THE MYTH OF COMMUNITY DEVELOPMENT

POLITICIANS LIKE IT. FOUNDATIONS LIKE IT. IT SOUNDS GOOD TO CONSERVATIVES AND LIBERALS ALIKE. BUT HISTORY SHOWS THAT OF ALL POSSIBLE SOLUTIONS TO THE CRISIS IN THE GHETTOS, IT'S THE ONE MOST LIKELY TO FAIL.

BY NICHOLAS LEMANN

Local officials touring Bedford-Stuyvesant, 1953. Above: A tenement panorama. From left, street kids in Manhattan, 1890; Henry Street, Manhattan, 1935; Lower East Side, 1960; a Gray Area in New Haven, 1963.

BURIED SO DEEPLY WITHIN PRESIDENT CLINTON'S first budget that it has barely been mentioned by the press is the biggest new Federal program for inner-city ghettos in more than a decade. The program is called Empowerment Zones, and it will cost the Government $3.5 billion over five years — an amount that puts it in the league of Great Society programs that we now think of as having been unimaginably vast, like the War on Poverty and Model Cities.

The crime, poverty and physical and social deterioration of the inner cities is America's most obvious problem. The crisis in health care that has Washington's main attention right now manifests itself in private individual tragedies and in frightening statistics; but the crisis in the ghettos is right there in plain sight, in the middle of our main population centers. It is constantly discussed over millions of dinner tables, and also in establishment circles in New York, Washington, London and Tokyo. The 1992 Los Angeles riots, our biggest domestic disturbance in a generation, dramatically underscored how bad conditions are. It shouldn't come as a surprise — in fact it seems natural — that the Government might want to respond.

What's surprising, instead, is the precise nature of the response — its modesty and the lack of enthusiasm and attention that have surrounded it. Vice President Al Gore has recently been made chairman of a new entity called the Community Enterprise Board, which a few months from now will pick six large, impoverished swaths of big cities (one of which, surely, will be South-Central Los Angeles) to receive special tax breaks and other Government benefits aimed at making them prosper economically. The official oratory associated with the program stresses that it is a new idea, conceived in the realization that, as one White House staff member puts it, "the approaches of both parties for three decades have failed" in the inner cities. "It moves beyond the old debate that the answer to every problem is top-down bureaucracy on the one hand or trickle-down economics on the other," said an Administration handout, with grandeur if not perfect grammar. Gore, in a speech at Harvard last month, said, "The solutions this Administration has in mind are different than those that had been proposed before."

The stated confidence is belied by the kind of launch Empowerment Zones is getting. Lyndon Johnson declared war on poverty in a nationally televised, prime-time address to a joint session of Congress; President Clinton unveiled Empowerment Zones in the parking lot of a Cleveland shopping center in September. Everyone involved with the program knows that, protestations of its newness notwithstanding, something quite similar was proposed by the Bush Administration after the riots in 1992, was passed by Congress and failed to become law only because Bush decided to veto it during the Presidential campaign, when he felt vulnerable to charges of being a tax-and-spender.

Empowerment Zones get remarkably lukewarm endorsements from many of the very people who dreamed them up. Here are a few voices from around the Administration: "The evaluations don't provide an encouraging picture." "It was a given." "There are a lot of problems with it." On Capitol Hill, the committee chairmen who were responsible for Empowerment Zones, Representative Dan Rostenkowski of the House Ways and Means Committee and Senator Daniel Patrick Moynihan of the Senate Finance

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Attempts at economic revitalization often take the place of other efforts that would do much more good, like improving schools, housing and police protection.

Committee, are both known to be nonbelievers. The person probably most responsible for the passage of Empowerment Zones is Representative Charles B. Rangel of New York. What does he think? "I rejected the whole concept under Reagan. But people came to me and said, 'How can it hurt?' So I just said, 'What the hell.' But when it started looking like the urban policy for the nation, it was obviously inadequate."

The predictions being made for Empowerment Zones' ability to perform their job of revitalizing distressed areas are striking in their modesty. "It depends on your expectations," says Andrew M. Cuomo, an Assistant Secretary at the Department of Housing and Urban Development and one of the program's architects. "If you expect to see Harlem as gentrified and mixed-income, it's not going to happen. If you look at people who moved out, it can be a success." Paul R. Dimond, the White House staff member most involved in planning Empowerment Zones, strikes a similar note: "I'm not saying it's going to succeed 100 percent. . . . If they're successful, lots of people will move out."

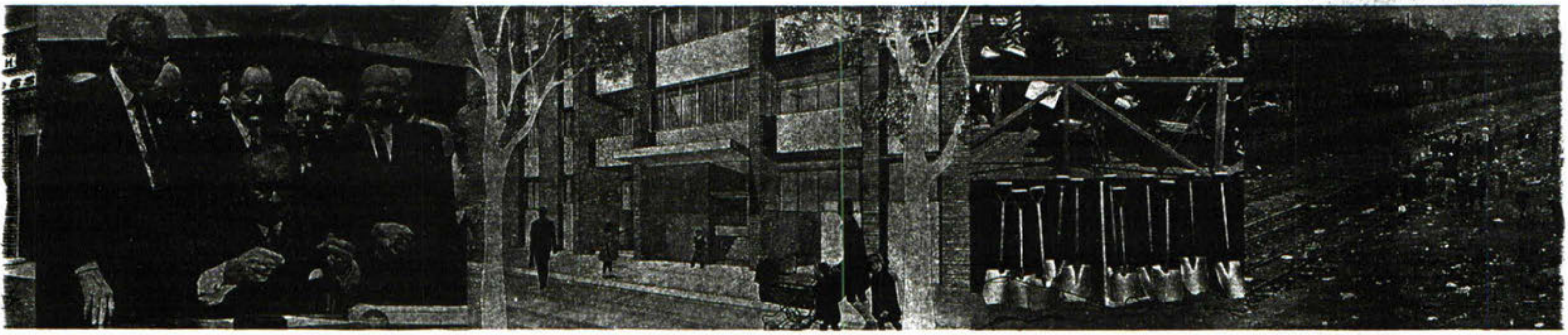
Someone who was able to look at this situation afresh — a modern-day de Tocqueville — might well ask, Why is the Government addressing a problem of this severity with a solution that its own officials don't really seem to believe in? The answer transcends the Clinton Administration. Instead, it has to do with the strange way American society outside the ghettos deals with the problems inside. For three decades, Administration after Administration has pondered the ghettos and then settled on the idea of trying to revitalize them economically — even though there is almost no evidence that this can work. Nearly every attempt to revitalize the ghettos has been billed as a dramatic departure from the wrongheaded Government programs of the past — even though many of the wrongheaded programs of the past tried to do exactly the same thing. The old cliché about ghetto life is that it's "a cycle of despair." Actually it's ghetto policy making that's a cycle of despair: The leadership class repeatedly turns to policies that sound appealing but are doomed to fail — and then their failure practically guarantees that the country won't face the issue head on.

INNER-CITY REVITALIZATION IS A PHRASE SO FAMILIAR THAT IT'S part of the unexamined background noise of society. In fact, it requires some explanation. The most obvious solution to poverty is simply to provide for poor people's material needs, through cash grants, vouchers like food stamps and services like Medicaid. But for 100 years — roughly since the publication of Jacob Riis's "How the Other Half Lives" — American reformers have felt that the problems of poor urban slums went beyond just a lack of income. The slums were unhealthful and physically dangerous, and people there didn't seem to behave in a way that would put them on the track out of poverty. Therefore it was necessary to make some special efforts to improve conditions in the slums.

Traditionally these efforts involved what used to be called "social uplift": education, counseling, improvement of the housing stock, crime control. In recent decades, though, the idea of social uplift has become thoroughly disreputable among both the poor (who see it as patronizing) and the not-poor (who see it as expensive and ineffective). But what all parties have found they can live with is the idea that the way to cure the special ills of the slums is to generate a lot of home-grown business activity there. This would not only give poor people jobs and therefore money; it would create in them a whole new spirit of self-reliance. They would be able to build independent communities that control their own resources and destiny; from the standpoint of middle-class voters, creating a job base in the ghettos would be hardheaded and unwasteful. Hence the emergence of "economic development" or "community revitalization" — as opposed to straight income support, or old-fashioned social services — as a supposed panacea.

The problem is that on the whole, urban slums have never been home to many businesses except for sweatshops and minor neighborhood provisioners. The slums are usually near downtown, and the residents, when they can find work, have usually found it downtown. Also, poor neighborhoods are usually transitional: rather than being stable, self-sufficient communities on the model of a village in Vermont, they tend to be home to people who plan to move out as soon as they make a little money. The standard model of progress for poor people living in urban slums, repeated millions and millions of times over the decades, is to get a good job outside the neighborhood and then decamp for a nicer part of town.

So to try to create a lot of new economic activity in poor neighborhoods is to swim against the great sweeping tide of urban life in America. Inside the ghetto, it usually does no harm — but it doesn't help much either. Outside the ghetto, though, it does a great deal of harm. Attempts at economic revitalization often take the place of other efforts that would do much more good (especially improving schools, housing and police protection), and they establish a public mission that can't be accomplished. Nothing does more to feed the public perception that antipoverty programs — in fact, Government programs generally — don't work than the poor physical appearance of the ghettos; the more the Government claims it's going to revitalize them, the harder it becomes politically to take on the problem in the future.



Mobilization for Youth trainees, Houston Street, 1963; President Johnson after signing housing legislation, 1968; a rendering of a building facade in Bedford-Stuyvesant, 1969; Model Cities groundbreaking with Mayor Lindsay.

THE STORY OF HOW AMERICA GOT TO THIS POINT IS NOT so much about urban poverty itself as it is about *perceptions* of urban poverty.

Cities rose during the first half of the 20th century and have fallen during the second half. In the early years of their rise, as Americans flocked to them, respectable opinion often found cities horrifying, partly because of their squalid immigrant slums and corrupt political machines, and partly because virtue was thought to reside in the countryside. Theodore Roosevelt, the only President born on Manhattan Island, created a Commission on Country Life to revitalize a depopulating rural America. (It was unsuccessful.)

Not many years after cities ceased to be alarming, they began to appear to need saving. By the late 1940's, it was clear that the mass migration to the suburbs was depleting urban America of population and retailing base, and the arrival of a new wave of poor newcomers (this time African-Americans from the South) led to a fresh round of concern about slum conditions. In 1949, the Truman Administration created Urban Renewal, the first Federal program to make a commitment to restoring cities to some kind of past glory.

But Urban Renewal quickly became unpopular, especially among liberals.

The rap on it, wholly justified, was that it bulldozed neighborhoods, especially black neighborhoods (hence its nickname, "Negro Removal") and replaced them with highways, sterile housing developments and municipal office complexes that looked wonderful when planners presented them at Chamber of Commerce meetings but, when built, only hastened the city's decline. In the late 50's and early 60's, books like Herbert J. Gans's "Urban Villagers" and Jane Jacobs's "Death and Life of the Great American Cities" enshrined the view that city neighborhoods, including poor ones, are precious, vibrant organisms with a complex life that planners don't understand.

When the next round of urban programs began, in the Kennedy Administration, they were animated by a backlash against urban renewal. A related line of thinking about slums that emerged at about the same time was hostility to the "ladies bountiful" who had been operating settlement houses and otherwise providing social services for many years. Both these oppositions, to urban renewal and to social work, led to the same conclusion — an elevation of the role that poor people themselves should play in the improvement of the slums.

The early 1960's, then, were the starting point for the current phase of thinking about ghettos. For fully 30 years, the reigning ideas about Government policy in poor city neighborhoods have been essentially the same — even though these ideas are still being referred to as new. They were first tried in the early 1960's, in small, foundation-financed efforts like the Gray Areas Project in New Haven and Mobilization for Youth on the Lower East Side (both underwritten by the Ford Foundation); then they were introduced into the Federal bloodstream through the work of the President's Council on Juvenile Delinquency, which was run by Attorney General Robert F. Kennedy; finally, in 1964, they became the basis for the centerpiece of the War on Poverty, the Community Action program. These are the ideas:

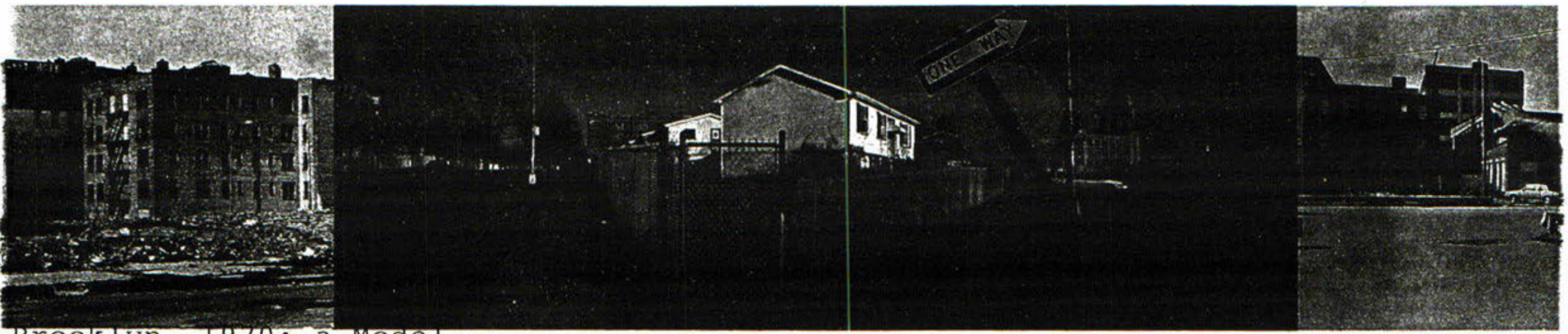
Bottom Up, Not Top Down. The people who know the most about the needs of poor neighborhoods are the residents; therefore, poverty programs should be designed and implemented by them, not imposed from above by mayors, members of Congress, social workers, intellectuals, Federal bureaucrats or other authority figures.

Comprehensive and Coordinated. Antipoverty programs are a confusing morass, run by competing, byzantine bureaucracies. Rather than being operated "categorically" by different agencies in Washington (welfare and Medicaid are examples of "categorical" antipoverty programs because each addresses a single problem in isolation), these programs should be, on a local level, housed under one roof and reorganized so that all the problems of poor people are addressed together systematically.

Revitalize the Neighborhood. Ultimately, the theory goes, the health of a neighborhood depends on its economic base. The only real long-term answer to the problems of an inner-city ghetto is for good jobs to be available there. Anyone interested in helping poor neighborhoods must primarily focus on economic development.

It took only a few months for the War on Poverty to start being perceived as a failure. In retrospect, the poverty warriors were always swimming upstream against public opinion and politics. As long as the economy was growing rapidly and the poverty rate was decreasing, newly prosperous middle-class voters were willing to tolerate some governmental generosity. But they never pressed their representatives to finance programs they perceived as benefiting disadvantaged minorities. Also, the "bottom up" idea in the War on Poverty found its expression in a provision that directed Federal funds to community groups without the advice and consent of local elected officialdom; so mayors, senators and representatives, deprived of the pork-barrel opportunities embedded in virtually every other Federal program, were generally unfriendly to the War on Poverty.

But in a way, these political weaknesses only served to solidify the ideas about neighborhood revitalization that underlay the War on Poverty: everyone was too busy fighting enemies to re-examine its theoretical basis. Even as it became clear that the War on Poverty itself was never going to become a large, successful Federal program, succeeding antipoverty programs usually accepted the War on Poverty paradigm. Model Cities, the Johnson Administration's last major antipoverty initiative, was supposed to correct the political shortcomings of the War on Poverty by dropping the exclusion of mayors and members of Congress — but the idea was still to revitalize poor neighborhoods. Robert Kennedy, by then Senator from New York and Johnson's archenemy, was contemptuous of Model Cities. His ambitious antipoverty program was the Bedford-Stuyvesant Restoration Corporation, which was different from Model Cities in crucial respects. But it was also driven by the idea of economically revitalizing the ghetto.



Brooklyn, 1970; a Model Cities site in Ocean Hill-Brownsville, 1972; abandoned tenements on Charlotte Street, South Bronx, 1981; Charlotte Street in 1993; Andrew J. Mayo, manager of the Bridgeport, Conn., Enterprise Zone 1983.

The 1970's saw a succession of programs, like Community Development Block Grants during the Ford Administration and Urban Development Action Grants during the Carter Administration, which were sold as being different from the failed programs of the past while resting on the same assumptions: bottom-up planning, coordination of programs, neighborhood redevelopment.

During the 1980's, the dominant new antipoverty idea in Washington was creating Enterprise Zones: ghetto areas that would be given special tax breaks to encourage business. Their most prominent advocate was — and still is — Jack F. Kemp, who first proposed legislation to create them back in 1980, when he was a Congressman from Buffalo. The Reagan and Bush Administrations regularly called for legislation to establish Enterprise Zones, as did Kemp when he was Secretary of Housing and Urban Development under Bush. Kemp has a sincere and boundless faith that miracles can result from tax cuts; in his HUD days, which coincided with the collapse of Communism, he would tell visitors that the ghettos were "akin to a third-world socialist economy" and capitalism would make them blossom.

The antipoverty talk in the Bush Administration was, as usual, full of the notion of rejecting the failed programs of the past in favor of new ideas, but the new ideas had a certain familiarity: Enterprise Zones were another revitalize-the-ghetto scheme. Many of the slogans used to promote Enterprise Zones — "empowerment," "a hand up, not a handout," "teach a man to fish and he'll eat for a lifetime" — were, consciously or not, verbatim appropriations of language that was used to sell the War on Poverty.

Kemp was well known to be frustrated with Bush's level of commitment to the enterprise zone idea — insufficient to get a bill passed. Then came the

Los Angeles riots, and, as one Government expert puts it, "the only thing on the shelf was Enterprise Zones." Their previous failure to become Federal policy suddenly became a virtue because they appeared to be a fresh approach. The Administration and Congress quickly put together legislation that landed on President Bush's desk in October 1992, in the heat of the Presidential race. The bill also contained a few tiny technical adjustments that would increase Government revenues, like a change in the tax-accounting procedure for securities dealers. Afraid he would be accused of again breaking his "no new taxes" pledge, Bush announced he would veto the bill.

WHY HAS THE FEDERAL GOVERNMENT CONSISTENTLY backed economic revitalization efforts in the ghettos? The answer to this question is not the one you'd expect— that these efforts have been successful. Ghettos aren't very attractive locations for businesses. As Andrew Cuomo puts it, "It's misleading to say, once I.B.M. moves to the South Bronx everything's going to be rosy. One, I.B.M. isn't going to the South Bronx, because the other cost of doing business outweighs the tax incentives. Also, if I.B.M. did show up, the people in the zone aren't in a position to show up. They need training, and services like day care — a comprehensive strategy."

In addition, the era of Government ghetto-revitalization programs has coincided with a major flow of population out of the areas that were supposedly being revived. Just during the 1970's, the peak decade of ghetto outmigration, Bedford-Stuyvesant lost one-third of its population. So did Central Harlem. The two community districts that make up the poorest part of the South Bronx lost two-thirds.

In New York City, most of these neighborhoods have stopped losing population — primarily because of immigration, not Government revitalization efforts — but in many other cities, the outflow has continued. A recent series of articles in The Miami Herald, for example, reported that all of Miami's traditional black neighborhoods are still heavy population losers: "In Liberty City, 27 percent of the population is gone. In the black section of Coconut Grove, 35 percent. In Overtown, where highway construction helped spur decline, 76 percent of the population is gone." The Herald also cited black-population-loss figures of 100,000 for Chicago, 124,000 for Atlanta and 224,000 for Washington.

It's no tragedy when people leave ghettos. They're just following the standard American pattern by moving to the outer city — places like Queens — or to the suburbs. Today, minorities are suburbanizing more rapidly than whites. A recent Urban Institute paper calculates that just during the 1980's, the black population of the suburbs in the 39 largest metropolitan areas increased by 38 percent. Jobs have followed people to the suburbs, and that makes it even more difficult to create an employment base in poor inner-city neighborhoods.

It is therefore extremely difficult to find statistical evidence that any inner-city neighborhood in the country has been economically revitalized. One often hears anecdotal revitalization success stories, but they usually involve either the building of a "festival marketplace," like South Street Seaport in New York, or the shoring up of an area that is blue-collar rather than poor and residential rather than industrial, like South Shore in Chicago, which President Clinton often mentions in speeches. An Urban Institute report produced after the Los Angeles riots said, "There are virtually no examples of success in restoring strong economic activity and job creation to an inner-city area the size of South-Central Los Angeles, as is being attempted in the wake of the riots." Rebuild L.A., the much-publicized local civic effort to revitalize South-Central, has been unable to induce businesses to locate major facilities there, which is one reason that its first director, Peter V. Ueberroth, resigned.

So then why is inner-city revitalization attractive to policy makers? One reason is that although Americans move around a lot, and poor people are especially mobile, politicians represent geographical areas and so naturally think of the welfare of people in terms of the welfare of places. Schemes to revive places are always popular with politicians, and with politicians' lobbies like the United States Conference of Mayors. The Model Cities program, to cite a famous example, was in early discussions supposed to be a demonstration project in a handful of cities. But in order to get it through Congress the Johnson Administration expanded it to 150 sites (and thus vastly diluted its chances of success) — which gave the program an automatic base of 150 votes in the House.

Philanthropic foundations also like revitalization. The idea that foundations wield great power might sound strange to people outside of fields like education, foreign affairs and social policy, but within their orbit, what they do matters tremendously. In poverty-fighting, during periods when the Federal Government isn't rolling out large, centrally administered programs, foundations become, by default, the key players. The foundations' strong attachment to revitalization comes partly from the natural tendency to believe that the thing you *can* do is the essential thing *to* do. Foundations don't have enough money or power to take control of inner-city public education, or impose work requirements on welfare recipients or send poor people money and food. But they can foster community-development efforts, which are relatively cheap because they're so localized and which don't require the wielding of Government authority. For decades, the Ford Foundation has invested heavily in inner-city economic development, and in recent years, other big foundations have followed suit. The heads of the two most important foundations involved in antipoverty work are both alumni of ghetto revitalization efforts: Franklin A. Thomas of the Ford Foundation previously ran Bedford-Stuyvesant Restoration, and Peter C. Goldmark Jr. of the Rockefeller Foundation as a young man worked for the Federal Community Action Program. Most conclaves devoted to devising solutions to the problems of ghettos are dominated by foundation people, and they usually end with ringing endorsements of economic revitalization.

Two other disparate constituencies are able to dwell comfortably under the theoretical roof of revitalization. Business groups — a city's local Chamber of Commerce, for example — like revitalization because it glorifies small business and presents itself as a practical alternative to the big-Government approach. Ghetto revitalization projects often have the word "corporation" in their name in order to enhance their appeal to business contributors.

At the other end of the spectrum, grass-roots inner-city community groups like revitalization because it puts them at center stage as saviors of their neighborhoods (and recipients of funds), provides administrative jobs

: **Jimmy and Rosalynn Carter lend their muscle to Habitat for Humanity in Washington, 1992; the HUD staff touring a town-house complex in Newark, 1993; Silver Ladle Soups in Bridgeport, Conn., will** soon move to a bigger

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and operates from a flattering set of assumptions about the hidden "strengths" of areas that are usually defined solely in terms of their poverty, crime rates, poor schools, dilapidated housing and other problems.

Finally, revitalization is bureaucratically appealing to White House staff members. In Administration after Administration, these people suffer the same frustrations: it's too difficult to get action at a reasonable cost, and the Cabinet departments are lumbering and intransigent. So when an Administration sets up a White House task force or working group on concentrated inner-city poverty, as has nearly every Administration of the past three decades, what usually happens is that the departments submit ideas for expensive programs to be run by them, and the White House, frustrated, looks for a cheaper and higher-impact alternative. The next step — in the Bush Administration, no less than in the Kennedy Administration — is that the White House becomes entranced with the idea that community development efforts should be run locally rather than by Federal bureaucrats. That is both the cheapest and the most dramatic-sounding option.

Given that the residents of many of the poorest urban neighborhoods are African-American, a final political advantage of community development is that it neatly avoids what is perhaps the most perilous of all issues for elected officials — racial integration. Scholars, policy analysts and journalists have been moving in recent years toward the view that "hypersegregation" of the black poor causes great harm. But politicians simply can't afford to embrace this view wholeheartedly. A good example is the position of Henry G. Cisneros, the Secretary of Housing and Urban Development. When Cisneros took office, he developed a list of four fundamental "commitments" driving all HUD activities — and then became so impassioned about integration that he added a fifth commitment, to, in his words "consistently working to deconcentrate the poorest of the poor, giving people a lift up and out" of the ghetto. At Cisneros's urging, President Clinton has decided to issue later this year a tough new executive order banning housing discrimination against people who want to leave all-minority neighborhoods. But Cisneros still loyally (though with noticeably less fervor) endorses developing the ghetto economically, which would seem to be exactly the opposite approach.

building, thanks to an Urban Enterprise Zone tax break; President Clinton in a Cleveland parking lot, just after unveiling Empowerment Zones; a swath of South-Central Los Angeles, a prime candidate for Empowerment Zone designation.

DURING THE 1992 CAMPAIGN, BILL CLINTON CAME OUT for Enterprise Zones — in a more careful and less breezily optimistic way than Kemp, but for them nonetheless. In a long interview with the staff of The Atlantic Monthly (including me) just before the Democratic Convention, he said, "I agree with Kemp about Enterprise Zones, but . . . I think it's a very narrow view of what needs to be done to . . . recreate that sort of economy there." And a little later: "I think they will be of limited impact unless you also have . . . the national initiatives I've called for on education, health care and the economy."

Besides his personal convictions about Enterprise Zones, Clinton had good political reasons to support them. Because they are primarily based on tax cuts, they don't have to be proposed in the form of new-spending legislation, which is unpopular. Enterprise Zones have a tough-minded, economic growth-oriented "new Democrat" aura of promoting the work ethic as a solution to poverty, rather than welfare and Government programs of the "throwing money at problems" variety. They tap into a longing for the restoration of community that seems to be at large in the country right now. They generate good will inexpensively among the urban lobbying groups. After the election, Clinton put his new National Economic Council in charge of fulfilling the Enterprise Zones campaign promise, and the Council wound up, in effect, revising the Republicans' abandoned Enterprise Zones bill.

State and local experiments with Enterprise Zones (which, admittedly, don't involve tax breaks on the scale that the Federal Government can provide) haven't produced impressive results. Enterprise Zones don't directly attack essential problems like poor education and crime, which act as a "tax" on businesses that often outweighs whatever actual tax break they have reaped. By targeting only certain places, Enterprise Zones are, in the words of one report, "a means of redistributing investment and employment, not a means of achieving more of each."

The Clinton Administration has demonstrated its lack of Kemp-like total belief in economic revitalization of ghettos by placing bets on several different antipoverty strategies. By far its largest antipoverty initiative is a $21 billion increase in the Earned Income Tax Credit, which is meant to get all working people above the poverty line. Financing for the Head Start program has also been increased. And President Clinton has talked about ambitious plans to improve education and public safety in the ghettos.

Still, because of Clinton's campaign promise, there was never any question that the Administration would propose Enterprise Zone legislation. What the planners of the Clinton bill came up with might be called Enterprise Zones for Liberals. Kemp believes the essential incentive in Enterprise Zones should be a break in the capital gains tax for investors in businesses there. In the Bush and Clinton plans, the central mechanism is a wage credit: employ a resident of the zone, and you save up to $3,000 a year in payroll taxes. Wage credits are more highly regarded by policy analysts than capital gains tax cuts because they insure that the Government's money goes directly into job creation. The Clinton bill, like the Bush bill, tried to avoid the old Model Cities problem of funds being spread too thinly by designating a handful of Empowerment Zones that get serious amounts and a lot of "enterprise communities" that get just enough to win the votes of their representatives. The War on Poverty's problem of generating political enmity by cutting politicians out of the action was solved by requiring each community to submit an application agreed to by community groups and endorsed by local government. (Kemp publicly opposed Empowerment Zones because governments have too large a role.)

Paul Dimond, the most involved White House staff member, is a lawyer who spent years trying desegregation cases and so is well aware of the desire of ghetto residents to move out. At his suggestion, the wage credit was made to apply to employers who hired residents of a zone, even if the job was outside the zone. Andrew Cuomo, the only Administration official involved in drawing up the bill who has actually worked in inner-city redevelopment, pushed to require communities to plan services like day care and job training as a condition of being chosen as an Empowerment Zone. Dimond and Cuomo have set up an elaborate plan to make it easier for Empowerment Zones to apply for additional financing and loans from Government agencies and to encourage them to line up local private and public financing as well.

Last May, an Administration delegation headed by Cisneros and Robert E. Rubin, who heads the National Economic Council, went to Capitol Hill to present the Empowerment Zones legislation to the Senate committee chairman who had jurisdiction over it, Daniel Patrick Moynihan. Moynihan has been able to maintain a reputation as a champion of social reform while actually believing that Government social programs almost never work. "That's a *Fabian* idea," he told his visitors — a comment that anyone who knows him well would recognize as a putdown (the Fabians having been, in the Moynihan cosmology, the opposite of the kind of practical machine politicians who get things done) but that the Administration's representatives took as praise. When the Clinton Administration included Empowerment Zones as part of its budget, the House passed it, adding an additional $1 billion to the appropriation. But Moynihan's Senate Finance Committee stripped Empowerment Zones out of the budget bill before sending the legislation to the Senate floor for a vote.

The fate of Empowerment Zones then rested with a House-Senate conference committee charged with resolving the differences between the House and Senate versions of the bill. It was a pure case of legislating behind closed doors: Empowerment Zones was too minor a part of the huge budget for anyone but the people in the conference to focus on. What happened was that Charles Rangel, who represents Harlem and was the only member of the Congressional Black Caucus on the conference committee, saved Empowerment Zones, with help from Senator Bill Bradley of New Jersey. That was interesting, because neither Bradley nor Rangel, who have long records of demonstrated concern for ghettos, especially believes in the Enterprise Zone idea. They used Empowerment Zones as an opportunity to get more Federal spending on what they do believe in, social services: drug counseling, preventive health care, job training, after-school mentoring and emergency housing.

The final legislation contained $2.5 billion in tax breaks and $1 billion in new financing for a very flexible social-services grant called Title XX. And the bill's original provision subsidizing the hiring of zone residents for jobs outside the zone — which the Administration authors were especially proud of, because it recognized the reality that significant job-creation *inside ghettos* is unlikely and probably unnecessary — was quietly dropped to save money.

Later this year, Vice President Gore's Enterprise Board will, after considering applications from all over the country, designate six urban and three rural Empowerment Zones. Of the six urban ones, it is a safe bet that one will be in South-Central Los Angeles. Another, given Rangel's role, will probably be in Harlem. Chicago, home of Dan Rostenkowski, would be a strong candidate, and so would Detroit because it has America's most severely distressed big-city ghetto. In conference, Senator Bradley inserted a requirement that of the six zones, "at least one must be in a city with a population of 500,000 or less and at least one of the zones itself must have a population of 50,000 or less and include areas located in two states." This would pave the way for applications from

Newark and Camden, which sits on the New Jersey-Pennsylvania border.

Then what? The Administration's optimism about Empowerment Zones is extremely limited. Paul Dimond, who is probably the leading Empowerment Zones enthusiast, says he believes that if the zones are located near existing facilities with job-generating potential, like universities and hospitals (a Harlem zone, for example, could abut Columbia University and the Columbia-Presbyterian medical complex) and in cities that are drawing immigrants, they could substantially improve conditions. Other Administration officials predict that perhaps one of the six zones could end up a visible economic success, while the rest can only hope to be somewhat safer and less deteriorated-looking.

Ghetto fact-finders: Representative John Lewis, Jack Kemp, HUD Secretary, and Mayor Andrew Young in Atlanta, 1989.

And this is the optimistic view. As an example of the pessimistic (though still Democratic) view, Lawrence F. O'Donnell Jr., staff director of the Senate Finance Committee and a protégé and soul mate of Moynihan's, says: "My own belief is this bill will represent a net harm to Empowerment Zone communities. I wouldn't be surprised if three years from now, you have an Empowerment Zone in which no employer of significance has moved in, because employers are not so concerned with the tax picture as the safety and service and transportation picture. ... There's going to be *tremendous* chicanery around this. ... What if the guy from the South Bronx who gets a job does what every guy does, which is move? He's no longer a tax break. Do you fire him? What he's going to end up doing is lying about his address. It completely ignores one of the most obvious phenomena of this century — people do not *want* to live near their work."

ALL OVER URBAN America, hundreds, even thousands of local organizations are engaged in efforts to revitalize neighborhoods. Much of this activity is extremely impressive, not least because of the dedication of the people involved. The War on Poverty set up more than 500 local community action agencies. Today, more than a decade after the last desiccated vestige of the Johnson-era Office of Economic Opportunity, a little-known agency called the Community Services Administration, was eliminated as an independent body by the Reagan Administration, hundreds of community action agencies still exist. An overlapping category, descended from Robert Kennedy's Bedford-Stuyvesant project, is Community Development Corporations, which are heavily supported by foundations and exist in poor neighborhoods in every big city.

It's unscientific and unfair to single out one of these local organizations as the best in the country — but if the title were being handed out it would, by common assent of people in the field, probably go to the New Community Corporation in Newark. Founded a year after the 1967 Newark riots, New Community became a substantial enterprise during the 1980's, under the direction of a rumpled, unassuming Catholic priest, William J. Linder. Today it operates 2,500 housing units that are home to 6,000 people; seven day-care centers; an elementary school; a shopping center anchored by a new Pathmark supermarket; a nursing home; a job-placement center; a newspaper and a restaurant. It has 1,266 employees and an $95 million annual budget. The neighborhood where New Community operates feels organized and safe. Right next to it, a private developer has built market-rate housing, which is a vote of confidence in New Community's ability to stabilize the area.

It would be a mistake, however, to make the leap from the impressive work of New Community, or that of other Community Development Corporations, to the conclusion that ghetto economic revitalization can work — although making that leap has become routine for journalists, foundation executives and Government officials. A strict unwritten code among Community Development Corporation people dictates that they must insist economic development is their primary mission. Linder certainly does. To the naked eye, though, economic development is hardly the most striking feature of Community Development Corporations. In the neighborhood where New Community operates, there is almost no private-sector economic activity. New Community, an imaginative and energetic harvester of grants, loans, subsidies and tax abatements from Government, foundations and business, owns outright almost everything there.

Its main activity — and the main activity of most other Community Development Corporations — is creating and operating housing for the poor. Because there are so many Community Development Corporations and other local efforts, and because these organizations are often run by inexperienced people, many are incompetent or even corrupt; they fizzle out, or limp along for years. The most impressive thing about the hundreds of good Community Development Corporations, though, is almost always their housing work.

Subsidized housing is the spiritual center of antipoverty work. In the dawning days of urban social reform, Jacob Riis and his allies believed that the key to solving the problems of the slums was building "model tenements." By the mid-1960's, the pandemic violence and social deterioration at big public-housing projects was the main evidence for the view (which still prevails) that Government antipoverty programs had failed. To visit successful Community Development Corporations is to see that subsidized housing for the poor can work — in fact, there seems to be a consistent model that works from neighborhood to neighborhood. The key points in common are heavy emphasis on security (New Community has a private security force of 120 people, almost one-tenth of its payroll); keeping the size of each development manageably small; creating some economic mix of tenants; screening prospective tenants and expelling tenants who commit crimes or otherwise break the rules. Subsidized housing of this kind tends to be run by a single strong leader. For example, the deputy borough president of the Bronx, Genevieve Brooks, started out as head of a Community Development Corporation called the Mid-Bronx Desperadoes.

The implications of an existing replicable formula for running subsidized housing for the poor are immense. It raises the hope of making some significant dent in problems like homelessness and inner-city dilapidation. Success stories in housing might well make the public more willing also to support Government efforts in education, child care, health, public safety and job training that would address what everyone knows is an intolerable crisis in the ghettos.

But the people who are doing good work in poor urban neighborhoods — who have significantly improved horrific conditions by figuring out how to deliver traditional social services well — almost always say that they are engaged in "economic development" or "grass-roots community development," rather than trumpeting their real story. (The most comprehensive national study of Community Development Corporations does admit, slightly through gritted teeth, that housing is "the C.D.C.'s' largest single program area," and that their "record in housing is stronger than it is in the development of commercial property or business enterprises.") The idea of poor people being ministered to today has a creepy, Kiplingesque feeling to it; everyone in the field finds the idea that poor people are being "empowered" much more comfortable. In a way, the whole notion of economic revitalization functions as a kind of code: it's a formulation that isn't taken literally and one that worked wonderfully well to bring all the antipoverty players together in a period when their cause wasn't receiving much attention from the general public or the Federal Government.

NOW THINGS ARE CHANGING. An Administration in terested in antipoverty programs is in the White House. Bill Clinton has made it obvious that he understands and is tormented by how bad things are in the ghettos. It is also his natural inclination to look to the Federal Government to do something about it. But what? Economic revitalization efforts pass every test but one, the reality test. They are popular among all the key players in antipoverty policy; they sound good; they have bipartisan appeal; they are based on tax breaks rather than on spending and so are easier to pass. The only problem is that so far they haven't worked — which creates a larger problem.

Think for a minute about *why* most people believe that the Great Society was a failure. What's the evidence? It is the enduring physical and social deterioration of poor inner-city neighborhoods. The Government promised to turn these places around, and instead they got worse; ipso facto, Government can't do anything right. This is exactly the button that Marlin Fitzwater tried to push last year when he blamed the Great Society for the Los Angeles riots. It's all too easy to imagine the Republican nominee in 1996 staging a press conference in one of the Clinton Administration's Empowerment Zones, waving a hand expressively at the scenery and saying: "See? They told us that by spending billions here they were going to create a nice place." All this will be hypocritical, of course, because the Republican nominee will probably be someone who supported a quite similar Bush plan, but it will be effective.

On the other hand, programs to make daily life in the ghettos decent and to put inner-city residents on the track to something better are problematic for Washington. Voters are absolutely certain that social services cost a lot and don't work, so political support for them is hard to come by. Meanwhile, there is considerable evidence that out in the ghettos, people are finding ways to deliver social services, especially housing and day care, effectively. Everybody involved in antipoverty work knows this, which is the reason that, on the ground, community efforts focus primarily on housing, safety, education and job training — and the reason that Washington tries regularly to sneak more financing for these social services into legislation. What the people who know won't do, at the moment, is state these goals directly. They fear that public hostility to Government social-service programs is too strong. It's a tragedy. What is gained in the short run by making a promise that sounds more appealing — economic development — is far outweighed by what is lost in the long run when the dream doesn't come true. ■

5-4-93

EMPOWERMENT ZONES

Across the country, communities are reeling from a decade of declining opportunity and rising social and economic isolation. The Clinton Administration is introducing the Economic Empowerment Act of 1993 as the first piece of a larger community empowerment agenda to bring on a new era of opportunity, responsibility and community for all Americans.

The Empowerment Zone proposal represents a new approach to the problems of distressed communities. It moves beyond the old debate that the answer to every problem is top-down bureaucracy on the one hand or trickle-down economics on the other.

The traditional enterprise zone approach assumed that tax breaks alone can revitalize communities without changing the way government does business. The Clinton proposal gives local communities the incentives, deregulation and flexibility they need to work with the private sector to develop comprehensive economic strategies to attract business, create jobs, make their streets safe, and empower people to get ahead.

1. BOTTOM-UP, COMMUNITY-BASED STRATEGY: Empowerment Zones will be awarded through a competitive, challenge grant process that gives communities new opportunity, but demands more responsibility from them in return. No applicant will be eligible for a single dollar of federal enterprise support unless it submits a comprehensive strategic plan that brings together the community, the private sector and local government <u>and</u> demonstrates how the community will reform the delivery of government services. The challenge grant process is designed to empower local communities to be as innovative as possible.

2. ONE-STOP WAIVER AUTHORITY: An Enterprise Board -- made up of relevant Cabinet Secretaries -- will provide communities a single point of contact, and have broad waiver authority to help communities use existing federal programs and resources more effectively and efficiently to carry out their strategic plans.

3. 10 EMPOWERMENT ZONES AND 100 ENTERPRISE COMMUNITIES: A total of 110 zones will be chosen through the empowerment challenge grant process. All 110 will be eligible for empowerment tax incentives and receive special priority for many innovative federal programs including Community Development Banks, Community Policing, and education reform. The 10 Empowerment Zones will qualify for additional tax incentives, including substantial Employment and Training Credits for businesses that employ people who live within the zones.

4. INDEPENDENT EVALUATION AND SUNSET: The Act provides for independent evaluation of what works and what doesn't before expanding to include other communities. The entire Act will sunset after 10 years.

SUMMARY OF ZONE INCENTIVES AND INVESTMENTS:

In addition to enhanced flexibility to coordinate strategic plans, the 10 Empowerment Zones and the 100 Enterprise Communities will receive or be eligible for five basic forms of incentives and investments: a) Capital incentives to spur private sector investment; b) Empowerment incentives; c) Employer wage credits that empower both businesses within the zone and businesses outside of the zone that hire zone residents; d) Investment programs, such as community policing and enterprise schools; and e) Zone Priority Investments: A host of federal programs will give recipients of the 110 zones priority status for grant applications for investments that may be essential to a comprehensive empowerment strategy. Starred incentives (*) are available only for the 10 Empowerment Zones.

CAPITAL INCENTIVES

- Tax-exempt private activity bonds for investments in tangible property in zone
- Expansion of Low Income Housing Tax Credit
- Increased Property Expensing under Section 179*
- Accelerated depreciation for tangible investments*

EMPOWERMENT INCENTIVES

- Resident Empowerment Savings Accounts -- tax credits for employer contributions; penalty-free withdrawals for education, purchase of first home, starting a small business or investing in community investment corporation or fund
- Resident Empowerment Opportunity Card
- Private activity bonds for zone businesses, community investment corporations and funds, and ESOPs owned 50% or more by zone residents*

EMPLOYMENT AND TRAINING CREDITS ("ETC") FOR ZONE RESIDENTS

- A multi-year ETC for zone employers*
- A one-year Targeted ETC for non-zone employers*

INVESTMENTS UNDER THE ACT

- Enterprise Grants
- Community Policing

ZONE PRIORITY INVESTMENTS

- Community Partnerships against Crime
- Community Development Financial Institutions and Banks
- HUD Matching Fund for CDCs
- Up to 30 Enterprise School Communities
- SBA, Commerce and EDA funds and technical assistance
- School-to-Work, Apprenticeship, Youthbuild, Youth Fair Chance, Job Corps
- Drug Prevention and Rehabilitation-to-Work
- "One Stop Shop" Career Centers (JPTA), Access and Moving to Opportunities
- Distressed Public Housing, McKinney Homeless Shelter Assistance

COSTS AND PLACEMENT

COSTS

Tax Incentives: The President's FY1994–1998 Budget includes a total $4.1 billion over five years in tax incentives. Approximately 75% of the cost comes from the Employment and Training wage tax credits.

Investments: The Empowerment Zone Proposal aims to match that amount by targeting existing investments towards Empowerment Zones and Enterprise Communities. Over the next two years, $500 million currently in the budget will be allocated to Enterprise Grants for empowerment zones and communities. An additional $500 million will go to community policing, of which a substantial amount will be targeted toward the 110 zones.

Innovative Programs: In addition, the President has requested that his Cabinet come forward with proposals to target at least $3 billion of existing funds within the zones and communities so that there can be an equal amount of investments and tax incentives.

Several departments have already made that commitment. For example, the Department of Education has already committed funding and support for local communities to create 30 Enterprise Schools -- 24-hour, year-round community centers -- within the zones. HUD has agreed to target $200 million of its Community Partnership Against Crime funds -- public safety and drug prevention -- in the zones.

PLACEMENT

100 Enterprise Communities: Of the 100 Enterprise Communities, 65 will be in urban areas, 30 will be in rural areas, and 5 will be on Indian reservations.

10 Empowerment Zones: Of the 10 Empowerment Zones, 6 will be reserved for urban areas, 3 will be rural areas and 1 will be an Indian reservation.

May 4, 1994

MEMORANDUM FOR THE PRESIDENT

SUBJECT: EMPOWERMENT ZONE ANNOUNCEMENT

THROUGH: BRUCE REED
GENE SPERLING
ANDREW CUOMO

FROM: COMMUNITY DEVELOPMENT TASK FORCE

I. BACKGROUND

You established an Interagency Working Group on Community Development and Empowerment to address the continuing distress in many places in urban and rural America. The working group is chaired by the National Economic Council and the Domestic Policy Council. Within this working group, an enterprise zones working group was established to develop and write your proposal on enterprise zones, which will be the cornerstone of your community agenda. The members of this working group include HUD, Treasury, Agriculture, Commerce, Justice, OMB, and CEA, and valuable contributions were made by DoED, HHS and Labor.

It is noteworthy that this working group is chaired by both NEC and DPC reflecting your philosophy that in order for a community to function well and sustain itself, appropriate resources and coordination must be invested in the people, infrastructure and economic development and growth. The Clinton enterprise zone initiative encompasses social and economic policy.

The proposal you are announcing today is a groundbreaking step in the way the federal government does business with distressed communities. There are two overarching issues which guide today's announcement:

1) The three basic tenets to your novel proposal -- economic empowerment; bottom-up strategy; and, reinvention of government.

2) This enterprise zone proposal is drastically different from the Reagan/Bush/Kemp proposal and different from all other previous proposals.

EMPOWERMENT ZONES

Today's announcement represents an unprecedented recovery initiative to empower distressed urban and rural communities to merge job creation with sustainable community growth through one coordinated, holistic response. The competitive process would require submittal of a Comprehensive Strategic Plan which would coordinate all resources going into the zone. This approach recognizes that long-term, stable economic growth in severely distressed areas must be achieved through a balanced plan of economic development, human development and physical development.

Designated communities will receive a combination of tax incentives and public investment grants to implement a holistic community revitalization plan which addresses barriers to self-empowerment and economic development. The initiative will also "reinvent government" by allowing consolidation, streamlining and flexibility of programs now administered by a multitude of federal agencies ranging from HUD to Agriculture to HHS to Transportation.

- **Three basic tenets to the proposal:**

  Economic Empowerment -- Before the ladder of economic opportunity can be climbed, the first rung must be caught. The goal is to empower zone residents to join the economic mainstream by making sure the first rung is within reach. Strategies would help residents own and manage enterprises within the zones and will connect them to jobs and opportunities throughout the region.

  The strategies will take into account existing obstacles to employment such as the absence of affordable child care and job-training and educational needs. Residents who participate in these programs will be required to enter a new form of social contract stressing self-help, hard work and social responsibility.

- **Bottom-up Strategy** -- The answers to a community's problems must be generated by that local community. Through a competitive process, a locality, in partnership with the community and private sector, will develop a comprehensive strategic plan which details how the applicant will coordinate all state, local and federal resources and incentives with private and other community resources to meet that community's needs.

- **Reinventing Government** -- Isolated, episodic government programs must be consolidated.

- This proposal changes the way government does business in distressed areas by streamlining regulations, rules and paperwork which discourage local initiative.

- The needs of American communities are vertical and the federal response is horizontal. This proposal will deliver "one-stop Federal responsiveness" -- an Interagency Enterprise Board will preside over the designation and implementation of the Zones and Neighborhoods.

COMPARISON WITH PAST PROPOSALS

Earlier enterprise zone concepts focused primarily on jobs and investments, regardless of who benefitted. The initial enterprise zone approaches were limited and simplistic, based on the flawed assumption that tax incentives alone would attract new businesses to distressed areas. These initial approaches were those of the Republicans based on initiatives in England and elsewhere.

Some enterprise zone proposals, however, have recognized the need for a comprehensive, enhanced approach by increasing existing services. But elements are missing -- the common thread which ties these comprehensive services together in an integrated holistic approach and the degree of freedom offered by a real block grant, which does not lock communities into many separate programs. The flaw in increasing funding for existing programs without increased waivers and reduced paperwork is the program then relies upon current, fragmented delivery systems which are both redundant and counterproductive.

It is important for you to know the major differences between your Economic Empowerment Act proposal and enterprise zone legislation introduced in the 103rd Congress by Congressman Rangel, HR 15, and Lloyd Bentsen's bill, HR 11, which was passed but vetoed last year:

- **Plan** -- The foundation of your proposal is the Comprehensive Strategic Plan developed through the challenge process which brings together all local, state, federal and non-profit resources and programs in a coordinated approach to economic, human, community and physical development in distressed areas.

  HR 11 and the Rangel bill base selection on a competition among eligible areas based on local commitments, course of action and zone conditions. While zones must meet certain eligibility criteria thresholds, your competitive process is based entirely upon the merits and innovation of the Strategic Plan.

- **Reinvent Government** -- The Enterprise Board will coordinate administration of all programs going into zones. Other proposals rely on current delivery systems.

Please see attached chart for other specific comparisons of your bill and other proposals.

You should note the commendable work Secretary Bentsen, Congressman Charlie Rangel, Congressman Rostenkowski and others have done on enterprise zones. Last year, these Members worked to make sense out of a proposal which just benefitted businesses. Stress Rangel's role in advocating an initiative to address the multi-faceted needs of a distressed community and Bentsen's role in the White House process.

SUMMARY	ADMINISTRATION'S BILL	RANGEL HR 15	HR 11 (1992)
NUMBER OF ZONES	Tier 1 - 10 (6, 3,1) Tier 2 - 100 (65 urban,30 rural, 5 Indian Reservation) in same yr.	150 (50 large cities, 50 other urban and 50 rural) phased in over 5 yrs.	50 - 25 city; 25 rural and 1 Indian Reservation phased in over 5yrs.
Selection Process	Competition based on comprehensive strategic plan -- bottom up solutions. Eligible criteria serves as a threshold; it does not weigh in competition.	Quality course of action and strength of local commitment. Level and priority of commitments and poverty ranking.	Intense competition in local areas based on local course of action and zone conditions
Reinvent Government	Allows coordination of relevant programs through enterprise board and one contact source. Provides extensive waivers.	No.	No.
Incentives	Tax credits for employers; penalty free withdrawals from IRA; tax-exempt private activity bonds; resident empowerment account. Property expensing, Accelerated depreciation	Employer tax credit ; deduction for EZ stock; non-recognition of capital gains for new investment; plant and equipment expensing	Employer wage credit; expensing for plant and equipment; investor credit;capital gains exclusion.
Zone Czar	No	No	50 local govt. officials
Bottom-up Planning	Yes.	No.	No.

THE WHITE HOUSE

WASHINGTON

April 26, 1993

MEMORANDUM FOR BOB RUBIN
GENE SPERLING
BRUCE REED

FROM: TODD STERN

SUBJECT: Enterprise Zones

I'm no expert on this stuff, but on the basis of your long memo and this morning's meeting, I had a thought I wanted to pass along.

I agree with the idea of focussing our main attention on 10 Empowerment Zones, which we hope will produce success stories, leading to an eventual expansion of the program. I also think that moving on a relatively limited, experimental basis to see whether the idea works before trying to do it on a national scale for big money is entirely consistent with our "new Democrat" message.

But, given that we are going to propose a kind of demonstration project approach, I wonder whether the review and evaluation periods discussed at p. 7 of your memo are too long **-- and will seem too long to Members of Congress unhappy that a city in their own state or district didn't win one of the first 10 grand prizes.** You propose a review by the Designating Secretaries at the end of the fourth and seventh years; and an independent evaluation, supervised by the National Academy of Sciences, after years 5 and 10. Wouldn't some earlier review be appropriate if we hope to (i) build a case for expanding the number of Empowerment Zones two or three years down the line, and (ii) persuade disappointed Members of Congress that their ship may still come in? Is it your calculation that we can sell the success stories, assuming they happen, without a real review, while, on the other hand, a real review might end up yielding results that we'd rather not hear about until 1997?

Ent zone mtg Roosevelt Room 4-26

(How big a deal on)
JDS: (Community Policy?)

Frank Newman

Bruce Katz
Gene Sperling
Esq

LP: I propose present this (Ent zones) as part of a larger urban (or rural area) policy that'd include ~~policy~~ policing / education

Ent zones

BC: how split 2-tier
10/100 vs eg 15/50 etc.

top 10 hit jackpot
other 100 seems like just pushing papers around, just consolation prize, not amount to much...

HR 11 ~~$5b~~ $2.5b on tax side - 50 zones

We're proposing $4.1b / on tax side for 10

we'd spend more / per city

max wage credit ~~grant~~ $3750 / worker HR 11
$5000 / worker ours

BC: still, why no big diff. 10 vs ~~100~~ 50 zones

How much total cost in the 100 2nd tier: about $200m vs. $2.6b in tax side

BE 10 is hard sell
the other 100 will seem phony
can't we get to 25

LP smaller # means better
chance for results; but recognize
great political difficulty of
a small number

LB: start w/10, you'll end up
w/25 anyway

in budget GS. – maybe use the $1.3b (betw.
$4.1b and 2.8b estimate) to sweeten
consolation prize, but small #
~~bets~~ keeps pres'l imprimatur
MESG these are demonstration projects to do
something bold. If right for
much, get to incrementalism & none
of ~~the~~ them works

A Cuomo — ability to combine existing
programs coord. with grants
new money we're providing
BL – use $1.3b to sweeten the 100
If use the $1.3b for tax side none
for discretionary spending

Gene: focus on the VD to make real success stories

if just sprinkle $ around too to mis[illegible] to buy off Congressman we'll be hit by Rs saying "waste of spend"

BC: so say we should propose parent proposal of VD & $ per Unit for Cong to rejigger it

TDJ - Chr review & assessment etc be on a shorter time frame jiving hope of expanding # of VD... core based on success stories

Pop'l'n --

BC -- 100,000 too small a box need at least 200,000

BC: Reason so expensive is propose to give credit to people who have job already

BR but big problem w/incremental approach -- eg gas st'n owner fires old ees, starts new one across street w/new ees to get credit

BC: do 3 at 200,000

Poverty Criteria

~~B.~~ Discn re more or less flexibility

LB wants less bec you'll ~~go to re move~~ leave out poorest

$ Cisneros Espy argue for more flexibil.

AC: go w/ more, but we retain control not to allow eg middle class neighborhoods in because it's a grant process...

10 As

[BC- historian should note pivotal moment in Admin when Sec. Treas. is to left of HUD & Ag.]

Existg Fed'l Progs.

BC: Begin w/ broad pilot waiver authority then maybe go to another...

Empowerment Savings

approach ER/EE could contrib to pension but w/draw for specified reasons

2d special savings bonds - not mutually exclusive

LB: not impressed by these as empowerment tool - need real grants & loans for poor people

Small Worker Control Enterprises --
BC - go w/ staff recommend'n if control ~~abuse~~ tax shelter abuse

L.T. objection isn't just sheltering, it's encouraging people to make risky investments

BC - limit to how many outside people to come into areas no matter how many incentives, so ~~help~~ need to help generate growth internally.

LT but encourage inv. in Less risky enterprises like community inv. funds not the ~~bus.~~ bus. itself where they work
BC: worry that ER ~~a~~ put squeeze on ees to invest in the firm...?

BC: is risk greater than less in ESOPs or SUCE

Only diff in sizes
the SUCE's lift to $5m / cos   ESOPs cover all cos.

Manning tolling major mistake to include -- tax writing comms. will be strong against

MF -- go w/ tax exempt bonds instead on both SUCEs & ESOPs

go w/ Flint ETC ~~[illegible]~~

BC: Need same amount of energy to figure out how to win these battles in Cong.

has went in to policy option memos

NEXT STEPS: ECONOMIC EMPOWERMENT ZONES/NEIGHBORHOODS & COMMUNITY DEVELOPMENT AND EMPOWERMENT WORKING GROUP

April 26, 1993

I. Enterprise Zones:

1. Draft Legislation: Maurice Foley (tax); Bruce Katz (spending)

2. Congressional Contacts:

– Monday:	Staff–to–staff Phone calls
– Tuesday:	House Staff and Senate Staff Meetings at White House
– Wednesday	House Member and Senate Member
Thursday	Meetings at White House with Bob Rubin

3. Release Enterprize Zone proposal on Monday, May 3 and give date of larger Community Empowerment Statement

II. Preparation for Community Development Announcement:

1. Reconvene Community Empowerment Task Force Thursday Evening with such departments as DOJ, HHS, Education as well as Economic Departments. Agenda would include two main items:

– Themes: Discuss over–arching themes for a community development & empowerment statement by the President. Secretary Cisneros will present his proposed themes as a starting point for the discussion. (communications and speechwriting people should be included)

– Other Initiatives: Each Department should consider what other 1993/1994 actions that can be included with Enterprise Zones and Community Development Banks.

III: Future Steps: Ask for Proposals and Suggestion as to how the Community Development and Empowerment Working Group should organize itself in developing a future comprehensive agenda.

Community Development Banks Mtg 4-15-93

Rubin, Panetta, Bn-Diamond, Ron Brown, Rivlin, Ed King, Reed, Sperling
(many others)

Estab. a fund

Acorn South Shore

* minority concern that Community ~~Reinv~~ Reinvestment Act would be weakened
Consensus had to be strengthened

- How to capitalize the fund

• Organiz'l struc. of fund look - more public or private

• Political issues

① CRA

- perf based stds or just better processes & sanctions. Agree to go to perf-based stds

BR: will banks be upset? A: Bankers ~~seem~~ seem positive rather have more certain target to shoot for. generally small banks hate CRA & big ones dislike it

Community groups think very important

(3) capitalizing fund

(a) take appropriat—

($380m / 14 yrs)

put it into fund use matching grants at local level

would need technical assistance too

(b) leverage appropriations w/loan from Treasury + seek matching funds

CDFI

CDFI

(c) Bank holding cos making major inv.

(i) directly into fund (eg 1/4% of equity ($320m in 1st yr)

Dinersand

(ii) 3/4% eq. create ~~community~~ bank holding ~~cos.~~ community develop. ~~cos~~ subsidiaries

might give incentive by saying where this is done successfully & CRA ~~keen~~ met then could do interstate

Frank Newman / Roger Altman — ~~you~~ ~~re~~ CDB's in South Shore mode are real FDIC banks; you might need a separate pool of money to support equity infusions into businesses that could create ~~ty~~ basis for loans — but lots of

small businesses you want to help
need equity, not just debt.

L.P.: you'll get killed on Hill if use
interstate banking -- a minefield - as a
~~carrot~~ carrot

Banking Comm. members would view ~~the~~
this in terms of bank reform + you'd
get thoroughly snagged

FN The $380 m figure in BC's plan
would fall dramatically short

BR: how would banks react to 1/4% proposal?
as a tax -

the interstate banking only in ~~the~~ states
that allow it + intrastate branching
there

FN: Even if capital takes long time
to develop expertise to get loans on
the street

LP: test ideas w/
Leach Schumer Bach but LP sees
any kind of interstate banking as a buzzsaw

Bruce —
Ex-Senate Banking Staffer: #3 won't go politically
if want to get something done,
need to go with #1 ~~##~~.

—— : the core banking part of CDB's would
still be conservative but they'd
have other subsidiaries or operations

GSp. - makes pitch for #3 - "don't shortsell
ability of Pres. to do more"

BR: you're being ~~too~~ unrealistic

Black guy ~~ex~~ ex Sen. Banking: #2 is a bailout
in effect will be viewed that way
so just go w/ #1

BR start #1 & talk to Schumer & others
Sarbanes etc & feel out #3

FN: But #1 is pitifully small compared
to Pres's vision

(Edley argues for #2

Bruce: Talk to Riegle & Sarbanes staff to get a
~~read~~ read

RB - Pres is frustrated re stimulus, investment - he'll ~~[illegible]~~ want to be bold & take risks

LP Talk to Chuck Schumer

BR: #3 is best public policy but agrees w/LP re political infeasibility

CE One poss. use of the #1 $350m is leverage -- get long term debentures from Treas. or HUD

BR political nonstarter?

black ex.-st. / yes

BR/SM Revised pkg. 4/15

NEC-DPC PRINCIPALS MEETING
AGENDA FOR CD BANKING AND CRA

I. Outline of Proposal

II. Issues

A. Should we recommend moving to performance-based CRA? Or should we recommend only improving the training of CRA examiners and strengthening the sanctions available for enforcing CRA and Fair Lending?

B. Should we present to the President the options of supplementing the basic CD Banking proposal by:

1. leveraging the federal appropriation and/or

2. Bank Holding Company (BHC) participation:

a. mandating BHC contributions to the Fund (and requiring establishment of CD Bank subsidiaries that meet performance standards) as a precondition to BHC application to consolidate BHC banking operations on an interstate basis in states where permitted;

b. permitting BHC's and thrifts to do the same on a voluntary basis?

C. With respect to the legislative strategy on the supplementary options, should we recommend

1. go all out to promote as much CD Banking as possible now, including BHC participation?

2. test the waters by calling in key congressional, banking and community leaders before making a decision?

3. submit the basic proposal (but with the announcement that we expect CD Banking to be supplemented next year as a part of broader banking/financial services reform)?

Draft 10: 4/14/93

DRAFT: NOT SEEN BY THE PRESIDENT

April 10, 1993

MEMORANDUM FOR THE PRESIDENT

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

SUBJECT: COMMUNITY BANKING PROPOSAL

I. ACTION-FORCING EVENT

Across the country, rural and urban communities are starved for affordable credit, capital, and basic banking services. Millions of Americans in low-income neighborhoods have no bank where they can cash a check, borrow money to buy a home, or get a small loan to start a business or keep one going. Perhaps more than any other proposal, the network of community development banks you promised in the campaign -- coupled with reform of the Community Reinvestment Act (CRA) -- have the potential to transform these communities by empowering people and businesses to join the economic mainstream.

II. BACKGROUND

Over the last two months, the NEC-DPC Interagency Working Group on Community Development and Empowerment has been developing a community banking initiative that tries to fulfill the basic principles you outlined during your campaign. This memorandum reflects ideas from HUD, Treasury, Agriculture, Commerce, OMB, CEA, NEC, and DPC, as well as outreach efforts to community groups and the banking industry.

A. The Problem. As you know, low-income communities face several chronic banking problems:

- Inadequate Basic Banking Services -- Millions of poor Americans have no access to nor relationship with a bank. They live in neighborhoods with no ATM machines, no drive-through windows, no checking or savings accounts. Instead, they are forced to deal with cash-checking operations that charge an exorbitant fee for a simple service.

• No Loans for Small Borrowers -- Most commercial lenders shun low-income communities because small loans have higher transaction costs and lower profit margins, and require more labor and attention, if not more risk.

• Lack of Expertise Among Lenders -- Lending in distressed communities, particularly for small business, is difficult. It requires specialized underwriting expertise and knowledge — of the borrower and the community, credit products, subsidies, and secondary markets.

• Lack of Expertise Among Borrowers — Small businesses, particularly those in distressed areas, often lack expertise in the basics of small business management, including accounting, borrowing, managing and repaying money. When commercial lenders abandon these communities, there is often no place to turn for essential capital, credit or information.

• Discrimination -- Home Mortgage Disclosure Act (HMDA) data suggest that, deliberately or not, home mortgage lenders deny loans to middle- and upper-income minority borrowers more often than to moderate- and lower-income whites. Anecdotal evidence suggests that the situation is even worse for commercial and consumer loans.

• Shortage of Credit and Capital -- The unmet demand for credit and capital in poor communities is therefore substantial. In too many low- and moderate-income neighborhoods, loans are unavailable for even the most credit-worthy housing and business purposes. A recent study found $360 million in unmet demand for credit-worthy small business loans in the City of Oakland alone. In New York City's distressed communities, several billion dollars in demand for housing loans that would qualify for federal insurance went begging. Economic revitalization cannot take root in these communities where good risks and sound businesses cannot get loans.

B. Promising Responses to the Problem. Many enterprising communities have come up with their own ways to fill the void in community development and banking services. We have looked at a variety of promising alternatives under way around the country, including community development banks, credit unions, corporations, and loan funds; loan consortia and other community development intermediaries; and community reinvestment by mainstream commercial banks.

1. Community Development Banks (CD Banks): South Shore Bank in Chicago, Elkhorn Bank and Trust in Arkansas, and Community Capital Bank in Brooklyn offer a comprehensive range of assistance to the communities they serve. Through for-profit and non-profit affiliates, they provide basic deposit, saving, checking, and consumer and mortgage lending services; venture capital for small business; microenterprise loans; and technical assistance. They also develop rental and cooperative housing for low-income residents and commercial real estate for small businesses. Three such integrated, full-service financial community development bank holding companies have emerged over the last twenty years.

2. Community Development Financial Institutions (CDFI's): A variety of other community-based organizations have found their own financial service niche:

- Community Development Credit Unions (CDCU's) are regulated financial cooperatives owned and operated by lower-income persons to serve the deposit, check-cashing, and small consumer loan needs of their members. A growing number of CDCUs are making development loans for small business expansion and start-up. Like CD Banks, CDCUs can offer federal deposit insurance up to $100,000. The largest CDCU is the Self-Help Credit Union in North Carolina. With more than $40 million in assets, it is second only in size to South Shore Bank among community lending institutions. Self-Help is part of a larger holding company that includes independent, non-depository credit and support mechanisms. There are over 100 CDCUs across the nation, and one the newest was chartered in South Central Los Angeles last November.

- Over 1000 Community Development Corporations (CDC's) have been created by civic and community groups, local or state development authorities, and banks to provide small business or micro-enterprise lending, large community development projects, or affordable housing. Their sources of capital and loans include other banks, federal small business and housing programs, local corporations and foundations, and major national assistance corporations such as LISC or Enterprise.

- Scores of specialized Community Development Loan Funds (CDLF's), both for-profit and non-profit, aggregate capital and contributions from socially conscious banks, investors, and foundations to provide equity, bridge loans, or below-market financing for affordable housing, revitalization of retail stores, or small businesses in distressed communities.

3. Community Development Intermediaries (CDI's): A number of state and local governments, community groups, and financial consortia provide specialized services that link communities, CDB's, and CDFI's to mainstream banking, credit, capital, and government insurance and subsidy programs and secondary markets. These intermediaries underwrite, guarantee, or repackage loans to credit-worthy businesses and individuals in distressed areas.

4. Community Reinvestment by Mainstream Banks: Either in response to pressure from community groups to meet their obligations under the Community Reinvestment Act or out of their own self-interest to learn how to better serve underserved markets, many mainstream commercial banks and thrifts have begun to provide essential financial services to distressed communities. Some have formed loan consortia, loan loss reserve funds, and community lending networks; others provide capital, loans, or contributions to the community development institutions described above. A few Bank Holding Companies (BHC's) have recently created and capitalized Community Development Banking subsidiaries to serve the financial needs of distressed communities.

It is a major uplift, for both lenders and borrowers, to learn that low- and moderate-income people in distressed communities also can work to pay off a home mortgage or a small business loan. As one of the founders of a CD Bank said, "One of the untold stories is that poor people with small loans can be better credit risks than rich people with large loans. And the personal reward to me is that my character loans provide a hand-up to enable the poor family to build a better life and a better community." That is what community development banking is all about.

III. PROPOSALS

Given the variety and promise of these local efforts, we advise against mandating any single model for community development banking -- although the program should encourage CDFIs which have reached a certain size and level of sophistication to eventually become chartered depository institutions. Instead, we recommend a flexible community lending initiative based on the principles you outlined during your campaign.

The community empowerment strategy we have proposed includes four pillars: economic empowerment zones; community development financial institutions (CDFIs); strengthened Community Reinvestment Act and Fair Lending laws; and community partnerships against crime. Together, they will help to stimulate the public-private-community partnerships that are essential to empowering poor people to join the economic mainstream and businesses in distressed communities to become engines of economic growth. These four initiatives are the first in a series of proposals to address the unique needs of urban and rural America.

In this memorandum, we present detailed options to 1) strengthen CRA and Fair Lending requirements by demanding performance instead of paperwork, and 2) develop a national network of community financial institutions -- community development banks, credit unions, revolving loan funds, microenterprise loan funds, and more.

A. Community Reinvestment Act (CRA) Reform

1. History

The Community Reinvestment Act requires regulated financial institutions to "serve the convenience and the needs of the communities in which they are chartered to do business."[1] Under CRA, regulators of financial institutions -- the Fed, Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) -- undertake periodic examinations of each federally chartered institution. Using a twelve-factor analysis, an examiner assesses the institution's lending practices and assigns the institution a CRA rating of "outstanding," "satisfactory," "needs to improve," or "substantial noncompliance." The examiner's CRA report is available for public inspection and an institution's CRA rating is taken into account in a regulator's evaluation of the institution's application for a charter, new branch, merger, or acquisition.

During the campaign, you promised to focus CRA evaluations on "performance, not paperwork." Both banks and community groups argue that current CRA policy suffers from several shortcomings:

- Vagueness -- The current evaluation process provides insufficient guidance for both regulators and regulated institutions on precisely which practices demonstrate CRA compliance. This vagueness is one source of the highly subjective nature of CRA evaluations and the "grade inflation" perceived by community groups.

- Paperwork, not results -- In the face of this uncertainty, both regulators and regulated institutions have focused on an institution's processes and paperwork, such as meetings with community groups and minutes from board meetings, rather than on results. This has created substantial burdens for both regulated institutions and regulators, without any corresponding gain in CRA effectiveness.

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[1] CRA focuses only on a limited set of financial institutions, but there is a considerable amount of basic banking, lending and other financial services done by other entities, including

- car loans extended by the credit arms of car companies
- personal and home loans by consumer finance firms
- commercial loans by commercial finance agencies
- basic deposit and checking by money market funds.

The total of such non-bank financing exceeds $1 trillion. The total assets of other financial sectors (insurance companies; investment companies, broker-dealers, mutual funds, money market funds; and pension funds) almost double the total assets of the regulated banks, thrifts, and credit unions. None of these other financial institutions is subject to CRA. At a later date, we will therefore explore how these other financial institutions might also play a constructive role in reinvesting in distressed communities.

- Poor performance -- Although more than 90% of all regulated institutions receive "satisfactory" or better CRA ratings, redlining persists in low- and moderate-income neighborhoods.

- Inequity -- Although some institutions reinvest heavily in their communities and others only lightly, almost all institutions receive passing CRA grades. This not only hampers the ability of regulators and community groups to monitor reinvestment practices. it also deprives responsible institutions of recognition for their performance.

2. Stronger, More Focused CRA Enforcement

We recommend three measures to improve CRA enforcement, none of which requires legislative action:

1) **Better examiners:** Many examiners lack experience in conducting CRA examinations. Bank regulators need to develop a well-trained corps of examiners who specialize in CRA examinations.

2) **Stronger sanctions:** Regulators should use supervisory letters, letters of reprimand, and civil money penalties to enforce actions against institutions with persistently poor CRA performance.

3) **Performance-based standards:** The most sweeping step we can take is to reform the CRA examination protocols to focus more on quantifiable measures of an institution's actual performance in providing credit and other financial services to its community. Banks should be judged on the basis of the magnitude and distribution of affordable housing and community development lending and investment, especially in low- and moderate-income neighborhoods, and the provision of basic banking services. For example, banks should receive partial CRA credit for investing in community development institutions (see below). Banks should also be subject to fair lending examinations to determine whether they engaged in a pattern or practice of discrimination.[2]

The first two steps are relatively non-controversial. The third measure, performance-based standards, will draw criticism from some financial institutions who are worried about "credit allocation" and increased paperwork, along with a few community groups who have

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[2]By the time of your announcement of your initial urban initiatives, we should also be able to include several other important contributions to augment community reinvestment and fair lending -- including new objectives and programs for the major GSEs like Fannie Mae and Freddie Mac.

been able to use vague standards to pressure banks into more specific agreements on community lending.

We believe that neither concern is well-founded: The proposed regime does not prescribe lending or investment quotas, and remains sensitive to the varied needs and strengths of financial institutions. Over time, performance-based standards will reduce uncertainty and paperwork for banks and regulators alike, by giving them measurable goals and clear guidance. A streamlined examination procedure will be developed for the examination of small and rural institutions.

Most community groups will support the new standards because of their potential to increase access to basic banking services, as well as lending and investment. Community groups' real concern is that after 12 years of strained relations, they don't trust the regulatory agencies. Affected communities need to know they will have a strong voice in the examination process. In conducting CRA and fair lending examinations, regulators should actively solicit the views and comments of residents, small businesses, and citizen's groups in the institution's community. (See Tab A for a more detailed description of CRA options as proposed by the Office of the Comptroller of the Currency and the Treasury Department).

B. A National Network of Community Development Institutions

To date, with almost no government support, community development financial institutions (CDFIs) have proved that it is possible to mobilize and lend significant amounts of capital for development in credit-deprived communities. We propose two measures to stimulate the growth and impact of these institutions:

1. A Community Banking and Credit Fund to provide federal capital assistance that will dramatically expand the amount of capital available for CDFI start-up and expansion without creating enormous financial liabilities for the federal government.

2. A national information clearinghouse and support system to help prospective CDFIs get off the ground and existing ones to expand, better meet their mission, and operate soundly

1. The Community Banking and Credit Fund

We envision a federally-chartered, quasi-private enterprise known as the Community Banking & Credit Fund ("Fund") to oversee the development of a nationwide network of community development financial institutions. The Fund would be governed by an eleven member Board of Directors appointed by the President and confirmed by the Senate. The Board would include the cabinet secretaries or designees of the Departments of Treasury, HUD, Commerce, and Agriculture, a representative of the Small Business Administration, two representatives of the CDFI industry, two representatives from community groups, and two representatives of the mainstream banking sector (including one of the regulators, e.g., the Federal Reserve or OCC). The Chairman would be appointed by the President. The Board would serve as a corporate board of directors to establish policy and would retain a full-time President/CEO to manage operations of the Fund. The size and composition of the Board could be expanded or altered to reflect the public purpose and the mix of public and private capital.

2. Selecting Network Participants

To receive financial or technical assistance from the Fund, an institution would have to be a member of the national CDFI network, and meet several stringent standards:

- Demonstrated ability to manage a CDFI.

- A primary, explicit and highly public commitment to community development. To qualify, a CDFI's loans and investments would have to go toward community development, and serve an area that needs it.

- A realistic, specific strategy to achieve the CDFI mission, consistent with the local community development plan, and become self-sustaining

- Leverage -- private capital or other support to match Fund support. For example, George Surgeon of Elk Horn recommends a one-dollar federal match for every two dollars of private money.

- Expertise in technical assistance. Many small borrowers default not because their businesses are not viable, but because of a lack of knowledge about management, financial, and legal matters. Existing CDFIs have shown that with active guidance and credit counseling, low-income residents of distressed areas can be extremely credit-worthy.

Attached at Tab B is a summary of the criteria for eligibility.

The Fund would solicit proposals for CDFI matching funds (and other assistance) on a competitive basis. Relevant federal agencies and existing CDFIs will be available to assist applicants in developing their strategic plans. A review board, comprised of agency, community and private sector representatives, would review and make recommendations for selection of applications.

3. Assistance Provided by the Fund

Attached at Tab C is a detailed explanation of the assistance the Fund would provide, including:

- Capitalization Assistance -- Matching equity that can be used to capitalize new CDFI's or expand existing ones.

- Technical Assistance -- Capitalization loans, grants, or technical assistance to applicants that present proposals in conjunction with new or expanding CDFIs. This could apply to subsidiaries of CDFIs as well as community groups with technical assistance expertise, such as ACORN.

- Coordinated Access to Relevant Programs -- The Fund would set out to give CDFIs a single point of access for relevant technical assistance, lending, and subsidy programs. Depository CDFIs could also be encouraged to provide a telecommunications network for one-stop loan centers that would make SBA, FHA, FmHA and minority business loans and other public and private loan and credit programs available to targeted areas.

- Deposits -- Monies being held by the Fund would be deposited with eligible CDFIs.

- Voice for Community Development Banking — By forming a network of CDFIs, the Fund can also become an important voice for Community Development Banking in the country -- to stimulate private support, to spur mainstream financial institutions and Wall Street to participate in CD Banking, to study and to promote new CD Banking products, services, partnerships and secondary markets.

4. How to Capitalize the National Network of CDFIs

A key question in establishing a national network of community development is how to make the most of the federal government's leverage. We present three basic alternatives, with no consensus recommendation. In the first approach, the Fund uses the federal appropriation to capitalize CDFIs on a matching basis with capitalization provided by each CDFI. In the second, the Fund would be given authority to request a loan from Treasury to leverage the size of the Fund's available capital based on the Fund's experience. In the third option, additional contributions to the Fund would be required (or encouraged) from mainstream banks; and mainstream banks would also be required (or encouraged) to create CD Bank subs.

The three approaches are not mutually exclusive and could supplement one another. Under all three, we could further stimulate the CDFI industry by

- providing partial CRA credit for bank investments and contributions to CDFIs[3]

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[3] As described earlier, a reformed CRA can steer more resources toward distressed communities. Under the current system, it is up to bank examiners whether to give banks CRA

- waiving the stock/purchase requirements for depository CDFIs that wish to join the Federal Home Loan Bank System (FHLB)[4]
- earmarking a greater share of the FHLB Affordable Housing and Community Investment Programs for use by CDFIs or other lending in distressed communities[5]
- encouraging mainstream banks to lend funds to CD Banks through the Fed Funds Market
- providing access to expanded community lending programs of Fannie Mae, Freddie Mac, SBA

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credit for investments in CDFIs. A simple regulatory change could assure banks partial CRA credit for investments or grants to CDFIs and community groups who work with CDFIs. If the banking regulators move to a performance-based system, assistance to CDFIs could be given a specific CRA weight -- large enough to increase investment, but not so great that banks could use contributions to CDFIs as a safe harbor to circumvent CRA.

[4] Another way to expand the pool of financial resources for community lending is to make it easier for CDFIs to join the Federal Home Loan Bank system. FHLB membership would give CDFIs a liquidity facility (a "window") and access to longer term funds at below-market rates. Under current law, any financial institution can join (Community Capital Bank and South Shore are members), but the cost of membership is much higher for banks and credit unions than for S&Ls. We propose a waiver of the FHLB membership fee for accredited depository CDFIs.

[5] The Affordable Housing Program (AHP) and Community Investment Program (CIP) of the FHLB system were implemented as part of the 1989 FIRREA legislation. AHP required the Federal Housing Finance Board (the regulator for the FHLB) to set aside from the profits of the FHLB banks $50 million in 1993, $75 million in 1994, and $100 million in 1995 and subsequent years for a range of activities related to affordable housing. CIP is a complementary program that authorizes the 12 District Banks of the FHLB to make advances to members for use in making community and economic development, commercial and small business loans in low- and moderate-income neighborhoods. Since CDFIs serve the same purpose, and since the Federal Home Loan Bank system is now well-capitalized, a portion of these funds could be made available for qualifying loans of CDFIs. With your leadership and, as appropriate, appointment of new members of the Federal Housing Finance Board, we believe that the FHLB system can be persuaded to cooperate fully in implementing your CD Bank initiative.

- assuring a more sympathetic regulatory environment and safer (even patient) capitalization for depository CDFIs which, together, encourage making more prudent loans within distressed areas without increasing the risks of bank failure or calls on federal deposit insurance

The three basic approaches for capitalizing the Fund are:

OPTION 1. DIRECT APPROPRIATION

In your budget proposal to Congress, you request $382 million for community development banks through FY97. This appropriation could be used for direct federal support to CDFIs -- equity capital with a reasonably firm but patient expectation of returns over time, more venturesome investments to test the full potential of community development banking, grants to "glue" together comprehensive CDFI financial service and development networks within communities, technical assistance and training, etc. We expect that the Fund, periodically, would make allocation decisions between such categories.

The appropriation alone represents a potential 50% increase in capitalization of the CDFI industry, which is currently capitalized at approximately $700 million and has extended almost $2 billion in loans nationwide. For example, on a matching basis of one Fund dollar for every two local CDFI dollars, the new federal funds could generate an additional $1 billion in capital — which in turn could lead to $3-10 billion in new loans in distressed, low-income communities. There may be a practical trade-off here: the higher the local CDFI match, the fewer the number of CDFIs that may be able to raise the capital necessary to apply, particularly in the early years of the Fund.

OPTION 2. LEVERAGED CAPITAL

Up to $300 million of the $382 million in your budget proposal for CD Banks could also be leveraged to obtain up to $1 billion in debt financing from the Treasury. Under current budget rules for credit reform, some of the appropriated money would be set aside to assure that the Fund's borrowing would be repaid and to provide a cushion to allow the Fund to make matching equity investments in CDFIs. The amount of leverage available would depend upon the anticipated returns, the risks of default, and the amount of private capital invested in the Fund.

The appendix at Tab D illustrates two financial models with different amounts of private investment in the Fund and different amounts of leverage. In either illustration, the Fund would have sufficient funding to capitalize over 100 independent CD Banks which together would have the capacity to make a total of over $10 Billion in new lending available to distressed communities. Under either model, $82 million of the total appropriation of $382 million would be used for technical assistance, setting up the network, and for other purposes.

In theory, this approach offers several advantages: It could leverage a substantial pool of CDFI equity. It would offer contributing banks and other investors a low but positive rate of return. It would present the federal government with a reasonable risk of default on its loan guarantee. Using Treasury or a HUD/ Government Sponsored Enterprise regulator as a watchdog could help ensure that the federal financial exposure is within appropriated levels.

In practice, although the financial experience of the two long-standing CD Banks is very encouraging, CDFIs are still a relatively new concept. If the rate of CDFI failure turns out to be higher (or the level of dividends lower) than anticipated by the Fund or its regulator, the Fund itself could run into financial trouble. Debt financing for the Fund might also pressure CD Banks and CDFIs to earn (and dividend) a higher return to cover the Fund's interest payments and thereby reduce their ability to meet their community development banking mission. At the outset, it may be particularly difficult for the Fund to determine the right balance between fostering sufficient financial profitability to attract capital and meeting the extensive community development banking needs.

Because of these concerns, we recommend that the Fund examine the merits of leveraged borrowing based upon its actual experience with how CDFIs perform. The Fund should have the flexibility to seek authorization for such leverage down the road based on the real needs, risks, and potential of the Fund and the CDFI network.

OPTION 3: INCENTIVES TO MAINSTREAM BANKS

Another innovative proposal involves bank holding companies (BHCs) investing a small percentage of their equity capital in community development banking, in return for the opportunity to consolidate all of their bank operations on an interstate branching basis in states where they maintain a successful CD Bank subsidiary.

By way of illustration, BHCs could invest three quarters of 1% of their capital in setting up one or more community development bank (CDB) subsidiaries dedicated to lending in distressed communities. To qualify for the limited consolidation, the BHC would have to create a CDB subsidiary in its home state and another in each state in which it seeks consolidate all of its banking operations. Another quarter of a percent of equity capital would be invested with the Fund and retained on the BHC's books as an investment.

In exchange for these investments, each BHC would have the opportunity to apply for the right to consolidate all of its bank operations through interstate branching in any state where it maintains a successful CDB subsidiary -- if all of the components of the BHC meet their CRA and Fair Lending obligations. This opportunity would be available only in those states that permit intrastate branching and have interstate banking agreements. [Banks in Arkansas would not qualify for the proposal under present state law because it does not permit intrastate branching].[6]

Treasury recommends that the 50 largest BHC's be required to establish CD Bank subs and to invest in the Fund. Following the "three-quarters-of-1%" illustration described above, this would provide approximately $1 Billion in capital for CD Bank subs.[7] In addition, $300 million would be available at the outset to finance the network of CDFIs; depending on the number, size and quality of the applications from CDFIs and the ability of the Fund to attract additional private investment, the Fund might not need any additional federal appropriations. The proposal could, however, be made voluntary for these BHCs as well as for the other banks and thrifts, although the extent of participation would then be less certain.

This proposal is based on the premise that distressed communities will never attract the financial resources they need until mainstream banks become full partners in community development banking. It is designed to make use of the mainstream banks' considerable expertise and capital to generate a substantial number of CD Banks in a hurry. At an average capitalization of $5 to $10 million per CD Bank, a network of well over 100 subsidiary CDBs might be established at the outset of the program, with the potential capacity to make over $10 billion in community development loans. By contrast, direct appropriation funds would support only 8 to 10 CD Banks in the first year. As the founder of one CD Bank told us, the only practical way to make a major, visible impact in community development banking in the first few years is to get the mainstream banks effectively involved and committed.

Why so great a diff.?

Under this proposal, banks -- not taxpayers -- would bear the primary risks and put up the bulk of capital. The BHCs would also have a major stake in making sure that both the Fund and their CD Bank subs are self-sustaining and successful. Many major banks would probably support the idea because it represents an opportunity to consolidate existing interstate banking operations. McKinsey estimates that multi-state BHCs which currently

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[6] Currently, only four states prohibit statewide branching (AK, IL, IA, MN) and two states prohibit interstate banking (HI and MT). These six states would not be directly affected by this Option, but would be able to stimulate their own CDFIs to apply for matching capitalization from the Fund, whose own capacity to finance independent CDFI's could be increased substantially by investments from the BHCs.

[7] The headquarters of the 50 largest BHCs are located in 22 different states. Approximately 40 now have bank subsidiaries operating separately in other states. For BHCs that do not have such local banking operations in more than one state, flexibility in the mission of its newly established CD Bank sub could be encouraged. For example, a BHC that specializes in certain niches (e.g., merchant banking or wholesaling) could establish a CD Bank sub with a similar specialty to serve CDFIs across the country.

operate interstate could save $400–$800 million a year from full interstate consolidation of all of their operations; savings from the limited consolidation provided here would be less. With technical assistance from the successful CDFIs and Community Development Intermediaries which have experience on the ground, CD Bank subs could begin to make the essential connections to the communities that need to be served by real character loans.

C. Political Analysis

Securing passage of any type of CDFI legislation this year will be difficult because of the short time available. Legislation to create a network of CDFIs on a large scale has never been proposed in Congress; Senator Reigle introduced a pilot program last year. But because this proposal was a major part of your campaign platform, Members seem willing to move on your legislative proposal this spring.

The three options described above are not mutually exclusive. You could offer a plan that encompasses any or all three proposals.

Direct Appropriation (Option 1) is the least controversial, and stands the greatest chance of passage this year -- assuring that some CD Banks would be up and running in the next few years. In fact, after four years of S&L bailout legislation and bad news for the Banking Committees, members of Congress are anxious for a victory of any kind. But Option 1 also provides the least leverage of any option. Even with a stronger CRA and easier access to the FHLB, the effects of this proposal would be limited.

Leveraged Capital (Option 2) could raise a significant amount of additional capital for the CDFI network without opening the controversial issue of bank reform. But it could raise the specter of an increased federal liability for untried and inherently risky institutions, and concern over another S&L bailout. It might be more prudent to phase in such leveraging over time, based on how CD Banks perform over the next few years.

Mainstream CD Banking (Option 3) could potentially raise the greatest amount of capital for the network, and private capital at that, plus create a network of CD Bank subs of BHCs. Getting the proposal through Congress, however, will be difficult. First, it could become a vehicle for those who want more ambitious banking reform, which would engender strong opposition from smaller banks and thrifts and other segments of the financial service industry. Every President since Jimmy Carter has supported some form of interstate branching reform, yet Congress has been unable to reach a consensus amid the special-interest fervor. Second, some community groups may strongly object that mainstream banks don't have the ties or expertise to succeed at the grass-roots level in community development banking. Finally, even if such a limited consolidation is enacted this year, some argue that Congress might not have the political will to consider comprehensive reform of the banking and financial services industry that you may wish to propose next year; however, others argue that successful passage of this option would set the stage for success with major financial reform legislation in the coming years. In any event, Option 3 will require a major political commitment on your part.

D. Legislative Strategy

We see at least three possible legislative strategies:

1. Go All Out -- Put considerable political weight behind Mainstream CD Banking and persuade Congress to pass this proposal.

2. Test The Waters -- In advance of submitting any bill, consult the leadership of the banking committees (and John Dingell, who killed interstate branching legislation in 1991) to gauge the likely reaction. If the reaction is not hostile, we could begin building a coalition to support the proposal. Treasury strongly recommends this approach.

3. Two-Stage Process -- Submit the Direct Appropriation option to Congress, but lay the groundwork for comprehensive bank reform in 1994 that would infuse additional capital into the Fund and involve mainstream financial institutions in CD Banking.

IV. DECISION

A. CRA Options

____ Comprehensive Reform Of CRA Examination Protocols to focus on Performance
____ Approve only process improvements to CRA
____ Reject options, discuss further

B. CDFI Funding Options:

____ Option 1 -- Direct Appropriation of CDFI Fund Only
____ Supplement with authority to request leveraged capital based upon experience
____ Supplement with BHC Contributions
  ___ Mandatory Contributions
  ___ Voluntary Contributions
____Reject all options, discuss further

C. Legislative Options

____Go All Out
____Test The Waters
____Two-Stage Process

The members of the NEC-DPC Working Group on Community Development Banking include:

Agriculture
Robert Nash

Commerce
Larry Parks

HUD
Bruce Katz
Mark Gordon
Claire Doyle

Treasury
Frank Newman
Brian Mathis
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Chris Edley
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