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How Would Rural Areas Fare Under Block Grants?

Current proposals would convert many domestic assistance programs into Federal block grants to be administered by State governments. Block grants give States broad discretion on how Federal funds are spent. In theory, this can lead to program improvements, reduced administration costs, and lower Federal deficits. Research on past block grants, however, indicates that block grants have had mixed success in achieving these goals. Block grants can also create inefficiencies and overlook national objectives, such as assisting poor communities. Whether or not block grants are adopted, rural communities will fare better if aid formulas and delivery systems account for rural-urban differences.

Congress is considering measures to consolidate hundreds of domestic assistance programs and give these funds to the States as block grants, which allow States to have broad discretion over which communities receive assistance and how the funds are spent. The Clinton Administration has also proposed program consolidation, including the Department of Agriculture's rural development programs, but it generally favors retaining Federal control.

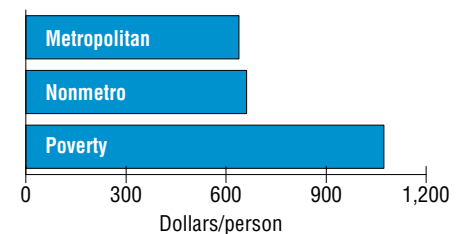
The first block grant program was created in 1966. As of 1995, there were 15 block grants, accounting for 11 percent of total Federal grants. If current proposals involving housing, education, training, infrastructure, health, welfare, and community and economic development were to be enacted, that percentage would increase dramatically. Many rural development programs could be absorbed by these block grants.

Federal rural development programs were designed to meet the specific needs of rural areas, such as challenges in delivering services to isolated communities and the need for technical assistance for rural communities that lack grant-writing expertise and other planning resources. Many other Federal programs have rural "set-asides" (funds for which only rural areas are eligible) so that rural areas do not have to compete against better-staffed urban areas to receive aid. Rural development programs target aid to poor communities because low incomes and inade-

quate tax bases severely limit rural development. In total, persistently poor rural areas receive over \$1,000 per person from Federal grants and have a large stake in how these programs are administered (fig. 1).

Arguments abound both for and against State-administered block grants. Supporters claim that block grants will: (1) move government decisionmaking "closer to the people" and, hence, enable a more efficient allocation of scarce Federal resources; (2) provide more spending flexibility, allowing States to target aid better to meet community needs; and (3) cut Federal costs and reduce the Federal deficit. Opponents claim that block grants: (1) may not necessarily result in greater efficiency; (2) may lead to less targeting to national objectives; and (3) may lead to State spending cuts during recessions, which could worsen the recession and add to the deficit. Research helps assess the validity of these claims.

Figure 1
Federal grants by type of county, FY94
Rural poverty counties disproportionately benefit from current Federal grants.



Note: Poverty counties are nonmetro counties with persistent poverty.
Source: Economic Research Service, based on data from U.S. Department of Commerce, Bureau of the Census.

Is Government Closer to the People More Efficient?

Block grant proponents suggest that shifting program administration to the States will increase program efficiency. Advocates argue that State officials are more familiar with local conditions than are Federal officials, and that State officials will spend less money on activities that do not address local needs, leading to improved program performance and cost efficiency.

Block grant opponents note that, while physically closer to the people they serve, State administrators still must conform to political and legal obligations that can prevent them from effectively responding to local needs. For example, where State governments are dominated by urban political interests, rural needs may be neglected. Even when State and local interests coincide, State-level decisionmaking can result in an inefficient allocation of resources because the economy extends beyond State borders. For example, State and local competition for industry can lead to costly subsidies designed to attract businesses into one State (or locality) from another State (or locality). Other examples of inefficient State behavior involve “negative externalities,” such as pollution and congestion which are often associated with development, whose effects on out-of-State residents are often ignored by in-State decisionmakers.

The Answer Seems To Be Yes... and No. A study of the Small Cities Community Development Block Grant (CDBG) program found that the program’s business credit assistance during the 1982-86 period succeeded in creating jobs at a relatively low cost, less than \$4,000 per job in nonmetro areas (Sidor, 1991). This program also provided assistance tailored to rural needs, including aid for new business startups and small business retention and expansion. However, 15 percent of the funding went to interstate or intrastate relo-

cation projects, and another 9 percent went to new branch plants which often are involved in interstate competition (fig. 2). A 1995 study by the Department of Housing and Urban Development found similar shares of funding in these categories. Thus, up to a quarter of the funding from this program might be viewed as being potentially inefficient in allocating aid to help one State or locality at the expense of another. Regulations prohibiting assistance to interstate relocations, such as in the Empowerment Zone/Enterprise Community program, could reduce such inefficiencies, but they would also reduce the flexibility associated with block grants.

Regional planning organizations and processes can also address these interstate coordination problems. Some block grants already incorporate such regional approaches for metropolitan areas. For example, metropolitan areas decide how to spend their CDBG and Surface Transportation block grant funds, but States determine how these funds are spent in nonmetropolitan areas. Regulatory changes could establish regional planning for nonmetropolitan areas in these programs at the expense of some State flexibility and added administrative costs.

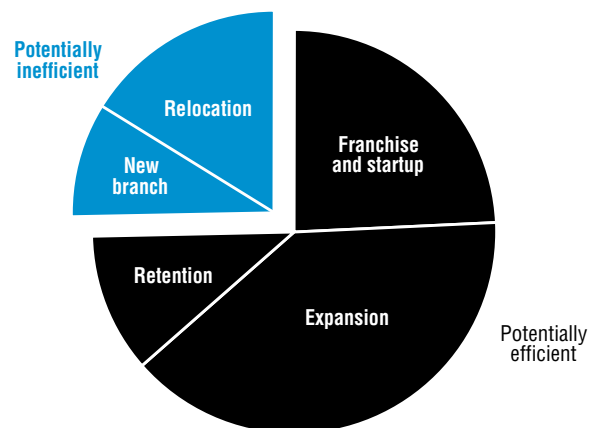
Is Greater State Flexibility Better?

One of the selling points of block grants is that they provide greater flexibility in the use of funds by consolidating programs and loosening restrictive regulations. Other grants tend to be narrowly focused on specific categories of uses and recipients and may become obsolete due to changing conditions or reduced perception of a national need for the program. Block grants allow States to retarget funds from other programs, within limits, to assist organizations or places believed to be more deserving of assistance and assist them in a more effective manner.

Block grants allow States more flexibility to respond to changing needs over time. For example, a State might be able to shift funding from capital assistance (such as housing loans) to operational assistance (such as aid for the homeless) during a recession. Different States may also use their funds in different ways depending on the nature of their problems. Block grant advocates expect States will respond to their greater flexibility by developing innovative new approaches.

Figure 2

Small Cities Program funding, by type of credit assistance project, 1982-86
State block grants subsidized business relocations and other potentially inefficient activities.



Note: The Small Cities Community Development Block Grant Program provides community development assistance to rural areas.
 Source: Economic Research Service based on Sidor (1991).

Perhaps more important to rural areas is the expectation that it will be easier and less expensive for rural communities to apply for assistance with block grants because consolidation and deregulation should simplify the process. This could allow more and different rural communities to participate in programs.

Opponents of block grants contend that block grants' greater flexibility leads to less targeting to national objectives in block grants than in the programs they replace. Most Federal programs originate from the perception of a national need or objective, such as the desire to save the family farm or to fight poverty. National objectives are incorporated into program legislation and regulations to target aid to address these objectives. Though block grants usually retain or slightly modify the national objectives of these programs, States have the flexibility to retarget this assistance, which may reduce the extent to which rural and high-poverty places benefit.

Another concern is that increased State flexibility may come at the expense of decreased Federal flexibility. State-administered block grants often have fixed State allocation formulas that prevent, without legislation, the shifting of funds from one State to another to respond to emerging regional problems.

Block grant opponents also note that much of the flexibility associated with block grants can be achieved without transferring program administration to the States. For example, as part of the 1996 Farm Bill, the new Rural Community Advancement Program (RCAP) will consolidate many rural development programs into several large Federal Government-administered programs. This will give USDA more flexibility in fund use and provide easier access for local program recipients. RCAP will also involve State and local input in the strategic planning process and provide standards and incentives to encourage innovation and improve program performance.

The Answer Seems To Be Yes... and No. The 1995 General Accounting Office (GAO) report on block grants created by the Omnibus Budget Reconciliation Act (OBRA) of 1981 found OBRA provided more flexibility, allowing States to shift funding to different uses. But State flexibility declined over time as congressional concerns about failure to achieve national objectives increased, resulting in new funding constraints, such as set-asides and cost ceilings for specific categories.

Sidor's study found that when States took over the the Small Cities program, they spread the business credit assistance around more than before. This may be viewed as a positive achievement because, unlike large urban areas that automatically receive CDBG funds through entitlements, relatively few rural communities benefit from community development grants. However, in spreading around the funds, States may have neglected one of the main national objectives of the program: to assist low- to moderate-income people, because rural counties receiving CDBG credit assistance actually had higher per capita incomes, on average, than did rural counties in general. In other words, these projects tend to benefit poor people but often do not benefit poor communities.

Some earlier studies of OBRA block grants found that States made use of their increased flexibility to retarget aid, resulting in less targeting to the needy. States sometimes assisted local governments rather than non-governmental, community-based organizations, which were the intended beneficiaries in some of the programs being replaced by block grants. Regulations to assure that the needy were served were often ignored by States after the funds were given to localities, and underserved constituents were often missing or under-represented on boards overseeing how funds were used locally.

Will Block Grants Reduce Costs and Cut the Deficit?

Proponents believe that block grants significantly reduce administrative costs and, therefore, States will need less funding to administer the programs. These reduced administrative costs should allow the Federal Government to cut funding levels without harming aid recipients. If the cuts exceed the cost efficiencies, States may make up the difference with their own funds.

Opponents of block grants argue that States and grant beneficiaries will bear the burden of block grant funding cuts because of the lack of significant administrative cost savings. If Federal spending on these programs declines, States will have to either cut their spending or increase taxes to maintain spending levels. Either approach could slow the economy and reduce Federal revenue receipts, thereby increasing the Federal deficit.

The Answer Again Seems To Be Yes... and No. GAO's study of the OBRA programs found some evidence of State administrative cost savings, but States also took on new responsibilities, making it impossible to measure the net change in administrative costs. Carryover funds from previous years eased the transition to block grants. However, Nathan and Doolittle (1987) found that many States had to use their own revenues to make up for Federal aid cuts, and few States fully compensated for Federal aid cuts. Poor States with limited capacity to raise funds were least likely to offset Federal aid cuts.

GAO's study noted that some programs currently considered for block grants differ fundamentally from those previously incorporated into block grants. For example, Medicaid and welfare are large programs that involve cash payments and matching grants. During a recession, States might have difficulty maintaining these programs. Without additional Federal assistance, significant benefit cutbacks could occur,

worsening the recession and adding to the Federal deficit.

Conclusions

Block grants have been proposed to improve program performance and reduce costs, allowing the Federal Government to cut the deficit without sacrificing benefits to intended grant recipients. Research on past block grants indicates that block grants have had mixed success in achieving these goals.

States have achieved some efficiency gains through block grants, but State-administered programs do not always result in the most efficient allocation of resources, such as when States and localities compete to attract businesses. States have used block grants to spread development funds around to benefit more rural communities. While most local officials welcome this change, it has resulted in less targeting to the intended beneficiaries, such as poor people and communities, and has caused Congress to impose new restrictions on block grant programs.

Rural areas probably have benefited from the consolidation of programs and reductions in regulations associated with block grants, enabling them to apply for aid more easily. However, unlike urban areas, rural areas have not generally benefited from regional planning with block grants.

It is difficult to predict what might happen in the future, because block grants can be designed differently

than in the past and may be applied in new program areas. However, if future block grants come with significant Federal aid reductions to reduce the Federal deficit, many States, and in particular poor States with limited tax bases, would have difficulty maintaining benefit levels, especially during recessions. These difficulties might be greatest if large programs, such as Medicaid and welfare, are converted into block grants. If States are forced to reduce benefits for these programs during recessions, the recessions could worsen and the Federal deficit increase.

Several additional points may be noted about any major reform of Federal grants for rural areas, whether or not block grants are employed. First, rural communities are at a disadvantage when they must compete with urban communities for grants because most rural communities lack grant-writing expertise and other planning resources. Rural set-asides can remedy this problem by guaranteeing that some funds will go to eligible rural areas. Second, rural communities often have different kinds of problems than urban communities, and these differences need to be considered when aid formulas and delivery systems are created. Third, persistently poor communities may require particular attention because they often fail even to qualify for subsidized loans since they cannot afford to repay the principal. Finally, to help assure that aid is well spent, many rural communities need additional planning and technical assistance.

Contacting the Author

Richard J. Reeder
(202) 219-0551 (voice)
(202) 219-0908 (fax)
e-mail: RREEDER@ECON.AG.GOV

Further Readings

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Sidor, John. "How the State Community Development Block Grant Program Assists Rural Economies," *Rural Development Perspectives*. Vol. 7, No. 2, Feb.-May 1991, pp. 15-20.

U.S. General Accounting Office (GAO). *Block Grants: Characteristics, Experience, and Lessons Learned*. GAO/HEHS-95-74, Feb. 1995.

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