
March 1997

RURAL DEVELOPMENT

New Approach to Empowering Communities Needs Refinement



**Resources, Community, and
Economic Development Division**

B-276194

March 31, 1997

The Honorable Richard G. Lugar
Chairman
The Honorable Tom Harkin
Ranking Minority Member
Committee on Agriculture,
Nutrition, and Forestry
United States Senate

The Empowerment Zone/Enterprise Community (EZ/EC) program was created by the Congress in 1993 to help distressed communities develop comprehensive approaches for dealing with their social and economic problems. The program is unique in its reliance upon the participating communities' own approaches and strategic plans for improvement. In addition, the program fosters partnerships between a variety of social service and economic resources, including those available through federal and state programs, private and nonprofit organizations, and others. Of the 227 rural communities nationwide that applied to the program, the Secretary of Agriculture, in December 1994, designated three rural areas as EZs and 30 as ECS, primarily on the basis of their strategic plans.¹ Over a 10-year period, both the EZs and the ECS will receive federal assistance through EZ/EC Social Services Block Grants (SSBG) and special tax incentives, technical assistance, and special consideration in many federal competitive grant and loan programs. Each of the EZs will receive \$40 million over the 10-year life of the program; each of the ECS will receive about \$3 million. Additionally, the businesses located in the EZs are eligible for more tax incentives than the businesses in the ECS. Several proposals have recently been introduced into the Congress to expand or revise the EZ/EC program.

This report responds to your request that we review selected aspects of the rural EZ/EC program. Specifically, you asked that we (1) estimate the federal funding levels of the rural EZ/EC program over the 10-year life of the program, (2) determine the status of the implementation of the program, (3) identify the difficulties that the communities have encountered in implementing their plans, and (4) examine the U.S. Department of Agriculture's (USDA) oversight of the program. We visited all 3 of the rural EZs and 5 of the 30 rural ECS. Additional information about the communities we visited is provided in appendix I.

¹This report focuses on rural areas. We reported on the status of urban EZs in Community Development: Status of Urban Empowerment Zones (GAO/RCED-97-21, Dec. 20, 1996).

Results in Brief

We estimate that federal funding for the rural EZ/EC program will total more than \$1 billion over the 10-year life of the program. This amount includes the \$208 million in EZ/EC funds from the Social Services Block Grant program and an estimated \$428 million from tax incentives. Estimates for direct funding from federal, state, and local programs as well as private sources are not generally available. However, one federal agency, USDA, reports that it plans to provide about \$246 million to the rural EZs and ECSs over the first 4 years alone and that its funding for the 10-year life of the program could reasonably be expected to reach \$600 million.

The status of the communities' implementation of the EZ/EC program varies. All 33 rural EZs and ECSs have established the basic organizational structures and procedures necessary to implement their strategic plans. In terms of implementing the projects contained in these plans (such as day care services, emergency 911 services, and job training), some communities have made considerable progress and some have made very little.

The rural EZs and ECSs have experienced a number of difficulties that have slowed their initial efforts, continue to impede their progress, or both. These difficulties include the short time frames provided for applying to the program and the initial misinformation provided by officials at USDA headquarters about the program's basic operations. While some of these difficulties have been or are in the process of being resolved, two issues continue to be of concern. These issues are (1) a lack of clarity about which federal regulations are applicable to the construction projects funded by EZ/EC Social Services Block Grants and (2) the conflict between the verbal guidance and the written guidance that the Department of Health and Human Services has provided to the states on their responsibilities for ensuring that funds are reasonably and prudently spent.

Under the EZ/EC program, USDA is responsible for overseeing the progress of the rural EZs and ECSs; the Department is to accomplish this oversight through reviews of the periodic reports submitted by the EZs and ECSs and by site visits conducted by USDA field personnel, known as EZ/EC state coordinators. However, USDA cannot adequately fulfill its oversight responsibilities because the EZs, the ECSs, and the EZ/EC state coordinators do not provide USDA with complete and systematic progress reports. Consequently, USDA lacks the basic management information for identifying problem areas.

Background

The Congress established the EZ/EC program in the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66, Aug. 10, 1993). Under the act, the communities that wanted to participate in the program had to (1) meet specific criteria for characteristics such as geographic size and poverty rate and (2) prepare a strategic plan for implementing the program. The act also specified that the Secretary of Agriculture could designate up to 3 rural EZs and 30 rural ECs on the basis of their strategic plans.

The act also amended title XX of the Social Security Act to authorize the use of the EZ/EC SSBG funds for the program and placed increased authority for funding decision-making with the local EZ/EC governance structures. Historically, the funds from the SSBG program that were allocated to the states could be used only for social service activities, such as programs to assist and feed children. However, under the EZ/EC program, the act expanded the permissible uses of the SSBG's funds by allowing their use for such activities as purchasing or improving land and facilities or for providing cash payments to individuals for medical care.

In addition to the EZ/EC SSBG funds, all of the designated communities are expected to receive several types of federal assistance. The businesses located in the EZs and the ECs are eligible for low-interest loans, resulting from the tax-exempt bonds issued by the state or local governmental unit, to be used to provide facilities and land for the businesses in the communities. In addition, the businesses located within EZs (1) are eligible to receive tax credits on the wages paid to the employees who live and work in the EZ and (2) may deduct higher levels of depreciation expenses. A number of federal departments and agencies also made a commitment to give all EZs and ECs special consideration in the competitions for funds from many other federal programs and to work cooperatively with them in overcoming regulatory impediments.

The federal assistance received by the EZs and ECs must be spent in accordance with the communities' strategic plans. These plans outline how the communities would achieve their goals, including ensuring the active participation of the members of the community, the local private and nonprofit entities, and the federal, state, and local governments. The EZs' and ECs' progress in achieving their goals is to be based on the performance benchmarks established by the communities, not on the amount of federal money spent. These benchmarks explain in some detail how the locality intends to achieve its goals. The benchmark document, which becomes a part of the overall plan, includes the specific projects that the EZ or EC will undertake and timelines showing when the projects

will be instituted or completed. The benchmark document, which generally looks ahead 2 years, requires continuous review and modifications to accommodate the changes in the community's needs as well as scheduling problems. These benchmark projects are to serve the EZs and ECs, as well as USDA, as an important management tool and provide the primary basis for evaluating the progress being made.

The Department of Health and Human Services (HHS), USDA, and the states play key roles in administering the program.² HHS makes grants to the states, and the designated state agency obligates the funds to the EZs and ECs as it receives, reviews, and approves requests from them to draw down funds for a particular benchmark project. In addition, the state must ensure that the requested expenditure is allowable under the state's standards. USDA, as the lead federal agency for the rural EZ/EC program, is responsible for helping the rural EZs and ECs achieve their goals by evaluating their progress and providing technical assistance.

Federal Funding for the Rural EZ/EC Program Is Likely to Total Over \$1 Billion

The federal funds invested in the rural EZ/EC program, including loans, grants, and forgone tax revenues, will far exceed the \$208 million in EZ/EC SSBG funds allocated to the program. In fact, we estimate that federal funds exceeding \$1 billion will be invested in the program over its 10-year life. This estimate includes the EZ/EC SSBG funds,³ plus an estimated \$428 million from tax incentives and about \$600 million from USDA's loan and grant programs. This \$1 billion estimate does not include the other significant sources of investments in the program that will be provided by other federal agencies. Estimates from these sources were not available. If the program is successful, some offsetting benefits, such as loan repayments, increased tax revenue, and reduced welfare costs, should occur in the communities.

Federal Tax Incentives Will Be About \$428 Million

The EZ/EC program has made three tax incentives available to the communities for economic development. The first two, available only to EZs, are (1) the Empowerment Zone Employment Credit, which provides qualified employers with a tax credit of up to \$3,000 for each employee who lives and works in the EZ, and (2) the Empowerment Zone Expensing

²In addition to HHS and USDA, at least 13 other agencies have agreed to support the program. The federal agencies involved in the program meet periodically through a Community Empowerment Board, chaired by the Vice President, to exchange information on the program's operations.

³By December 1996, the entire \$208 million was obligated by the participating states. As of that date, the 33 EZs and ECs had drawn down \$36 million of the \$208 million.

Allowance, which allows a qualified business to take a special depreciation deduction of up to \$20,000 (for an annual total of up to \$37,500) for equipment purchases each year. The third incentive, available to both the EZs and the ECs, is the Enterprise Zone Facility Bond, which provides up to \$3 million in tax-exempt bond financing to qualified businesses for buildings or equipment.

Using the data and assumptions from the Internal Revenue Service, we estimate that the cost of the EZ/EC tax incentives in rural areas will be about \$428 million over the 10-year period. The EZs' employment credit will account for \$406.5 million of that total; the facility bonds and the expensing allowances will make up the remainder at \$4.3 million and \$17.2 million, respectively.

Incomplete Information Is Available on the Extent of Preferential Treatment

USDA, HHS, and 13 other federal agencies have agreed to give special consideration to eligible EZ/EC applicants by giving them preferential treatment for funds from the agencies' existing funding sources over the life of the program. Most federal agencies had not estimated the amount of support they expect to invest in the rural EZs and ECs over the 10-year life of the program. USDA, however, indicated that it alone intends to provide about \$246 million to rural EZs and ECs over the first 4 years through existing funding sources such as its Rural Business Enterprise Grant program and the Water and Waste Disposal Loan and Grant programs. If this funding level is maintained over the 10-year life of the program, an assumption that USDA officials consider a reasonable expectation, USDA will provide about \$600 million to EZ/EC communities. USDA officials noted that these funds, as well as those from the other agencies that have pledged to provide special consideration to EZ/ECs, represent existing appropriations that would be expended—not new moneys.

In addition to the funds provided by federal agencies, the rural EZs and ECs are expected to obtain assistance from state, local, and private sources. Some EZs and ECs are using the EZ/EC SSBG funds as seed money to attract even larger amounts from nonfederal sources, such as foundations. USDA provided data showing that for the 3 EZs and 25 of the ECs, the communities were receiving more than one dollar from their state and local governments and from private and nonprofit organizations for every dollar of EZ/EC SSBG funds received. To the extent that the loans are repaid and that new jobs result in increased tax revenues and reduced welfare payments, the federal investment in the rural EZ/EC program will be offset.

EZs and ECs Vary in Their Progress Toward Implementing the Program

The 33 EZs and ECs have established the structures and procedures needed to implement their strategic plans. Nevertheless, the boards of directors for two of the ECs we visited were experiencing problems that could hinder their progress toward completing their benchmark projects. Overall, progress on these projects has varied widely.

Most EZs and ECs Have Created the Basic Foundation for Managing Development

According to USDA officials, all communities have taken the initial necessary actions to manage and begin implementing their strategic plans, such as establishing a board structure and basic operating principles. These actions had to be formally agreed upon by the community, the state, and USDA in a memorandum of agreement. In order to complete a memorandum of agreement, the communities had to, among other things, establish their benchmarks and develop a budget for the first 2 years of implementation; create the bylaws and/or articles of incorporation for the group, known as the lead entity, that will manage the EZ or EC program; and establish the EZ's or EC's board structure. In addition, USDA reviewed the documents prepared by the lead entities to ensure that they had a policy to prevent conflicts of interest and strategies for ensuring broad participation within the community.⁴

We visited all three EZs and found that they were generally well-organized to manage the implementation of their strategic plans. For example, while the geographical boundaries of all of the EZs cut across several local government boundaries, such as county lines, they had all developed mechanisms for overcoming the potential problems in having the EZ work with more than one political entity. One EZ that spanned parts of four counties created four subzone boards to overcome the political divisions inherent in its organization. These subzones consider the communities' proposals for implementing the benchmark projects that originate in their area. The proposals approved at the subzone level are then considered by the EZ's full board. As of June 1996, nearly 1 year after the memorandum of agreement, the EZ reported some progress toward 45 of the 49 projects serving the subzones. Some of these projects served several subzones, while others served only one.

Although the EZs appear to be well organized, two of the ECs that we visited were experiencing problems. For example, at one EC we visited, the board members were in such disagreement with the lead entity over the

⁴As of January 3, 1997, USDA was able to document that these actions had been completed for 23 out of the 33 communities. However, USDA could not locate the files for all of these actions for the remaining 10 ECs. As a result of our review, USDA officials told us that they will take steps to create a central filing system for the reports submitted by the EZs and ECs.

control of the EC funds that little business has been conducted, and the program has not been moving forward. At another EC, the state agency found that the board members were, among other things, submitting applications for projects that would benefit them financially.

EZs and ECs Vary in Implementing Their Benchmark Projects

USDA requires EZs and ECs to report periodically on the progress they are making toward implementing the benchmark projects. These projects include such things as constructing child care facilities, initiating job training programs, beginning 911 emergency response services, and improving wastewater systems. While USDA has not received complete progress reports from all communities, the progress made by those that have reported varied widely.

USDA had sufficient centralized information on 14 communities for us to determine whether (1) progress had been made toward implementing the benchmark projects scheduled to start before December 1996 and (2) the projects that were scheduled to be completed prior to December 1996 had in fact been completed.⁵ Progress, by these measures, varied widely among the 14 communities we examined. For example, one community reported that it had made at least some progress toward implementing all of the benchmark projects scheduled to start prior to December 1996 and that one project had been completed. On the other hand, two communities reported that either no progress had been made on projects or that they had not finished any of the projects scheduled for completion prior to December 1996. Overall, 8 of the 14 communities reported that they had not started or completed at least 50 percent of their benchmark projects on time.

Appendix I presents information on selected benchmark projects at the eight communities we visited.

⁵We found that 21 communities had at least partially reported on their progress as of January 1, 1997. We did not include 7 of the 21 communities in our analysis because they had reported on their progress for less than 60 percent of their projects or had met less than 60 percent of their planned start and end dates.

EZs and ECs Have Faced a Number of Difficulties in Implementing Their Plans

The rural EZs and ECs have experienced difficulties that have slowed their initial efforts, continue to impede their progress, or both. The difficulties were the short time frame allowed for applying to the program and the misinformation provided by officials at USDA headquarters about the program's basic operations. While these difficulties have been or are in the process of being resolved, two other issues continue to be of concern. These issues are a lack of clarity about which standards the communities should follow for construction projects when using EZ/EC SSBG funds and the disparity between HHS' verbal guidance and written guidance to the states on their responsibilities for releasing the EZ/EC SSBG funds to the communities for the EZ/EC program.

Short Time Frames Caused Organizational and Planning Concerns for Communities

Officials at each of the rural EZs and ECs we visited commented that the period for preparing an application for the EZ or EC designation was too short for the amount of work required. The communities applying for the program had 5-1/2 months after the President announced the program to submit an application. During that time, they had to achieve grass-roots involvement, gain consensus on the needs and vision of the community, elect a board of directors, produce a strategic plan, and prepare to begin operating. These tasks were particularly difficult to carry out in rural areas that often (1) did not have organized coalitions or the expertise available to articulate a vision and develop a complex strategic plan and (2) are spread out over a large geographical area, which makes putting together all parts of the application more difficult.

While the communities met their application deadlines, some officials believe that a longer period to organize would have allowed them to better galvanize the public's support and involvement and that, in some instances, they would have been better able to identify their needs and establish appropriate goals.

USDA and HHS officials acknowledged that the communities faced short time frames. Some USDA officials stated that the short time frames required that the rural communities act quickly both to generate local involvement and to create the vision and strategic plan required to meet the application deadline. They noted that the federal agencies involved faced organizational pressures as well. The EZ/EC program's timetable required the federal agencies to develop their coordination strategy, perform detailed planning, hire and train staff, and begin operating the program within the 16 months between the passage of the legislation and the designation of the EZs and the ECs.

HHS and USDA officials generally agreed that, should a second round of EZs and ECs be authorized, it may be beneficial to allow the communities a somewhat longer time to apply in order to facilitate broader public involvement and a fuller consideration of the vision and the steps needed to accomplish it. Furthermore, some officials said that, if a second round is authorized, the federal government may need to provide more guidance on how to prepare the application documents to ensure a somewhat greater uniformity than they had experienced in the current program.

**Early Misstatements by
USDA Officials
Contributed to
Implementation Problems**

At seven of the eight rural EZs and ECs we visited, officials noted that erroneous information, provided primarily by officials from USDA headquarters at meetings around the nation, caused misunderstandings about the operations of the EZ/EC program. At some of the meetings, the federal headquarters officials said that the EZs and ECs would receive the EZ/EC SSBG funds directly. Two of the EZs expected to receive the total amount of the EZ/EC SSBG funds—\$40 million—in two consecutive annual payments, while some ECs believed that they would receive their total payment of about \$2.9 million shortly after they were selected. In fact, as we discussed earlier, the communities are receiving their funding incrementally through the state agency as needed to pay for benchmark activities. Furthermore, some communities were told, incorrectly, that they did not have to get approval from any federal or state entity to use the funds for projects that were consistent with the strategic plan.

The incorrect information provided by USDA officials caused difficulties for several state agencies and rural communities. For example, one EC had to revise its plan when it learned how the funds were actually to be distributed. The community had planned to obtain the lump-sum payment, put it into an interest-bearing account, and use the interest, which would have been considerable, to fund some part of certain projects. Since no lump sum was made available, the EC revamped its plan to obtain alternative sources of funding for some of its projects.

**HHS Has Not Provided
Clear Guidance on the
Applicability of Federal
Standards**

Several of the EZs and ECs that we visited have encountered some difficulty in sorting out which federal standards apply to certain types of projects financed with EZ/EC SSBG funds. Those funds can be used for construction projects, such as water and sewer proposals, if the projects are related to one of the program's goals, such as providing training to disadvantaged youth. However, the act did not specify any standards for these new

allowable uses. As a result, the communities have been deciding for themselves which construction standards they will follow.

The communities have taken different approaches to address this difficulty. For example, officials at one EZ seeking to build a water system told us that they were unable to get guidance from HHS and decided to follow the environmental regulations that they considered most appropriate—those governing the use of the Department of Housing and Urban Development’s Community Development Block Grant program—for that project and for any other project that might involve environmental issues. Faced with a similar dilemma, another EZ took a different approach, deciding to follow the environmental regulations associated with the primary funding source for a given project.

Some rural EZ officials seeking clarification on this issue contacted HHS, which oversees the EZ/EC SSBG funds. According to these officials, HHS did not indicate what construction standards should be used. Consequently, the community officials have used their best judgment on how to proceed with specific projects and activities. Some EZ officials added that they are concerned that they may be legally liable if they choose to follow an incorrect standard and may have to replace such things as improperly sized water or sewer pipes, thereby incurring considerable costs and causing disruption.

HHS’ Verbal Instructions to the States on Administering EZ/EC SSBG Funds Appear to Conflict With HHS’ Regulations

According to the HHS regulations and the Terms and Conditions of the EZ/EC program, the financial standards that the states are to apply in administering the EZ/EC SSBG funds are the standards that they use for expending their own state funds. However, officials in three of the states we visited told us that HHS program officials had verbally appealed to them to be flexible in applying their standards.

This conflicting guidance has led to disagreements between some of the state agencies and the EZs and ECs over who has oversight responsibility. For example, when one EC requested a drawdown of funds for expenses that included liquor, the state agency disallowed payment for the liquor. The state agency argued that Office of Management and Budget Circular A-87, the standard adopted by the state, did not allow expenditures of federal funds for liquor. State agency officials told us that HHS verbally asked the state agency to be flexible and allow the expenditure and advised them not to worry about having to repay the expenditure at a later date. The state agency officials told us that they wanted to cooperate with

HHS in the EZ/EC program, but they also wanted the state to comply with its own regulations, including Circular A-87. The state ultimately disallowed the expenditure.

In another state, the EZ submitted 22 project proposals to the state agency for its review prior to a formal request to draw down funds. According to state agency officials, the proposals did not meet the state's fiscal standards in that most of the proposals had budgets that were inconsistent with reasonable and prudent business practices. These budgets reportedly included such items as salaries and fringe benefits that were above the industry's average. State officials told us that HHS had appealed to them on numerous occasions to be more flexible in their reviews of the EZ's proposals. As of February 3, 1997, the state had approved no funds for these 22 proposals.

USDA Cannot Adequately Oversee the Implementation of the EZ/EC Program

Under the EZ/EC program, USDA's Office of Community Development is responsible for overseeing the participating rural EZs and ECSs. It is to carry out its responsibilities through site visits by USDA state coordinators⁶ and USDA headquarters' reviews of the progress reports periodically submitted by the EZs and ECSs. However, USDA cannot adequately fulfill its oversight responsibilities because it has not received complete progress reports from all of the USDA state coordinators or the EZs and ECSs.

USDA's EZ/EC state coordinators do not provide systematic reporting on the progress of rural EZs and ECSs. Among other things, the state coordinators are responsible for reviewing all benchmark changes to ensure the communities' participation and conformance with the strategic plan. They are also involved with the initial approval of these changes. Most of these coordinators, who were chosen from the existing staff at the USDA state offices, have had little experience in overseeing the broad range of a community's economic and social development projects and have not received training in how to monitor and report on the communities' progress. USDA officials agreed that their EZ/EC state coordinators needed training but told us that funding constraints prevented them from developing and offering oversight training.

Oversight is further hampered because the EZs and ECSs are not consistently reporting their progress to USDA. USDA's regulations require the EZs and ECSs to report their progress at least annually. However, as noted earlier, the

⁶Although the state coordinators have the primary responsibility for site visits, USDA headquarters staff also perform site visits for community review and intervention purposes.

information provided is inadequate. Only 14 of the 33 communities had provided systematic information on their progress as of January 1, 1997.

Conclusions

As a new approach to providing development assistance to rural areas, the EZ/EC program has faced a number of problems, several of which were associated with the program's start-up and are no longer of immediate concern. However, some issues related to the guidance for the program continue to cause confusion among the program's participants and could hamper the program's progress. These issues include (1) the absence of written guidance defining the standards to be followed when using EZ/EC SSBG funds for construction-related projects and (2) conflicting guidance about the fiduciary responsibilities that the participating states should exercise for ensuring that the EZ/EC SSBG funds are spent in accordance with the appropriate financial standards.

Additionally, in view of the significant level of federal funds supporting rural EZs and ECSs, it is important that USDA have a sufficient capability to oversee the progress that these communities are making in implementing the program. USDA's current oversight system, however, provides only piecemeal information on the EZs' and ECSs' progress. As a result, USDA lacks the systematic information necessary for overseeing the program, including identifying problems and helping the communities to develop solutions.

Recommendations to the Secretary of Health and Human Services

To reduce confusion about the program's guidance on the uses of and financial controls over the EZ/EC SSBG funds, the Secretary of Health and Human Services should direct the Assistant Secretary for Planning and Evaluation to (1) clarify which construction-related standards the EZs and ECSs should follow in using the EZ/EC SSBG funds and (2) eliminate the conflicts between the Department's verbal and written guidance on the states' fiduciary responsibility for the EZ/EC SSBG funds.

Recommendation to the Secretary of Agriculture

To improve USDA's oversight of the EZ/EC program, the Secretary of Agriculture should instruct the Director of the Office of Community Development to upgrade the Office's monitoring system so that it can routinely provide the necessary information for assessing the progress of the EZs and ECSs in implementing the program. This action could be accomplished by more strictly enforcing the EZs' and ECSs' current

self-reporting requirements and by developing more systematic reporting requirements for USDA's EZ/EC state coordinators.

Agency Comments and Our Evaluation

We provided copies of the draft report for review and comment to USDA and HHS. These agencies' written comments and our responses appear in appendixes III and IV, respectively.

In commenting on the draft, USDA noted that it concurred with our conclusions and was implementing changes in response to our recommendation. USDA also made a number of comments about the difficulties of beginning a new kind of program, and we have revised our report, where appropriate, to reflect these comments. In particular, USDA concurred with our finding that the time frames for communities to apply for EZ/EC status were short and that should a second round of EZs and ECs be authorized, the Department would expect to be more fully staffed and able to better assist the applicants, both through direct guidance and with a more structured application format. USDA also made a number of comments about our analysis of the federal investment in the EZ/EC program and provided additional information about the Department's future anticipated financial support of rural EZs and ECs. We have included this additional information and revised our estimates in consultation with USDA program officials.

In their comments on the draft report, HHS officials stated that they will work to clarify several issues raised in the report, including the applicability of construction standards and federal fiscal standards to the program. HHS officials also suggested a number of changes to the report that would, among other things, clarify local, state, and federal roles in the EZ/EC program. Furthermore, these officials emphasized the need for flexibility in administering the program so that it can achieve its full potential. We incorporated these comments where appropriate.

We also sent the detailed information on each EZ and EC we visited (as presented in app. I) to the cognizant local officials for their review and comment. We made several technical changes in response to the comments we received. In addition, we sent the sections of the report describing the problems resulting from the conflict between HHS' written and verbal guidance on financial standards to the cognizant state government officials for review and comment; these officials concurred in our presentation of the issues discussed in the report.

Scope and Methodology

We conducted our review from June 1996 through February 1997 in accordance with generally accepted government auditing standards. Our scope and methodology are discussed in more detail in appendix II.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time, we will send copies of this report to the House Committee on Agriculture, other interested congressional committees, the Secretaries of Agriculture and Health and Human Services, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available upon request.

If you have any questions about this report, please call me at (202) 512-5138. Major contributors to this report are listed in appendix V.



Robert A. Robinson
Director, Food and
Agriculture Issues

Contents

Letter		1
Appendix I		18
Description of the Empowerment Zones and Enterprise Communities GAO Visited	Kentucky Highlands Empowerment Zone	18
	Mid-Delta Empowerment Zone Alliance	20
	Rio Grande Valley Empowerment Zone	22
	Central Savannah River Area Enterprise Community	24
	Crisp/Dooly Enterprise Community	26
	City of Lock Haven Enterprise Community	28
	North Delta Mississippi Enterprise Community	30
	City of Watsonville Enterprise Community	32
Appendix II		34
Objectives, Scope, and Methodology		
Appendix III		35
Comments From the Department of Agriculture	GAO Comments	39
Appendix IV		41
Comments From the Department of Health and Human Services	GAO Comments	47
Appendix V		48
Major Contributors to This Report		
Figures	Figure I.1: Kentucky Highlands Empowerment Zone	18
	Figure I.2: Mid-Delta Empowerment Zone Alliance	20
	Figure I.3: Rio Grande Valley Empowerment Zone	22
	Figure I.4: Central Savannah River Area Enterprise Community	24
	Figure I.5: Crisp/Dooly Enterprise Community	26

Contents

Figure I.6: City of Lock Haven Enterprise Community	28
Figure I.7: North Delta Mississippi Enterprise Community	30
Figure I.8: City of Watsonville Enterprise Community	32

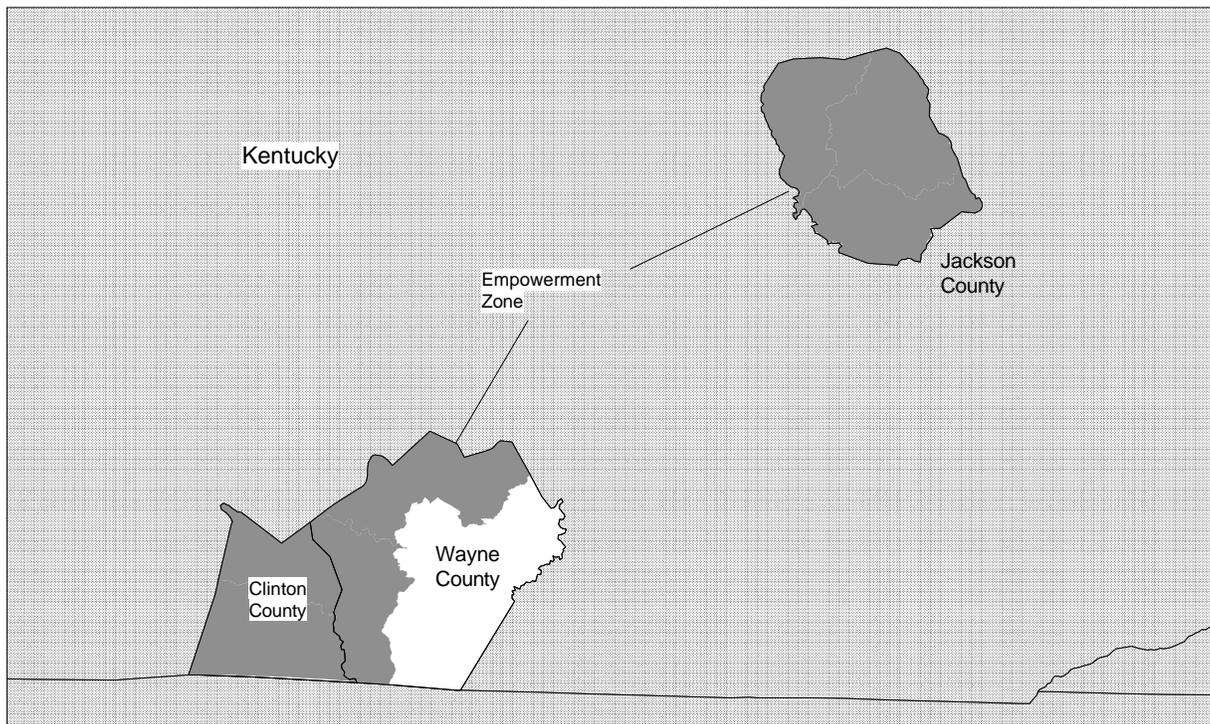
Abbreviations

EC	Enterprise Community
EZ	Empowerment Zone
HHS	Department of Health and Human Services
SSBG	Social Services Block Grant
USDA	U.S. Department of Agriculture

Description of the Empowerment Zones and Enterprise Communities GAO Visited

Kentucky Highlands Empowerment Zone

Figure I.1: Kentucky Highlands Empowerment Zone



Governance

The Kentucky Highlands Investment Corporation is the lead entity for the Empowerment Zone (EZ); this Corporation was created in 1968 to foster economic development in the area. A steering committee consisting of representatives from each of the three subzone areas was established; an effort was made to ensure that the committee was balanced in terms of geographical representation, income, and expertise. The steering committee also includes representatives from the Board of Directors of the Kentucky Highlands Investment Corporation, local and state governments, economic development agencies, universities, and local residents. The steering committee has the overall responsibility for implementing the strategic plan and for providing guidance throughout the implementation of the plan.

Funding

The Empowerment Zone/Enterprise Community Social Services Block Grant (EZ/EC SSBG) funds for the EZ pass through the Kentucky Department of Financial Incentives to the Kentucky Highlands Empowerment Zone for its use. As of December 31, 1996, the EZ had obtained about \$7.4 million of its allocated EZ/EC SSBG funds for use in its projects.

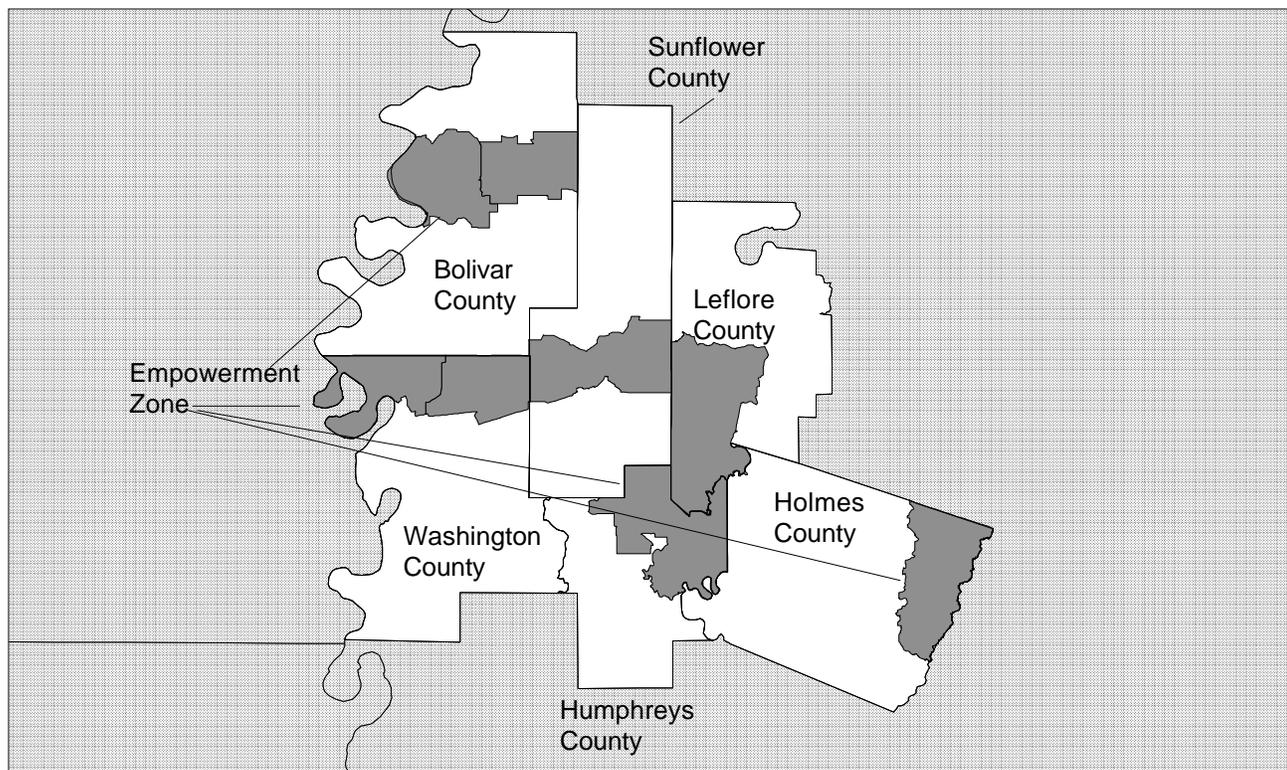
Strategic Plan

The EZ's strategic plan sets forth a four-pronged approach to revitalizing the communities included within the Zone: developing economic opportunity; promoting tourism; building infrastructure; and enhancing the quality of life. The EZ has 24 benchmarks. The projects include the following:

- establishing a development venture capital fund to invest in businesses located within the EZ;
- starting 150 home-based businesses in each of the three subzone areas, including training the home keyers to perform data entry work and assisting them in purchasing the computer equipment;
- building and equipping four rural fire stations within the EZ; and
- expanding a county library and increasing its telecommunications capacity.

Mid-Delta Empowerment Zone Alliance

Figure I.2: Mid-Delta Empowerment Zone Alliance



Governance

The Mid-Delta Empowerment Zone Alliance originated in January 1994 as a collaborative arrangement between The Delta Foundation and The Delta Council, representing poor minority and more affluent white interests, respectively. These two organizations came together to develop a strategic plan to benefit all citizens of the area, to apply for the EZ/EC program, and to establish the Alliance.

The Mid-Delta Empowerment Zone Alliance Commission was formed in April 1994; it includes representatives from—among other elements—businesses, churches, colleges, community groups, low-income groups, and public schools from all areas of the zone. The Commission reviews and votes on all proposals for projects to address the benchmark projects on the strategic plan.

Funding

The EZ/EC SSBG funds pass through the Mississippi Department of Human Services to the Mid-Delta Empowerment Zone Alliance for its use. As of December 31, 1996, the EZ had obtained about \$221,000 of its allocated EZ/EC SSBG funds for use in its projects.

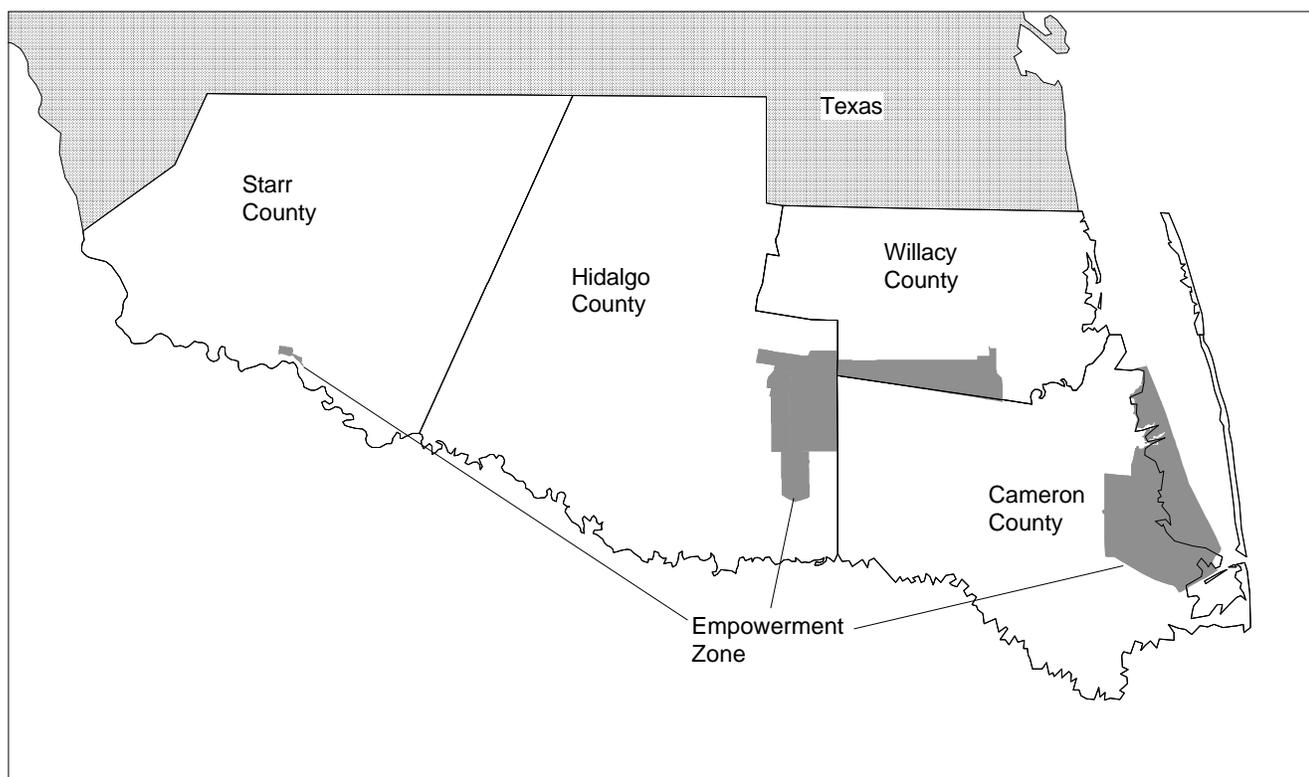
Strategic Plan

The EZ's strategic plan focuses on three themes: building community in the Mississippi Delta, increasing economic opportunity in Mississippi Delta communities, and sustaining community and economic development in Mississippi Delta communities. The EZ has 41 benchmarks. Specific projects for the EZ include the following:

- expanding and strengthening businesses and industries by providing assistance in accessing capital, business and technical assistance, and marketing;
- improving the quality and accessibility of health care by seeking to increase the number of doctors serving the Mid-Delta region;
- improving race relations by creating a race relations council; and
- promoting community beautification through the creation of a recycling program.

Rio Grande Valley Empowerment Zone

Figure I.3: Rio Grande Valley Empowerment Zone



Governance

The lead entity is the Rio Grande Valley Empowerment Zone Corporation, which was created to manage the EZ and implement the strategic plan; the corporation is headed by a chief executive officer who manages a small staff. The Corporation reports to a 19-member board of directors, the majority of whom were appointed by the county judges of the four counties. The board members include two directors from each of the four counties' subzone advisory committees. Each of the four counties appoints a subzone advisory committee for advocating matters within the subzone; two of the four subzones have also allocated funds to administration to employ a full-time professional subzone manager to oversee the day-to-day operations within the subzone.

Appendix I
Description of the Empowerment Zones and
Enterprise Communities GAO Visited

Funding

The EZ/EC SSBG funds pass through the Texas Health and Human Services Commission to the Rio Grande Valley Empowerment Zone for its use. As of December 31, 1996, the EZ had obtained about \$4.9 million of the EZ/EC SSBG funds for use in its projects.

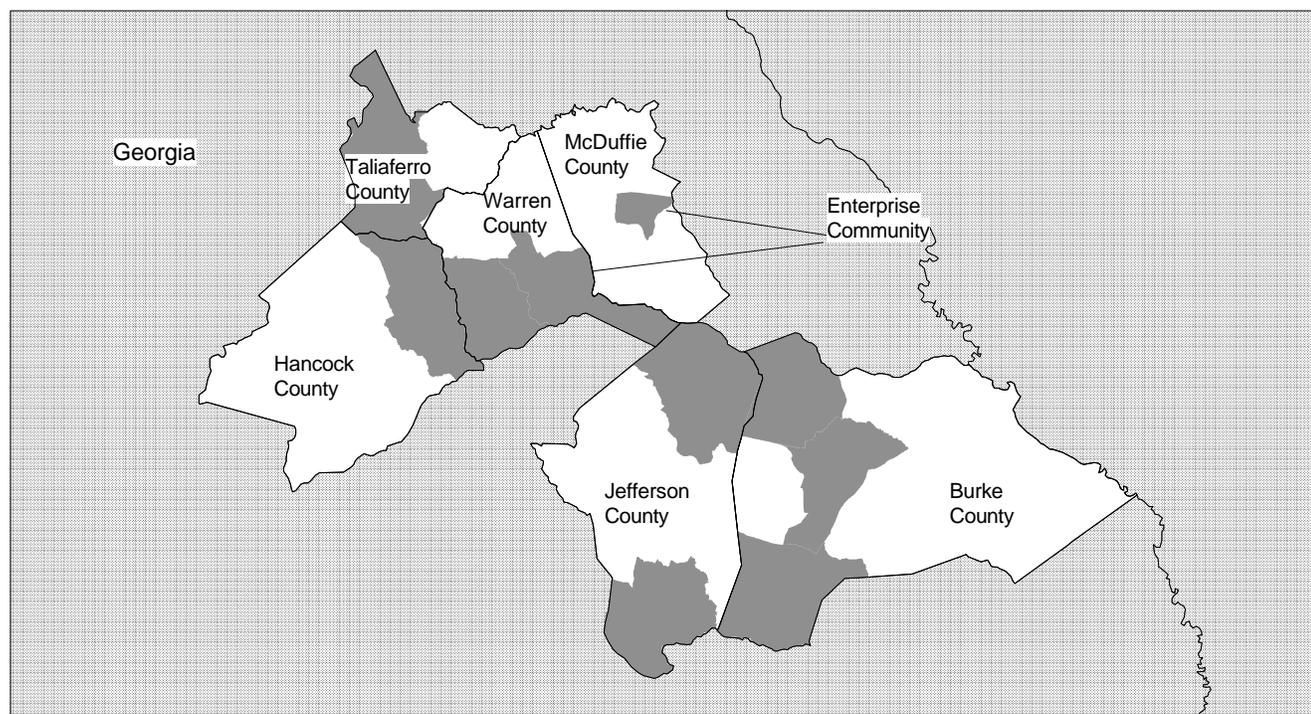
Strategic Plan

The EZ's strategic plan focuses on 10 objectives, including (1) improving the quality of life to discourage outmigration from the area, (2) providing programs for literacy and living skills, (3) initiating regional business development, and (4) improving the availability of housing by providing new housing and increasing access to the existing housing. The EZ has 49 benchmarks. Specific projects include the following:

- establishing a small business incubator;
- developing a historical district for small businesses;
- implementing a flood control project; and
- establishing a community elder care/youth recreation center.

Central Savannah River Area Enterprise Community

Figure I.4: Central Savannah River Area Enterprise Community



Governance

As of January 1997, the EC was in the process of reincorporating and negotiating revisions to the memorandum of agreement. At the time of our visit, the EC was governed by a board drawn from the 10 Census tracts comprising the EC. In addition, each of the 10 subzone areas had established local EC boards to oversee projects within the subzone. The Central Savannah River Area Regional Development Center was the lead entity for the EC.

Funding

The EZ/EC SSBG funds pass through the Georgia Department of Community Affairs to the Central Savannah River Area Enterprise Community for its

**Appendix I
Description of the Empowerment Zones and
Enterprise Communities GAO Visited**

use. As of December 31, 1996, the EC had obtained about \$429,000 of the EZ/EC SSBG funds for use in its projects.

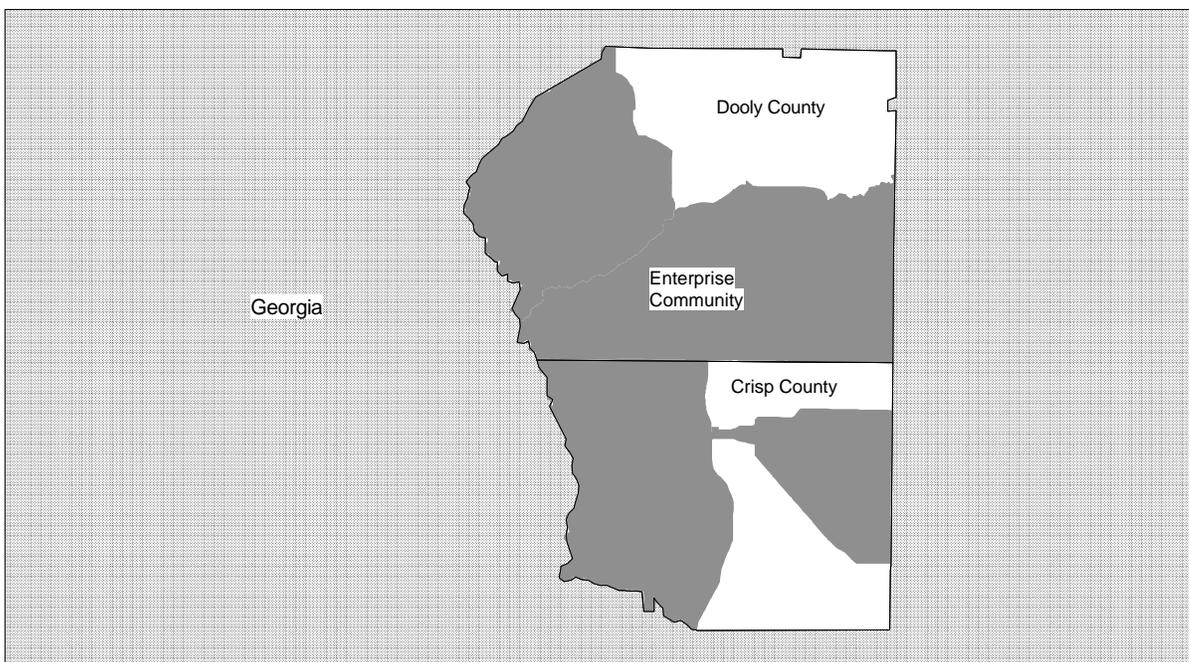
Strategic Plan

The EC's strategic plan emphasizes seven goals: (1) agriculture, business, and economic development; (2) human development, health, and public safety; (3) education; (4) housing; (5) arts, recreation, and cultural tourism; (6) public infrastructure; and (7) community organizing, coalitions, and partnerships. The EC has 12 benchmarks. Specific projects include the following:

- operating general education degree classes for the EC's residents;
- establishing family service centers providing such services as youth recreation and leadership classes and adult literacy classes; and
- training community outreach organizers to foster community involvement.

Crisp/Dooly Enterprise Community

Figure I.5: Crisp/Dooly Enterprise Community



Governance

The Crisp/Dooly Partnership, Inc., is the lead entity and is responsible for implementing the enterprise community's strategic plan. The Crisp/Dooly Partnership reports to a 32-member board consisting of representatives of Crisp and Dooly counties, 16 from each county, and are drawn from such organizations as economic development councils, chambers of commerce, and boards of education as well as from law enforcement groups, churches, and low-income residents.

Funding

The EZ/EC SSBG funds pass through the Georgia Department of Community Affairs to the Crisp/Dooly Joint Development Authority, which is fiscally

responsible for the EZ/EC SSBG funds. The Crisp/Dooly Joint Development Authority consists of a separate board of eight directors who are appointed by the Crisp and Dooly county governments and who, in turn, release the funds to the Crisp/Dooly Partnership, Inc., for the implementation of the strategic plan. As of December 31, 1996, the EC had obtained about \$215,000 of its EZ/EC SSBG funds program for use in its projects.

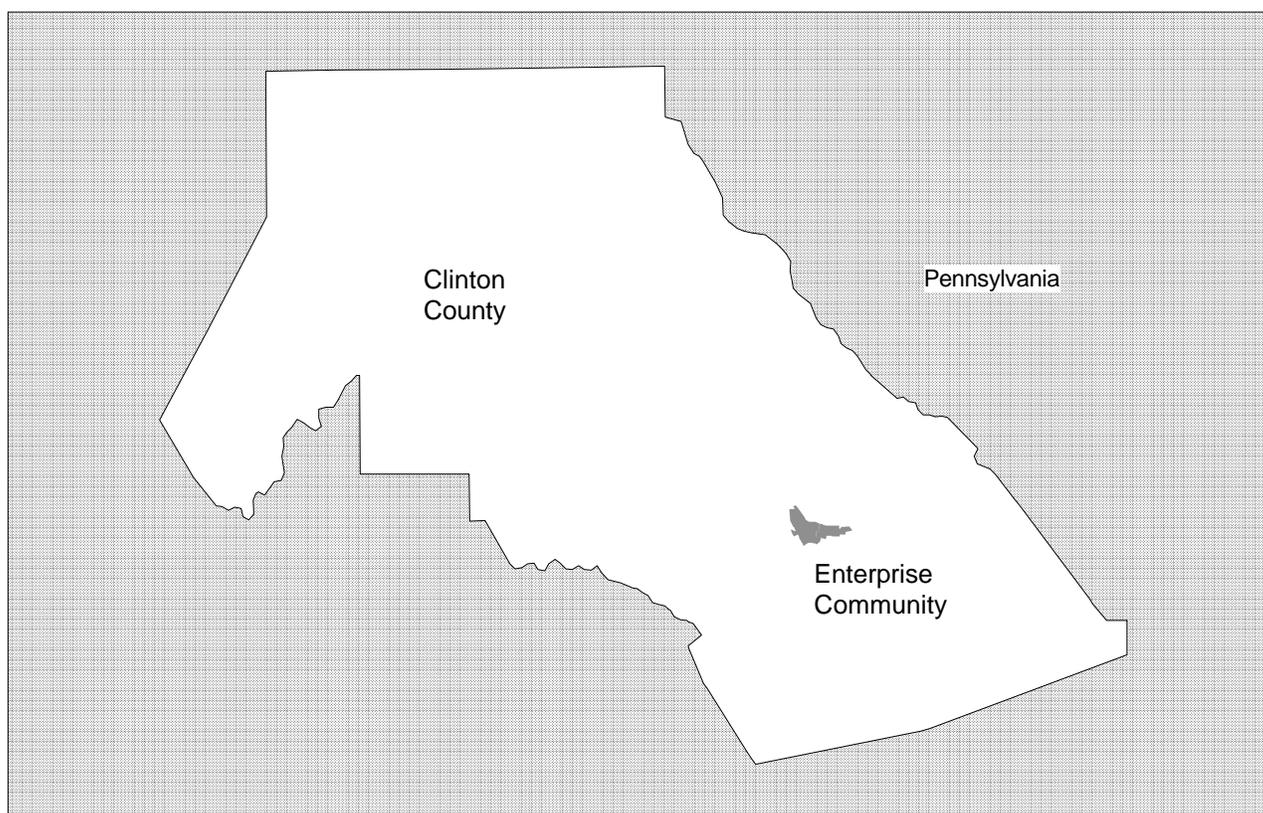
Strategic Plan

The EC's strategic plan emphasizes five goals: (1) social and economic empowerment for developing innovative community services, (2) development of Crisp/Dooly counties' economic partnership to coordinate economic development initiatives, (3) human and community development through improved community relations, (4) improving education, and (5) improving the quality of life and of the environment. The EC has 37 benchmarks. Specific projects include the following:

- building a postsecondary vocational-technical center;
- establishing an adult literacy program; and
- developing a rural transportation system.

City of Lock Haven Enterprise Community

Figure I.6: City of Lock Haven Enterprise Community



Governance

The lead entity for the EC is the City of Lock Haven City Council; a full-time Federal Enterprise Coordinator was hired by the city to manage the day-to-day operations of the EC. A Federal Enterprise Committee oversees the EC; several subcommittees, such as the economic development subcommittee and health and human services subcommittee report to the EC Committee.

**Appendix I
Description of the Empowerment Zones and
Enterprise Communities GAO Visited**

Funding

The EZ/EC SSBG funds pass through the Pennsylvania Department of Public Welfare to the City of Lock Haven Enterprise Community for its use. As of December 31, 1996, the EC had obtained about \$456,000 of the EZ/EC SSBG funds for use in its projects.

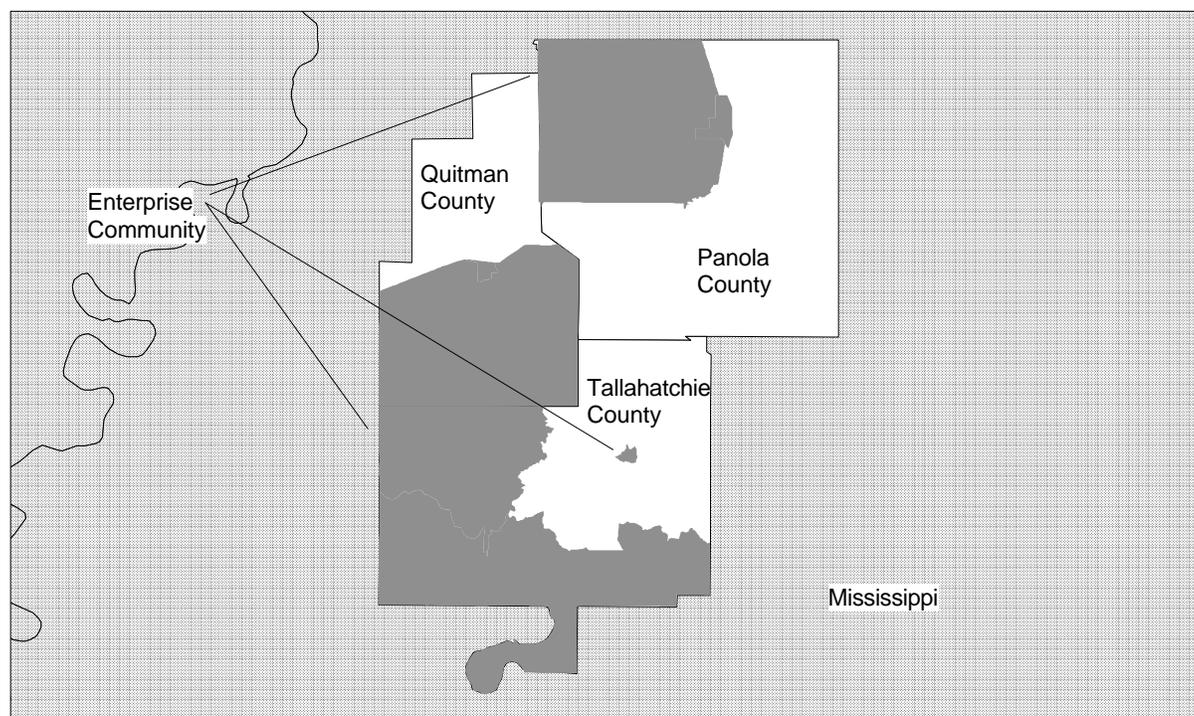
Strategic Plan

The EC's strategic plan states that its main goal is to promote economic development through job creation and retention. The EC has 36 benchmarks. Specific projects include the following:

- establishing a micro-revolving loan fund to assist small and start-up businesses;
- establishing a partnership among the city, Clinton County, local banks and lending institutions, local housing nonprofit organizations, and housing developers to expand the supply of affordable housing for elderly and low-income residents; and
- assisting in the renovation of a job training facility and in funding job training workshops in such subjects as computer skills.

North Delta Mississippi Enterprise Community

Figure I.7: North Delta Mississippi Enterprise Community



Governance

When the EZ/EC program was announced in 1994, a group of 22 citizens from this very poor area of Mississippi came together to discuss applying for designation as an EZ or EC. With the assistance of an established local Planning and Development District, they applied for and were subsequently designated as an EC. In November 1995, this group was incorporated as the North Delta Mississippi Enterprise Community Development Corporation. A 22-member board, consisting of the citizens who had been involved in the preparation of the strategic plan, was installed and authorized to determine the major personnel, fiscal, and program policies and the overall program plans and priorities and to give final approval to all corporate initiatives.

Appendix I
Description of the Empowerment Zones and
Enterprise Communities GAO Visited

Funding

The EZ/EC SSBG funds pass through the Mississippi Department of Human Services to the North Delta Enterprise Community for its use. As of December 31, 1996, the EC had obtained about \$25,000 of the EZ/EC SSBG funds for use in its projects.

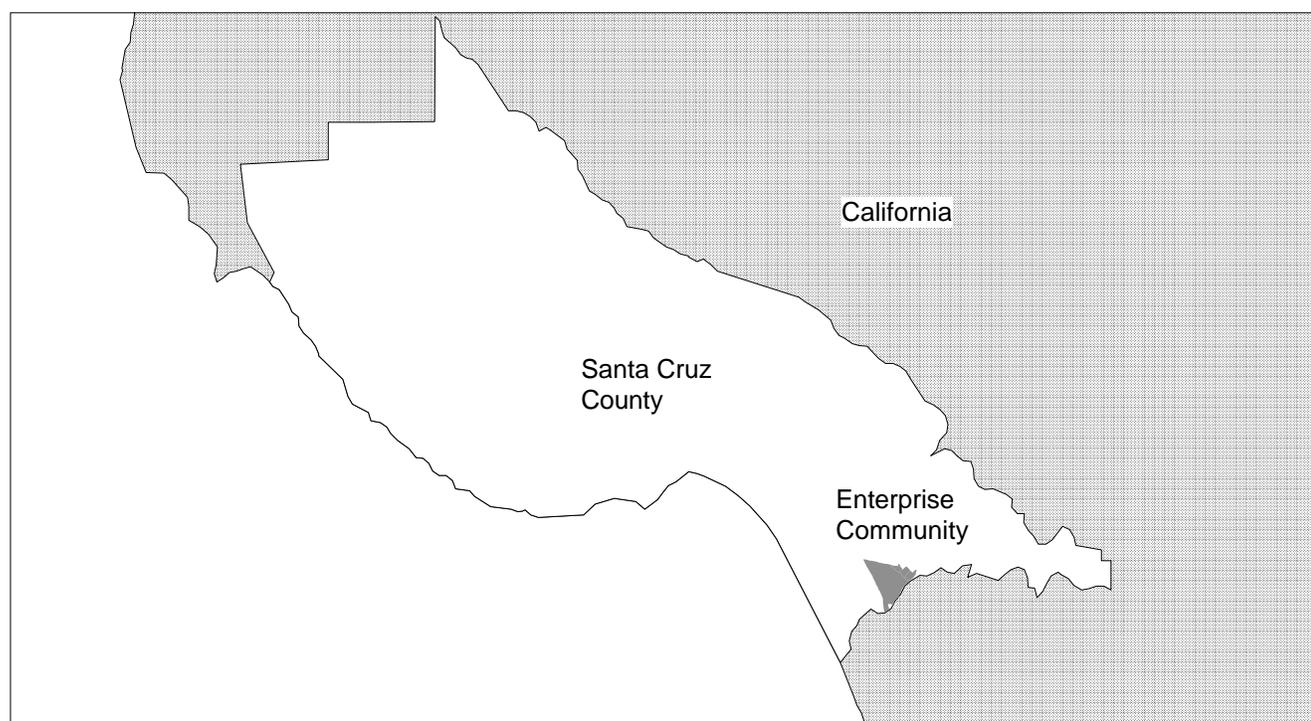
Strategic Plan

The EC's strategic plan focuses on four areas: (1) economic and community development, (2) empowerment through the ability of the EC to solve its own problems and create its own opportunities, (3) human services and physical development, and (4) natural resources and environmental concerns. The EC has 16 benchmarks. Specific projects include the following:

- developing parks,
- recommending state legislation for a tax-incentive program,
- providing small business training, and
- increasing the availability of safe and affordable housing.

City of Watsonville **Enterprise** **Community**

Figure I.8: City of Watsonville Enterprise Community



Governance

The City Council of Watsonville is the lead entity for the EC; the deputy city manager has the day-to-day responsibilities for the EC. An advisory steering committee represents the residents of the EC; however, the city council has decision-making responsibility.

Funding

The EZ/EC SSBG funds pass through the California Department of Social Services to the City of Watsonville Enterprise Community for its use. As of December 31, 1996, the EC had obtained about \$250,000 of the EZ/EC SSBG funds for use in its projects.

Strategic Plan

The main emphasis of the EC's strategic plan is youth development. The EC has 15 benchmarks. Specific projects include the following:

- establishing youth job training, including teaching basic job-seeking strategies;
- expanding and renovating recreation facilities for at-risk youth in several impoverished parts of the city;
- building and operating a small business retail incubator in conjunction with the new transit center; and
- improving the downtown area by refurbishing retail businesses' facades.

Objectives, Scope, and Methodology

To estimate the cost of the rural EZ/EC program, we reviewed information on the resources available to the EZ/EC program from the U.S. Department of Agriculture (USDA), the Department of Health and Human Services (HHS), and 13 other federal agencies. We also obtained tax-incentive information from the Internal Revenue Service and spoke with officials in the Office of Tax Assessment.

To review the status of the EZ/EC program's implementation and identify the difficulties that communities have encountered, we talked with officials and obtained information at all 3 rural EZs, 5 of the 30 rural ECs, six states, and the two principal agencies, USDA and HHS. We selected ECs that are located in the same state as the EZs and added ECs from three other states to provide geographic distribution. During our visits to these communities, we visited selected projects to discuss the EZ/EC program with the individuals most directly involved at the local level. We also reviewed the strategic plans, benchmarks, status reports, and funding documents for the eight EZ/ECs visited, as well as information maintained by USDA on the remaining 25 rural ECs. We also examined the progress reports available at USDA's headquarters.

To evaluate USDA's oversight of the EZ/EC program, we reviewed the applicable regulations, discussed the roles of the USDA state coordinators with USDA headquarters officials, examined USDA's central files on progress reports, and requested reports from USDA's State coordinators. We also interviewed the USDA state coordinators in the six states we visited.

We performed our work in accordance with generally accepted government auditing standards from June 1996 through February 1997.

Comments From the Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

March 10, 1997

Mr. Robert A. Robinson
Director
Food and Agriculture Issues
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Robinson:

We have reviewed the draft of the GAO report to the United States Senate Committee on Agriculture, Nutrition, and Forestry regarding the rural Empowerment Zones/Enterprise Communities (EZ/EC) Initiative.

The report identifies two areas which require immediate attention: (1) up-grading of both the Office of Community Development's (OCD) and field staffs' monitoring and reporting capacities; and (2) increasing compliance by the Empowerment Zones and Enterprise Communities with their self-reporting requirements. We concur with these conclusions and are implementing the changes indicated later in this response.

While we are in general agreement with the report's findings, it is our opinion that the report does not acknowledge that certain problems are inherent during the initial phase (s) of implementing a new, non-traditional Federal strategy to solve rural poverty. We believe that many problems mentioned in the report are not due to mismanagement or lax execution of oversight duties, rather, they are the result of a steep "learning curve" for all participants in any new and unique endeavor.

The Empowerment Initiative is different from traditional, project-driven Federal programs. Its primary objective is to build capacity within the designated communities so that they assume responsibility for sustaining community and economic development long after the Federal Initiative ends. Each designated EZ/EC is a poverty stricken area historically bypassed by the mainstream of this country's social and economic development. Inclusion in this Initiative is often the community's first experience with organizing itself as a community, to say nothing of the economic planning and dealing with multiple levels of bureaucracy that follows. Most of these communities bring few skills and little expertise to the process.

See comment 1.

See comment 2.

See comment 1.

**Appendix III
Comments From the Department of
Agriculture**

The first steps these communities had to take were organizational, leading to the finalization of operating plans and performance benchmarks. These steps alone consumed more than half of the time period since the communities' designation as an EZ/EC. The progress they have made has been achieved in less than one year of actual implementation activity. Slower rates of implementation in some communities indicate nothing more than substantially different initial levels of capacity, and the development of prudence in the exercise of their newly acquired fiscal responsibility. These organizational activities are essential to the long-range success of the entire Initiative.

The process of empowerment represents a period in which transition from dependency to capacity will occur. The different points from which communities start this process naturally tend to produce the varying rates at which they solve local organizational issues and master technical knowledge taken for granted in most communities. Further, Federal agencies and staffs, long experienced in the traditional ways of relating to program recipients, must also reorient their thinking and methods to a program which seeks to empower and return responsibility to the local level. Everyone is faced with the steep learning curve.

To address the GAO report's two specific recommendations mentioned earlier, the Office of Community Development has identified deficiencies within USDA's oversight system and is currently implementing three field staff training projects to improve the technical assistance to, monitoring of, and reporting on the EZ/EC. A training workshop for all State Coordinators scheduled for this summer will focus on revision and systemization of USDA's reporting process. Another summer workshop is designed to increase the skills of State Coordinators needed for more effective interaction with both the client communities and local empowerment boards. In 1996, OCD began a program in which State Coordinators are rotated into the national office for intensive, two-week, individualized training sessions. Unfortunately, in the past training need has been delayed by budget limitations.

Further, steps have already been taken by OCD to address the inadequacy of information provided by the communities through the State Coordinators. The re-training of the State Coordinators, revision of the reporting format used in the two reports received to-date, and a new training program for EZ/EC reporting personnel will result in dramatic improvement of the data available to OCD for exercise of its oversight responsibility. Also, OCD has just recently added new staff who will be able to assist in analyzing the reports to identify issues as they arise and to design and implement corrective actions.

In addition, we believe that the following comments are pertinent to specific issues raised in the report:

- A) There is agreement among all parties as to the inadequacy of the time allotted to the application process in Round One. Two or three additional months would have been helpful to communities who had to overcome sometimes difficult community conflicts and develop far-reaching strategic plans during this period. By using electronic technology to speed up the application review process, USDA hopes to provide more time to applicants. Both the hurried attempt to build

See comment 3.

See comment 4.

**Appendix III
Comments From the Department of
Agriculture**

community organization and technical skills in the designated communities and the implementation of the first phase with a staff of only four FTEs contributed to the problems associated with the application process. If Congress authorizes a Round Two, a better trained and more experienced USDA staff will be able to provide a substantially higher quality of effective guidance to applicants, while assuring that a more structured application format preserves the local community's lead role in the strategic planning process.

See comment 5.

- B) The report notes a circumstance in which a state agency administering the Social Services Block Grant funds criticized a community for attempting to use these funds when other sources of funding might have been "available" for the same purpose. This action, by a contract employee of the state agency, represented an interpretation of "supplantation of funds" which was erroneous. Corrective action has already been taken to change the administration of the program within the state in question.

See comment 6.

- C) While it is true that State Coordinators have a primary responsibility for monitoring EZ/EC by performing site visits, it should also be noted that the OCD national staff perform site visits both for review and community intervention purposes. Further, State Coordinators have the responsibility to review all benchmark changes to ensure that wide community participation exists, that the proposed changes conform with the community's strategic plan, and that there is no evidence of conflict of interest. After "signing-off" on the changes, the State Coordinators submit them to OCD for a final review and concurrence before approval is granted.

See comment 7.

- D) The report's notation of conflict between one community's Board Members and the Lead Entity is an example of community "growing pains." We believe that this is an understandable phase in the growth process of an underdeveloped, inexperienced, and socially fractioned poverty community. It is exactly situations such as this that demonstrate the need to provide these communities with the skills and expertise required to resolve such disputes and to forge new cooperative local partnerships.
- E) It is instructive to note that it was the local community that identified the problem, cited in the report, of requests not tied to benchmarks being submitted for approval. This provides some validation of the Initiative's principle of shared accountability as a responsible management principle.

See comment 8.

- F) The report's analysis of the Federal cost of the Initiative is, in our view, not entirely accurate for at least three reasons. It overstates the Congressionally-earmarked USDA funds devoted to the Initiative during Fiscal Years 1995-98, which are approximately \$30 million less than the GAO's estimate. It incorrectly implies that the total projected Federal costs are new appropriated funds for this Initiative when in fact the earmarked projected funding represents existing

**Appendix III
Comments From the Department of
Agriculture**

appropriations that would be expended by these or other eligible recipients -- these are not new monies. And, the report's estimate of tax expenditure costs ignores any potential offsetting increases in tax revenues resulting from the investment of Federal, state, and other dollars to implement the communities' strategic plans and the creation of new jobs.

We welcome this opportunity for an external review of this new, innovative Federal program, and we appreciate the time you and your staff have dedicated to completing the report. We are hopeful that you will take into account our suggestions and concerns and remain convinced that the report will significantly contribute to the EZ/EC Initiative's success.

In advance, thank you for your time and consideration.

Sincerely,



Jill Long Thompson
Under Secretary
Rural Development

The following are GAO's comments on the U.S. Department of Agriculture's letter dated March 10, 1997.

GAO Comments

1. We agree with USDA that the EZ/EC program is different from traditional federal programs and that the program challenges communities to engage in activities with which they have little experience. We have modified our report accordingly.
2. While we recognize that this program required a steep learning curve for all participants, we still believe that USDA has had a sufficient amount of time—42 months after the passage of the authorizing legislation—to have put into place systematic oversight of the program.
3. We believe the commitment and actions outlined by USDA to address the recommendations in our report go a long way toward correcting the problems we noted concerning the need to upgrade the Office of Community Development's monitoring system.
4. We have modified our report to include USDA's concurrence that all parties agreed that the initial time frames permitting communities to apply for EZ or EC status were inadequate.
5. We have deleted the references to supplantation in the report. A discussion of supplantation was not needed to illustrate our concern about the possible conflicts between verbal instructions and written regulations on administering EZ/EC SSBG funds.
6. We have added statements about USDA headquarters staff members' visits to rural EZs and ECs and about the responsibilities of the state coordinators.
7. We agree with USDA that situations such as the one portrayed in our report will arise. This is precisely the reason why we believe that USDA needs a strong oversight capability, i.e., one that will identify problems early on and help focus the assistance, training, and consultation needed to help the EZs and ECs resolve the problems.
8. We have clarified the language to recognize that the report's estimates of total EZ/EC funding includes funds that would not represent additional appropriations but, rather, a special targeting of appropriations that would have been made in any case in order to support rural communities under

Appendix III
Comments From the Department of
Agriculture

the various programs of the participating agencies. We have also added language to the report which notes that there may be some offsetting benefits to the government, such as increased tax revenues, resulting from the creation of new jobs. Finally, USDA's statement that funds are approximately \$30 million less than GAO's estimate was in response to a prior GAO estimate. USDA agrees with the estimates contained in this report.

Comments From the Department of Health and Human Services

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of the Secretary

Washington, D.C. 20201

MAR 17 1997

Mr. Robert A. Robinson
Director, Food and Agriculture Issues
Resources, Community, and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Robinson:

Thank you for the opportunity to review your draft report on implementation of the rural Empowerment Zone / Enterprise Community program.

As you know, the unique statutory division of federal agency responsibilities and focus on community-based decision-making in the EZ/EC program presents several unique challenges and opportunities. Your survey appropriately identified several of the intergovernmental relationship and community empowerment issues that the U.S. Department of Health and Human Services (HHS) and U.S. Department of Agriculture (USDA) continue to address with our State and local partners.

I am pleased to provide comments from the perspective of the Office of the Assistant Secretary for Planning and Evaluation. As noted below, we will be working with our partners at USDA, the U.S. Department of Housing and Urban Development (HUD), and the Office of Management and Budget (OMB) to clarify several issues, including the applicability of federal fiscal standards to this program.

General Text Comments

(1) Describing additional federal grant assistance to EZ/EC designees.

The report accurately indicates that many federal agencies are providing "special consideration" to EZ/EC-related applicants in some discretionary grant programs. However, the terms used to describe this additional federal grant assistance are not consistent for each of the three references in the report (page 1, paragraph 1; page 4, paragraph 1, page 6, paragraph 2).

Specifically, words like "priority", "preference", and "earmark" imply a more narrow, decisive approach to providing "special consideration" than may be accurate in all cases. For example, HHS does not earmark any discretionary grant funds for EZ/EC sites. While some federal programs do include set-asides or clear priorities for EZ/EC-related applicants, others must work within different statutory and departmental grants policy constraints to provide some alternative

Now on pp. 1, 3, and 5.

**Appendix IV
Comments From the Department of Health
and Human Services**

Page 2 -- HHS Response to GAO Draft Report

form of appropriate “special consideration” for applicants serving EZ/EC locales and similarly distressed areas.

Therefore, in describing additional federal grant assistance, we encourage you to refer to “special consideration” throughout the report (as on page 4, paragraph 1).

Specific Text Comments

(2) “Each of the EZs will receive \$40 million over the 10-year life of the program, compared with about \$3 million for each of the ECs.” (page 1, paragraph 1)

A more precise statement is that each EZ was awarded \$40 million to be expended in accordance with their strategic plans over the 10-year life of the program, compared with about \$2.95 million for each EC. The exact amount awarded for each EC was \$2,947,368.00.

(3) “The act also amended title XX of the Social Security Act....” (page 3-4, paragraph 3)

This paragraph describing the EZ/EC funding amendments to the Title XX SSBG mechanism omits several changes that are essential to an accurate understanding of the State and local comments and final recommendations included in the report. We suggest the following description --

The act also amended the Title XX SSBG program in the Social Security Act to create a special appropriation of \$1 billion in new “no-year” EZ/EC SSBG funds for use by designated EZ/ECs, expanding the authorized uses for the monies and modifying the decision-making process for funding projects. Under the existing Social Services Block Grant program, Title XX SSBG funds are allocated on a formula basis to States, which determine their use for an array of social service activities. However, the EZ/EC program amendments to Title XX placed funding decision-making authority with local EZ/EC governance structures, and extended programmatic applications of the EZ/EC SSBG funds to allow various economic development and infrastructure-related activities.

Again, we recommend that you include the enclosed HHS guidance on “Use of EZ/EC SSBG Funds” for reference in an appendix.

(4) “HHS, USDA, and the States each play a key role....” (page 5, paragraph 1)

More detail in this paragraph describing HHS, USDA, and State roles in EZ/EC implementation

See comment 1.
Now on pp. 1, 3, and 5.

See comment 2.

Now on p. 3.

See comment 3.

See comment 4.

Now on p. 4.

**Appendix IV
Comments From the Department of Health
and Human Services**

Page 3 -- HHS Response to GAO Draft Report

would provide important context for the State and local comments and final recommendations included in the report. We suggest the following description --

USDA, HHS, and the States each play a key role in administering the program. USDA is the lead federal agency for the rural EZ/EC program, responsible for helping the EZ/ECs achieve their goals by monitoring and evaluating their progress, and by providing technical assistance when appropriate.

As required by statute, HHS awarded grants to States for distribution to EZ/EC designees upon selection of those sites by USDA. Generally, HHS made the EZ/EC SSBG awards to State agencies that are the usual recipients of Title XX SSBG funds; in a few cases, including Georgia, States asked HHS to award the grant to another State agencies, and HHS complied with those wishes.

States serve as the federal grantees which distribute the funds to the EZ/EC designees.

- (5) “While USDA and HHS officials acknowledged that the communities faced short time frames, they disagreed on whether these time frames were a problem.” (page 10, paragraph 3)

It is not clear whether this sentence indicates that USDA staff disagreed with HHS staff on whether short planning time frames during the application process were a problem, or whether both USDA and HHS staff disagreed with community officials on that issue.

In any case, HHS officials do feel that the short application period created planning and organizational difficulties for several communities, particularly those community-based and rural entities that lack the highly developed grantsmanship skills or resources of more experienced cities and service organizations.

- (6) “According to HHS, SSBG funds can be used for construction projects ... if the projects are related to a program option...” (page 12, paragraph 2)

The OBRA '93 statute explicitly provides this enhanced flexibility in use of EZ/EC SSBG funds for construction projects; it was not an autonomous HHS decision.

See comment 5.

Now on p. 8.

See comment 6.

Now on p. 10.

See comment 7.

**Appendix IV
Comments From the Department of Health
and Human Services**

Page 4 -- HHS Response to GAO Draft Report

Comments on Findings

Now on p. 10.

- (7) “HHS Has Not Provided Clear Guidance on the Applicability of Federal Standards”
(page 12)

HHS concurs in part with this finding, and is working with USDA, HUD and OMB to address some points of confusion.

In keeping with the community empowerment philosophy and federal flexibility that are the hallmark of the EZ/EC program funding mechanism, HHS policy is to defer to appropriate State and local EZ/EC governance processes to set various standards for grant use where the statute affords that opportunity.

See comment 8.

As the report correctly indicates, the statute did not specify any standards for newly allowed construction activities, so EZ/ECs are able to adopt locally-appropriate standards, in accord with State and local laws. We believe that local officials are as capable as federal staff in identifying and adopting appropriate standards to address their local circumstances.

Now on p. 10.

In the specific instance cited, after conferring with HHS staff, EZ officials appropriately used their best judgment to decide the most suitable standards to adopt for such matters as proper water and sewer pipe sizes (page 13). Again, the ability to make that local determination is consistent with the overall community empowerment approach.

While we believe that we have already communicated HHS policy on this issue, HHS will work with USDA and OMB to clarify this issue and to provide further guidance to rural EZ/ECs on this topic within the next few weeks. In addition, USDA, HUD, and HHS are already collaborating to resolve the separate question of appropriate processes to comply with federal environmental standards for EZ/EC-related infrastructure projects.

Now on p. 10.

- (8) “HHS’ Verbal Instructions to the States on Administering EZ/EC Funds Appear to Conflict with HHS’ Regulations” (page 13)

HHS concurs in part with this finding, and is working with USDA, HUD and OMB to address some points of confusion.

Perhaps more than any other large-scale federal effort, the EZ/EC initiative is about redefining intergovernmental and cross-sector relationships, and resolving issues through consultative partnerships rather than top-down mandates. The unique complexities in implementing the EZ/EC program create the need for all partners to be flexible as we continue to refine our respective roles to accommodate the program’s philosophy and unusual funding mechanism.

**Appendix IV
Comments From the Department of Health
and Human Services**

Page 5 -- HHS Response to GAO Draft Report

The GAO report cites examples of situations where HHS instructions seem to conflict with HHS regulations. Our comments on two of the examples are outlined below.

Undefined State standards for funding proposal review (page 14, paragraph 2). As explained in the EZ/EC Application Guide, HHS policy memoranda, and HHS supplemental audit guidance, the Federal government intended that States serve as fiscal intermediaries for the EZ/EC SSBG award and provide funds to the designees with few restrictions on the flexible use of the money.

In the example cited of a State agency refusing to approve any of 22 EZ project proposals submitted for funding drawdowns, HHS staff offered no opinion on the acceptability of those particular projects. However, in conjunction with USDA officials, HHS staff did request that State personnel define for the EZ what standards the State applies to determine that a given proposal does not conform to "reasonable and prudent business practices." In addition, HHS staff suggested that the State consider whether its rules unduly limit the flexibility afforded to communities by Congress in the EZ/EC SSBG statute, or run counter to the community empowerment objective.

Interpretation of supplantation restrictions (page 14, paragraph 2). In prohibiting supplantation, the statute restricts a State, locality, or EZ/EC from using EZ/EC SSBG funds as a substitute for existing funds that are already committed to a particular activity. Of course, the statute does permit supplementation of funding (i.e. providing additional EZ/EC SSBG funds to expand a current activity).

The report should provide a more accurate description of the issues in the example cited. In this instance, staff in one State are actually misinterpreting the term "supplantation," construing it to mean that EZ/EC SSBG monies cannot be used when there may be another conceivable grant source to which the EZ might apply for funding. Operating under this misconception, the State requires the EZ to seek funding from all other potential sources (federal, state, local, foundation, etc.) prior to requesting EZ/EC SSBG funds for a particular project, effectively denying access to the federal grant award intended to make funding available for those EZ project purposes. The State has maintained this approach despite written and verbal guidance to the contrary from both HHS and USDA.

HHS will continue its efforts to assist the Empowerment Zones, Enterprise Communities, and their State governments in implementing this important program, and will take further action, in concert with USDA and OMB, to address the particular examples noted in the GAO report.

Now on p. 11.

See comment 9.

**Appendix IV
Comments From the Department of Health
and Human Services**

Page 6 -- HHS Response to GAO Draft Report

HHS EZ/EC Contacts

Again, thank you for this opportunity to comment. Please do not hesitate to contact me, or Marek Gootman and Jim Gatz of the HHS EZ/EC Support Team, if you have additional questions.

Sincerely,



David Garrison
Principal Deputy Assistant
Secretary for Planning and Evaluation

Enclosures

HHS Guidance document:
"Use of EZ/EC SSBG Funds"

The following are GAO's comments on the Department of Health and Human Services' letter dated March 17, 1997.

GAO Comments

1. We have revised the report to consistently use the term "special consideration."
2. We have revised the report to clearly note that EZ/EC SSBG funds are to be spent in accordance with the communities' strategic plans.
3. We have revised the report to highlight the authority that local governance structures were given under the amended SSBG program.
4. We do not believe that the additional information on HHS' guidance was necessary to understand the report's findings. Therefore, we did not include it as an appendix.
5. We have added more detail on USDA's role in the EZ/EC program.
6. We have revised the report to recognize that HHS officials believe that the short application period created planning and organizational difficulties.
7. We have revised the report as suggested to note that the 1993 act provided the authority to use the EZ/EC SSBG funds for a wider variety of purposes than was previously permitted.
8. Our report is not intended to question the ability of local officials to make decisions. Rather, it merely points out that local officials told us that they need additional guidance on what standards to apply to the EZ/EC SSBG funds.
9. We have deleted the references to supplantation in the report. A discussion of supplantation was not needed to illustrate our concern about the possible conflicts between verbal instructions and written regulations on administering EZ/EC SSBG funds.

Major Contributors to This Report

Robert C. Summers, Assistant Director
John K. Boyle, Project Leader
Clifford J. Diehl
Carol Herrnstadt Shulman
Patricia A. Yorkman

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

