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**Testimony of**

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Before the

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Information and International Security of the Senate Subcommittee  
on Homeland Security and Government Affairs

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Mr. Chairman and Members of the Subcommittee:

Thank you Senator Coburn, Senator Carper and Members of the Subcommittee for inviting me to testify on “Community Development Block Grants; The Case for Reform.” We are currently engaged in a study of this and similar economic development programs across the federal government. Our research considers whether such programs are able to meet their intended goals.

Our research does not reflect an official opinion of George Mason University.

**I. Background**

The Community Development Block Grant (CDBG) program was authorized under Title I of the Housing and Community Development Act of 1974, P.L. 93-393, as amended (42 USC 5301). The program was created by combining seven smaller direct grant programs originating with the Johnson Administration’s War on Poverty: the Urban Renewal Program, the Model Cities

program, open space acquisition, and beautification grants, neighborhood facilities grants, and water and sewer facilities grants.

These seven programs focused on “restoring urban neighborhoods through acquiring land, clearing blight, and encouraging private development; providing physical development, and human services; providing health, welfare, social and recreational services; and improving existing and developing new low and moderate income housing.”<sup>1</sup>

The belief was that such urban aid programs could, “stimulate local economies, finance social services that could restore the sense of community evaporating from inner-city neighborhoods as poverty demoralized its residents. In the 1960s Sargent Shriver, head of the Office of Economic Opportunity, predicted that with this approach the federal government could all but eliminate poverty in a decade.”<sup>2</sup>

The mission of CDBG under Title I of the Community Development Act is to “increase the viability of urban communities by addressing housing needs and creating healthy living environments by expanding economic opportunity primarily for low- and moderate-income persons.”

Since its inception, CDBG has awarded over \$100 billion to state and local governments to fund various housing, community development, neighborhood revitalization, economic development and public service provision projects. According to its statute, such projects must serve at least one of three requirements. They must:

- 1) Principally benefit low-and-moderate income people

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<sup>1</sup> U.S. Department of Housing and Urban Development, Federal Funds, local choices: An evaluation of the Community Development Block Grant Program (1995).

<sup>2</sup> Steven Malanga, “America’s Worst Urban Program.” City Journal, Spring 2005 p. 1

- 2) Eliminate or prevent slums
- 3) Remedy urgent threats to the health or safety of the community

At least 70 percent of CDBG funds distributed to the states and local governments must principally benefit low-and moderate-income persons.

CDBG-funded activities must satisfy a two-part eligibility test. First they must align with one of 25 eligible uses. Each of these uses must satisfy one of the above three requirements of the program.

The full list of eligible activities is included in Appendix I<sup>3</sup>. Briefly, these activities range from the acquisition and disposition of properties, to housing construction, removal of lead-based paint, assisting with rental income and providing loans to for-profit business to create jobs in the community.

In FY 2005, 57 percent of total CDBG funds were spent on housing and public improvement projects. Appendix II<sup>4</sup> shows the breakdown for how total CDBG funds were expended in FY 2005.

The question this hearing seeks to answer is: Can CDBG successfully meet its goals given its current structure? Our research indicates that the program faces several barriers to successfully delivering on its mission.

- The formula is worsening in its ability to target high need communities resulting in grants going to relatively wealthy communities and college towns.

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<sup>3</sup> Appendix I – Eligible Activities available at [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

<sup>4</sup> Appendix II – Copy of All CDBG Disbursements available at [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

- Lack of transparency in the collection and display of grantee level data.
- The inherent difficulties of assessing economic development outcomes.

## **II. The Current Formula**

The formula grant has worsened in its ability to effectively target grantees. In 2005 a HUD report indicated that,

“...the current formula continues to target to need: the top 10 percent of communities with the greatest need receive four times as much as the 10 percent of communities with the lowest need. The study shows that the current formula’s ability to target community development need has substantially declined over the past 30 years. A growing number of communities with similar needs receive substantially different grants. Further, the per capita grants awarded to the neediest of communities have decreased while the per capita grants awarded to the least needy of communities have increased.”<sup>5</sup>

This is due a few reasons, one primarily being the variables used to calculate the size of grants awarded to communities. The study found four of the five variables: population, poverty, pre-1940s housing and growth lag all produce anomalies in how grantee awards are calculated.

In particular, the poverty rate variable is problematic. Though poverty rate is a good indicator of community need, “the current formula allows for relatively low-need college towns to receive relatively large per capita grants because off-campus college students are recorded as being in poverty, when many are receiving

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<sup>5</sup> See, Todd Richardson, Office of Policy Development and Research, Department of Housing and Urban Development, CDBG Formula Targeting to Community Development Need. p. x (2005)

unrecorded support from their families. It is better to measure the poverty rate for the non-college student population.”<sup>6</sup>

We should also note also that even the students who are not receiving “unrecorded support” have made a decision to temporarily survive on a low standard of living (by economizing on food and sharing housing with other students) as an investment because the returns to a college education are high. The poor households the federal programs are intended to help, on the other hand, have not chosen temporary poverty to make an investment in their earning potential.

The Administration’s Reform proposal, “The Community Development Block Grant Reform Act of 2006” recommends adopting an alternative formula designed by HUD to rectify this, among other problems. The new formula would fix the poverty rate variable in particular by excluding individuals enrolled in college.<sup>7</sup>

HUD should be commended for identifying and working to solve this problem that will result in funds being allocated more fairly to communities with greater need.

### **III. Transparency in reporting data**

Where CDBG funds are effectively targeted to high-need communities the question is, can CDBG deliver on its mission to, “increase the viability of urban communities by addressing housing needs and creating healthy living environments by expanding economic opportunity primarily for low- and moderate-income persons”?

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<sup>6</sup> See. Op. Cit p. 46

<sup>7</sup> See, The Community Development Block Grant Reform Act of 2006, p. 2.

The answer is: no one knows. The reasons for this are broadly speaking due to data inadequacies, and theoretical. I will return to the theoretical problems in the fifth section. For now I will discuss the data problems.

In order to find out how CDBG dollars affect communities, we need good data. Reporting on CDBG over the decades has not lent itself to either statistical or empirical testing or general transparency to the public. I do not believe this was intentional, but a function of reliance on an outmoded data collection system and the inherent difficulties in gathering consistent data from grantees.

### **How does HUD currently collect data on grantee activities?**

Grantees must submit a Consolidated Plan (ConPlan) indicating how they will spend CDBG funds. This report serves to verify that funds are to be spent in accordance with the statute, rather than to approve of projects at the outset.

A second report, called the Consolidated Annual Performance Evaluation Report (CAPER) contains a narrative describing how CDBG funds were expended in the community, while describing (in varying levels of detail) the public benefits achieved.

Individual grantee level data is sometimes appended to the CAPER reports. The CDBG Activity Summary reports, also known as the GPR describe the dollar amount of the grant, the details of the project, and in some cases, output and outcome information such as the number of persons assisted or the number of jobs created as a result of the grant. In some communities these GPR reports exceed 1000 pages. The grantee level data is submitted to and managed by the Integrated Disbursement and Information System (IDIS), HUD's internal database.

IDIS provides the most comprehensive and specific source of data on how grantees spend dollars. For now, IDIS remains an internal tool and is not readily accessible to researchers or the public. Upgrades to IDIS are underway and HUD has consulted with the National Academy of Public Administration to improve the system.

### **Obtaining CDBG grantee spending data**

In seeking to understand the effects of CDBG dollars, we sought to obtain grantee level spending data for the most recent fiscal year available for a sample of 71 cities.

On its website, HUD offers aggregated data, or disbursement reports, on how funds are expended on the local, state, and national level. But it does not make accessible the more specific data.<sup>8</sup>

Per HUD's advice we contacted the local HUD offices to obtain their CAPER reports with IDIS data, either online or via mail.

Of the 71 cities in our sample, we found that 8.5 percent had their reports with IDIS data on their websites<sup>9</sup>.

The most transparent city in our study<sup>10</sup> was Washington, DC, which not only contained the CAPER report with information on individual grantee projects but issued a press release the day it was published and made copies available to the local public library and local community-based organizations.<sup>11</sup>

49 cities offered to mail the report. We have received 40 to date.

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<sup>8</sup> See, <http://www.hud.gov/offices/cpd/communitydevelopment/budget/disbursementreports/>

<sup>9</sup> 21 cities had the CAPER on their website, but only 6 of those included IDIS data.

<sup>10</sup> Other cities may have similarly transparent practices. We only reviewed the practices of 71.

<sup>11</sup> See, [http://www.dhcd.dc.gov/dhcd/cwp/view,a,11,q,634644,dhcdNav\\_GID,1577.asp](http://www.dhcd.dc.gov/dhcd/cwp/view,a,11,q,634644,dhcdNav_GID,1577.asp)

Seven cities noted that they were unable to send the report with IDIS data due to the sheer volume of the document, in some cases between 1000 to 2000 pages. These offices noted that the unwieldy size made it difficult to upload the documents to their websites, and also too expensive to mail. A few offices offered to send us the report for a fee.

Fifteen cities were unreachable<sup>12</sup>, but nearly all of the offices we spoke with in our study were helpful and courteous.

We encourage HUD to continue upgrading the IDIS system and hope they will consider making the database accessible to the public. We understand that one concern of HUD is that some of the information they collect is private, such as addresses. While respecting the privacy of grantees, we hope HUD will consider displaying at least some of the grantee level information. We believe interested citizens should be able to query how CDBG funds were spent on the individual grantee level with relative ease.

This kind of reporting facilitates a few things:

- ❖ Local citizens are able to better understand the effects of CDBG dollars.
- ❖ There is enhanced monitoring to verify that funds are being expended appropriately, minimizing the potential for waste, fraud, and abuse. It is a low-cost way to improve oversight.
- ❖ We agree with local offices that the current display of data is unwieldy, making it difficult to publish and disseminate. We hope part of the IDIS upgrade effort is to make the presentation of this data more streamlined and amenable to

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<sup>12</sup> These cities either had an out-of-service number listed on the HUD website or did not return phone calls after multiple attempts.



electronic display, and analysis. We believe it should be possible for a citizen to query such a database to retrieve, for example, “all lead-based paint removal projects in a geographic region over a given number of years.” In an information age, this is not an impossible task.

In addition to providing general transparency to the public, there is another good reason for HUD to continue working on upgrading both data collection and display.

- ❖ It will permit social scientists to empirically test of the effects of this program.

Indeed, empirical and statistical testing of this program and similar programs has been hampered by a general lack of data. The only recent independent empirical study I am aware of was conducted by the Urban Institute in October 2002, at the request of HUD.<sup>13</sup>

The purpose of the study was to help the agency develop meaningful performance measures in order to gauge the effectiveness of CDBG dollars in communities.

The study noted that it was relatively difficult to construct a dataset for its sample of 17 cities (chosen because they had enough data), over a long-enough period of time to have measurable effects. The study encouraged HUD to continue upgrading the IDIS system in order that more testing of the data could be performed in the future and over longer periods of time, “Performance measurement activities going forward stand to gain from the accumulation of CDBG expenditure information for periods after the three-year period covered in this analysis.”<sup>14</sup>

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<sup>13</sup> See, Christopher Walker, et. al “The Impact of CDBG Spending on Urban Neighborhoods.” The Urban Institute, October 2002, [http://www.dhcd.dc.gov/dhcd/cwp/view,a,11,q,634644,dhcdNav\\_GID,1577.asp](http://www.dhcd.dc.gov/dhcd/cwp/view,a,11,q,634644,dhcdNav_GID,1577.asp)

<sup>14</sup> See, Op. Cit p. 76.

They further noted that HUD's IDIS system was already much better than data collection systems in place in similar programs, such as the Community Services Block Grant program in the Department of Health and Human Services.<sup>15</sup>

The fact that CDBG can be considered a leader in data collection for community development programs at the federal level indicates the absolute need for good data collection from the *outset* of a program's creation. Former Federal Reserve Chair Alan Greenspan noted in 2003, "The relative paucity of data and research on community development programs has limited the ability to fully demonstrate their impact and credibly differentiate those that are successful from those that are ineffective."<sup>16</sup>

CDBG has been awarding money for over 30 years, and has its roots in the War on Poverty urban-aid grants of the mid-1960s. Poor data collection in the past is one reason why we are not able to reliably measure the effectiveness of this approach to community and economic development outcomes.

Requiring good information is essential. One way to require good data collection is to require outcome measures of program performance.

#### **IV. The Importance of Outcome Measures**

Transparency encourages good practices and minimizes on waste. Good data collection may facilitate statistical testing. Outcome measures allow us to try to monitor the management and progress of programs, ultimately helping us to answer the questions, "Does

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<sup>15</sup> See. Op. Cit. p. 76.

<sup>16</sup>See, Alan Greenspan, "Sustainable Community Development: What Works, What Doesn't, and Why?" remarks delivered at Federal Reserve System conference on Community Affairs Research, March 28, 2003. <http://www.federalreserve.gov/boarddocs/speeches/2003/20030328/default.htm>

CDBG work? Can it meet its statutory objectives?” “How is this program compared to similar programs in the federal government?”

The good news is HUD has developed and is beginning to use more outcome-oriented measures. The Joint Grantee/HUD/OMB Outcome Measurement Working Group published 18 new measures in the Federal Register on June 10, 2005.<sup>17</sup> These measures are included in Appendix III<sup>18</sup>.

The program objectives contained in the new Outcome Measurement System are also contained in the Administration’s reform package.

These objectives are:

- 1) Foster a suitable living environment within the community for families and individuals,
- 2) Focus on developing decent affordable housing for families and individuals; and
- 3) Foster and create economic opportunity, economic development, commercial revitalization and job formation.

Grantees will decide if their activities serve one of these three aims and report accordingly.

Separate from this performance measurement system, HUD states that, “it would like to be able to demonstrate potential outcomes such as higher homeownership rates and property valuations, lower unemployment rates and improved education levels, increased

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<sup>17</sup> See, Federal Register, Department of Housing and Urban Development, Notice of Outcome Performance Measurement System for Community Planning and Development Formula Grant Programs. Vol. 71, No 44, March 7, 2006.

<sup>18</sup> Appendix III – Federal Register available at [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

commercial and private investments, and additional assisted businesses that remain operational for at least three years.”<sup>19</sup>

These performance indicators should help HUD identify whether the activities undertaken by grantees are having some effects in the communities being served by CDBG dollars.

In this system, grantees must determine which of the objectives the activity is serving: suitable living environment, decent housing, or creating economic opportunity. Once the objective for the activity is selected, the grantee must choose one of three outcome categories reflecting what they are trying to achieve with the project: availability, affordability and sustainability. Each outcome category is connected to one of the three objectives resulting in a total of nine groups of outcome/objective statements where grantees report the activity to document the results of their activities. These are:

- 1) Accessibility for the purpose of creating suitable living environments
- 2) Accessibility for the purpose of providing decent housing.
- 3) Accessibility for the purpose of creation economic opportunities
- 4) Affordability for the purpose of creating suitable living environments
- 5) Affordability for the purpose of providing decent affordable housing
- 6) Affordability for the purpose of creating economic opportunities
- 7) Sustainability for the purpose of creating suitable living environments
- 8) Sustainability for the purpose of providing decent affordable housing

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<sup>19</sup>See, Op. Cit. p. 11470.

## 9) Sustainability for the purpose of creating economic opportunity

Based on these statements, IDIS selects the specific outcome indicator for each activity. These 18 “outcome indicators” are included in Appendix II<sup>20</sup>.

Most of these indicators are still mainly output-oriented. The next step is for HUD to demonstrate that these activities being reported by grantees are delivering on the mission of increasing the viability of urban communities by addressing housing needs and creating healthy living environments by expanding economic opportunity primarily for low- and moderate-income persons.

Indeed as noted earlier, HUD has expressed interest in developing more outcome-oriented indicators such as lower unemployment, increased education and increased private investment in order to demonstrate the impact of CDBG funds.

Grantees have expressed anxiety that outcome measures will compromise the flexibility of the program on the local level and that underperformance according to narrow outcome measures will result in the sanctioning of funds.

We believe that any system of performance measurement is only one piece of information in making funding decisions. Certainly in a program such as CDBG grant amounts vary widely from community to community. We should not expect its effects to be the same in every locality. The types of activities undertaken are highly variable. This means that some outcome measures may not be appropriate for some activities. And as we shall see in the next

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<sup>20</sup> Appendix II – Copy of All CDBG Disbursements available at [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

section the problem of measuring the impact of economic development programs is a very complex one.

But, the program must still demonstrate that it is meeting its overall mission as stated in its statute. Local flexibility does not preclude program-wide accountability. This is a locally administered program, but it is also a federally-funded one.

## **V. A Challenge for HUD and Congress: Does CDBG work?**

The job HUD faces: demonstrating the economic and community effects of CDBG dollars is fraught with difficulty. In this section I would like to consider how we might evaluate how CDBG performs in terms of its third objective: “Foster and create economic opportunity, economic development, commercial revitalization and job formation.”

This objective is reflected in HUD’s outcome indicator 4.2.1.7 “Neighborhoods with substantial levels of CDBG investment will show improvements in dimensions such as household income, employment, business activity, homeownership and housing environment.”<sup>21</sup>

There are three kinds of information we can use to assess whether CDBG can deliver on this objective: statistical, other forms of empirical evidence such as case studies, and theoretical.

### **a) Statistical**

As mentioned earlier, the most recent and comprehensive study of the effects of CDBG dollars was performed by the Urban Institute. The purpose their study was to help HUD design reliable

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<sup>21</sup> See, The Department of Housing and Urban Development Annual Performance Report, FY 2005, p. 16.

performance indicators that would measure the effects of CDBG dollars as they relate to community and economic development outcomes.

The study concluded that, “larger CDBG investments are linked to improvements in neighborhood quality in 17 cities.”<sup>22</sup> Two indicators: median loan amount and number of businesses created are good proxy measures for some (but not all) dimensions of neighborhood quality.<sup>23</sup>

They found an overall relationship between CDBG spending and neighborhood quality improvements. But the study was not broad enough to conclusively prove that CDBG investments are positively correlated with specified measurable results.<sup>24</sup>

Among its limitations given the state of the data:

- ❖ The study did not reflect a nationally representative sample of jurisdictions.
- ❖ It could not account for other public investments, including earlier CDBG investments.
- ❖ And it could only test the years 1994-1996, a relatively short period of time.

The study tried to get a sense of whether these two potential outcome measures, median loan amount and number of businesses created, reflect what grantees believe to be CDBG’s main effects, based on their experiences with the program. That is, are these measures reasonable where grantees are concerned?

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<sup>22</sup> See, Walker et. al, p. iii.

<sup>23</sup> See, op. cit

<sup>24</sup> See, op. cit.

The researchers found that, "... performance measures based on the median loan amount are more likely to conform to the views of local practitioners than the performance measures that use the number of businesses in a tract."<sup>25</sup>

In other words, from the local grantees' perspective, the "median loan amount" indicator does a better job overall of capturing the impact of the program than does the "number of businesses" indicator.

Grantees expressed additional concern that any performance measurement system, if misapplied, could result in the sanctioning of funds for poor performance.<sup>26</sup> These findings indicate, "...the kinds of challenges HUD is likely to encounter in implementation of a performance measurement system."<sup>27</sup>

This concern of performance measurement is not unique to CDBG grantees. Rigorous evaluations of the effects of local, state and federal economic development programs are rarely undertaken, as economist Timothy Bartik writes,

"Program administrators fear the political consequences of a negative evaluation. If a program is not evaluated, one can claim success. A process evaluation or survey evaluation is subjective enough that it may be easier to manipulate the evaluation process or reinterpret the results to make the program look better. But if a study shows that firms participating in the economic development program, compared to a truly comparable group, show no difference in performance, then it is difficult to argue that the program works."<sup>28</sup>

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<sup>25</sup> See, op. cit. p. 66.

<sup>26</sup> See, op. cit. p. 74.

<sup>27</sup> See, op. cit. p. 63.

<sup>28</sup> See, Timothy J. Bartik, "Can Economic Development Programs Be Evaluated?" Upjohn Institute Staff Working Paper 95-29. p.20.



The Urban Institute concluded that improved data collection is crucial to developing meaningful performance indicators. It noted the difficulty of being unable to account for other forms of federal spending, in order to isolate the effects of CDBG dollars, and of applying these two performance measures to all communities, where dollars may be spent to achieve variable aims.

## **b) Case-Studies**

Many claims of CDBG's effectiveness rest on local examples of how CDBG dollars have been spent. One often cited accomplishment is CDBG's role in the creation of a high-tech business incubator in Los Angeles County, which created 475 jobs. If done correctly and of sufficient scope, empirical studies that involve field work, interviews, and surveys can be very valuable and can compliment statistical inference. They can provide evidence when after exhausting econometric methods, statistics fail to show significance.

The most useful and effective type of case study is one that takes into account other factors that might have influenced the results. If the case is supposed to be used to help evaluate a program, the researcher should also present evidence that the particular case is more likely to represent "typical" results, rather than a special situation.

However, this should not be confused with anecdotal evidence which can be abused. The hazard with anecdotes is that the experience of one person or one community is offered as evidence for what the program is accomplishing nationwide. Further, depending on the quality of the evidence, they may not tell the full story.

We wanted to better understand the job-creation activities undertaken by the CDBG program. With the evidence provided by

the CAPER reports we were able to get a sense of what kinds of jobs are being created as a result of the program.

One of the eligible activities under the CDBG statute is economic development.<sup>29</sup> This takes three specific forms. HUD categorizes these activities under the following Matrix Codes in the IDIS database.

- a) 18A) ED Direct Financial Assistance to for-profit businesses
- b) 18B) ED Direct Technical Assistance
- c) 18C) Micro-Enterprise Assistance

In FY 2005, of the \$4,848,113,239 disbursed by CDBG nationwide, 8.77 percent or \$425,217,999 of funds were spent on these three activities.

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<sup>29</sup> See, “The Housing and Community Development Act of 1974 Section 5303 a.  
<http://www.hud.gov/offices/cpd/communitydevelopment/rulesandregs/laws/sec5305.cfm>

“(17) provision of assistance to private, for-profit entities, when the assistance is appropriate to carry out an economic development project (that shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods) that--

(A) creates or retains jobs for low- and moderate-income persons;

(B) prevents or eliminates slums and blight;

(C) meets urgent needs;

(D) creates or retains businesses owned by community residents;

(E) assists businesses that provide goods or services needed by, and affordable to, low- and moderate-income residents; or

(F) provides technical assistance to promote any of the activities under subparagraphs (A) through (E);

One of the outcome indicators associated with this activity is the total number of jobs created. In FY 2005, HUD states that 91,237 jobs were created nationwide as a result of these activities.

Some localities elect to spend none of their funds on this activity. Others elect to spend a significant portion of their funds on providing assistance to businesses.

We examined how one locality: Madison, Wisconsin spent its CDBG funds in FY 2005. Madison expended 32 percent or \$1,462,123 of its CDBG funds in FY 2005 on Direct Financial Assistance to for-profit businesses and on Micro-enterprise Assistance. We include as Appendix IV<sup>30</sup> Madison, Wisconsin's disbursement report for 2005. Included as Appendix V is the relevant portion of Madison, Wisconsin's CAPER report.

According to its CAPER report, CDBG funds are managed by the Madison Development Corporation, which is described as "one of the more successful community-wide development corporations in the country."<sup>31</sup> It indicates that as a result of its lending activity to local area businesses, in 2005 it was responsible for creating 99.24 full time jobs filled by 110 low-to-moderate-income individuals.<sup>32</sup>

What sorts of jobs were created by these loans? A closer look reveals that these businesses include two coffee houses, a bakery, restaurant, several biotechnology firms and information technology companies.<sup>33</sup>

Madison, Wisconsin is a college town. Fifty nine percent of its college students are classified as living in poverty because they do

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<sup>30</sup> Appendix IV – Madison Disbursement available at [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

<sup>31</sup> See, City of Madison, Wisconsin, Consolidated Annual Performance and Evaluation Report (CAPER) on Community and Neighborhood Development for the Period January 1, 2005 to December 31, 2005. pp. 29-30.

<sup>32</sup> See, op. cit included as Appendix V of this report. [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

<sup>33</sup> See, Appendix V of this report. [http://www.mercatus.org/CDBG\\_Testimony](http://www.mercatus.org/CDBG_Testimony)

not report unearned support from their parents. And the current CDBG formula does not exclude them. The percent of non-college students living in poverty is eight percent. The average per capita income of Madison, Wisconsin is \$23,498. The average per capita grant is \$11.

As a comparison, San Marcos, Texas has an *actual* poverty rate of 28.5 percent and an average per capita income is \$13,468. It receives a per capita grant of \$14.86.

According to CDBG's statute, these business loans in Madison, Wisconsin are *legitimate uses* of CDBG funds for the following reasons:

- ❖ These activities satisfy the first requirement of the statute: to principally benefit low-and-moderate income people.
- ❖ These activities address one of the statutorily defined eligible activities: economic development as defined by the provision of assistance to profit-motivated businesses to carry out economic development and job creation/retention activities.
- ❖ These activities serve objective three of the program's performance indicators: foster and create economic opportunity, economic development, commercial revitalization and job formation.

The 99 jobs created in Madison, Wisconsin in 2005 helped HUD reach its actual target of 91,237 jobs nationwide.

The deeper questions behind Madison, Wisconsin's job formation successes are: Was CDBG created to generate coffee house jobs for college students in relatively wealthy communities? Did these local biotech firms create jobs for truly low-to-moderate income

individuals as envisioned by the program's intent, or for graduate students? Were these jobs actually created because of CDBG, or would some of the jobs have been created anyway? Did taxpayers subsidize private businesses to do something they would have done without a subsidy?

Are these negative outcomes? It depends on what Congress is attempting to achieve with this program. Certainly these are not negative outcomes for the businesses or the individuals who got those jobs. But, is this an effective use of CDBG dollars? There are several programs in the federal government that focus exclusively on awarding loans to small businesses such as the Small Business Administration's Basic 7(a) Loan program. Is CDBG effectively placed to award small business loans to middle and upper-middle class communities?

Congress needs to decide what policy aim it is trying to achieve with CDBG. Then it must decide if the program is able to meet that aim. The creators of CDBG imagined this program would address the policy aim of eliminating or preventing urban blight and decay. But the program has morphed into something else, due to the broad nature of its mission, its local flexibility and its varying purposes and applications.

Both grantees and those who evaluate and study the program are frustrated. It is difficult to define measures and ultimately understand what this program's actual effects are. Some argue that's the reason why it should be immune to evaluation.

Indeed, grantees have expressed frustration specifically with the "ineffective" assessment the program received as a result of the Office of Management and Budget's Program Assessment Rating Tool.<sup>34</sup> In a hearing on the Strengthening America's Communities

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<sup>34</sup> See, <http://www.whitehouse.gov/omb/expectmore/detail.10001161.2005.html>

Initiative, before the House Committee on Government Reform on March 1, 2005, Don Plusquellic, President of the U.S. Council of Mayors testified, “PART infers that somehow we’re doing something with these monies other than what was intended, and that we’re not meeting some performance standard.”<sup>35</sup>

This comment is very important because it reveals that the program has drifted from what its authors intended. Its current implementation does not match the policy outcomes that the federal government had in mind when it was created. Madison, Wisconsin was *legitimately* awarded funds under the current formula. And it used them *legitimately* to fund economic development activity to serve the performance objective of job creation.

In our example, we examined one of CDBG’s activities: job creation. What is the outcome? Is the community now more prosperous than they would have been without those CDBG-generated jobs? Would those jobs have existed without the CDBG funds? Simply because money was received and spent in accordance with the statute, does not mean that the purpose of the program is being met. Congress must know whether these activities are resulting in less blighted communities, or are they subsidizing activities that would have occurred anyway.

### **c) Theoretical**

Can CDBG meet its objectives of stimulating economic development?

In considering the effects of economic development programs, the economic literature is vast and also inconclusive. Even with decent

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<sup>35</sup> See, U.S. House of Representatives, 109<sup>th</sup> Congress, Second Session,, “Bringing Communities into the 21<sup>st</sup> Century: A Report on Improving the Community Development Block Grant Program” Fifth Report by the Committee on Government Reform, 109-365, p. 34.

data, economists face problems in fully capturing the effects of a particular program. The main difficulty is establishing what would have happened in the absence of the program. The literature refers to this as the “but for question” or the difficulty of establishing the counterfactual.

For example,

- ❖ Did some of the ‘created’ jobs represent ‘relocated’ jobs?
- ❖ Would the firm have created the job in the absence of the funding?
- ❖ How would the resources used to create those jobs have been used in the absence of CDBG? That is, could these dollars have been spent to achieve a more effective outcome by stimulating more economic growth through other means?

Establishing a comparison between CDBG entitlement communities and those that do not receive CDBG funds might seem to solve this problem. However, one must still locate matching groups and control for confounding factors. This is difficult considering the variable nature of how CDBG funds operate in different communities and the multiple ends these funds serve.

Aside from the methodological issues associated with evaluating the effects of job creation as a result of CDBG funds, we might want to consider the role job creation plays in economic development.

It’s tempting to think that creating jobs or encouraging companies to hire new employees leads to economic growth. The idea is that these new employees will have income and will spend it, increasing the demand for goods and services, and thus labor.

Job creation is the result of sustainable economic growth, not its cause. The emphasis should not be on employing as many people as possible, but rather on using society's resources (land, labor, capital and time) in the most efficient and productive way possible.

This can be summed up as: Economic growth creates jobs. Jobs do not create economic growth. The goal of policy should be to encourage an institutional environment (the right legal, regulatory and tax structure) to promote entrepreneurial discovery. Economic development is about helping individuals and businesses to produce, as efficiently as possible, the goods and services that society demands. Prosperity is the result of market exchange. Market exchange is the result of entrepreneurship. And entrepreneurship depends on the institutional framework established by government.<sup>36</sup>

San Jose State economist, Benjamin Powell summarizes the misguided idea behind the government directly financing job creation, "If creating more jobs were the goal of economic development, then it would be quite easy to achieve. The state could tax citizens and use the revenue to hire people to dig holes and fill them up again. It doesn't generate any new services, or goods, but it creates jobs."<sup>37</sup> Indeed, this was a Keynesian-inspired suggestion during the Great Depression.

There are those here who might disagree with this analysis based on their experience with this kind of program. In that case, if job creation remains a policy goal of CDBG, as economist Paul Courant recommends, this goal should be measured closely to find out who gets the jobs and the incomes from such interventions, and

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<sup>36</sup> See, Israel Kirzner and Frederic Sautet, "The Nature and Role of Entrepreneurship in Markets: Implications for Policy." Mercatus Policy Series, Policy Primer No. 4, June 2006.

<sup>37</sup> See, Benjamin Powell, "Promoting Economic Development: Government Programs or Economic Freedom." Global Prosperity Initiative Working Paper 17, Mercatus Center at George Mason University, 2004.



that this is in accordance with the intent of the program.<sup>38</sup> A simple count of number of jobs created does not tell us the whole story.

## **V. Recommendations**

The Community Development Block Grant program was established with a particular policy outcome in mind: alleviate slums and blight in urban areas to generate economic opportunities for residents. However, it has drifted from its original aim for two reasons: the formula grant is worsening in its ability to target high-need communities, and this kind of program is not well-suited to delivering its third stated objective of *directly* creating economic growth through job creation.

We believe Congress should:

- 1) Change the formula as recommended by the Department of Housing and Urban Development.
- 2) Improve transparency: Require that grantee level data be made publicly available in a searchable database.
- 3) Require the performance measures designed by HUD. This will serve to minimize on waste, as well as provide researchers with the ability to empirically evaluate the program.
- 4) Re-consider what mission Congress was trying to accomplish when it created this program in the light of more recent economic thinking. We believe this program is not well-suited to deliver direct economic benefits, namely objective three: “Foster and create economic opportunity, economic development, commercial revitalization and job formation.” This program needs to develop a more realistic, targeted,

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<sup>38</sup> See, Paul Courant, “How Would You Know a Good Economic Development Policy If You Tripped Over One. Hint: Don’t Count Jobs.” National Tax Journal, December 1994, p. 877

mission .CDBG's provision of loans to small businesses overlaps with several current lending programs in the federal government such as the Small Business Administration's 7(a) Loan program.

- 5) Refocus the program on meeting infrastructure and housing needs in low-income communities, the program is better placed to potentially achieve the aim of helping revitalize distressed communities. Communities should still be able to identify what specific projects best serve this aim of general community development. But local flexibility should not preclude good data reporting practices, enhanced transparency, and frequent assessment of the outcomes served by these activities.
- 6) As the Urban Institute discovered, grantees in their study suspect that business creation would not be a reliable measure of how CDBG funds affect their community. Economists widely suspect that such programs are not likely to have significant or meaningful effects on economic outcomes. This is a case where individual experience and theoretical insight seem to agree. Further empirical studies, may shed light on whether this program can have the *direct* economic effects intended by its creators. But, we should remember that this is a program that has spent \$100 billion over 30 years. With such a dramatic expenditure of funds, we would expect to see at least a few profound examples of community and economic revitalization as a result of this program. Together empirical, theoretical, and experiential evidence should support the belief that this program can help revitalize communities.
- 7) HUD is to be commended for identifying structural and management deficiencies in the Community Development Block Grant program. We believe that better targeting of

funds, a more realistic mission with achievable outcome measures may better serve some of the goals this program is trying to meet.