipped to provide oversight. Treasury has also raised a concern that a commercial revitalization credit could result in negative effective tax rates and cause investors to make purely tax-motivated decisions in order to shelter other income from higher taxes.
- **The Work Opportunity Tax Credit:** H.R. 815 would expand the existing law to include Renewal Community residents who work in Renewal Community businesses. The bill would also provide a different tax credit rate and maximum on wages, resulting in a more generous credit for the new target group in the second year of employment. Renewal Community youth, even those who work outside of community, would be eligible for the same treatment available to youth under the EZ program which requires that substantially all of the employees' services be provided in the EZ.
- **Transfer of HUD-Owned Property:** The proposal for American Renewal communities requires the transfer of any HUD-owned property to the local government. HUD and OMB have raised strong objections to this provision which requires HUD to transfer to the local government any substandard multifamily property, or any vacant single family property that is located in a Renewal Community. HUD contends that the FHA single family and multifamily insurance programs depend upon the process of sales of property to reduce costs of the insurance programs. In addition, because there is no limit on the sales prices (for example not greater than the cost recovery basis) there is the potential for fraud and abuse by the local government, which would be the beneficiary of real estate at no cost which could then be sold at a higher price.
- **Charitable Choices:** The proposal includes a provision for charitable choices that allow religious organizations be treated in the same manner as other non-profit organizations.
- **Expensing Provisions:** The bill includes expensing provisions for certain qualified Renewal Community Businesses as well as for Brownfields expensing. Expensing is already available for small businesses; however this Act would increase the phase-out range. In addition it would provide an additional \$35,000 per year of expensing for depreciable property. The proposed bill would also extend the period for Brownfields expensing that is currently available. (See description above).

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Provision	New Markets Tax Credit (Administration Budget/ Rangel Bill - H.R. 2713)	Conference Agreement (H.R. 2488)	Senate (S. 1429)	House (H.R. 2488)	U.S. House Watts
Capital gains for sales of business property and assets in a designated area.	No provision.	Zero percent capital gains for sale of business property and assets held for more than 5 years in renewal communities.	No provision.	Same as Conference.	Same as Conference.
Tax Credit/ Deduction	Treasury Department allocates tax credit for \$6 billion of new investment in selected community development investment entities. Investors claim a 6 percent credit for each year during the five-year period after investment.	Commercial revitalization deduction: either a 50 percent deduction or 10 percent deduction for 10 years allocated for nonresidential building investment. Up to \$6 million per State per renewal community.	No provision.	Same as Conference.	Commercial revitalization credit: a 20 percent allowance credit for nonresidential building investment. Up to \$6 million per State per renewal community.
Expensing for depreciable property used by small businesses	No provision.	\$35,000 of additional expensing for depreciable property used by small businesses in certain renewal communities.	No provision.	Same as Conference.	Same as Conference.
Brownfields	Not included in Rangel bill. Permanent extension of §198 expensing is included in the Administration's budget. H.R. 1630 in House (Coyne with Rangel cosponsor).	Brownfields expensing available beyond 2000 in renewal communities.	No provision.	Same as Conference.	Same as Conference.
Work Opportunity Tax Credit (WOTC)	No provision in Rangel Bill (H.R. 2713). The Administration has included a one-year extension to the credit to include those who begin work before July 1, 2000. The credit percentage is 25% of wages for at least 120 hours to 400 hours and 40% for more than 400 hours of employment. The maximum amount of qualified wages paid to an individual is \$6,000.	Renewal community youth receive the same treatment as EZ youth under WOTC. If WOTC expires, WOTC targeted group added of renewal community residents who work in the community. Credit is more generous \$10,000 of wages at 15 percent for the first year and 30 percent for the second year.	No provision.	Same as Conference.	WOTC targeted group added of renewal community residents who work in the community. Credit is more generous \$10,000 of wages at 15 percent for the first year and 30 percent for the second year.

Provision	New Markets Tax Credit (Administration Budget/ Rangel Bill – H.R. 2713)	Conference Agreement (H.R. 2488)	Senate (S. 1429)	House (H.R. 2488)	H.R. 815 Watts-Talent
Family Development Accounts	No provision. Leiberman has a proposal for Individual Development Accounts -- IDA's (S. 895). Treasury has provided technical assistance to Sen. Leiberman's staff but has not endorsed the proposal.	Family development accounts (FDA) for renewal community residents who receive the EITC. Deductible contributions up to \$2,000 per year (\$1,000 by others on behalf of renewal residents). Earnings tax-free and no tax on withdrawal if used for specific expenses.	No provision.	Same as Conference but in 5 renewal communities, 50 percent match. Tax paid on withdrawal for this part of the FDA.	Same as House.
Designation of new EZ/ECs, additional areas.	No provision. (Note: the Administration and Rep. Rangel are seeking to provide full funding for two round 2 EZs and to extend the wage credit for these zones for an additional two years from 2007 to 2009)	HUD would designate 20 renewal communities of which 4 in rural areas, 10 EZs or ECs.	No provision.	Same as Conference.	HUD would designate 100 renewal communities of which 20 in rural areas, 50 EZs or ECs.
Definition of Low Income Communities	Selected community development entities must invest in businesses located in tracts with poverty rates of at least 20 percent, or the median income does not exceed the greater of (1) 80 percent of statewide median, or (2) in the area, 80 percent of the area median.	Renewal Communities chosen by competition (as in the EZ program). Areas with poverty rates of at least 20 percent, 1 2 times unemployment rate, and 70 percent of households with median incomes no greater than 80 percent of the median for the area.	No provision.	Same as Conference.	Same as Conference.
Effective Date	For new investments from 1/1/00 through 12/31/04.	Designation 1/1/01 through 12/31/07.	No provision.	Same as Conference.	Same as Conference.

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BUSINESSLINC

Summary

In the six years since President Clinton took office, the economy has created 17.7 million new jobs. Yet even during one of the greatest periods of sustained economic growth in American history, we still have not achieved true equality of opportunity. Concentrations of poverty and joblessness continue to have a devastating effect on the social and economic fabric of communities across the country. This lack of opportunity is at the heart of our deepest social divisions.

The evidence strongly suggests that there are attractive business opportunities in underserved rural and inner city communities that are not being met. One of the most critical needs of these communities is access to technical assistance.

The President's BusinessLINC Initiative is designed to encourage and support mentoring relationships between businesses. This will improve the commercial prospects of small businesses and ensure that the opportunity to stimulate job growth, neighborhood revitalization and economic development of America's untapped new markets are not lost.

BusinessLINC is a key component of the president's New Markets Initiative. It complements SBA's existing small business counseling programs and encourages small business expansion by providing mentoring and technical assistance from larger businesses.

BusinessLINC Initiative

The BusinessLINC Initiative is a new partnership between the Federal government and America's business community to encourage large businesses to work with small business owners and entrepreneurs, especially in America's rural areas and inner cities. BusinessLINC, which stands for Learning, Information, Networking, and Collaboration, is designed to stimulate business-to-business relationships that will produce one-on-one technical advice and consulting, classroom and group training, peer group consulting, strategic alliances, and supplier and marketing development for small businesses.

BusinessLINC will help facilitate the technical advice and assistance, access to resources and personal contacts that are necessary for small businesses to compete successfully.

The SBA and the Department of Treasury will jointly create mentor-protégé programs. The Treasury Department program - Success Partnerships - will help increase the participation of small, disadvantaged and women-owned businesses as contractors and subcontractors by offering technical advice, financial and management skills, endorsement credibility, and one-on-one advice from large companies. The SBA counterpart will seek to enhance the capabilities of participants in the Agency's 8(a) business development program, and to improve their ability to compete and receive Federal Government contracts. In addition, SBA will expand *ACENet* (Angel Capital Electronic Network), which helps link minority and women-owned businesses with investment capital.

SBA will recruit national and local organizations to advocate BusinessLINC strategies through their

networks, and encourage companies to 1) build them into their core business strategies, 2) disseminate best practices, 3) create forums for businesses to exchange information and practices, and 4) support an Internet website to encourage BusinessLINC activities.

SBA will assemble a BusinessLINC leadership coalition of experts, comprised of both public and private sector representatives. The coalition will work to expand business-to-business relationships between large and small businesses and will provide businesses with on-line information, resources, and a database of companies with an interest in mentor or protégé programs (www.businesslinc.sba.gov).

SBA also will support activities throughout the Country that foster direct business relationships between larger and smaller firms on specific projects.

The Federal Government's HUBZone Empowerment Contracting program also will support the BusinessLINC initiative. Under the HUBZone program, up to \$6 billion in new federal contracts will be targeted to small businesses and distressed areas by the year 2000. In addition, it will widen the pool of potential government contractors and create an estimated 25,000 new jobs in more than 7,000 rural and inner city communities.

Several large private sector firms have already committed resources to the project. Those include:

- GE Capital will expand its Small Business Colleges, which offer business advice to entrepreneurs in distressed areas, and to open a fifth college in St. Louis and a new pilot program for women business owners in Washington, D.C.
- Science Applications International Corporation (SAIC) will execute joint marketing agreements with small businesses and support relationships with small businesses in the new HUBZone areas.
- Chase Manhattan Bank will create a new program that will connect its senior bank officers with women and minority small business owners, and a new partnership with the National Association of Black Management Consultants.
- Bell Atlantic will spend \$1.8 billion, through a partnership with SBA, to increase purchasing and subcontracting with minority and women-owned businesses.

BusinessLINC:**Business-to-Business Relationships that Increase the Economic Competitiveness of Firms
January 15, 1998**

Today, Treasury Secretary Robert E. Rubin and SBA Administrator Aida Alvarez announced that the Administration's FY 2000 budget includes seed funding of \$3 million to expand BusinessLINC to new markets in economically distressed communities around the country.

In June 1998, Vice President Al Gore launched BusinessLINC -- Learning, Information, Networking, and Collaboration, and asked Secretary Rubin and Small Business Administration Administrator Alvarez to lead the effort. BusinessLINC is a unique partnership between the federal government and America's business community to encourage large businesses to work with small business owners and entrepreneurs, in order to improve the economic competitiveness of smaller firms located in distressed areas, both urban and rural.

As a part of the initiative's efforts to gather information on current efforts encouraging business-to-business linkages, a series of six regional meetings were held in Atlanta, Cleveland, Chicago, Dallas, Los Angeles, and New York. The regional meetings, which included participation by business leaders from both large and small companies; local business and civic organizations; and federal, state and local government officials, served as forums to spark further interest from the private sector community, share information about their business-to-business partnerships and mentor-protégé programs, and exchange ideas and best practices.

Vice President Gore released a report on successful corporate strategies, *BusinessLINC: Business-to-Business Relationships that Increase the Economic Competitiveness of Firms*, at the second White House Business and Entrepreneurial Roundtable on December 16, 1998. At the Roundtable, leading businesses announced new BusinessLINC initiatives, including BankBoston; Bell Atlantic; Chase Manhattan Bank; Delilah's Southern Cuisine; GE Capital; ITC Personnel Services; Lazo Technologies; McDonald's Corporation; Science Applications International Corporation; and Trumark Metal Stamping.

Vice President Gore also announced a new private sector BusinessLINC leadership coalition; a Treasury mentor-protégé program -- *Success Partnerships*; and a BusinessLINC website (businesslinc.sba.gov) that will serve as a national database for small and large companies and intermediaries to identify business linkages. The \$3 million in new funding will leverage these private sector efforts to spur BusinessLINC at the national and local level, to bring vital business expertise to economically distressed communities across the country.

The benefits to large and small firms from BusinessLINC can be significant. Smaller firms can use these strategies to obtain technical assistance and management development, leverage core strengths, access new sources of financing, increase marketplace credibility, and enter into subcontracts and joint ventures. Larger companies may use BusinessLINC to reach new markets, partner with agile companies, create a strong supplier base, thrive in industries that call for inter-firm collaboration, and create a stronger community and overall business environment.

BusinessLINC: Learning, Information, Networking and Collaboration

**Business-to-Business Relationships
that Increase the Economic Competitiveness of Firms**

A Report to Vice President Al Gore

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Executive Summary

Vice President Al Gore launched an initiative in June 1998 called "BusinessLINC"— Learning, Information, Networking, and Collaboration — to galvanize business-to-business relationships that build the competitive strengths of small businesses, especially those located in economically distressed urban and rural areas. The Vice President asked Treasury Secretary Robert E. Rubin and U.S. Small Business Administration's Administrator Aida Alvarez to co-chair the effort to research business-to-business advisory services in all contexts and to suggest how best practices could be applied in urban and rural economically distressed communities.

Small businesses are critical to job growth and the economic vitality of the United States. Of the approximately 6.6 million employers in the U.S., over 5.5 million are businesses that employ fewer than 100 employees.¹ Small businesses with fewer than 100 employees employ over 37 percent of all full-time employees.² As America grows more diverse, the face of small business is also changing: in the most recent survey of business ownership prepared by the Bureau of Census, the number of minority-owned small businesses grew at a 62 percent rate while the total number of firms grew 26 percent, from 1987 to 1992. Yet relatively little attention has been paid to the ways that business relationships with larger firms can help smaller firms thrive and compete effectively.

The Department of the Treasury and the Small Business Administration, in partnership with other Federal agencies, held a series of BusinessLINC Regional Meetings across the country with over 500 business people, civic leaders and practitioners in the summer and fall of 1998. In addition, Treasury staff have conducted additional research, including in-depth interviews with experts from corporate and civic organizations, to learn from a wide array of experience. Because there has been little academic research on this topic, Treasury also contracted with Harvard Business School Professor Michael Porter's research and consulting firm, the Initiative for a Competitive Inner City, which has expertise in business strategy and economic development, to conduct additional research and develop detailed case studies of several business-to-business relationships. Finally, members of a CEO working group put together by Secretary Rubin, and outside expert reviewers, provided additional material and extensive input for the report. The report is based on our findings from these meetings, interviews and additional research.

Our work suggests that business-to-business relationships -- which include learning, information-sharing, networking among firms and intermediaries, and collaboration on specific projects— can be essential to business success and a vital resource to help economically distressed

¹ U.S. Census Bureau, U.S. Firms, Establishments, Employment, Annual Payroll, and Estimated Receipts by Industrial Division and Enterprise Employment for 1995.

² Office of Advocacy, U.S. Small Business Administration, from data provided by the U.S. Department of Commerce, Bureau of the Census, March 1997 Current Population Surveys.

communities. Both companies and individual business professionals can bring their expertise and resources to bear through BusinessLINC activities. As Michael Porter has stated, "business-to-business connections, whether they be in training, purchasing, mentoring, or supplier relationships, are the most precious resource companies can contribute. A network of business relationships and sources of advice is critical to any company's success."³

Based on the meetings, interviews and research conducted as part of the BusinessLINC initiative, this report for the first time catalogs these corporate relationships ("BusinessLINC strategies"), sets forth the lessons to be learned from them, and presents an action agenda for businesses to create more BusinessLINC relationships -- at the individual business level, in local initiatives and at the national level.

"Chase has long recognized that the growth and strength of small businesses is a key element to the overall health and vitality of our communities and of our own business success in those communities."
 — Walter V. Shipley, Chairman, The Chase Manhattan Corporation

The Regional Meetings also illustrated how BusinessLINC strategies can have an important impact on distressed areas. An objective of this report is to encourage businesses outside economically distressed communities to enter into partnerships with businesses in these areas. The action agenda is designed to provide a blueprint for allowing the benefits of BusinessLINC strategies to reach more small and large businesses, particularly those in economically distressed areas.

Companies enter these business-to-business collaborations to further their business objectives. The report presents how companies are creating profitable opportunities with smaller firms as part of their business strategy. For example,

- Turner Construction operates a nationwide training program that has trained over 7,000 construction subcontractors, providing Turner with high-quality low-cost suppliers;
- The North Texas Commission and the Dallas/Fort Worth Minority Business Development Council annually match 35-40 entrepreneurs with corporate mentors to advance the growth of small minority and woman-owned companies and also to benefit the mentors;
- Chase Manhattan Bank's Business Resource Centers have counseled over 5,000 small business owners directly or through referrals to outside professionals,

³ Porter, Professor Michael E., "The Next Agenda for America's Cities: Competing in a Global Economy," First Annual James W. Rouse Lecture, June 24, 1997.

resulting in more than \$38 million in loans to more than 500 small businesses; and

- The Women's Network for Entrepreneurial Training program, operating from the Boise, Idaho SBA District Office since 1995, has served over 1,000 women business owners with assistance through mentoring roundtables.

The benefits to both large and small companies from BusinessLINC practices can be significant, as discussed in Chapter I. Smaller firms can use BusinessLINC strategies to enhance their capability and their capacity through:

- obtaining technical advice;
- enhancing management development;
- leveraging core strengths;
- accessing sources of financing;
- increasing marketplace credibility; and
- entering subcontracts and joint ventures.

Larger companies may see benefits such as:

- reaching new markets;
- partnering with agile companies;
- cultivating a world-class supplier base;
- thriving in industries that call for inter-firm collaboration; and
- creating stronger communities and a stronger business environment.

Based on our extensive interviews, we found that the major participants in business-to-business relationships often are: (1) corporations that rely on smaller companies as suppliers and sales channels; (2) financial institutions; (3) business-led membership organizations; (4) specialized nonprofits; and (5) individual business professionals. We discuss this more fully in Chapter II, along with the range of partner firms. Although this report primarily focuses on BusinessLINC strategies used by corporations, these activities are often led by entrepreneurial individuals within firms. Individual business professionals may be interested in applying the ideas in this report within their company or through the intermediary organizations mentioned above.

In Chapter III, we classify this range of business-to-business relationships into five basic strategies: (1) one-on-one technical assistance and consulting; (2) classroom and group training; (3) peer groups and boards of advisors; (4) supplier development and strategic alliances; and (5) sales channel development.

No matter which BusinessLINC strategy was used, firms and practitioners who were interviewed repeated many of the same keys to successful BusinessLINC strategies, discussed in Chapter IV:

- The business-to-business relationship must be mutually beneficial -- a "win-win" for both firms. These BusinessLINC have the hallmarks of a serious business relationship -- a

focus on business outcomes, commitment, efficient and effective interactions, and accountability.

- The greatest benefits of BusinessLINC relationships come over a long term and often in unanticipated ways. BusinessLINC relationships rarely generate large profits in the short-term, but often provide real benefits over time.
- The business must be committed to the relationship at both the top management and staff levels, with appropriate incentives for performance.
- Successful business-to-business relationships often rely on successful personal relationships. People often tend to do business with people they like and trust. BusinessLINC strategies are a method for finding and developing common business goals and capacities, and developing trust and personal ties.

Chapter V focuses on the role of intermediary organizations – specialized nonprofits and business-led membership organizations – in forging and supporting BusinessLINC. These organizations can provide the necessary local market knowledge and business skills to maximize a company's investment in BusinessLINC strategies.

"General Motors believes a positive working relationship between small and large businesses is critical to the development of healthy, vibrant communities. By working together, small and large companies can learn from each other, benefit from each other, and provide the economic growth needed for communities to flourish."
 -- John E. Smith, Jr., CEO, General Motors

In particular, these strategies can have force in economically distressed communities, as is discussed more fully in Chapter VI. Successfully partnering with businesses in distressed communities requires the same type of local market knowledge – about the companies, about the marketplace, and about the competitors – as it does to penetrate any new market. Although there are important challenges to BusinessLINC with firms in these communities, there are also real business opportunities. Secretary Rubin has said, "these BusinessLINC relationships can play an important role in helping firms in economically distressed communities to grow and succeed."

A number of companies and organizations target their efforts to foster business-to-business relations in economically distressed areas. For example,

- GE Capital's Small Business College is an 11-week structured networking and educational seminar for small business owners that partners with organizations that reach local firms in distressed areas, such as the Port Authority of New York and New Jersey, and Public Service Electric & Gas of New Jersey.

- Coastal Enterprises in rural Wiscasset, Maine provides technical assistance and financing to small businesses, having loaned or invested \$50 million in 1,000 ventures and provided training and technical assistance to roughly 4,000 women-owned businesses. Coastal Enterprises facilitates peer networks and advisory boards for owners, in conjunction with training or individual consultation.
- Baltimore Advisors is a privately funded nonprofit whose mission is to increase employment in Baltimore by strengthening companies with annual sales from \$1 million to \$20 million. A network of corporate partners, comprised of business professionals and owners and mid- to large-size businesses provides one-on-one direct work, group strategy sessions and advisory boards.

Distressed urban and rural areas face a number of challenges. Businesses often must deal with outsiders' lack of market information about the local business community and its resources; outsiders' preconceived stereotypes of businesses, workers or consumers located in poorer areas; and the limitations business owners in these areas may face due to their isolation from mainstream business networks.

Despite these barriers, certain advantages may enhance business opportunities for firms interested in investing in, or linking with, smaller firms in these communities.

Michael Porter suggests that inner cities have four basic competitive advantages: strategic location near business, transportation or communication networks; unmet local customer demand in high density areas; committed and available workforce; and integration with regional industries and clusters.⁴ Likewise, in rural areas, latent competitive advantage may be found in proximity to natural and extractive resources, availability of developable sites, and human resources.

"GE Capital views the GE Capital Small Business College as a sound investment in the communities it serves. It yields stronger small businesses, enhanced employment, improved economic conditions, and the potential for future business partnerships with our company" — Gary Wendt, CEO, GE Capital

At the Regional Meetings and follow-up interviews, most successful examples of BusinessLINC activity in economically distressed communities involved the use of intermediaries brokering business-to-business connections. In Chapter VI, this report identifies special considerations and recommendations for BusinessLINC initiatives in economically distressed areas:

- Partner with a skilled intermediary organization to fill market information gaps, supplement skill training and build trust;
- Profile the business community and its existing support organizations;
- Access to new customers and new markets is critical;

⁴ "The Competitive Advantage of the Inner City," *Harvard Business Review*, May/June 1995.

- Create a long-term growth plan to provide useful encouragement; and
- Consider the full range of skills distressed-area businesses will need to grow.

BusinessLINC concepts also part of the first Roundtable in June, including the announcement by Pam Aguirre, CEO of Mexican Industries, that her firm had undertaken two joint ventures with larger firms in the automotive industry that would strengthen all the firms involved. These ventures continue to move forward today, and this report reviews a much wider range of BusinessLINC strategies.

Treasury Secretary Rubin and SBA Administrator Alvarez transmitted this BusinessLINC report at the second in a series of White House Business and Entrepreneurial Roundtables on Community Empowerment. At this Roundtable, the Vice President announced a series of initiatives to implement BusinessLINC:

Secretary Rubin explained that the Administration would launch:

- a new BusinessLINC website developed by Treasury and to be maintained by SBA that will allow businesses to identify local resources for BusinessLINC activity, success stories, and interested small and large companies;
- the launch of a Departmental BusinessLINC program to encourage these business relationships in its own procurement practices;
- To carry on BusinessLINC in the private sector and apply the expertise gathered in this report, Secretary Rubin acknowledged the creation of a new coalition of organizations that will take up the Action Agenda. Participating organizations include the Business Roundtable, the National Minority Supplier Development Council, the Conference Board, the National Black Chamber of Commerce, the U.S. Hispanic Chamber of Commerce, National Association of Women Business Owners, the Women's Business Enterprise National Council, the National Association of Minority Contractors, and the National Congress for Community Economic Development;
- A number of local organizations in the cities where we held regional meetings have also agreed to foster BusinessLINC in their communities:

New York City:	American Women's Economic Development, Asian Women in Business, Chase Manhattan Bank, New York City Partnerships & Chamber of Commerce.
Cleveland:	Cleveland Regional Minority Purchasing Council - Greater Cleveland Growth Association.
Dallas:	Dallas-Ft. Worth Minority Business Development Council, GTE, North Texas Commission, North Texas Women's Business Council.
Los Angeles:	Asian, Inc., UCLA School of Public Policy and Social Research, Vermont Slauson Economic Development Corporation.

Chicago: Chicago Association of Neighborhood Development
Organizations, Chicagoland Chamber of Commerce.
Washington, DC: The Greater Washington Board of Trade.

SBA Administrator Alvarez stated that "SBA has made a strategic commitment to increasing access to its programs by these new, emerging small business communities. SBA is committed to increasing economic opportunity for all Americans." SBA helps small businesses succeed by acting as an intermediary for capital, counseling, contracting, and networking for small businesses. Administrator Alvarez explained the SBA announcements:

- The launch of the HUB Zone program to provide Federal contracting opportunities for qualified small businesses in distressed communities. The SBA expects that HUBZone contracting will equal roughly \$2 billion in FY 1999 and increase to almost \$6 billion in 2003.
- The approval of the first formal mentor-protégé relationship before the first of the year under SBA's new 8(a) Mentor-Protege Program to enhance the capacity of these firms and improve their ability to receive federal contracts.
- The development of a new on-line "Small Business Classroom" for training and informing entrepreneurs on how to raise capital, how to write a business plan, and how to reach counselors and mentors.
- The expansion of ACENet (Angel Capital Electronic Network) that will help minority- and women-owned businesses to access investment capital.

Companies also announced several new BusinessLINC activities including:

- Bell Atlantic will target \$1.8 billion in direct purchases and subcontracts to small businesses by the year 2000, pursuant to a Memorandum with the SBA. Bell Atlantic will also formally mentor at least three companies each year.
- Science Applications International Corporation (SAIC), with \$4 billion in sales, will sign joint marketing agreements with small businesses to pursue commercial contracts, applying its lessons learned from federal mentor-protége programs. In addition, SAIC will establish a high-level committee to examine how to develop relationships with small businesses in HUB Zones, Empowerment Zones and Enterprise Communities.
- Chase Manhattan Bank will open a Business Resource Center in the Bronx, its third BRC, to provide technical assistance to an estimated 500 small businesses per year. Chase will also offer in-depth, structured BusinessLINC assistance to selected Chase suppliers and other minority- and women-owned businesses from Chase's senior executives and the National Association of Black Management Consultants. Additionally, Chase will become a corporate sponsor of the new coalition promoting BusinessLINC activities.

- GE Capital will further extend its successful outreach for its four Small Business College sites (New York City, Newark, NJ, Philadelphia and Stamford, CT) with 200 graduates annually to small businesses in distressed areas. In the Spring of 1999, GE Capital will open a fifth College site, in St. Louis. GE Financial Assurance will pilot a new seminar series for women business owners in Washington DC, reaching an estimated 2,500 people in the first year.
- Trumark broke ground in the last month for a joint venture with Mackie Automotive Systems that will create over 300 jobs in Detroit's Empowerment Zone, an example of an increasingly common BusinessLINC strategy in the automotive industry. In addition, Trumark has enlisted the National Association of Black Automotive Suppliers to act as the BusinessLINC intermediary in the Detroit area to foster new BusinessLINC's.
- McDonald's, as part of its efforts to support small business entrepreneurship in central cities, facilitated the sale of 19 restaurants in Youngstown, Ohio, including inner city sites, to an African-American franchisee. McDonald's also announced that of the 125 applicants in training to be new McDonald's franchisees, 65% are minority and women, including 43 African-Americans, 13 Hispanic-Americans and 12 Asian Americans. Moreover, McDonald's reported that purchases from minority suppliers have more than quadrupled since 1997, putting such purchases at almost \$3 billion in 1998.

This report is intended to spark further efforts by the private sector, local organizations, and government, working together. To foster these initiatives, the report suggests a BusinessLINC Action Agenda, summarized on the next page and detailed in the final chapter.

Summary of Action Agenda

A. Starting Individual BusinessLINC

1. Consider objectives and desired outcomes.
2. Profile the potential BusinessLINC partners.
3. Learn about existing organizations and resources, public and private, that could complement the effort.
4. Formulate a BusinessLINC strategy for your company or organization, such as:
 - one-on-one technical advice and consulting,
 - classroom and group training,
 - peer groups and boards of advisors,
 - supplier development and strategic alliances, or
 - sales channel development.
5. Consider special factors in establishing BusinessLINC in economically distressed areas.

B. Catalyzing More BusinessLINC at the National Level:

1. Recruit a coalition of organizations to advocate BusinessLINC strategies through their networks, and corporations to build into their core business strategies.
2. Disseminate BusinessLINC best practices and case studies, and create forums for businesses to exchange information and practices.
3. Develop a national award for leading BusinessLINC practices, and compose case studies of winning companies.
4. Create a seed fund that a national BusinessLINC coalition could award to local BusinessLINC initiatives focused on economically distressed areas.
5. Promote and support an Internet website to encourage BusinessLINC activity.

C. Catalyzing more BusinessLINC at the Local Level:

1. Recruit local firms to employ BusinessLINC strategies.
2. Galvanize support to bolster local intermediary organizations, such as specialized nonprofits and business membership organizations, that foster BusinessLINC.
3. Target resources to enlist existing organizations that can encourage more BusinessLINC activity in economically distressed communities.

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**New Markets Tax Credit:
Spurring Investment for Business Growth in Urban and Rural Communities**

President Clinton's FY 2000 budget includes a "New Markets Tax Credit" to help spur \$6 billion in private sector investment for business growth in low and moderate income rural and urban communities. Businesses in our nation's inner cities and isolated rural communities often lack access to equity capital to grow and succeed. To help attract new capital to these businesses, President Clinton is proposing a new tax credit for equity investments in these communities. Investors would be able to claim a tax credit worth 25 percent of the amount invested, in present-value terms. Investments in a wide range of investment vehicles focused on serving these communities would be eligible for the credit. Over the next five years, these funds would be able to attract an aggregate of \$6 billion in new equity capital eligible for the tax credit.

What investment funds can use the tax credit? To provide flexibility and attract a range of investors, investments in a wide range of vehicles would qualify. Under the proposal, the Treasury Department would allocate tax credits to investment vehicles whose primary mission is to serve low and moderate income communities. These might include community development banks or venture funds, community development corporations (including for-profit subsidiaries of nonprofits), small business investment corporations focused on low and moderate income communities, funds established under SBA's new programs - America's Private Investment Companies and New Market Venture Capital Firms - or other investment funds set up to serve low and moderate income communities. Tax credits could also be provided for investments in designated national or regional funds that, in turn, invest in local community development funds. Similarly, tax credits could be provided for secondary market investments for qualified purposes.

What businesses would qualify? The designated investment entities would make their own decisions, based on local knowledge and expertise, about what investments or loans to make to help create and grow businesses in low and moderate income communities, subject to certain rules designed to ensure that the businesses are operating in these communities. A wide range of businesses could be funded by these investment entities, from small technology firms to inner city shopping centers, from manufacturers with hundreds of employees, to retail stores.

How would the tax credit work? Investment funds would apply for designation. Designated entities would be given the authority to allocate a given amount of tax credits to investors. The entities would use the tax credits to attract investment capital, and then provide the investors with tax credit authorizations, worth approximately 25 percent of their investment (in present-value terms). On their tax returns, the investors would claim a 6 percent tax credit for each of five years of a mandatory minimum holding period on their investment. The investment funds would report to the Treasury Department on the tax credit allocations made and on the use of the investment for qualified purposes.

"The New Markets Tax Credit is the most significant proposal for the economic development of distressed urban and rural communities in a generation." Michael Rubinger, President and CEO of Local Initiatives Support Corporation (LISC)

PROVIDE NEW MARKETS TAX CREDIT

Current Law

In general, there are limited tax incentives for investing and making loans to businesses in low-income communities. For example, current law provides for targeted tax incentives that are intended to encourage investment in specialized small business investment companies that are licensed by the Small Business Administration to make loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

Reasons for Change

Businesses in our nation's inner cities and isolated rural communities often lack access to equity capital to grow and succeed. To help attract new capital to these businesses, a new tax credit for equity investments in these businesses is proposed.

Proposal

In general.—Taxpayers would be allowed a credit against Federal income taxes for qualified investments made to acquire stock or other equity interests in a selected community development entity. The credits would be allocated to selected community development entities by the Department of Treasury, pursuant to regulations to be issued by that Department. For each year during the period 2000-2004, the Treasury Department would be permitted to authorize selected community development entities to issue an aggregate of \$1.2 billion of equity interests with respect to which credits could be claimed under the proposal (a total of \$6 billion of new equity investment).

If the selected community development entity fails to sell equity interests to investors up to the amount authorized within five years of the authorization, then the remaining authorization would be canceled, and the Treasury Department would have up to two years to authorize another community development entity to issue equity interests for the unused portion.

The credit allowed to the investor (either the original purchaser or a subsequent holder) would be a six-percent credit for each year during the five-year period after the equity interest is purchased from the selected community development entity. A taxpayer holding a qualified investment would be entitled to a credit on each credit allowance date (meaning each one-year anniversary, during a five-year period, of the date the investment was originally purchased from the community development entity). The taxpayer's basis in the investment would be reduced by the amount of the credit. The credit would be subject to the general business credit rules.

Qualified investments.—"Qualified investments" which entitle the investor to a credit must be common stock or other similar equity interest acquired from a selected community development

entity in exchange for cash.⁷ The stock or other equity interest must not be redeemed (or otherwise cashed out) by the selected community development entity for at least five years. Substantially all of the proceeds of the investment must be used by the community development entity to make "qualified low-income community investments," meaning equity investments in, or loans to, qualified active businesses located in low-income communities.⁸ Qualified low-income community investments could be made directly by a selected community development entity, or could be made indirectly through another community development entity.⁹

Community development entities. -- "Community development entities" that could apply for credit allocations would include (but would not be limited to) Community Development Financial Institutions, Community Development Corporations, Small Business Investment Corporations-LMIs, New Market Venture Capital Firms, America's Private Investment Corporations, or other investment funds (including for-profit subsidiaries of nonprofit organizations). To be selected for a credit allocation, the community development entity's primary mission must be serving or providing investment capital for low-income communities or low-income persons, the entity must maintain accountability to residents of low-income communities (through representation on governing or advisory boards, or otherwise), and at least 60 percent of the aggregate gross assets of the entity must be invested in "qualified low-income community investments" or residential property located in low-income communities.¹⁰

As part of the credit allocation process, the Treasury Department would certify entities as eligible "community development entities." Certified entities would be required to file annual

⁷ To ensure that credits are available only for new equity investments in selected community development entities, the term "qualified investment" would not include any stock or other equity interest acquired from a community development entity which made a substantial stock redemption or distribution (without a bona fide business purpose therefor) in an attempt to avoid the purposes of the proposal.

⁸ If at least 85 percent of the aggregate gross assets of the community development entity are invested (directly or indirectly) in equity interests in, or loans to, qualified active businesses located in low-income communities, then there would be no need to trace the use of the proceeds from the particular stock (or other equity ownership) issuance with respect to which the credit is claimed.

⁹ A community development entity would be treated as indirectly making "qualified low-income community investment" when it purchases loans previously made by another community development entity which, in turn, uses the proceeds from the transaction to provide additional capital to qualified active businesses located in low-income communities.

¹⁰ Expenditures made by a community development entity to provide financial counseling and certain other services to businesses located in, and residents of, low-income communities would also be treated as "qualified low-income community investment."

reports demonstrating that they continue to meet all the requirements for initial certification, and would be required to identify the amount (and purchasers) of equity interests with respect to which allocated credits may be claimed by the purchaser and to demonstrate that the entity monitors its investments to ensure that capital is used in low-income communities.

If an entity fails to be a community development entity during the five-year period following the taxpayer's purchase of an equity interest in the entity, or if the equity interest is redeemed by the issuing entity during that five-year period, then any credits claimed with respect to the equity interest would be recaptured and no further credits would be allowed.

Low-income communities.—For purpose of the credit, "low-income communities" would be defined as census tracts with either (1) poverty rates of at least 20 percent (based on the most recent census data), or (2) median family income which does not exceed 80 percent of metropolitan area income (or for a non-metropolitan census tract, 80 percent of non-metropolitan statewide median family income).

Qualified active businesses.—"Qualified active businesses" generally would be defined as businesses¹¹ which meet the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in low-income communities; (2) a substantial portion of the use of the tangible property of such business is used within low-income communities; (3) a substantial portion of the services performed for such business by its employees are performed in low-income communities; and (4) less than 5 percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property (e.g., debt, stock, partnership interests, options, futures contracts) or to collectibles (other than collectibles held primarily for sale to customers).

For purposes of the credit, there would be no requirement that employees of a "qualified active business" be residents of the low-income community. Rental of improved commercial real estate located in a low-income community (e.g., an office building or shopping mall) would be a qualified active business, regardless of the characteristics of the commercial tenants of the property. In addition, a qualified active business that receives a loan from a community development entity could include an organization that is organized and operated on a non-profit basis. The purchase and holding of unimproved real estate would not be a qualified active business. In addition, a qualified active business would not include (a) any business consisting predominantly of the development or holding of intangibles for sale or license; (b) operation of any facility described in sec. 144(c)(6)(B) (e.g., commercial golf course, country club, massage parlor, hot tub facility, suntan facility, liquor store); or (c) any business if a significant equity interest in such business is held by a person who also holds a significant equity interest in the community development entity.

¹¹ As under current-law section 1394(b)(3)(D), the term "qualified active business" would include any trade or business which would qualify as such a business if the trade or business were separately incorporated.

Regulatory authority.—The Treasury Department would be granted authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the proposal, including regulations limiting the benefit of the proposed tax credit in circumstances where investments are directly or indirectly being subsidized by other Federal programs (e.g., low-income housing credit and tax-exempt bonds), and regulations preventing abuse of the credit through the use of related parties. The Treasury Department would issue regulations describing the certification process for community development entities, annual reporting requirements for such entities, and application of the low-income community investment requirements to start-up entities.

Effective date.—The proposal would be effective for qualified investments made after December 31, 1999.

**NEW MARKETS TAX CREDIT:
SPURRING INVESTMENT FOR BUSINESS GROWTH IN URBAN AND RURAL
COMMUNITIES
Summary**

President Clinton's FY 2000 budget includes a "New Markets Tax Credit" to help spur \$6 billion in private sector investment for business growth in low and moderate income rural and urban communities. Businesses in our nation's inner cities and isolated rural communities often lack access to equity capital to grow and succeed. To help attract new capital to these businesses, President Clinton is proposing a new tax credit for equity investments in these communities. Investors would be able to claim a tax credit worth 25 percent of the amount invested, in present-value terms. Investments in a wide range of investment vehicles focused on serving these communities would be eligible for the credit. Over the next five years, these funds would be able to attract an aggregate of \$6 billion in new equity capital eligible for the tax credit.

What investment funds can use the tax credit? To provide flexibility and attract a range of investors, investments in a wide range of vehicles would qualify. Under the proposal, the Treasury Department would allocate tax credits to investment vehicles whose primary mission is to serve low and moderate income communities. These might include community development banks or venture funds, community development corporations (including for-profit subsidiaries of nonprofits), small business investment corporations focused on low and moderate income communities, funds established under SBA's new programs - America's Private Investment Companies and New Market Venture Capital Firms - or other investment funds set up to serve low and moderate income communities. Tax credits could also be provided for investments in designated national or regional funds that, in turn, invest in local community development funds. Similarly, tax credits could be provided for secondary market investments for qualified purposes.

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"The New Markets Tax Credit is the most significant proposal for the economic development of distressed urban and rural communities in a generation." Michael Rubinger, President and CEO of Local Initiatives Support Corporation (LISC)

New Markets Summaries - All.rtf

New Markets Tax Credit

Hold - Exempt
Briefing
on the Road

“Businesses must have equity capital before they are considered viable candidates for debt financing... Continued efforts to develop the markets for private equity investments will be rewarded by an innovative and productive business community. This is especially true in lower income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects...”

Alan Greenspan, Federal Reserve Board Chairman

New Markets Tax Credit

“I remember from my time on Wall Street that there really had been no practical means, even for professional investors, to invest in inner cities even if they wished to do so. Hopefully the creation of CDFI and other vehicles, and this new tax credit, will interact to make investment opportunity more readily available and to provide incentive for such investment.”

Robert E. Rubin, U.S. Treasury Secretary

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Government-wide New Markets Programs (in millions of dollars)

<u>Program:</u>	<u>FY 2000</u>		<u>FY 2001</u>			
	<u>Request</u>	<u>Enacted</u>	<u>Agency Request</u>	<u>Settlement</u>	<u>Change from Request</u>	<u>Change from Enacted</u>
APICs/HUD	37	20	37	37	0	+17
NMVC/SBA	15	6	15	21.7	+6.7	+15.7
NM TA/SBA	30	9	20	30	+10	+21
BusinessLINC/SBA	3	1.5	4	6.6	+2.6	+5.1
PRIME ^a /SBA	0	0	0	15	+15	+15
7(a) targeted loans/SBA	37	0	0	0	0	0
First Accts/ Treasury	0	0	0	10	+10	+10
Postal ATM/ Treasury	0	0	0	20	+20	+20
University Partnerships/HUD	0	0	0	5	+5	+5
Native American SBDC/SBA	0	0	0	3	+3	+3
Native American/EDA	3	3	50	49	-1	+46
TOTAL, NM Initiative	125	39.5	126	197.3	+71.3	+157.8
Micro Loans/SBA	4	0	5.8	5.4	-1.2	+5.8
Micro Loan TA/SBA	32	23.2	59	45	-14	+21.8
TOTAL, NM + Microloans	161	62.7	190.8	247.7	+56.1	+185.4

<u>Loan Volume:</u>						
APICs	1,600	800	1,600	1,600	0	+800
NMVC	100 ^b	40	100	150	+50	+110
7(a) targeted loans	2,500	0	0	0	0	0
Microloans	60 ^c	30 ^d	75	60	-15	+30
TOTAL, Loan Volume	4,260	870	1,775	1,810	+35	+940

GH:\DIVISION\Total_FY01NewMarkets_chart.doc, 1/12/2000 5:39 PM

^a s program was originally requested for CDFI and was not a part of the New Markets initiative. SBA did not have sufficient time to include PRIME in its budget test when it became clear that SBA would administer the program.

^b When discounted, the debentures will be worth 2/3 of their face value upon issuance. Therefore, the loan volume for the FY 2000 Request and Enacted, and the FY 2001 Agency Request and Settlement will be \$67 million, \$28.6 million, \$67 million, and \$100 million, respectively.

^c The \$60 million loan volume request assumed \$4 million in subsidy appropriations and \$1 million in carryover balances.

^d The \$30 million loan volume for FY 2000 is funded entirely from \$2.5 million in subsidy carryover balances.

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New Markets Initiative

White House National Economic Council
U.S. Small Business Administration
U.S. Department of Housing & Urban Development
U.S. Department of the Treasury

1999

Goals of the New Markets Initiative:

- **Provide incentives to stimulate \$15 billion of new private capital investment in targeted areas;**
- **Build a network of private investment institutions focused on economic development in underserved areas; and**
- **Provide the expertise to small businesses and microenterprises that will allow them to use new investment to grow.**

Elements of the New Markets Initiative

- **New Markets Tax Credit**
- **America's Private Investment Companies (APICs)**
- **SBICs Targeted to New Markets (SBIC-LMI)**
- **New Markets Venture Capital Firms (NMVCs)**
- **Microenterprise Lending and Technical Assistance**
- **Continued Growth for CDFIs**
- **BusinessLINC**

New Markets Initiative

U.S. Small Business Administration

1999

What is an SBIC?

- **A Private Company**
- **With Private Management**
- **And Private Investors**

Formed specifically to invest in small businesses, generally where equity participation is a significant component of the financial return.

How SBICs Work



SBA

**Guaranteed Debt
(Leverage)**

**Small
Business
Investment
Company**

Investments

**Small
Business**

**Small
Business**

Investments

**Small
Business**

Equity

**Private
Investors**

Managers

What is an LMI (Low and Moderate Income)-Focused SBIC?

- **A Regularly Licensed SBIC**
- **\$5 Million Minimum Capital**
- **Up to 3:1 Debenture Leverage**
- **Five Year Deferment of Interest**

Formed to invest in LMI areas where 20% of the population is below poverty level or median income is less than 80%.

What Is the SBIC/LMI Target Market?

- **Growth Small Businesses in Rural Areas, Inner Cities, or**
- **35% of Employees from LMI Areas**
- **Investments from \$150,000 to \$1 Million**

What is New Markets Venture Capital (NMVC)?

- **A Community Based Venture Capital Fund**
- **5 Year Deferment of Interest**
- **Formed to Invest in Companies Requiring both Equity and Technical Assistance in LMI Areas**

What Is the NMVC Target Market?

- **Small Businesses in Rural Areas or Inner Cities that Require both Equity and Technical Assistance**
- **Small Business Has Unique Market Niche**
- **Moderate Growth Prospects**
- **Investments from \$50,000 to \$300,000**

New Markets Initiative

**U.S. Department of Housing
and Urban Development**

1999

Overview: Goals and Need

APIC Adapted from:

SBA's Small Business Investment Companies

APIC Created to:

- **Expand private investment in large-scale businesses in LMIs.**
- **Reach untapped markets in urban and rural areas.**
- **Complement HUD's existing programs for large-scale revitalization.**
- **Enable a wide variety of project types, including commercial real estate.**

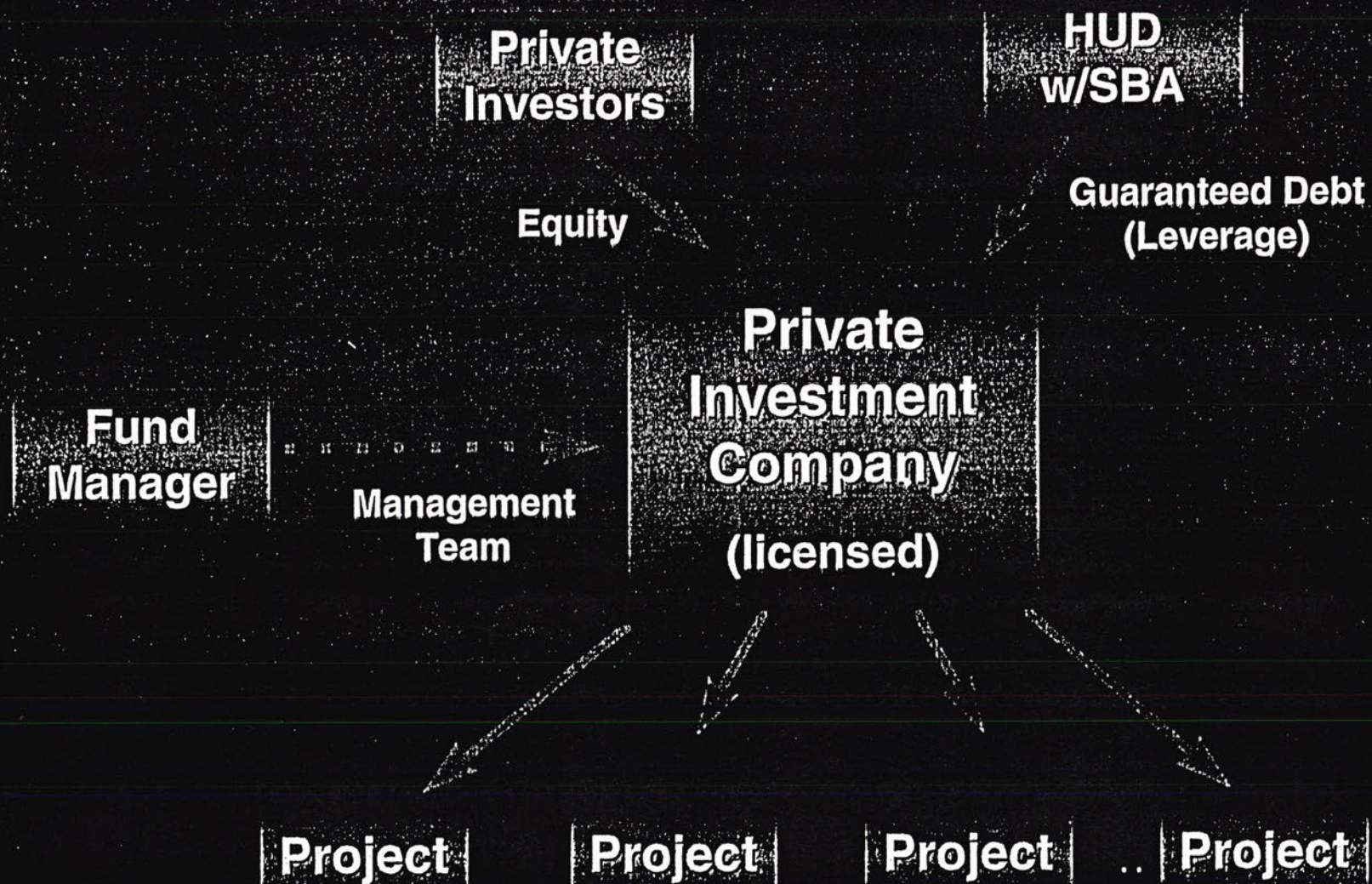
APIC: Long-term Capital Targeted to Development Needs

- **Direct investments in active businesses**
- **“Patient capital” -- long-term equity and debt**
- **Eligibility for New Markets Tax Credit**

Scale

- **\$36M in credit subsidy leverages \$1 billion in private loans and \$500M in private equity (\$1.5 billion per year)**
- **APIC will create large investment companies (expected \$75 - 450M) able to fund large projects (expected \$5 - 50M)**

How the APICs Will Work



The Investors

Broad Array Eligible:

- o **Corporations**
- o **Insurance Companies**
- o **Banks** (eligible for CRA credit)
- o **Pension Funds**
- o **“Social Investors”**
- o **Other Individual and Institutional Investors**

Selecting Experienced Fund Managers

Team Qualifications:

- Proven track record in direct equity investment and portfolio management
- Demonstrated ability to raise capital from private investors
- Experience in community development settings

APIC: Basic Numbers

Example

**\$50 Million
Private Equity**

+

**\$100 Million
Government
Guaranteed Debt
(Debentures)**

\$150 Million

**Equity
& Debt
into
Projects
\$\$\$**

Ensuring Financial Soundness and Rewarding Performance

- **Financial Soundness Review**
- **Performance Review**
 - **Local hiring, quality jobs, other community benefits target by APICs themselves**
- **High performers eligible for more favorable financing**

New Markets Initiative

U.S. Department of the Treasury

1999

New Markets Tax Credit

“I remember from my time on Wall Street that there really had been no practical means, even for professional investors, to invest in inner cities even if they wished to do so. Hopefully the creation of CDFI and other vehicles, and this new tax credit, will interact to make investment opportunity more readily available and to provide incentive for such investment.”

Robert E. Rubin, U.S. Treasury Secretary

New Markets Tax Credit

“Businesses must have equity capital before they are considered viable candidates for debt financing... Continued efforts to develop the markets for private equity investments will be rewarded by an innovative and productive business community. This is especially true in lower income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects...”

Alan Greenspan, Federal Reserve Board Chairman

New Markets Tax Credit

- **Attract New Equity Capital to Businesses located in Economically Distressed Communities**
- **Build the Capacity of Institutions with Business Development Expertise and Knowledge of their Local Community**
- **Promote Partnerships between Skilled Community Development Entities and Mainstream Sources of Capital**

What Community Development Entities Can Use the New Markets Tax Credit?

- **A Flexible Approach**
- **The Community Development Entity Must meet a 3-Part Test:**
 - Primary mission to serve or provide investment capital for low and moderate-income communities
 - 60% of gross assets invested in qualified investments or residential property located in low-income communities
 - Accountable to residents of low-income communities

Eligible Community Development Entities

- **Community Development Financial Institutions:**
Banks, Thrifts, Credit Unions, Venture Funds, Micro-Enterprises
- **Community Development Corporations**
(for-profit subsidiaries of nonprofits)
- **Small Business Investment Companies**
Primarily Serving Low and Moderate-Income Communities

Eligible Community Development Entities

- **New Market Venture Capital Firms**
- **America's Private Investment Companies**
- **Funds that Invest in Other Community Development Entities**
- **Funds that Purchase, Pool and Sell Loans Made by Community Development Entities**
- **Other Targeted Investment Funds**

New Markets Tax Credit

Qualified Business:

- **Must be located in low or moderate-income area**
- **Must meet certain criteria to assure active business**

Examples of businesses that may qualify include:

- **Small technology firms**
- **Inner-city shopping centers**
- **Manufacturers**
- **Retail stores**

New Markets Tax Credit: How Would it Work?

- **Community Development Entities would apply for designation.**
- **Designated entities would be able to allocate a given amount of tax credits to investors.**
- **Community Development Entities use the tax credits to attract investment capital.**
- **The investors would claim a 6% tax credit for 5 years on their investment.**
- **The designated Community Development Entities would report the tax credit allocations made and the use of investment to the Treasury Department.**

CDFI Fund Awards

CDFI Program

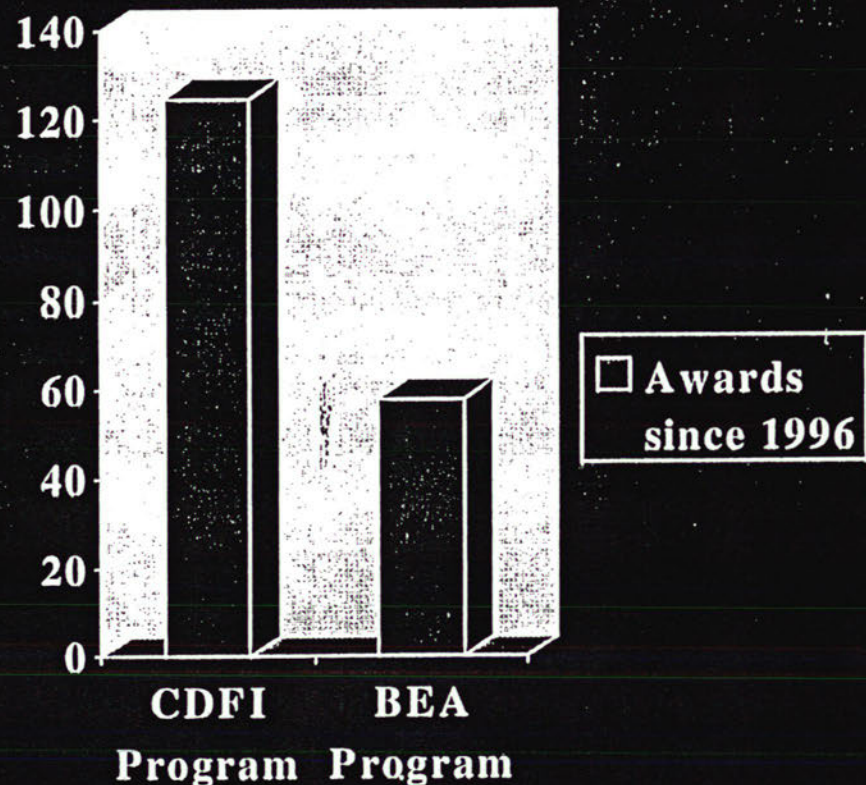
- 123 institutional awards

- \$122 Million

BEA Program

- 171 awards

- \$58 Million



CDFI Program Awardees by Type

	Total Awards	Total Institutions	Established Institutions	Start-up Institutions
Banks and Bank Holding Companies	13	11	5	6
Business Loan Funds	45	38	34	4
Community Development Credit Unions	40	37	33	4
Multi-Bank Community Development Corporations	7	7	7	0
Intermediaries	4	3	3	0
Housing/Facilities Loan Funds	53	46	40	6
Microenterprise Funds	24	21	17	4
Total Number of Awards	186	163	129	24

Includes all three years of CDFI funding (1996 - 98). For 1998, includes both Core and Technical Assistance awards.

New Micro-Enterprise Initiatives

- **President's Domestic Micro-Enterprise Agenda to increase funding by 159%, from \$32M to \$83M, including:**
 - \$15M and new legislation for the CDFI Fund's Program for Investments in Micro-Entrepreneurs (PRIME)
 - Doubling technical assistance and lending in the SBA's Micro-Loan Program

BusinessLINC: Learning, Information, Networking and Collaboration

- In 1998, Vice President Gore launched Treasury/SBA's BusinessLINC.
- BusinessLINC encourages large businesses to work with small businesses to improve the competitiveness of firms located in economically distressed areas.
- The Vice President has released *BusinessLINC: Business-to-Business Relationships that Increase the Economic Competitiveness of Firms*, which details successful strategies.

BusinessLINC: Learning, Information, Networking and Collaboration

- **A BusinessLINC website will serve as a national database to identify business linkages.**
- **BusinessLINC help smaller firms...**
 - **Obtain technical advice**
 - **Enhance management development**
 - **Access sources of financing**
 - **Increase marketplace credibility**
 - **Enter subcontracts and joint ventures**
- **New private sector BusinessLINC coalition will work with local communities to foster more BusinessLINC.**

New Markets Initiative

**White House National Economic Council
U.S. Small Business Administration
U.S. Department of Housing and Urban Development
U.S. Department of the Treasury**

1999