

Economic Freedom Zones

By Senator Rand Paul

Twenty-five counties in Kentucky, most of Detroit, and many of America's large cities suffer from chronically high unemployment. Government stimulus packages haven't worked because they insist on picking winners and losers.

I propose a stimulus that simply leaves more money in the hands of those who've earned it.

Economic Freedom zones - areas of reduced taxes - are different than a government stimulus. Economic Freedom Zones encourage businesses and individuals which the market has already selected. Only one out of ten small businesses succeed. Consumers vote every day on which businesses succeed. Reducing taxes in economically depressed areas is a stimulus that will work because the money is returned to businesses and individuals who have already proven that they can succeed.

Economic Freedom zones are a bold variant of the enterprise zones first promoted by Congressman Jack Kemp. Kemp's words still ring true,

"By giving people access to capital and allowing them to take ownership of assets, entrepreneurship will be encouraged and the cycle of poverty can begin to be broken. All persons should have the opportunity to go as high as their merit and determination can carry them..."

According to the Bureau of Labor Statistics, the U.S. unemployment rate has remained above seven percent for more than 57 months, and the underemployment rate – including those who gave up looking for employment altogether – is as high as 19 percent in Nevada and above 15 percent in eight other states.

Many regions and cities across America need much more than government welfare checks. They need the exact opposite: relief from government policies and the opportunity to escape poverty. Detroit, despite having received a large increase in federal assistance, remains economically depressed and bankrupt today. It was once the leading American city for manufacturing, home to nearly 300 thousand manufacturing workers in 1950, whereas today, fewer than 30 thousand of these workers remain. 60 percent of Detroit's children live in poverty, and nearly 47 percent of the city is illiterate. High taxes, burdensome regulation, and a rigid federal structure of educational mandates have prevented creative, innovative and free enterprise solutions that are desperately needed.¹

Similarly, the entire eastern Kentucky region has more than 25 counties with unemployment rates above 10 percent, and nearly the whole of eastern Kentucky is well above the national average. High tax rates, EPA regulations, and the war on coal are to blame for decimating the region.

This is why I'm renewing the spirit of Jack Kemp's Enterprise Zones and introducing a new plan for the 21st century that provides depressed or bankrupt areas with new opportunities. These "Economic Freedom Zones" allow blighted and bankrupt areas to remove the shackles of big government by reducing taxes, regulations, and burdensome union work requirements. These zones give parents and students the flexibility to find better schools, allow talented immigrants to pursue entrepreneurial and job-creating endeavors, and will provide additional incentives for philanthropy to help those in need.

The Plan: Economic Freedom Zones

Eligibility:

Eligible areas of the country, whether a city, county, or even zip code, may have the opportunity to utilize the provisions of this plan for a period of 10 years, starting from the date of eligibility.

1. Any city, county, or municipality that has officially entered Chapter 9 bankruptcy proceedings,
2. Any city, county, or municipality that is “at risk” of bankruptcy or financial insolvency,
3. Any city, county, or municipality that meets an economic threshold of 1.5 times the national unemployment rate, or:
 - a. At least 30 percent of the residents have incomes below the national poverty level; or
 - b. 70 percent of the residents have incomes below 80 percent of the median income of the local government.
4. Any city, county, or municipality located in a state deemed “high poverty” and that meets an economic threshold of 1.25 times the national unemployment rate, or:
 - a. At least 25 percent of the residents have incomes below the national poverty level; or
 - b. 65 percent of the residents have incomes below 80 percent of the median income of the local government.

Economic Freedom Zone Opportunities –

Promoting Job Creation by Reducing Taxes

- a. *Reduce the Individual Income tax to a single, flat rate of 5 percent.* The individual income tax rate not only taxes individual wage earners, but also taxes small businesses. More than 75 percent of small businesses are organized as pass-through entities (businesses which pass along income directly to the individual, thus get taxed at the individual income tax rates). According to the Tax Foundation, small businesses organized as sole proprietorships in states like Kentucky and Michigan have a top marginal tax rate above 45 percent; in California as high as 52 percentⁱⁱ. A lower tax rate provided to Economic Freedom Zone areas will significantly encourage business expansion.
- b. *Reduce the Corporate Income tax to a single, flat rate of 5 percent.* The U.S. corporate income tax rate is among the highest in the world. Countries like Spain, the United Kingdom, and Switzerland have tax rates at 30 percent or less – and one of our largest international competitors, China, has a corporate tax rate of just 25 percentⁱⁱⁱ. Even our closest neighbor, Canada, is outcompeting us with a tax rate of only 15 percent^{iv}. We need to allow U.S. business to better compete internationally, and reducing the corporate rate from the current 35 percent to a low rate of five percent for businesses in economically depressed areas will allow those businesses to expand and compete globally.
- c. *Reduce the payroll tax by 2 percent for the employer, and 2 percent for the employee.* There is an oft-cited document by the Congressional Joint Committee on Taxation highlighting the statistic that 47 percent of all U.S. households pay no federal income tax. This fact is true, but is not the entire story. All workers still pay the federal payroll tax – and for many of these households, it is their largest tax liability. In order to encourage employers to hire more employees in blighted areas we should

allow the employer to reduce the amount of payroll tax they pay per employee. In addition, allowing low-to-middle- income families to keep more of their hard earned money will help increase their standard-of-living.

- d. *Double the amount of 100 percent expensing through Section 179 expensing.* Section 179 of the tax code allows businesses to deduct 100 percent of the purchase price for qualifying equipment and other goods. Currently, Section 179 places a limit on the amount that can be fully expensed in the first year. Economic Freedom Zones would double the amount available in 2013. This will allow all small and medium-sized businesses to fully deduct most investments in the first year of purchase. Such provisions will incentivize businesses to increase investment in equipment and machinery that will increase productivity of the area.
- e. *Suspend the capital gains tax.* This proposal allows any individual that owns stock or tangible assets that are located within the areas deemed “Economic Freedom Zones” to reduce their long-term capital gains tax rate to zero. This will reduce capital costs and encourage greater investment in business and real estate in these areas.

Educational Enhancements to Improve Local Opportunities and Workforce

- a. *Provide states with Title I portability for Economic Freedom Zone areas.* Currently, states are allocated educational funding from the Department of Education under Title I. Each state is required to allocate this funding to public schools in order to meet specific national education standards. Under the Economic Freedom Zone areas, we allow Title I funds to be portable. Portability divides the Title I funding up between the areas student, and allows that money to “travel” with the student. The school the student decides to attend would receive the Title I funding – eligible to any school, both public and private. This option will give students and families better educational options, allowing for improved standards.
- b. *Educational Tax Credit to Parents and Guardians.* Many families face the dilemma of sending their child to a subpar public school or paying out-of-pocket costs to send their child to a better private school. This option would allow any individual, including distant family members, relatives, and friends, to deduct up to \$5,000 per child any costs associated with the education of an eligible student. This provides families with more options, and incentivizes any individual who wants to help send a student to a good school.
- c. *Special Economic Freedom Zone Visa.* One of the primary reasons businesses may not be inclined to locate in the areas deemed eligible for the Economic Freedom Zone status is the lack of a local, skilled workforce to fill job openings. At the discretion of the Governor of each state and the local communities, this plan would allow skilled and entrepreneurial immigrants to gain regional, Economic Freedom Zone jurisdiction-only, visa status if they comply with the following:
 - *Entrepreneurial investment.* Qualified immigrant invests capital in the amount of \$50,000 and creates and sustains no fewer than 5 full-time U.S. citizen employees in Economic Freedom Zone area; and/or
 - *Abandoned property investment opportunities.* Qualified immigrant invests in the purchase of a property deemed dilapidated or abandoned, and invests a minimum of \$25,000 to rebuild, rehabilitate, or repurpose the property located in an Economic Freedom Zone area; and/or

- *Educational performance needs.* Qualified immigrant has a specialty degree or a bachelor's degree or higher that is in demand from businesses within the Economic Freedom Zone. The requirements would be similar to those required of the H-1B visa.

(The visa opportunity will be treated like other visa programs, and recipients may apply for citizenship as is provided under current law)

Reducing the Regulatory Burden on Cities

- a. *Suspend EPA non-attainment designations in areas eligible for EFZ status.* The EPA assigns “non-attainment” designations to counties that don’t meet certain pollution control requirements under the Clean Air Act. Non-attainment status *severely* limits economic growth opportunities and state sovereignty due to the following:
 - *Loss of Federal Highway and Transit Funding.* One year from the date of a non-attainment designation, federally funded highway and transit projects will not be allowed to proceed unless the state demonstrates there will be no increase in emissions associated with the projects.
 - *Boutique Fuels.* Non-attainment areas are subjected to the Clean Air Act's reformulated gasoline program, which significantly raises the price of motor vehicle fuels for consumers.
 - *Enhanced Regulatory Oversight.* Once an area is designated as being in non-attainment, EPA has the authority to intervene and revise permitting decisions throughout the state.
 - *Restrictive Permitting Requirements.* New and upgraded facilities in, or near, non-attainment areas are required to install the most effective emissions reduction controls without consideration of cost. Operators of existing facilities may also be required to install more restrictive control technologies than are otherwise required for similar units in areas that are in attainment.
 - *Mandatory Emissions Offsetting.* Prior to permitting the construction of new facilities, a state must offset any emissions increases by achieving reductions at existing facilities.
 - *Loss of Economic Development Opportunities.* The added regulatory and paperwork burdens, as well as expenses associated with constructing new facilities, or expanding existing ones, limit the amount of economic investment in non-attainment communities.

(All of these restrictions will be suspended in an Economic Freedom Zone)

- b. *Provide municipalities the option to waive certain land use restrictions resulting from federal land designations.* In times of prosperity, states and communities petition for certain areas to be designated as Wilderness Areas, National Heritage Sites, or Wild & Scenic Rivers. These designations put commercially valuable tracts of land under federal control, and impose severe land use restrictions – in most cases, limiting economic development completely, and human activity significantly. During an economic crisis, the community should have the option to waive these restrictions, and make these lands available for economic development, including resource extraction, recreation, and tourism.
- c. *Exempt municipalities from the Municipal Separate Storm Sewer Systems (MS4) requirements.* MS4 mandates were imposed on local communities by the EPA in 1990, and require municipalities to control “point source” water pollution – in this case, from

storm drainage. The mandate requires a complicated process of permit applications and compliance with a federal determination of pollutant loads, which defines how much pollution is allowed in a single water-body. In some cases, revenue must be raised to assist communities in implementing federal requirements – dubbed by some counties as a “rain tax.” While the cost of compliance varies per community, it can easily run into the millions. A recent set of these regulations handed down to Carroll County, Maryland, will cost the municipalities \$16.4 million^v. This is one of the most expensive federal regulatory mandates imposed on local communities.

- d. *Streamline the National Environmental Policy Act (NEPA)*. Construction for new roads and bridge projects in various states requires a sundry assortment of permits, licenses and approvals from the federal government. The most onerous of them are governed by NEPA. There is no set timeline for NEPA decisions, so lawsuits and bureaucratic agendas delay the approval of NEPA reviews by an average of 4.4 years^{vi}. Setting a deadline for NEPA reviews will help expedite construction projects all over the country

Encouraging Community Assistance and Rebuilding

- a. *Suspend expensive Davis-Bacon prevailing wage work requirements*. According to the Chamber of Commerce, the Davis-Bacon prevailing wage law inflates federal construction projects and costs by 15 percent or more^{vii}. Cities that are economically depressed, in bankruptcy, or fiscally insolvent often experience deteriorating infrastructure. Every dollar that must be allocated to higher-than-normal union wages could be invested in improving the local infrastructure.
- b. *Economic Freedom Zone charitable tax credit*. Americans are a generous and giving people. Last year, some statistics put the total U.S. philanthropic giving as high as \$315 billion^{viii}. However, the opportunity to deduct such donations is left to those who itemize their deductions, which is roughly only a quarter of U.S. taxpayers. Therefore, only a small number of individuals take advantage of the charitable deduction. The charitable tax credit offered in this plan would allow all Americans to reduce their tax liability by the amount they donate to any educational institution, religious organization, or homeless shelter that is located within Economic Freedom Zone areas. In general, donations to these areas would only be counted once – as either a charitable tax credit or deduction – but not both.

End the Federal Government Bailouts –

The plan will prohibit the use of taxpayer dollars to bailout any state or local government. In 2008, the government wrote a \$700 billion taxpayer-funded check to irresponsible Wall Street entities, under the narrative that it was necessary to avoid a major recession. However, Wall Street lived beyond its means, acted recklessly, and embraced the moral hazard mentality that the federal government would bailout their irresponsible actions.

The government shouldn't have bailed out Wall Street and shouldn't bail out irresponsible states or local bureaucrats either. Providing a blank check only encourages the behaviors of the past, which ripened the problems of the present. The country can't afford any more bailouts – just as we cannot afford to stymie the power of free enterprise and capitalism.

State and Local Policy Recommendations -

- a. *Pension Reform*. State and local governments should reform any fiscal shortfall in pension funding based on market value of liabilities accounting methods utilized by the

- private sector. Pension funds deemed insolvent or underfunded should be restructured or renegotiated.
- *Defined benefit pension plans.* States can significantly reduce their future pension problems, including alleviating skewed accounting problems, by moving to a defined contribution pension system.
- b. *Taxes.* State and local governments should reduce jurisdictional tax rates below that of the national average in order to help facilitate capital investment and economic growth to work in tandem with the provisions of this act.
 - c. *Education.* State and local governments should begin to adopt school choice options to provide children and parents with more educational choices, including expanding charter schools.
 - d. *Regulations.* State and local governments should streamline the regulatory burden on families and businesses. One example would be streamlining the opportunity for occupational licenses.
 - e. *Abandoned properties.* The following should be considered to clean up and remove dilapidated and abandoned properties:
 - In the case of foreclosures, tax notifications should be sent to both the lien holder (if different than the homeowner) and the homeowner;
 - Where state constitutions permit, provide property tax abatement or credits for individuals who purchase or invest in abandoned or dilapidated properties;
 - Allow or encourage non-profit or charity demolition entities to help remove abandoned properties;
 - Government or municipality fees and penalties associated with late or delinquent tax payments should be limited, and be proportional to the outstanding tax amount;
 - The sale of tax liens to third parties should be reviewed, and where available, should prohibit the selling of tax liens below a certain threshold (e.g. a prohibition of selling tax liens below \$1,000).

ⁱ Michael Snyder of the Economic Collapse Blog, www.zerohedge.com, *25 Facts About the Fall of*

ⁱⁱ Kyle Pomerleau, "Individual Tax Rates Impact Business Activity Due to High Number of Pass-Throughs," Tax Foundation, September 3, 2013 (available at <http://taxfoundation.org/article/individual-tax-rates-impact-business-activity-due-high-number-pass-throughs>)

ⁱⁱⁱ Kyle Pomerleau, Another Study Confirms: U.S. Has One of the Highest Effective Corporate Tax Rates in the World, Tax Foundation, May 31, 2013.

^{iv} PricewaterCooper. Assessing tax 2013 tax rate benchmarking study for industrial products and automotive sectors. May 2013

^v Christian Alexandersen, "Environmental regulations bring stormwater costs to town, county," Carroll County Times (August 4, 2013) (Available at http://www.carrollcountytimes.com/news/local/environmental-regulations-bring-stormwater-costs-to-towns-county/article_8b56dfe2-648b-5251-bf95-ea53338c8a8d.html)

^{vi} Press Release, Federal Highway Administration, "Evaluating the Performance of Environmental Streamlining: Development of a NEPA baseline for Measuring Continuous Performance (Date not available) (Available at <http://www.environment.fhwa.dot.gov/strmlng/baseline/section2.asp>)

^{vii} Chamber of Commerce, The Davis-Bacon Act background, (available at www.uschamber.com/issues/labor/davis-bacon-act)

^{viii} Robert Frank, "Charitable Giving Hits \$316 billion in 2012," CNBC News, June 20, 2013. (Available at www.cnbc.com/id/10831257)