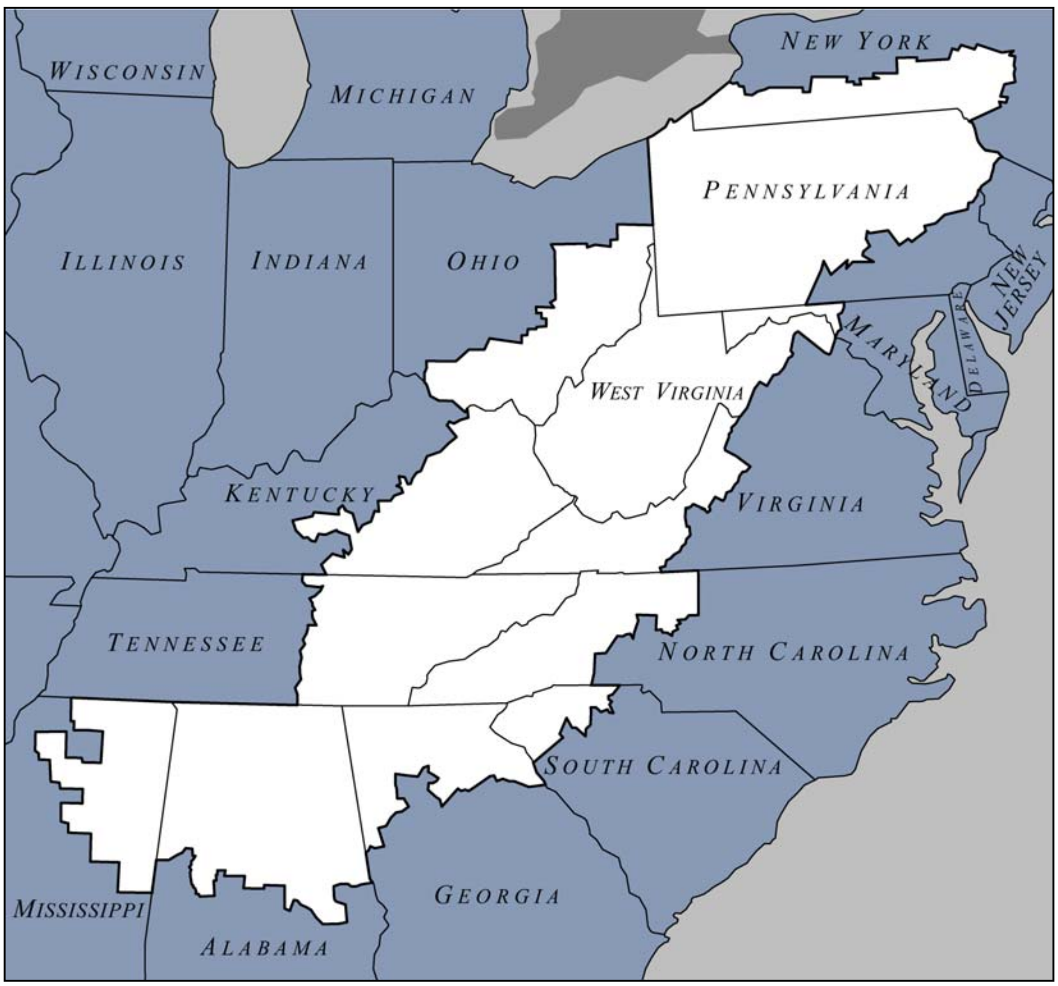
APPALACHIAN REGIONAL COMMISSION

FY 2005 Performance Budget Justification

As submitted by the Federal Co-Chair to the Appropriations Committees of the House and Senate

February 2004



Appalachian Regional Commission—A Federal-State Partnership

Alabama	*Kentucky*	*Mississippi*	*North Carolina*	*Pennsylvania*	*Tennessee*	*West Virginia*
Georgia	*Maryland*	*New York*	*Ohio*	*South Carolina*	*Virginia*	

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Table of Contents

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FY 2005 Budget Request Summary and Highlights

The President's FY 2005 Budget requests $66 million[1] in direct appropriations for the Appalachian Regional Commission (ARC) to address the requirements set forth by the Appalachian Regional Development Act Amendments of 2002, which reauthorized the Commission for five additional years. This funding is within the level authorized in the amended Act and is vital for positioning the Appalachian Region for vigorous, self-sustaining growth.

Because Appalachia's economic problems are widespread and generational, Congress directed ARC to address the needs of severely distressed areas of the region and focus special attention on areas of greatest need. Despite recent progress, Appalachia still does not enjoy the same economic vitality and living conditions as the rest of the country. The region continues to battle economic distress, as its economy is disproportionately dependent on extractive industries and manufacturing. Concentrated areas of high poverty, persistent unemployment, and low incomes—exacerbated by inadequate health care, educational disparities, and out-migration—still prevent many Appalachians from participating fully in the American economy. At the same time, the region possesses important assets: a rich cultural heritage, substantial natural resources, a spirit of independence, and a dedicated workforce. ARC seeks to capitalize on these assets.

ARC achieves its mission by promoting economic and community development through a framework of joint Federal and State initiative. This Federal-State partnership provides the mechanism to identify and address the most critical regional and local needs, enabling federal resources to be tailored to the unique needs of individual communities.

Improved transportation has been a longstanding strategy to help connect the Region to the rest of the country and stimulate economic growth. Congress provided significant funding to build highways throughout the Region but also placed particular emphasis on positioning the entire Appalachian Region to take advantage of the associated economic growth that would come with those highways.

ARC was explicitly directed to help generate a diversified regional economy through a broad range of responsibilities, such as fostering human resource development, enhancing the competitiveness of the region's industries, improving the skills of the Appalachian workforce, providing technical and financial resources for business development, and coordinating the economic development activities of other Federal agencies within the region.

[1] This amount includes funds for 11 Federal full-time equivalent positions and 48 non-Federal Commission full-time equivalent positions.

These responsibilities require the Commission to play a unique Regional development role, studying the problems confronting Appalachia, partnering with State and local governments and communities to systematically address the major causal factors, providing one-time "seed money," and leveraging funds contributed by other public and private organizations. In fact, leveraging other public and private funds is foremost in our thinking at ARC. A recent study of Commission infrastructure projects demonstrated that for every one-dollar invested by ARC between 1990 and 1997 Appalachia gained 33 dollars in long-term benefits.

Because of its State partnership and flexible problem-solving approach, ARC is able to identify and help fund innovative grass roots initiatives that might otherwise languish as missed opportunities. In many cases, ARC functions as a predevelopment agency, providing modest amounts of initial funding that are unavailable from other sources. Successful initiatives, such as ARC's Appalachian Higher Education program, can be replicated across the Region. These funds jumpstart new projects that help communities develop regional economic development opportunities.

Return on Investment

Historically, ARC projects have proven cost-beneficial. For example, a recent outside study, *Evaluation of the Appalachian Commission's Infrastructure and Public Works Program Projects,* examined 99 projects initiated and completed between 1990 and 1997. It found that there was a 33 to 1 return for every ARC dollar invested in terms of income from jobs created. For a *one-time* public investment in these economic development projects, there was approximately $9 of annual recurring personal income per public dollar invested. The investment in the Appalachian Development Highway System has resulted in efficiency benefits of $1.18 for each $1 invested; and economic development benefits of $1.32 for each $1 invested.

For example, ARC:

- Targets 50 percent of its funds to distressed counties and/or distressed areas;
- Funds small projects that would typically not meet the threshold of other Federal economic development agencies but are essential for addressing deeply rooted regional problems,
- Funds projects that use new and innovative approaches to tackle local problems;
- Provides the critical dollars for many initiatives so that they qualify for other public and private sources of funds; and
- Provides some funding to assist distressed communities in conducting feasibility studies for capitalizing on economic opportunities.

Through the years, ARC has effectively used its funds to help communities make better use of limited resources from other federal agencies. These Federal funds combined with state, local, and private money provide a broad program of assistance to the Region.

ARC is a performance-driven organization, evaluating progress and results on an ongoing basis and relying on clearly defined priorities and strategies for achieving them. Based on performance information, ARC adjusts its strategies, emphasizing what works and discontinuing what does not, in order to ensure maximum return for taxpayers. A new set of goals and strategies for tackling Appalachian economic problems has been designed and is presented in Table 1.

As Table 1 indicates, ARC focuses first and foremost on significantly reducing regional economic distress. It achieves this goal by focusing on the predominant inhibitors – regional isolation and preparedness for being economically competitive as the isolation problems are overcome. This logic specifically addresses Congress' mandate set out in the Appalachian Regional Development Act of 1965. It ensures that the large Federal highway investment in Appalachia does not result in a highway that is used to bypass the region, but instead achieves Congress' original intent of using the highway as a regional development catalyst that benefits both the Region and the U.S. economy as a whole.

During FY 2005 ARC will devote its resources to programs that tie to and specifically support the strategic and supporting goals. Table 1 presents ARC's new performance framework. It represents a shift for ARC by emphasizing a macroeconomic framework for reducing Regional economic distress. The two general goals are inter-related. Reducing isolation positions the region to be more economically competitive, but other investments are essential to ensure that the Region will benefit as a result. The logic for this second important goal and accompanying set of critical strategies is included in the budget justification.

The Commission will continue to designate the most severely distressed counties and areas in the Region as a strategy for targeting resources to the greatest need and addressing the priority for funding those areas under its 2002 reauthorization statute. ARC recognizes the severely distressed designations as a way to identify the parts of the Region that have substantial pre-developmental needs and few resources to address them through traditional federal programs.

During FY 2005, ARC will achieve its goals by investing approximately $450 million from the Highway Trust Fund to build approximately 30 additional miles of highway, $5 million to improve telecommunications, $14 million to improve employability of the Appalachian workforce, $32 million to improve infrastructure, and $15 million to diversify the Appalachian economy. The Commission will work with its partners in Appalachian states and communities to identify specific local projects that fit the parameters of ARC goals and strategies. These investment areas will change over time as certain problems are solved and new issues and needs emerge.

Five major emphases will guide Area Development funding in FY05, enabling the Commission to address compelling needs in the Region and to build on its assets:

- *Clean Water*. Clean water is the most basic infrastructure requirement for health and economic growth. Few Americans realize that many distressed Appalachian communities still lack this basic infrastructure.

- *Telecommunications.* Creating access to high-speed telecommunications is critical to Appalachia's future. Without it, the Region's businesses and institutions will continue to lag behind the rest of the nation, and the potential for growth of technology-related industries will be impaired.

- *Education.* Achieving parity with the nation in educational attainment is key to enhancing the employability of the work force in Appalachia. The largest remaining challenge is reducing the gap in college-going rates between Appalachia and the rest of the country. Additionally, efforts will focus on vocational training and moderate- to long-term on-the-job training.

- *Health Care.* Appalachia suffers from disproportionately high rates of chronic diseases such as cardiovascular disease, cancer, and diabetes. They have a significant adverse affect on the Region's workforce participation and productivity and impede the opportunity for economic growth.

- *Cultural Heritage.* The rich cultural heritage and natural beauty of the Region are unique assets that can and should be a basis for strategies to diversify the economy of Appalachia.

The Commission is also committed to implementing the President's Management Agenda. The ARC governance model is ideally suited for implementing it. Detailed discussion regarding progress is included as Appendix A.

Table 1 – ARC Goals and FY 2005 Priorities	
STRATEGIC GOAL: Significantly reduce regional economic distress	
Supporting General Goals	During FY 2005, ARC will:
1. Reduce isolation	Build approximately 30 miles of highway in FY 2005. Expand availability of broadband telecommunications by providing broadband service to 5 communities for every $1M invested.
2. Optimize ADHS Investment by Improving Regional economic competitiveness	Leverage ARC limited assets by attracting other public and private funds to ARC sponsored projects, achieving specific leverage ratios for infrastructure, employability, and economic diversification projects.

Table 2 summarizes the request for FY 2005. The attached budget justification explains and supports the Federal Co-Chair's request for resources to respond to this mandate.

Table 2 - Summary of FY 2005 Request by Performance Goal
($ Millions)

	Program Funding	Local Development District Planning	Salaries & Expenses	Total Request
Goal 1 Reduce Isolation				
1a Constructing ADHS	[$450] *	-	-	**[450]** *
1b Expanding Telecommunications Capacity	4.2	0.4	0.4	**5.0**
Goal 2 Improve Regional Economic Competitiveness				
2a Improving Infrastructure	27.5	2.6	1.9	**32.0**
2b Increasing Employability	11.7	1.1	1.2	**14.0**
2c Diversifying the Economy	12.2	1.3	1.5	**15.0**
Total Current Request	**55.6**	**5.4**	**5.0**	**66.0**

** To be provided from the Highway Trust Fund; excluded from current request totals*

Appalachian Regional Commission
FY 2005 Performance Budget Justification

The mission of the Appalachian Regional Commission is to be an advocate for and a partner with the people of Appalachia to create opportunities for self-sustaining economic development and improved quality of life

I. Introduction

The Appalachian Region is home to nearly 23 million people living in 410 counties within 13 Eastern states. Congress, in 1965, acknowledged the profound economic and social problems in the Region that made it "a Region apart" from the rest of the nation. It authorized the creation and funding of the Appalachian Regional Commission (ARC) to provide leadership in identifying and tackling the root causes of those economic and social problems so that the Region could join the rest of the nation and contribute to the overall prosperity of the country rather than being a drag on its resources.

Congress directed ARC, as a partnership of the Federal Government and the 13 Governors of the Appalachian states, to tackle two major Regional barriers to success – its isolated geography and its other specific deficits that have historically inhibited economic and social progress. The two issues were not seen as independent – even if the isolation could be resolved by building major highways throughout the Region, the other deficits would continue to inhibit Regional progress. In fact, if Federal highway investments were not accompanied by corresponding investments in economic and social development, the highways could end up serving as an Appalachian "by-pass" that would exacerbate rather than remedy its problems.

A "Region Apart"

Employment
A majority of Appalachian counties have a higher unemployment rate than the national average and 145 counties exceed the national average by 150%.

Income
Appalachia trails the rest of the nation by 18% in per capita income, reflecting the difficulty in closing the income gap in the higher and middle-income brackets.

Education
The number of Appalachian residents possessing a college degree is about two-thirds of the national average.

Health
Appalachia has higher rates of cancer, heart disease, diabetes and chronic obstructive pulmonary disease compared to the nation as a whole.

Infrastructure
Thirty percent of Appalachian households are not connected to a centralized wastewater treatment facility. 15% of households in central Appalachia lack both public water and wastewater services.

Since 1965, through leadership, partnership, leveraging public and private funding, coordination, and careful utilization of its resources, ARC has made considerable progress. It has:

- *Reduced the Region's isolation* by constructing more than 2,400 miles of new highways, which represents approximately 80% of the Appalachian Development Highway System (ADHS) initiative. The ADHS replaces a network of worn, narrow, winding two-lane roads, snaking through narrow stream valleys or over high rugged mountains.

- *Improved the Region's economic progress* by improving the employability of the workforce (education, health care, skills training, school-to-work transition), improving living conditions (water and sewer and environmental quality), and strengthening the Region's basic infrastructure to support a growing workforce and encourage public and private sector organizations to locate in Appalachia.

- *Promoted Appalachian entrepreneurship and business development*, by providing technical assistance, financing, and support to the Region in marketing its unique cultural heritage and Appalachian products.

These strategic investments have produced positive outcomes for the Region. For example, ARC's efforts have helped the Region:

- decrease the number of severely distressed[2] counties by almost 60 percent, from 223 to 91 counties (see Appendix B);

- reduce the Region's poverty rate by one-half, from 31 percent to 13 percent;

- lessen the per capita income gap between Appalachia and the rest of the U.S from 22 percent below the national average to 18 percent;

- reduce the infant mortality rate by two-thirds and strengthen the rural health care infrastructure through the addition of over 400 rural health facilities;

- increase the percentage of adults with a high school diploma by over 70 percent; and

- increase the number of Appalachian households with drinking water and in-door sanitation facilities by 800,000.

Two independent studies found that ARC's coordinated investment strategy has paid off for the Region in ways that have not been evident in other parts of the country without a regional development approach. A study in 1995 funded by the National Science Foundation compared changes in Appalachian counties with their socioeconomic twin counties outside the Region over 26 years, from 1969 to 1991. This analysis, controlled for factors such as urbanization and industrial diversification, found that the Appalachian counties grew significantly faster than their economically matched counterparts outside Appalachia. A more recent similar analysis by East

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[2] ARC uses a very conservative measure of severe economic distress. Distressed counties meet three criteria: 1) per capita market income is not greater than two-thirds of the U.S. average, 2) three year unemployment rate is 150 percent of the U.S. average or greater, and 3) poverty rate is at least 150 percent of the national average. Counties with at least twice the national poverty rate and meeting one other criterion for economic distress are also classified as distressed.

Carolina University compared Appalachian counties with matched non-Appalachian counties in the southeastern states, with similar findings.

Yet ARC's mission has not been completed. Over 90 counties and many more areas still are classified as severely distressed. Much work remains to leverage the Federal investment in the ADHS and to position the Region to achieve economic and social parity. This integrated budget and performance request for FY 2005 describes the outcomes that will be achieved, strategies for achieving them, and the funding necessary to do so. ARC will continue to provide leadership, analysis, and problem resolution approaches to make strategic investments in the Region. It will work closely with the State and community partners, building on existing public and private sector partnerships, and seeking new and innovative approaches for achieving desired results.

II. Current Challenges Confronting Appalachia That Require ARC Attention

Despite recent progress, Appalachia still does not enjoy the same economic vitality and living conditions as the rest of the country. The Region continues to battle economic distress, concentrated areas of high poverty, unemployment, low income, poor health, educational disparities, and population out-migration that are among the worst in the nation.

Increased global competition and technological change have resulted in job losses and restructuring in many key Appalachian industries. Employment losses in non-durable goods and manufacturing and resource-based industries have been severe and disproportionately impacted much of the Region because of its manufacturing dependence. Some of these declines have been offset by employment growth in service sectors, but service sector average wages are considerably lower than those in the goods producing sectors. The Region's isolation and difficulty in adapting to changes over past decades and in retooling to be competitive are major factors contributing to the gap in living standards and economic achievement between the Region and the rest of the country.

The Region has been battered by structural economic shifts because of its disproportionate reliance on extractive industries and manufacturing. The Appalachian apparel industry has lost 100,000 jobs since 1991, and the textile industry has lost 23,000. Jobs lost in Appalachian-based steel and other primary metals businesses totaled over 24,000 in the last ten years. Over the last decade, one out of five jobs lost in textiles nationally occurred in Appalachia, and one out of three jobs lost in apparels occurred in Appalachia. An estimated one-third of the apparel losses and one-half of the textile losses are due to imports or plant relocations overseas. Appalachian coal-mining employment has fallen from 101,500 workers in 1987 to 58,600 in 1997.

The coming years are critical. Considerable investment has been made in reducing Regional isolation through the funding and development of the ADHS. When ARC was established, Congress found that economic growth in the Region would not be possible until the Region's isolation had been overcome. As the highway system progresses toward completion, the Region is positioning itself to take advantage of its newfound accessibility. However, it must overcome deficits in a number of areas in order to leverage the highway investment and the Region's cultural heritage in attracting businesses, development, and visitors to the area. Two of the key challenges are addressed in ARC's major goals, as discussed below.

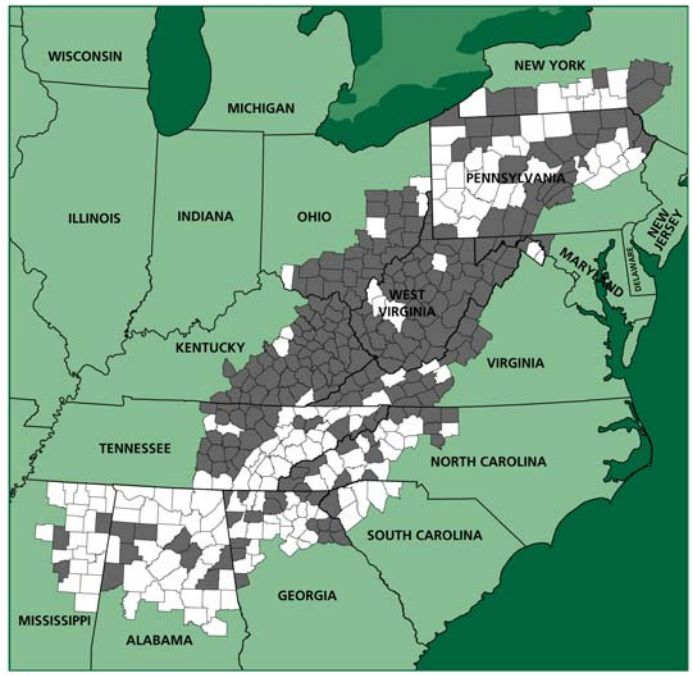
Goal 1: Reducing Geographic and Technological Isolation

Appalachian isolation must be overcome. The Region is well on its way to doing so by building the ADHS. As highways are constructed, considerable secondary and tertiary highway and road construction occurs. This "spider web" effect makes it significantly easier to move products in and out of the Region, to travel longer distances for employment opportunities, and entice businesses to locate along major thoroughfares and therefore strengthen the economy of the Region.

Completion of the ADHS will permit the nation to realize the system-wide efficiencies of linking with the interstate highway system and the nation's intermodal transportation networks. Appalachia's strategic location between the eastern seaboard and the Midwest enhances the national value of the ADHS as a transportation asset to channel increasing domestic and international freight traffic between metropolitan centers and trade gateways. Forecasts of national freight demand over the next ten to twenty years by the U.S. Department of Transportation underscore the potential of the ADHS to help relieve congestion along major transportation routes and offer new and more efficient freight flows to trade gateways.

Figure 1

Appalachian Counties Underserved by Internet Services



Counties Lacking Significant High-Speed Internet Services

Data Source: Links to the Future: The Role of Information and Telecommunications Technology in Appalachian Economic Development. *(2000 data.) Michael Oden and Sharon Strover, University of Texas, 2002.*

Technological isolation must be overcome, as demonstrated by Figure 1. While progress has been made in reducing geographic isolation, the information superhighway and the digital revolution have been slow in coming to Appalachia's businesses and 23 million residents. The Region lacks an adequate telecommunications infrastructure. Its people are less familiar with and therefore more easily intimidated by its complexity.

Communities across the Appalachian Region, especially those in rural areas, face serious challenges in using new information, computing, and telecommunications technologies (ICT) to expand their economic development horizons. The telecommunications infrastructure in the Region is underdeveloped, and compares negatively to national averages on various indicators. In addition, the capacities to use these technologies to improve performance in public and private sector institutions are often not as developed as in urban centers. A recent study found that the lack of advanced telecommunications services at prices affordable to local businesses and public organizations is a significant barrier to economic and social development in parts of the Appalachian Region.[3] For example, tech-related job growth in the Region's rural areas from 1996-2000 was 21 percent versus the national average of 53 percent.

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[3] Links to the Future – The Role of Information and Telecommunications Technology in Appalachian Economic Development, Michael Oden and Sharon Strover, June 2002.

Goal 2: Improving Regional Economic Competitiveness by Overcoming Major Deficits and Building on Assets

A major challenge for ARC involves creating a diverse resource-rich competitive environment that is attractive to businesses and entrepreneurs. Increasingly, the majority of jobs will require workers who have acquired knowledge and skills by attending college, vocational training, moderate to long-term on-the-job training, and real work experience. Businesses will also be attracted to regions that offer reasonably priced properties suitable for development, and locations that are considered desirable places for its employees to live. Programs will be geared to reduce deficits such as the lack of clean water, poor access to telecommunications, low college-going rates, and limited health care. They will also build on assets such as the Region's cultural heritage, indigenous products, and natural beauty.

2-1 Strengthening Infrastructure and Services to Support Business Development

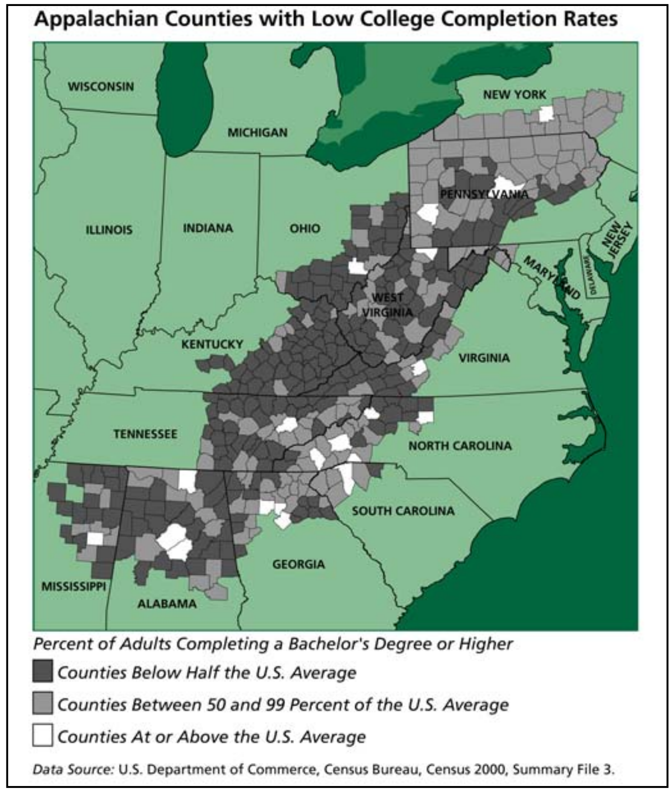
Numerous distressed areas within Appalachia, that would benefit the most from economic development, are constrained by a lack of basic infrastructure services that other areas take for granted. Many people in Appalachia do not have clean drinking water or environmentally safe wastewater disposal facilities. Chronic water and waste problems threaten public health and environmental quality and consume resources that might otherwise be utilized for economic development. Adequate water and wastewater facilities, in addition to protecting public and environmental health, enable communities to grow and attract businesses.

Many rural Appalachian communities lack even the most basic services, with over 30 percent of households not being connected to centralized waste water treatment, particularly in central Appalachia, and other communities that rely on private septic systems. In addition, at least 15 percent of households in central Appalachia lack both public water and wastewater services, with the lack of service posing serious environmental problems such as "straight piping" of wastewater into streams. Also, reliance on private well water systems that are poorly regulated presents serious environmental problems for communities, particularly because these systems are not currently reported in EPA's needs assessments for safe drinking water requirements. Preliminary investment requirements for wastewater infrastructure and for safe drinking water systems in Appalachia are estimated at $10 billion and $8.4 billion, respectively. These estimates may understate the magnitude of problems; Kentucky estimates that in the Appalachian portion of the State the total 20-year gap for drinking water and wastewater treatment requires an investment of over $1.9 billion.

In Appalachia, smaller, rural systems face relatively higher investment costs to meet increasing environmental requirements, especially for those communities experiencing declining customer bases and low household incomes. Affordable rate increases to meet these investment needs is likely to be a challenge for 331 counties in the Region where average household income was two-thirds or less of the national average, according to the 2000 Census. These communities need additional technical, managerial, and financial assistance to meet their future needs.

Appalachia has other environmental problems that inhibit economic development. For example, in addition to inadequate water and sewer services, the Region has many tracts of land known as Brownfields, properties that have been developed for industrial or commercial purposes, polluted, and then abandoned or underused. These properties are also some of the best in the Region for economic development purposes, but restoring them to productive use requires considerable effort and resources.

Figure 2

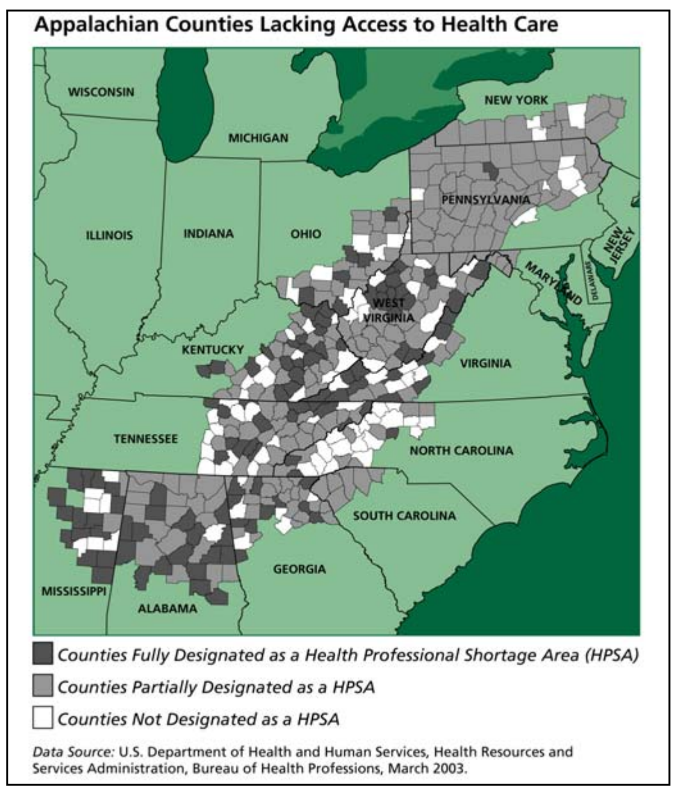


2-2 Improving Employability

Jobs growth will not occur in places where there is an uneducated or unskilled workforce. Global competition is reinforcing the economic premium on workers in knowledge-based industries, leaving low or unskilled U.S. workers increasingly vulnerable. ARC seeks to increase the employment rate and productivity of Appalachia's workers, and attract educated and skilled workers to the Region. This will attract desirable business to the Region. Doing so will require considerable investment in improving educational achievement at all levels, as evidenced by Figure 2.

For example, closing the job gap in telecommunications and information services industries will require an additional 200,000 information technology workers over the next seven years. The current education and technical skill level of the Regional workforce cannot meet this need. Appalachia's higher education attainment gap with the rest of the nation has widened in the last decade for those with a college degree or graduate degree. In 1990 the difference between the Region and the nation's share of adults with college degrees was 6.0 percentage points, but in 2000 the gap widened to 6.7 percentage points.

Figure 3



As evidenced by Figure 3, access to quality health care is also lacking, which makes Appalachia a less desirable place to live and work. Appalachia suffers from disproportionately high rates of chronic diseases such as cardiovascular disease, cancer, and diabetes. Although the Region has improved its health care infrastructure in recent years, it still needs to attract more physicians and medical facilities in order to be on par with the rest of the Nation. Over two-thirds of the Region's counties are fully or partially designated by HPSA as areas having a health care professional shortage. Most Appalachian counties have had difficulty attracting basic services such as dentistry, outpatient alcohol treatment, outpatient drug treatment, and outpatient mental health services.

2-3 Diversify the Appalachian Economy

Structural changes in sectors such as coal mining, steel, furniture manufacturing, textiles, and agriculture have hit Appalachia disproportionately hard, threatening to reverse the modest economic gains that many Appalachian communities have made over the last decade.

Appalachia's economic vitality and stability require a more diversified regional economy. In addition to attracting new industry and retaining and expanding existing businesses, the Region needs to nurture home-grown firms and encourage innovation and risk-taking, as well as foster greater private sector investment. Appalachia's rich cultural heritage, which includes the Region's natural beauty, products, and crafts, must be better harnessed to provide local economic opportunities.

The Region also faces entrepreneurial shortcomings that stem from Appalachia's longstanding dependence on extractive industries and branch plant manufacturing, and the presence of absentee landlords who, in some cases, have siphoned off value from the Region. Furthermore, the culture of entrepreneurship is neither broad nor deep and research findings indicate that there are many gaps in the infrastructure for supporting entrepreneurship, ranging from technical assistance to development finance.

III. Past Performance

ARC's Unique Regional Development Role and Contribution

ARC is Congressionally mandated to address the unusual economic and quality of life issues facing the people in Appalachia by partnering with public and private entities to evaluate, coordinate, and implement efforts to improve the Region.

Although resources from various public and private organizations contribute to addressing these issues, the partnership between the Appalachian states and the Federal government is key. It should be noted that the States pay one-half of ARC staff costs and are therefore fully and actively involved in ARC initiatives. By using a "bottom up" approach, ARC seeks input and solutions from local, regional, and state bodies. ARC provides funds to communities that cannot afford to meet other federal or state agency requirements.[4] In so many cases, ARC is the predevelopment

[4] The Commission is a partnership composed of the governors of the 13 Appalachian states and a presidential appointee representing the federal government. Grassroots participation is provided through 72 local development districts—multi-county organizations with boards made up of elected officials, businesspeople, and other local leaders.

agency – it provides seed money unavailable elsewhere to stimulate activities that ultimately allow a community to seek additional public funding.

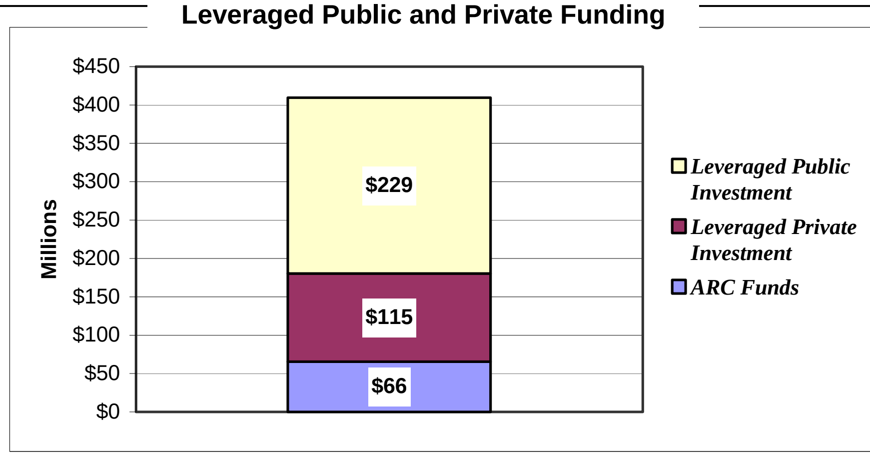
Through the years, ARC has effectively used its funds to help communities make use of limited resources from other federal agencies. These Federal funds combined with state, local, and private money provide a broad program of assistance to the Region. Historically, every ARC dollar is leveraged five times with matching funds from other public and private sources. In short, ARC grants often serve as the "glue" that helps initiate or keep together projects that may not be viable otherwise. ARC leadership, coordination, and advocacy help local communities in Appalachia leverage other resources.

Another important ARC distinction is its long-standing focus on results. As stated previously, specific emphasis is placed on providing assistance to severely distressed counties and areas where over 50% of ARC funds are expended. The ARC strategic plan is used as a planning framework and a decision making tool. Individual projects must demonstrate how they support the goals and strategies in the ARC strategic plan. In addition, grant applications must include a description of the benefits to be derived from the project with particular emphasis on the extent to which the benefits will be realized on a continuing rather than a temporary basis. Specific output, outcome and efficiency measures must be included in the application. The results of each individual funding initiative are reviewed to determine if the investment met its objectives.

From a strategic perspective, macro indicators are reviewed to evaluate progress in improving the standard of living within the region. The number of distressed counties is evaluated along with key indicators such as poverty, per capita income, and unemployment levels. In addition, needs assessments, program evaluations, and look-back studies are endemic to ARC's operations. Reviews of program initiatives are conducted every 5 years on a rotating basis. These studies are used to plan future projects, evaluate the results of ARC's programs, and adjust and develop new strategies for tackling difficult and in most cases generational, long-standing problems.

ARC's Return on Investment

Figure 4
Leveraged Public and Private Funding



Because of its close ties to the local community and ability to help communities leverage both public and private resources, ARC is uniquely positioned to make or facilitate investments that promote the development of the Region and the well-being of its the citizens. ARC provides seed money for local investments that leverages other federal, state and local funds as well as private funds. For example, for public works projects completed during the 1990's, each dollar provided by ARC helped to make possible a package of $2.61 in other public funding and every dollar of public funding brought in $16.65 of private investment (See Figure 4.)[5]

In addition to helping communities leverage other funds, ARC's investments focus on improving the economic vitality of the Region in terms of jobs, income, educational attainment, and quality of life. ARC's achievements are summarized below.

Results from Recent Program Evaluations

A. Finishing the ADHS

An independent study has documented the benefits of the completed portions of the Appalachian Development Highway System (ADHS.) An extensive independent study found that the benefits and impacts of the completed portions of the ADHS include:

- A net increase of 16,000 jobs that would not have existed without the completed portions of the ADHS; the study estimates that these twelve corridors will, by the year 2015, have created a net increase of 42,000 Appalachian jobs, and will rise to 52,000 by 2025.

- Travel efficiencies valued at $4.89 billion over the 1965-2025 period.

- Efficiency benefits of $1.18 for each $1 invested; and economic development benefits of $1.32 for each $1 invested.[6]

- Crash and injury rates drop as much as 60 percent, with fatality rates reduced over 40 percent, when a two-lane highway is replaced with a four-lane divided controlled access highway.

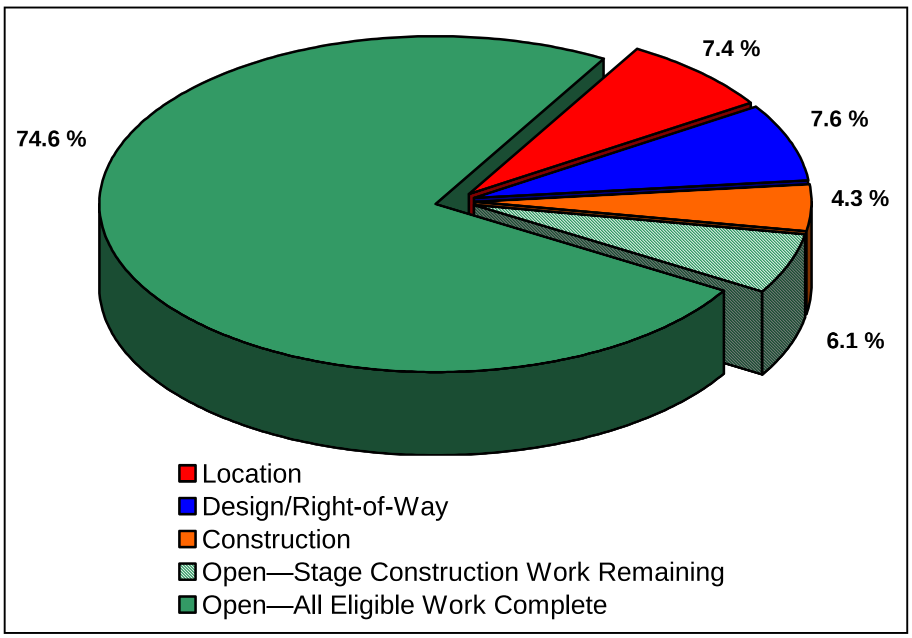
Table 3 and Figure 5 below illustrate the progress made on the Appalachian Development Highway System in each State through the end of FY 2002.

[5] Evaluation of the Appalachian Regional Commission's Infrastructure and Public Works Program Projects, The Brandow Company and Economic Development Research Group, June 2000.
[6] Appalachian Development Highways Economic Impact Studies, Wilbur Smith Associates, July 1998. (Note – This study was unique in that the results of the investments in public highways are rarely examined to determine if original stated objectives were met.)

Table 3 - Status of Completion of the ADHS (Miles) as of September 30, 2002

State	Miles Open to Traffic		Miles Not Open to Traffic			Total Miles Eligible for ADHS Funding
	Complete	Remaining Stage Construction	Construction Under Way	Design Stage	Location Stage	
Alabama	126.4	43.4	47.2	11.8	1.9	230.7
Georgia	99.1	2.4	0.0	7.7	23.3	132.5
Kentucky	388.0	0.0	8.8	21.9	7.6	426.3
Maryland	77.0	3.7	0.0	0.0	2.5	83.2
Mississippi	90.3	0.0	6.7	20.5	0.0	117.5
New York	202.9	11.5	0.0	7.6	0.0	222.0
North Carolina	162.8	4.2	12.6	16.4	8.3	204.3
Ohio	168.3	0.0	9.4	0.5	23.3	201.5
Pennsylvania	256.0	17.2	26.0	42.6	111.3	453.1
South Carolina	16.8	0.0	1.8	4.3	0.0	22.9
Tennessee	194.2	100.1	0.0	11.2	23.8	329.3
Virginia	160.2	0.0	0.0	10.3	21.7	192.2
West Virginia	315.2	0.9	17.5	76.0	0.0	409.6
System Totals	2257.2	183.4	130.0	230.8	223.7	3,025.1

Figure 5
ADHS Status as of September 30, 2002



B. Telecommunications Capacity

There are 240, or 59 percent, of the counties in the Appalachian Region that are underserved by Internet services. An ARC report, Program Evaluation of the Appalachian Regional Commission's Telecommunications Projects (2003), examined 70 projects that were started and completed between 1995 and 2001. Investments involving information technology based training, e-learning/distance learning, e-commerce, telemedicine, network and infrastructure initiatives, and community access centers were among the projects evaluated. The study measured the extent to which the projects enhanced access to telecommunication services and improved the use of these services to meet communities' needs. Also, the study assessed the degree to which projects involved and served community stakeholders.

Most projects reported fulfilling their goals to the same or greater extent than projected. For example, for projects involving:

- **Skills training and educational applications**, 69 percent indicated that their success was the same as expected, 23 percent indicated that it was more than expected and 8 percent reported that it was less than expected.

- **Economic development applications**, 71 percent reported their success to be the same as expected, 14 percent indicated that it was more than expected, and 15 percent indicated that it was less than expected.

C. Ensuring That the Region Has Basic Running Water and Sewage Services

ARC non-highway infrastructure projects, which typically include infrastructure investments such as the development of industrial parks and sites, water and sewer systems, access roads, and

Distance Learning and Telemedicine

Pickens County is a distressed county in west central Alabama. Only 69 percent of its adults have a high school education. The county could not afford to hire new teachers for advanced or specialized courses. At the same time, the local medical system saw a telemedicine opportunity for area residents but considered it unaffordable.

Working together, the County and medical system sought and received $200,000 in funding from the ARC to develop a joint distance-learning and telemedicine service network.

Over a 12 month period, the project saved over $130,000 in costs, provided 257 high school students with enhanced educational courses, offered adults 22 continuing education classes, permitted teachers to earn 51 Continuing Educational Units, trained 144 medical staff, and conducted eight telemedicine sessions.

First Public Water Supply

"I'm 60 years old and have never been able to buy white towels because of the way the water turns them brown," lamented a resident of Julian, an economically distressed area in the coal mining mountains of West Virginia. For decades the residents of Julian had suffered from contaminated groundwater. With no public water supply, they relied on individual wells whose water emitted strong odors and contained numerous minerals and dangerous impurities. To the limited extent that they could afford it, residents bought bottled water for bathing and cooking. An ARC grant, matched two-to-one by state dollars, will provide the first public running water to 110 homes and two businesses in the Julian area. In addition, the new water line will serve a potential business park on Appalachian Highway Corridor G, creating new opportunities for this rural area.

business incubators, have been highly successful. A recent study of ninety-nine projects initiated and completed between 1990 and 1997, found a 33:1 return for every ARC dollar invested in terms of income from jobs created. For a one-time public investment in these economic development projects, there was approximately $9 of annual recurring personal income per public dollar invested.[7]

As indicated earlier, preliminary estimates of investment requirements are $10 billion for wastewater infrastructure in Appalachia, and $8.4 billion for safe drinking water systems. These estimates may understate the magnitude of problems, since Kentucky estimates that in the Appalachian portion of the State the drinking water and wastewater treatment requires an investment of over $1.9 billion.

D. Improving Employability

A 2000 study of the results of 84 ARC education projects funded during the 1990's found that most of the projects in the study reached those segments of Appalachia that are most economically disadvantaged or geographically isolated and that the projects were successful in achieving the outcomes they set forth in their original requests for ARC support.[8] Case Studies provided convincing evidence that the sample projects resulted in a broad range of educational, economic, and social gains. Moreover, the study found that 67 percent of these education projects reported that they would never have been implemented without their ARC award.

Educational Achievement Results

The ARC-funded Appalachian Higher Education Network initiative increased college-going rates for Appalachian high school graduates by double digits for only a few hundred dollars per student. This highly regarded program has been replicated in 29 schools in five additional Appalachian states with two additional States coming on board in Fall 2003. The Ohio program received the "Innovations in American Government Award" from the Harvard University Kennedy School of Government in 2003.

E. Diversifying the Appalachian Economy

Expanding entrepreneurship and supporting business development is essential to improving the viability and diversity of the Region's economy. A study issued in March 2001 of ARC's Entrepreneurship program found that the program has leveraged funds from other sources, helping businesses develop new products, expanding new businesses and creating jobs.[9]

The study found that three-quarters of the projects had assisted firms to develop new products or upgrade new technologies. In addition, half of the projects reported starting new businesses that led to the creation of 304 new firms -- 46 new firms with employees and 258 firms that were sole proprietors. There were 377 new jobs created according to the survey, with 69 jobs in new firms,

[7] Evaluation of the Appalachian Regional Commission's Infrastructure and Public Works Program Projects, The Brandow Company and Economic Development Research Group, June 2000.
[8] Evaluation of ARC's Educational Projects, Westat Corporation, 2000
[9] An Early Stage Evaluation of ARC's Entrepreneurship, Regional Technology Strategies, March 2001

50 in existing firms, and 258 through self-employment. Furthermore, there were 74 jobs saved by project interventions.

Since the 1980's the Commission has supported business development and assisted communities in the creation of over 60,000 jobs in Appalachia. A key component of this business development effort has been the 30 plus Appalachian revolving loan funds that received ARC support. In addition to revolving loan funds, ARC has invested in international trade and market expansion for Appalachian companies; provided funds for downtown renewal and business incubators; supported tourism initiatives and industrial park development; and sponsored conferences on business issues.

IV. FY 2005 Budget and Performance

Congress created the Appalachian Regional Commission to:

- Provide a forum for consideration of problems of the Region and proposed solutions and establish and utilize citizens and special advisory councils and public conferences;
- Provide the infrastructure for economic and human resource development;
- Generate a diversified Regional economy, develop the Region's industry, and build entrepreneurial communities;
- Serve as a focal point and coordinating unit for Appalachian programs;
- Coordinate Regional economic development activities and the use of Federal agency economic development resources;
- Make the Region's industrial and commercial resources more competitive in national and world markets;
- Improve the skills of the region's workforce;
- Adapt and apply new technologies for the Region's businesses including eco-industrial development technologies;
- Improve the access of the Region's businesses to the technical and financial resources necessary to the development of business; and
- Coordinate the economic development activities of and the use of economic development resources by Federal agencies in the region.

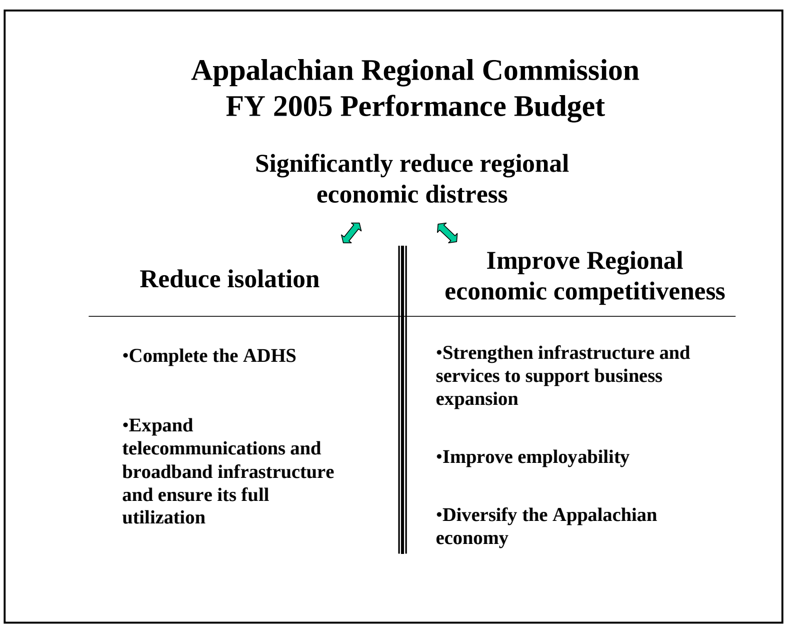
ARC's overarching strategic goal, two supporting general goals, and associated performance measures are displayed below in Table 4. These goals specifically address the Congressional mandate set out in the Appalachian Regional Development Act of 1965. They are designed to ensure that the large Federal highway investment in Appalachia does not result in a highway that is used to bypass the Region but rather that it achieves its original promise of serving as an economic catalyst, benefiting not only the Region, but the U.S. economy as a whole. During FY 2005 ARC will devote its resources to programs that tie to and specifically support these goals.

Table 4 – ARC Goals and FY 2005 Priorities	
STRATEGIC GOAL: ***Significantly reduce Regional economic distress***	
Supporting General Goals	During FY 2005, ARC will do the following:
1. Reduce isolation	Build approximately 30 miles of highway in FY 2005 Expand availability of broadband telecommunications by providing broadband service to 5 communities for every $1M invested
2. Optimize ADHS Investment by Improving Regional economic competitiveness	Leverage ARC limited assets by attracting other public and private funds to ARC sponsored projects, achieving specific leverage ratios for infrastructure, employability, and economic diversification projects.

ARC Priorities in FY 2005

ARC's FY 2005 priorities are designed to help it achieve its long-term goals. At the highest level, ARC is determined to significantly reduce economic distress within the Appalachian Region and target the neediest areas. Doing so requires successful achievement of two inter-related long-term goals, as shown in Figure 6. The first is to reduce the Region's isolation and the second is to position the Region, as it becomes more accessible, to take advantage of that achievement and be prepared to be economically vibrant and competitive.

Figure 6



ARC general and performance goals for FY 2005 are summarized on the following pages. Strategies for achieving the goals are summarized below and presented in more detail within the respective program budget descriptions. The linkage between ARC's strategic goals, general goals, performance goals and annual goals is shown in Table 5 on page 24.

General Goal 1: *Reduce Appalachian isolation so that it can fully participate in and benefit from the strong and vibrant U.S economy*.

The complexity and difficulty of resolving the causes of isolation make this goal long-term. Nevertheless, building blocks toward this goal will continue to be put in place during FY 2005. In order to reduce Regional isolation, ARC will continue to build highways and will also focus on improving Appalachia's participation in the "electronic highway."

Strategies to Reduce Appalachian Isolation

Strategy 1.1 - Complete the ADHS

Approximately 30 additional highway miles will be completed in FY 2005. Achieving this objective will require planning and management, coordination with the Federal Highway Administration, State highway departments, and Federal and State environmental agencies, proper allocation of ADHS funds, ensuring the highway system's integrity, and opening the highway to the traveling public.

Strategy 1.2 - Expand the telecommunications and broadband infrastructure within the Region and ensure its full utilization

In FY 2005, ARC will:

- Focus on small business access to the Internet, ensuring that the Region develops telecommunications plans, creates "aggregation of demand" projects, and installs necessary infrastructure in distressed areas.

- Receive maximum benefit from Internet access by funding e-commerce training programs, developing joint planning strategies with various agencies and organizations such as the Small Business Administration and National Business Incubator Association, supplementing the work of other federal programs, facilitating technology ownership in the home, funding community learning/technology access centers, and assisting in providing enhanced telecommunication services to facilitate smart parks and IT incubator development opportunities.

General Goal 2: *Position the Appalachian Region to be economically competitive as its isolation is reduced.*

Even as the highway and telecommunications strategies succeed, Appalachia may be confronted by other deficits that have persisted for many years. These challenges, if left unchecked, could undermine the Region's emergence from years of economic distress. In response, ARC will carry our various strategies, described below, and measure progress using performance indicators included in Table 5.

Strategies to Position the Region to Be Economically Competitive

ARC will place significant emphasis on reducing Regional deficits and building upon Regional assets. This includes ensuring that the Region has an employable workforce, ensuring that non-highway infrastructure such as water and sewage meets basic standards, and encouraging and promoting entrepreneurship and business development throughout the Region.

Strategy 2.1 - Ensure that the Region has basic infrastructure and services

It is hard for most Americans to fathom that in the 21st century basic water and sewer problems remain a critical issue, but this is true for many smaller, poorer communities of Appalachia. And without the basics, business and industry simply are not interested in locating in the Region. A fundamental feature of the Commission since its creation has been to coordinate with and make best use of all public and private resources to assist Appalachian community development.

ARC has collaborated with federal agencies to support water resource management and cooperative solutions among providers; promote multi-county approaches and private sector partnerships to manage solid waste disposal, water, and wastewater treatment; support waste recycling and new disposal technologies; ensure that remote rural area needs are represented in infrastructure policy formulation and funding; and identify innovative ways to address unmet needs in Appalachian communities and sub-regions.

Currently, the Economic Development Administration, Rural Development, the Department of Housing and Urban Development, and the Tennessee Valley Authority are administering active projects under the supplemental grant provisions of the Appalachian Regional Development Act. Agreements are also still in place with other agencies that have conducted substantial program activities with ARC in the past, including the Federal Aviation Administration, the Federal Railway Administration, the Environmental Protection Agency, the Natural Resources Conservation Service, the Army Corps of Engineers, and the National Park Service. Appalachia will also work to make developable prime sites that have not been available due to environmental problems such as pollution.

Strategy 2.2 - Increase workforce employability

ARC will work with the Region to improve educational capabilities and achievement. In partnership, it will upgrade the Region's education climate, as a whole, improving educational capabilities and providing re-entry programs, school-to-work transition programs, and skills training for specific employers located in or moving into the Region. The Department of Education and the Public Health Service have longstanding agreements in place with the Commission to support projects in the Region.

In FY 2005 ARC will:

- work to increase the college-going rate in Appalachia;

- work with States to start or expand worker skills programs;

- continue its Department of Energy alliance to provide summer math, science, and technology workshops;

- partner with the Appalachian Rural Systemic Initiative to improve student math and science scores in distressed counties;

- identify and duplicate exemplary educational models throughout the Region; and

- identify opportunities for school readiness, adult literacy, dropout prevention, GED, and school-to-work programs and targeting resources to these areas.

ARC will also improve workforce employability by strengthening Regional health care capabilities. It will increase the supply of health professionals in underserved communities and support telemedicine as a means of universal access to comprehensive health care. ARC will identify and address health care delivery gaps and, through continuing partnerships with the Centers for Disease Control and Prevention (CDC) and various medical centers/health care organizations, institute screening, prevention, and control programs in distressed counties. The CDC and the National Cancer Institute (NCI) have committed funds to special initiatives in Appalachia in recent years as a result of ARC advocacy. ARC intends to continue developing its relationships with the CDC and NCI to focus on chronic diseases such as diabetes, cancer, and heart disease. Other ARC activities have been jointly funded or administered by the Economic Development Administration and the Tennessee Valley Authority.

Strategy 2.3 - Promote diversity of the Appalachian economy

As indicated earlier, Appalachia's economic vitality and stability require a more diversified regional economy. Diversified regions are associated with economic growth. In addition to attracting new industry and retaining and expanding existing businesses, the Region needs to nurture home-grown firms and encourage innovation and risk-taking, as well as foster greater private sector investment. Appalachia's rich cultural heritage, which includes the Region's natural beauty, products, and crafts, must be better harnessed to provide local economic opportunities.

ARC has jointly funded many business development projects over the years with federal agencies, and has vigorously reached out to both public and private partners in recent years to promote entrepreneurship in the Region. The Commission launched a Regional entrepreneurship initiative in 1997 to foster homegrown businesses. The Regional strategy involves cooperating with the Federal Reserve, SBA, EDA, TVA and the National Endowment for the Arts to educate current and future entrepreneurs, both youth and adults; improve access to capital for local businesses; strengthen local economies by capitalizing on strategic sectors such as Regional cultural heritage products; and nurture new and expanding businesses by providing technical assistance and creating and supporting rural business incubators and multi-tenant facilities.

ARC has provided a forum for stakeholders and forged alliances with major financial institutions to pursue this strategy. Partner organizations include banking institutions, including the Federal

Home Loan Banks in Atlanta and Cincinnati, the Federal Reserve Banks in Cleveland and Richmond, the Federal Deposit Insurance Corporation in Atlanta, and Wachovia/First Union Bank; and national foundations, including the Ford, Kauffman, Bennedum, and Kellogg foundations, community colleges and local development organizations. The National Commission on Entrepreneurship, National Business Incubator Association, Distributive Education Clubs of America, and Future Farmers of America have also joined with the Commission in supporting Appalachian initiatives.

Table 5 – ARC Goals and Measures				
Program Area	**General Goal And Strategies**	**Long-Term Performance Measures**	**Short-Term Performance Measures**	**Expected Benefits**
Appalachian Development Highway System (ADHS) $450 million	**Goal 1: REDUCE ISOLATION** **Strategy 1.1:** Complete the ADHS	Complete the ADHS by 2021	Miles per $100 million FY 2001: 11.2 miles FY 2002: 8 miles FY 2003: 8 miles FY 2004: 8 miles FY 2005: 7 miles	For every dollar invested, $1.18 in increased travel efficiency benefits
Area Development $ 5 million	**Goal 1: REDUCE ISOLATION** **Strategy 1.2:** Expand Tele-communications and broadband infrastructure	Expand availability of broadband telecommunications to 100 communities by 2015	Achieve 2:1 average investment ratio for telecommunications projects Broadband service provided to 5 communities for every $1M invested	Reduced isolation and improved regional access Enhanced economic competitiveness
Area Development $61 million	**Goal 2: OPTIMIZE ADHS INVESTMENT** **Strategy 2.1:** Ensure basic infra-structure/services	200,000 households served by 2015	Annual: 20,000 households served – 10% of long-term goal Five-year: 10 to 1 private investment ratio	Achieve 4:1 average investment ratio for water/sewer projects Enhanced economic competitiveness
	Goal 2: OPTIMIZE ADHS INVESTMENT **Strategy 2.2:** Increase Workforce Employability	350,000 Appalachians with enhanced employability by 2015*	Annual: 35,000 Appalachians with enhanced employability – 10% of long-term goal* Five-year: 175,000 participants with enhanced employability*	Achieve 1:1 average investment ratio for employability projects Enhanced economic competitiveness
	Goal 2: OPTIMIZE ADHS INVESTMENT **Strategy 2.3:** Promote Economic Diversification	200,000 jobs created/retained by 2015 **	Annual: 20,000 jobs created/retained– 10% of long-term goal** Five-year: 5:1 ratio of annual personal income to total public investment	Achieve 2:1 investment ratio for diversification projects Enhanced economic competitiveness

** measured in higher educational attainment, increased access to health care, or employment after training.*
*** ARC reports total target jobs of funded projects; related validation studies and ROI data separately reported*

Table 6 presents ARC's summary of its performance and resource levels for FY 2005. Additional detail and discussion is included below.

Table 6 - Summary of Performance and Resource Levels

	FY 2003	FY 2004 Estimate[10]	FY 2005 Request
Goal 1a Reduce isolation by building approximately 30 miles of highway in FY 2005	$450 million*	$450 million*	$450 million*
Goal 1b Reduce isolation by expanding broadband telecommunications capacity	$6 million	$ 5 million	$ 5 million
Goal 2a Optimize ADHS investment by increasing employability	$17 million**	$ 13 million	$14 million
Goal 2b Optimize ADHS investment by improving infrastructure	$34 million	$ 33 million	$32 million
Goal 2c Optimize ADHS investment by diversifying the Appalachian economy	$14 million	$ 15 million	$15 million
TOTAL BY FISCAL YEAR (NON-ADHS)	$70.827 million	$ 65.611*** million	$66 million

** Funding for the Appalachian Development Highway System is included in the Federal Highway Trust Fund and therefore is not included in the total requested FY 2005 appropriation.*

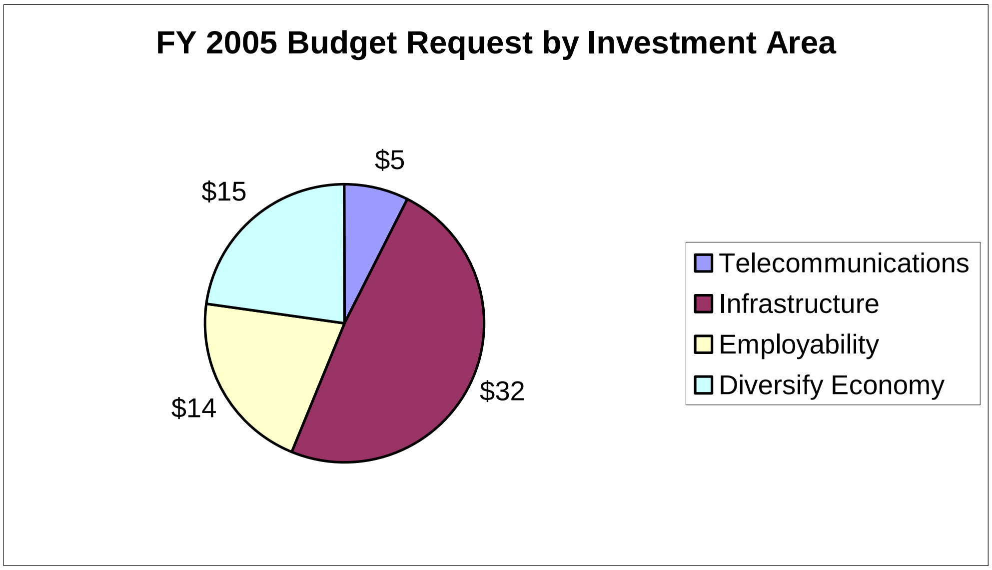
***The amount includes a $5 million earmark to construct a child development center in Alabama.*

**** After rescission*

[10] Estimated based on grant applications to be submitted

The allocation of requested funds across program areas for FY 2005 is displayed in the pie chart in Figure 7.

Figure 7



Performance Challenges

ARC can effectively and efficiently implement its FY 2005 strategies and achieve its performance targets, assuming that it obtains sufficient resources and is able to carry out its planned activities. However, several external and a few internal factors might affect ARC's ability to achieve its goals. These risks are discussed below.

External Challenges

Economic downturns could adversely impact ARC performance goal achievement. Economic down turns are felt earlier in the Appalachian Region. They hit deeper and last longer. This may have an impact on what ARC is able to accomplish in the Region.

Success is very dependent on both State and Regional cooperation and having flexibility to shift funds when new and promising projects are identified. ARC works in partnership with 13 states and 72 local development districts. While for the most part, these partnerships have functioned smoothly; ARC does not have full control over funds or projects funded. ARC may plan that funding will be used for one particular purpose and the states may use those funds to meet what they perceive to be a more pressing need.

Seventy-two local development districts (LDD) serving the Appalachian Region work closely with the states and ARC in developing project packages. These LDDs receive ARC funding to support their operations. ARC plans to maintain LDD funding at $5.4 million.

Sustained funding levels consistent with amounts authorized by Congress are essential for ARC's strategies to be effective. Any significant reduction in funding could have an impact on the willingness of the states to cooperate and partner with the ARC. Although ARC achieves a 5 to 1 leverage ratio of the funds it invests in the Region, the seed money must be sufficient to make cooperative efforts worthwhile.

Government regulations and policies could counteract ARC efforts to reduce distress in Appalachia. In spite of their benefits, environmental law/regulation and trade policy have had a negative effect on the Region. Examples include the impact on the apparel/textiles and coal industries. The Appalachian apparel industry has lost 100,000 jobs since 1991, and the textile industry has lost 23,000. Over the last decade, one out of five jobs lost in textiles nationally occurred in Appalachia, and one out of three jobs lost in apparels occurred in Appalachia. An estimated one-third of the apparel losses and one-half of the textile losses are due to imports or plant relocations overseas. Appalachian coal-mining employment has fallen from 101,500 workers in 1987 to 58,600 in 1997. The Energy Information Administration has projected that over the next decade mining jobs in Appalachia could fall to between 49,000 and 22,000, or even lower, depending on economic and environmental assumptions that are made.

Internal Challenges

ARC is a small streamlined organization and therefore faces challenges in preparing staff to succeed current leadership. ARC has a streamlined organizational structure. There are 11 Federal employees and 48 FTE non-Federal trust fund employees. Although this means that ARC is able to operate efficiently, with extremely modest administrative costs, it also means that key ARC staff members have no “back ups”—in sports parlance, “no bench.” This creates potential challenges when considering succession planning and even in more mundane matters such as vacation time and juggling workload.

Early or forced retirements or poor market performance could substantially accelerate the requirement for contributions to the Commission’s retirement fund from the Federal Appropriation or from member States to keep the fund actuarially sound. ARC is under a separate retirement system that is not fully funded. A large number of retirements could impair the financial health of the system. Additionally, should a reduction in funding necessitate a reduction in staff size, ARC would not have sufficient monies to fund severance benefits.

Limited money for administrative/IT expenses creates challenges in keeping pace with government-wide requirements and initiatives. Implementing e-government initiatives can be an expensive undertaking for small agencies with very limited resources. ARC will need to integrate with the e-grants system and the e-travel system.

Appalachian Regional Commission
FY 2005 Performance Budget

Major Program:
AREA DEVELOPMENT

The Federal Co-Chair requests $66 million for Area Development. This includes funding to support telecommunications and funding for specific initiatives in support of ARC's strategic goal. Table 7 illustrates the goals, measures, and benefits that will be realized from this investment.

Table 7 – Area Development - $66M for FY 2005

Program Area	General Goal And Strategies	Long-Term Performance Measures	Short-Term Performance Measures	Benefits
Area Development $ 5 million	**Goal 1: REDUCE ISOLATION** **Strategy 1.2:** Expand Tele-communications and broadband infrastructure	Expand availability of broadband telecommunications to 100 communities by 2015	Achieve 2:1 average investment ratio for telecommunications projects Broadband service provided to 5 communities for every $1M invested	Reduced isolation and improved regional access Enhanced economic competitiveness
Area Development $61 million	**Goal 2: OPTIMIZE ADHS INVESTMENT** **Strategy 2.1:** Ensure basic infra-structure/services	200,000 households served by 2015	Annual: 20,000 households served – 10% of long-term goal Five-year: 10 to 1 private investment ratio	Achieve 4:1 average investment ratio for water/sewer projects Enhanced economic competitiveness
	Goal 2: OPTIMIZE ADHS INVESTMENT **Strategy 2.2:** Increase Workforce Employability	350,000 Appalachians with enhanced employability by 2015	Annual: 35,000 Appalachians with enhanced employability – 10% of long-term goal Five-year: 175,000 participants with enhanced employability	Achieve 1:1 average investment ratio for employability projects Enhanced economic competitiveness
	Goal 2: OPTIMIZE ADHS INVESTMENT **Strategy 2.3:** Promote Economic Diversification	200,000 jobs created/retained by 2015	Annual: 20,000 jobs created/retained – 10% of long-term goal Five-year: 5:1 ratio of annual personal income to total public investment	Achieve 2:1 investment ratio for diversification projects Enhanced economic competitiveness

FY 2005 Initiative: *Improve Telecommunications Capacity - $5 million*

Expand the telecommunications and broadband infrastructure within the region and ensure its full utilization.

As local leaders assess the economic future of Appalachia, one clear message reverberates: Appalachia must have universal, affordable access to modern telecommunications and information technology, and the people and businesses of the Region must make this technology an integral component of their daily lives. With technological innovation driving the most remarkable revolution in business, industry and communications in a century—diminishing the relevance of geography—there has never been a better moment for Appalachia to participate fully in the nation's economic mainstream.

There are two primary aspects to achieving Appalachia's full participation in the telecommunications revolution: access and full utilization. Key 2005 strategies for addressing these issues are as follows.

Focus on small business access to the Internet. The first priority must be a concentrated effort to connect Appalachia to the Information Highway through a variety of telecommunication services, ranging from basic Internet to higher-speed, switched broadband access. Access to the infrastructure must be both universal and affordable. These technologies must bring voice, video, and data transmission within the practical reach of Appalachia's communities. Building the infrastructure will require public-private partnerships that encourage private investment and aggregate local demand. It will also require strategic planning to identify gaps, assess demand, and establish priorities. As a practical matter, this means addressing several key issues: expanding the telecommunications backbone to the smaller cities and towns and more remote communities; making the "last mile" connections to residential users; and, providing two-way advanced capabilities that can support widespread business-to-business commerce. Specific program activities related to ARC's focus on small business access to the Internet include the following:

- Develop telecommunications plans;
- Create aggregation of demand projects; and,
- Install necessary infrastructure in distressed areas.

Ensure full utilization of opportunities provided by Internet access. The investment in the infrastructure will be wasted unless the people, particularly the business people, have the appropriate skills to use the technology. Moving Appalachia's businesses into the digital world will require a broad array of technical assistance. Both existing businesses and aspiring entrepreneurs need guidance in how to migrate traditional face-to-face activities to an Internet world, craft strategies for marketing products over the Web, and plan for meeting production and shipping requirements in the Internet economy. Positioning Appalachia to thrive in the e-commerce/Internet environment demands powerful partnerships that link nonprofit organizations, the media, and local Appalachia. ARC serves as the catalyst to ensure the cooperation and commitment of these varied organizations. ARC also supplements the work of other federal programs by addressing barriers that are unique to Appalachia, thus ensuring full participation in programs, and by serving as a clearing house for federal telecommunications activities in

Appalachia. Specific strategies related to ensuring full utilization of opportunities provided by Internet access include the following:

- Fund e-commerce training programs;
- Develop planning strategies jointly with the Small Business Administration, National Business Incubator Association, Industrial Development Authorities, Chambers of Commerce, Local Development Districts, Small Business Development Centers, and other organizations that promote IT sector development;
- Supplement work of other federal programs such as those at the U.S Department of Commerce's National Telecommunications and Information Administration, the U.S. Department of Agriculture's Rural Utilities Service, the U.S. Department of Transportation, and others
- Facilitate technology ownership in the home;
- Fund community learning/technology access centers; and,
- Assist in providing enhanced telecommunication services to facilitate smart parks and IT incubator development opportunities.

FY 2005 Initiative: *Ensure That the Region Has Infrastructure and Services - $32 million*

Inadequate water and sewer service is still a critical issue in Appalachia—particularly in smaller, poorer communities. Without basic services, business and industry is simply not interested in locating in the Region. ARC is working in partnership with others to:

- Support water resources management and cooperative solutions among providers;
- Promote multi-county approaches and partnerships with the private sector to manage solid waste disposal, water, and waste treatment;
- Support waste recycling and new disposal technologies; and,
- Ensure that the needs of remote rural areas are taken into account in infrastructure policy formulation and funding.

FY 2005 Initiative: *Increase Workforce Employability - $14 million*

Education: Business can neither start nor thrive without an educated, skilled workforce. Education is the driving force behind economic growth. ARC and the states in the Appalachian Region recognize this as is evidenced by the strategies proposed for the upcoming year. ARC and state strategies include upgrading the education climate of the Region, as a whole, to improve educational capabilities, to provide re-entry programs, school-to-work transition programs, and skills training for specific employers located in or moving into the Region. Because no one organization can achieve these goals alone, the strategies have required close coordination with businesses and local school districts, and, in some cases, with the non-profit sector as well as with federal and state education departments. Nurturing partnerships and coordinating efforts of diverse organizations is a one of ARC's key roles. ARC is not the traditional grant-making organization. Instead ARC works with its partners—and takes a "bottoms up" approach to take full advantage of the synergy generated when various partners, with the same goal, focus together on solving regional problems. Specific strategies related to work force employability issues are as follows:

- Work to increase the college-going rate in Appalachia

- Work with the states to start or expand programs which prepare workers for new jobs or to upgrade worker skills and abilities in current jobs;

- Participate in public-private, national, and regional collaborations to improve education and training practices;

- Continue the alliance with the U.S. Department of Energy to provide summer workshops in math, science, and technology;

- Partner with the Appalachian Rural Systemic Initiative, a National Science Foundation initiative that works to improve the math and science scores of students in distressed counties;

- Identify exemplary models of education improvement and devising strategies to duplicate them throughout the region; and

- Identify the need for school readiness, adult literacy, dropout prevention, GED, and school-to-work program and targeting resources to these areas.

Health Care Infrastructure: A healthy work force and access to health care is also crucial, and Appalachians suffer from disproportionately high rates of chronic disease. Employee absences for medical reasons can be a major drain on productivity and good preventive health care inevitably means less chronic illness and fewer sick days. Also, access to affordable, quality health care can be a major consideration when considering where to locate a new business, a branch office, a new plant, etc., and therefore can impact the economic vitality of the Region. Although Appalachian communities have improved the health of their citizens through expanded access to quality health-care services, affordability remains a problem. Additionally, there are significant challenges related to manpower shortages and persistent health-care problems in isolated and distressed communities. Strategies listed below address these concerns.

- Increase the supply of health professionals in underserved communities through the J-1 Waiver program and by collaborating with the region's medical schools and other health profession institutions.

- Support telemedicine as a means of universal access to comprehensive health care;

- Identify gaps in the delivery of health services, particularly in the areas of oral health, mental health, and substance abuse, and working to eliminate those gaps; and,

- Continue partnerships with Centers of Disease Control and Prevention and various medical centers to institute screening, prevention, and control programs in distressed counties.

FY 2005 Initiative: *Diversify the Appalachian Economy - $15 million*

As described earlier, Appalachia's economic vitality and stability require a more diversified regional economy. In addition to attracting new industry and retaining and expanding existing businesses, the Region also needs to nurture home-grown firms and encourage innovation and risk-taking, as well as foster greater private sector investment. Appalachia's rich cultural heritage, which includes the Region's natural beauty, products, and crafts, must be better harnessed to provide local economic opportunities.

The Commission launched a regional entrepreneurship initiative in 1997 to foster homegrown businesses and more rural and small town Appalachia away from branch plant recruitment. The regional strategy involves educating current and future entrepreneurs, both youth and adults; improving access to investment capital for local businesses; strengthening local economies by capitalizing on strategic sectors including the Region's rich cultural heritage and nurturing new and existing businesses by creating and supporting rural business incubators. ARC has provided a forum for stakeholders and forged alliances with major financial institutions, national foundations, community colleges and local development organization to pursue this strategy. Specific strategies for 2005 include the following:

- Help communities to develop and implement strategies to cause entrepreneurs to start and expand local business;

- Encourage the transfer of new processes and product technologies that increase productivity and create new entrepreneurial opportunities;

- Support the development of industry networks and trade organizations that promote inter-firm collaborations, resource sharing, and the coordination of business-assistance services;

- Support leadership, marketing and planning efforts to enhance local strategies for economic development;

- Promote efforts to enhance export development by increasing numbers of firms engaged in exporting and increasing exported goods and services volume;

- Work with local chambers of commerce and other similar organizations to market Appalachian locations as good places to live and do business; and

- Make strategic investments in the region to take advantage of business opportunities and business development along the ADHS.

Appalachian Regional Commission
FY 2005 Performance Budget

Major Program:
APPALACHIAN DEVELOPMENT HIGHWAY SYSTEM

Congress expressly created the Appalachian Development Highway System (ADHS) to provide economic growth opportunities for the residents of the region – the same benefits afforded the rest of the nation through the construction of the Interstate Highway System, which largely bypassed the region due to its rugged terrain. Reauthorization of the program, currently referred to as SAFETEA, is pending. It is anticipated that the ADHS funding will continue at the present level.

Table 8 – Appalachian Development Highway System - $450M for FY 2005

General Goal	Long-Term Performance Measure	Short Term Performance Measures	Expected Benefits
Goal 1: REDUCE ISOLATION: Reduce Appalachian isolation so that the region can fully participate in and benefit from the strong and vibrant U.S. economy	Complete the ADHS by 2021	Miles per $100 million: FY: 2001 – 11.2 miles FY: 2002 - 8 FY: 2003 - 8 FY: 2004 – 8 miles FY: 2005 – 7 miles	For every dollar invested, Appalachia will realize $1.18 in increased travel efficiency benefits

The Appalachian Regional Development Act of 1965 authorized the Commission to construct the Appalachian Development Highway System (ADHS), a 3,025-mile road system, with assistance from the Secretary of Transportation as a highway system that supplemented the Interstate System and other Federal-aid highways programs. P.L. 108-199 added 65 miles to the system in 2004, for a new system total of 3,090 miles. Congress authorized this initiative because it recognized that Regional economic growth would not be possible until the Region's isolation had been overcome.

Because of the high cost of building roads through Appalachia's mountainous terrain, adequate roads had not been built in much of the Region. When the interstate system was built, large areas of Appalachia were simply bypassed, compounding the problems of the Region's already troubled economy. The ADHS was designed to link Appalachia with the US interstate system.

In 1998 ARC completed a study to objectively measure, in retrospect, the extent that completed portions of the ADHS had contributed to the Region's economy. The study found the ADHS has been instrumental in creating thousands of new jobs and generating economic benefits that will exceed highway construction cost and maintenance cost by more than a billion dollars. The ADHS corridors generate economic development benefits in the Region by improving the competitive position of existing and new industries through lower transportation costs and higher productivity.

In addition, the new corridors will increase access to health care, education, and cultural amenities that improve the quality of life in the region they serve and will indirectly boost labor productivity.

Moreover, the corridors increase roadside business and significantly boost the opportunities for tourism development in the Region through improved access. The ADHS corridors improve travel efficiency by reducing travel time, lowering vehicle-operating costs, and reducing the number of accidents. These efficiencies are the result of:

- An increase in the number of lanes and lane and shoulder widths,
- Improved grades and road conditions with fewer curves,
- Restricted access and egress and more freeway miles, and
- Overall, higher operating speeds.

The study determined that over the life of the ADHS, each dollar invested is expected to result in $1.32 in economic benefits and $1.18 in travel efficiency benefits.

More than 80 percent (2,440.6 miles) of the total 3,025 miles of the ADHS authorized by Congress for construction before 2004 are open to traffic, and another 130 miles are under construction. The remaining 454.5 miles are in the preliminary or final design stages. The Federal Co-Chairman of the Appalachian Regional Commission and the governors of the 13 Appalachian states continue their strong commitment to complete the ADHS, the centerpiece of ARC's strategic plan for the Region.

The Transportation Equity Act for the 21st Century (TEA-21) authorized funding from the Federal Highway Trust Fund at a level of $450 million in fiscal year (FY) 1999 through FY 2003. The authorizations and annual appropriations toward completion of the ADHS, at an average rate of $583 million a year over the past 5 years, have provided a steady, dependable, and substantial source of funding toward the completion of the Appalachian highway system.

Cost increases have occurred on individual corridors since the 1997 estimate due to inflation in the highway construction industry and design refinements and corridor location changes to accommodate changing conditions and to provide environmental mitigation. The estimated cost to complete the ADHS (combined federal and state cost in year 2000 dollars) is $8.5 billion, including $0.3 billion of approved prefinanced projects that were advanced with state funds and $0.7 billion of work that is not eligible for ADHS funding.

As shown on Table 9 below, the federal share of the eligible work to complete the ADHS is $6.2 billion in year 2000 dollars. The remaining federal funds needed from Congress to complete the ADHS are $4.5 billion. This is a significant reduction from the remaining needs at the time of the 1997 estimate, which was $6.2 billion.

Table 9 – Federal Funding for the ADHS			
Federal share of eligible work			**$6.206 billion**
Total Federal fund apportionments and allocations available:			
	Unobligated balance of federal funds as of 9/30/01	$0.5925 billion	
	FY 2002 apportionments and allocations	$0.6733 billion	
	FY 2003 projected apportionments and allocations (authorized in TEA-21)	$0.4736 billion	
Total federal fund apportionments and allocations available			**$1.739 billion**
Remaining federal funds needed			**$4.467 billion**

Local Access Road Program

Section 201(a) of the ARDA authorized the construction of up to 1400 miles of local access roads (LAR) to complement the ADHS by providing new or improved access to local areas. A State may spend a portion of their ADHS funds or Area Development funds each year on access to industrial and commercial sites to create/retain jobs as well as provide access to recreational areas, educational facilities, residential areas, and timber access areas.

The ADHS program is a major factor in the Commission's success in reducing the region's isolation and providing mobility and access to its residents.

FY 2005 Initiative

During FY 2005, make progress toward completing the ADHS:

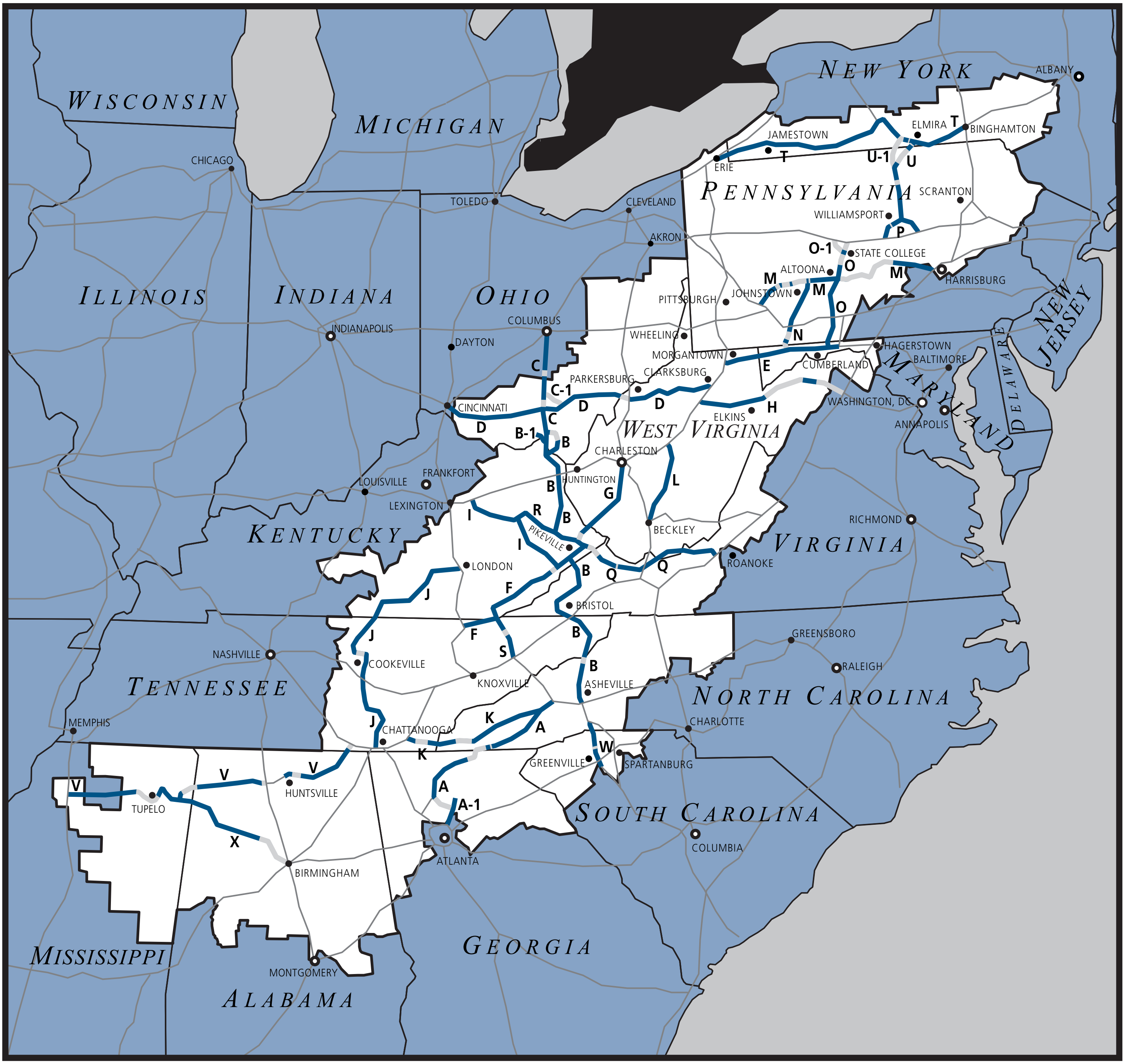
- The economic impetus to complete the system has never been more compelling. A modern system of highways is an essential first step toward fostering economic growth and enabling Appalachia to become a significant contributor to the national economy.

- Completion of the ADHS will permit the nation to realize the system-wide efficiencies of linking with the interstate highway system and the nation's intermodal transportation networks. Appalachia's strategic location between the eastern seaboard and the Midwest enhances the national value of the ADHS as a transportation asset to channel increasing domestic and international freight traffic between metropolitan centers and trade gateways. Forecasts of national freight demand over the next ten to twenty years by the U.S. Department of Transportation underscore the potential of the ADHS to help relieve congestion along major transportation routes and help develop new and more efficient freight flows to trade gateways.

Strategies for 2005 include the following:

- Manage ADHS overall planning and development;
- Identify for completion critical highway interchanges and priority miles;
- Coordinate with the Federal Highway Administration, State highway departments, and Federal and State environmental agencies;
- Establish ADHS terminal points and alignments;
- Ensure the integrity of the ADHS highway system; and
- Work with Congress and the states to secure full funding for completing the Appalachian Development Highway System.

APPALACHIAN DEVELOPMENT HIGHWAY SYSTEM



Adequate or Complete--
September 30, 2002

To be Completed

Interstate System

Appalachian Regional Commission
Salaries and Expenses

The following summarizes the total request for salaries and expenses in 2005, compared with prior years.

Salaries and Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted /2 /3	2005 Request /2	Change
Appropriation	3,993	4,707	5,039	332

1/ Includes a $30,000 rescission pursuant to P.L. 108-7
2/ Includes the estimated cost of the Administration's legislative proposal to show the full cost of retirees' annuities and health benefits.
3/ Reflects rescission.

The totals for salaries and expenses in FY 2004 reflect a program level of $65.611 million, after rescission. The requested totals for FY 2005 are based on maintaining staffing levels currently in effect for FY 2004 and to implement the requested $66 million program

The request for salaries and expenses provides for the full costs of the Office of the Federal Co-Chair, its immediate staff, and the Office of the Inspector General. The request also includes the 50 percent federal contribution to the Commissions Trust Fund for administrative expenses of the non-federal Commission staff. Subtotals for each are in the Table 10.

Table 10 - Salaries and Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted	2005 Request	Change
1. Federal Co-Chair				
Immediate Staff	964	1,163	1,265	102
Inspector General	321	433	462	29
Subtotal:	1,285	1,596	1,727	131
2. Commission Administrative Expenses *(50% Federal contribution)*	2,708	3,111	3,312	201
Total Request:	**3,993**	**4,707**	**5,039**	**332**

Pursuant to the *ARDA*, member states collectively contribute the other 50 percent of the Commission's non-federal staff and related costs.

Office of the Federal Co-Chair

The request of $1.265 million for the Office of the Federal Co-Chair provides for an immediate staff of eight positions, with related benefits, travel, services, and other expenses. This includes the estimated cost associated with the Administration's legislative proposal of having agencies show the full costs of retirees' annuities and health benefits.

The Federal Co-Chair's staff is paid entirely by the Federal government and assists in carrying out the Federal Co-Chair's responsibilities. These include working with federal agencies and chairing an interagency organization as provided in the ARDA; serving as the Commission's liaison to the Congress and the Administration; representing the Administration in working with the Member states to formulate regional strategies and other policy; and reviewing projects for final approval by the Federal Co-Chair.

Office of Inspector General

The *Inspector General Act Amendment of 1988 (P.L. 100-504)* requires ARC to maintain an independent Office of Inspector General (OIG), which reports directly to the Federal Co-Chair. The OIG workload includes a variety of headquarters and grantee reviews/inquiries/investigations that are performed by permanent and contract staff. For certain investigations and legal issues, the OIG uses reimbursable agreements and Memoranda of Understanding with other Federal OIGs.

The OIG requests $462,000 for the expenses of a three-person staff, related expenses, and required contract audit/investigative/legal support. Inspector General activities will continue to emphasize the effectiveness and efficiency of program operations and compliance with laws and regulations affecting grant programs. This includes review and evaluation activities in connection with the *GPRA*, the Single Audit Act, and GISRA, as well as coordination and cooperation with other oversight offices on crosscutting issues and legislated reviews. An expansion of audit activities is anticipated to enable the Commission to produce audited financial statements, as other agencies are required to do under the Accountability of Tax Dollars Act. The request will cover expenses for necessary investigative and legal support, which will be obtained through reimbursable agreements and Memoranda of Understanding with other Federal Offices of Inspector General.

Tables 11 and 12 show object class estimates for the request for the Offices of the Federal Co-Chair and the Inspector General, respectively.

Table 11 - Federal Co-Chair's Office Administrative Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted	2005 Request	Change
Personnel Compensation	638	825	904	79
Personnel Benefits	144	205	226	21
Travel & Transportation	40	75	75	0
Rent, Communications	14	15	15	0
Printing	5	5	5	0
Services	102	18	20	2
Supplies	12	10	10	0
Equipment	9	10	10	0
Total:	**964**	**1,163**	**1,265**	**102**

Table 12 - Inspector General's Office Administrative Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted	2005 Request	Change
Personnel Compensation	245	248	254	6
Personnel Benefits	42	62	64	2
Travel & Transportation	4	9	9	0
Rent, Communications	23	27	27	0
Printing	0	1	1	0
Services	6 *	79	100	21
Supplies	0	2	2	0
Equipment	1	5	5	0
Total:	**321**	**433**	**462**	**29**

***** Additional $57 thousand provided from prior obligation

Commission Operating Expenses

Annual appropriations for ARC fund half of the costs to maintain a professional staff to provide technical support to the states and the federal staff in implementing Commission programs. These funds, and an equal contribution from member states, are deposited into a Treasury trust fund account. Together with prior year balances, these resources finance all non-federal Commission operating expenses.

The Commission's founding legislation specifies that ARC staff employed under the Trust Fund shall not be considered federal employees for any purpose. Accordingly, these professionals are neither state nor federal employees, even though they work directly for the joint federal-state partnership agency. An Executive Director, who is appointed by the states and the Federal Co-Chair, manages this staff and is the chief executive officer of the Commission. Table 13 shows the plan for financing Commission operations.

Table 13 - ARC Operating Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted	2005 Request	Change
State Contribution	2,708	3,111	3,312	201
Federal Contribution	2,708	3,111	3,312	201
Prior year balances used	200	99	0	-99
Total:	**5,616**	**6,321**	**6,624**	**303**

The request would provide minimum operations to support regional planning and programs at the requested level and to manage the 2,000 ARC grants in force. Staff operations have included a significant effort by ARC to assure performance accountability and strong financial management, as well as to implement e-government business processes.

Each year, the states and the Federal Co-Chair must approve the Commission's operating budget. Following completion of appropriations action, final non-federal staffing decisions are made and must be approved at a Commission meeting of the member states with the Federal Co-Chair. As a result of this consultative process, final allocations may differ from the estimate in Table 14 of amounts by object class.

Table 14 - ARC Operating Expenses
(Thousands of dollars)

	2003 Actual	2004 Enacted	2005 Request	Change
Personnel Compensation	3,397	3,806	4,023	217
Personnel Benefits	1,017	1,135	1,163	28
Travel & Transportation	93	100	111	11
Rent, Communications, Utilities	713	723	747	24
Printing	50	108	111	3
Services	217	315	334	19
Supplies	68	87	76	-11
Equipment	61	47	59	12
Total:	**5,616**	**6,321**	**6,624**	**303**

The ARC management goal remains to develop effective and efficient management systems and processes and to promote a high-performance organizational culture supporting the strategic plan.

Commission staff will continue to use available resources to promote innovation, improve core competencies and internal communications, enhance technical assistance, improve the monitoring and evaluation of project operations, stress customer service, and deploy affordable technology wherever possible.

Personnel compensation for Commission staff generally follows that of Federal employees in the metropolitan area. Benefits are budgeted accordingly, and also include an additional increase for the Administration's legislative proposal to show the full costs of CSRS retirees' annuities and health benefit costs during retirement for those few employees affected.

Commercially purchased benefits plans for non-federal personnel are projected to increase well above inflation, as is the case with telecommunications and commercial insurance. In October 1999 the Commission revised its retirement program for its non-federal employees. These changes contained costs for new hires by instituting a fixed contribution 401(k) plan. However, in the short term, the Commission's defined benefit retirement plan remains in effect for some staff, and that plan will continue to require periodic infusions of funds to remain actuarially sound. In recent years, the poor performances of investment markets have required additional funding significantly above plan assumptions.

APPENDIX A
President's Management Agenda

The PMA is a sound agenda for government reform that resonates with the Commission's long-standing focus on responsiveness and effectiveness. As a small partnership organization, ARC has capitalized on its unique advantages for 38 years:

- The intrinsic and active involvement of state members in investment and operating policy, as well as the use of public-private advisory groups, assures a high degree of responsiveness to governments, grantees, citizens, and changing conditions in Appalachia.

- Sharing operating costs between state funds appropriated by state legislatures and federal funds appropriated by Congress ensures that the Region's economic well-being is coordinated with state and national economic policy.

- Its small size leads to greater levels of flexibility and communication, and provides for a simplified internal control structure.

- The organization of technical and professional staff under a CEO provides stability as state and federal Commission members change.

- The nature of the agency provides greater management flexibility than that available to executive agencies under federal personnel and administrative policies.

While ARC's small, specialized organization works well to address its mission, it also imposes certain limitations. Increasing external demands for detailed planning and compliance reporting seldom distinguish between micro-agencies and very large executive agencies. For example ARC can and does provide appropriate state-of-the-art IT security envisioned by FISMA and similar requirements. However, the formal internal studies, documentation, and compliance reporting primarily intended for large agencies are inordinately expensive and disruptive in an organization with an IT staff of one or two. The management challenge to ARC is to respond to such requirements within its resources.

Human Capital

ARC recruits successfully from both the private and public sectors to fill its nonfederal vacancies. The Appalachian Act specially provides that federal employees leaving a federal agency may accept a nonfederal ARC position and retain federal employee benefits. ARC nonfederal human resource policies also provide employment packages that are reasonably competitive with the private sector. For example, ARC instituted as early as 1992 a banded salary structure with pay incentives very similar to options that are only recently being considered at some of the larger federal agencies. ARC also has an excellent record of employee retention. Succession planning for senior management and technical staff is an issue for relatively few positions, and it can be addressed on a predictable basis. The Commission has also gradually adapted staff skills and makeup in anticipation of increased use of technology in business processes. The state and federal members expect a high degree of technical competence, so the organization values and promotes employee training and professional development in relevant program fields.

Competitive Sourcing

ARC has only eleven federal positions, all performing work in direct support of the Office of the Federal Co-Chair and the OIG. Two of these positions are PAS and two are Schedule C. ARC's inventory of federal positions is posted on the agency website. While not directly relevant to FAIR, it is important to note that ARC consistently employs competitive sourcing in major procurement, especially in its research business function.

Financial Performance

Unlike many small agencies, ARC maintains written guidelines for financial management and internal control, and has moved aggressively in recent years to update core accounting and financial management functions. During FY 2003, the Commission engaged KPMG to review and reassess accounting policies. ARC also engaged another accounting firm to conduct an audit in accordance with the recommended standards. In addition, ARC conducted routine assessments of internal control procedures in keeping with FMFIA. Although the Accountability of Tax Dollars Act does not technically apply to ARC because it is not an executive agency under U.S.C. 5 and 31, the Commission is prepared to produce timely and accurate audited financial statements as directed by OMB. OMB waived the need for quarterly statements for FY 2002, but ARC has completed an audited statement as of September 30, 2003 with an unqualified opinion from the independent auditor. The Commission OIG has been closely involved in all these developments in financial management.

Budget and Performance Integration

ARC moved promptly in 1995 to complete a strategic plan under GPRA based on extensive policy meetings, field hearings, workshops, and consultancies. Concurrently, ARC worked with member states, some of which already had performance measurement systems in place, to design and conduct performance assessments for GPRA reporting. The Commission formally submitted annual performance plans and reports as part of the budget for the 2003 and 2004 budget cycles. During FY 2002 and 2003, ARC trained key staff in current developments in performance measurement, continued discussions with the state and federal policymakers, and examined measurements used by other agencies. The newly appointed Federal Co-Chair has initiated additional discussions with OMB to further strengthen measurement for the 2005 cycle. The Commission also engaged outside experts to advise on integration of budget and program performance. A new strategic plan is scheduled for the coming year, along with additional performance measurement protocols.

E-Government

ARC seeks to apply appropriate and affordable technology to improve services in all its business processes. For example, an on-line grant information system now provides real-time detailed information to staff professionals and state partners. A revamped web site provides all public documents in electronic form, as well as a new on-line resource center that makes staff expertise readily available to community leaders in Appalachia. Virtually all vendor and grantee payments are electronic. An on-line time and attendance system simplifies HR management, eliminates paperwork, and interfaces directly and accurately with the USDA National Finance Center for payroll purposes. ARC fully participates in the Treasury GOALS I and GOALS II on-line reporting systems. The Commission continues to monitor major cross-agency information technology projects, particularly Grants.gov and eTravel. ARC obviously does not have the resources or mission to absorb the initial development costs of such large-scale cross-agency products, but will be able to deploy them expeditiously when they are available and if client costs are not prohibitive.

APPENDIX B
Designated Distressed Counties

Using the following rigorous set of criteria, in FY 2004, 22 percent, or 91 of the Appalachian Region's 410 counties will be designated as economically distressed.

(1) Distressed counties meet all three of the following economic indicators:

Per capita market income no greater than two-thirds (67 percent) of the US average;

Three-year unemployment rate at 150 percent of the US average or greater; and

Poverty rate which is at least 150 percent of the US average; or

(2) Distressed Counties have at least twice the national poverty rate and meet one other criterion for economic distress.

The following 91 counties will be designated for special assistance as distressed counties in FY 2004 based on these criteria:

Alabama (5) - Bibb, Franklin, Hale, Macon, and Pickens

Kentucky (35) - Adair, Bath, Bell, Breathitt, Carter, Casey, Clay, Clinton, Cumberland, Elliott, Estill, Floyd, Harlan, Jackson, Johnson, Knott, Knox, Lawrence, Lee, Leslie, Letcher, Lewis, Magoffin, Martin, McCreary, Menifee, Monroe, Morgan, Owsley, Perry, Powell, Russell, Wayne, Whitley, and Wolfe

Mississippi (12) - Chickasaw, Choctaw, Clay, Kemper, Marshall, Montgomery, Noxubee, Oktibbeha, Panola, Webster, Winston, and Yalobusha

North Carolina (1) - Graham

Ohio (6) - Athens, Lawrence, Meigs, Pike, Scioto, and Vinton

Tennessee (8) - Campbell, Clay, Cocke, Fentress, Grundy, Hancock, Johnson, and Scott

Virginia (3) - Buchanan, Dickenson, and Wise (including the city of Norton)

West Virginia (21) - Barbour, Boone, Braxton, Calhoun, Clay, Fayette, Gilmer, Lewis, Lincoln, Logan, Mason, McDowell, Mingo, Nicholas, Ritchie, Roane, Summers, Webster, Wetzel, Wirt, and Wyoming

APPENDIX C

Program Evaluations of ARC Investments

I. Appalachian Development Highways Economic Impact Studies by Wilbur Smith Associates, July 1998. This study evaluated both the transportation efficiency benefits and economic development impacts of the completed portions of the Appalachian Development Highway System (ADHS). The study focused on 12 of the 26 ADHS highway corridors that were largely completed, totaling 1,400 miles of the system. A primary objective of the study was to measure, in retrospect, the extent to which the completed portions of the ADHS have contributed to the economic well-being of Appalachia.

Two major effects are estimated using transportation data and a state-of-the-art, regional economic model: (1) travel efficiency benefits due to reduced travel time, lower vehicle operating costs, and the reduced number of accidents; and (2) economic development impacts on the Region due to the enhanced competitive position of industry in the Region, increased roadside business, and increased tourism. The economic model used for the study was developed by Regional Economic Models Inc., REMI, of Amherst, Massachusetts, which estimated the employment, wages, value-added and population increases attributable to the ADHS in the 165 county study region.

The following impact estimates are only for the completed portions of the system and do not include benefits from completing the system.

- ***Economic Development Job Creation***. By 1995 a net increase of 16,000 jobs are estimated to have been created that would not have existed without the completed portions of the ADHS; it is estimated that these twelve corridors will, by the year 2015, have created a net increase of 42,000 Appalachian jobs, and will rise to 52,000 by 2025.

- ***ADHS Has Led to Increased Production***. The net increase in value added was $1 billion in 1995, and will increase to $2.9 billion by the year 2015.

- ***ADHS Has Created Efficiency.*** The ADHS highway corridors have created travel efficiencies valued at $4.89 billion over the 1965-2025 period. Improved road conditions and access resulted in greater efficiency.

- ***Life Cycle Return on Federal Investment*** Over the life cycle of these portions of ADHS, the Federal investment will realize a solid return:
  - In terms of efficiency benefits, for each $1 invested, the return is expected to be $1.18;
  - In terms of economic development benefits, each $1 invested is expected to yield a return of $1.32.

II. External Evaluation of ARC's Infrastructure and Public Works Projects

In Fiscal Year 1999, the Appalachian Regional Commission issued its first evaluation report on non-highway ARC projects, ***Evaluation of the Appalachian Regional Commission's Infrastructure and Public Works Program*** by the Brandow Company and Economic Development Research Group. Ninety-nine projects were examined in this study and all were initiated and completed between 1990 and 1997. Total ARC funding for these projects was $32.4 million. These infrastructure projects are representative of the range of different types of projects typically funded by the Commission, including industrial parks and sites, water and sewer systems, access roads, and business incubators. The universe of these types of projects (both open and closed) during this period was 1,376, with 663 projects closed. Thus the sample represents fifteen percent of closed projects.

Job Creation. The estimated total number of jobs created by the ARC-funded sample projects was 44,331. This includes direct new jobs and indirect/induced new jobs. It does not include the retained jobs. Overall, the economic development projects examined cost $2,412 per new job created, including indirect and induced job creation. If retained jobs are also counted, then the average cost drops to $1,761 per job. The benefit cost ratio of income generated by these jobs was 5.4 to 1 when counting only income resulting directly from job creation, but increased to 8.9 to 1 when indirect job creation was included.

Personal Income. The new jobs led to increased personal income for residents of the affected counties. For a *one-time* public investment in these economic development projects, there was approximately $9 of *annual recurring* personal income per public dollar invested.

Projections and Results. All project types performed well:

Non-residential water and sewer projects: The number of new jobs created was about 62 percent over projections, and the number of new businesses served was almost four times the projected total.

Industrial parks: Projections for new businesses and existing households served were exceeded; projections for existing businesses were met, while the percentage of actual jobs retained was slightly lower than projected (91 percent).

Incubator projects: Actual results for new businesses ran more than three times the projections. The number of retained businesses served was double the projection. The number of new jobs created was almost five times the projections, and the number of retained jobs was 50 percent above projections.

Industrial access road projects: The number of new businesses served was greater than four times the projections, while the percentage of retained businesses served was below projections (77 percent). However, the numbers of new and especially retained jobs assisted by the projects came in above projections.

Recommendations: Key recommendations in the study were that:

- ARC work with other federal economic development agencies to address the generic issue of how to develop methods for assessing the quality of jobs created by public sector economic development investments, and;

- Project close-out reports should re-estimate the final amount of private investment made in each project.

III. External Evaluation of ARC's Education Projects

In Fiscal Year 2000, ARC issued a report *Evaluation of ARC's Educational Projects* by the Westat Corporation which assessed the implementation and impact of 84 education projects funded by the Appalachian Regional Commission (ARC) during the 1990s. The study examined the type of activities that projects used to enhance learning opportunities, the extent to which these activities were implemented, the accomplishments associated with these activities, and whether the projects were able to sustain themselves beyond the ARC grant period. Of particular interest was the extent to which projects achieved the outcomes set forth in their original proposals to ARC. In addition, site visits were conducted at eight projects that had successfully provided community residents with a new or enhanced educational service.

- Study findings indicate that most of the projects in the study reached those segments of Appalachia that are most economically disadvantaged or geographically isolated.

- Projects were successful in achieving the outcomes they set forth in their original requests for ARC support.

- Almost three-quarters of projects reported that results met or exceeded original expectations.

- Just under half met expectations;

- Nearly one-third achieved more than planned;

- Thirteen percent achieved less than planned.

Types of Performance Measured:

- Educational attainment, e.g. high school completion rates, and college-going rates.

- Economic well-being, e.g. job skills; wages.

- Family/individual well-being, e.g. family stability.

- Barriers, e.g. student behavior problems; access to educational support.

- Case Studies provided convincing evidence that the sample projects resulted in a broad range of educational, economic, and social gains. However, only a few of the typical outcomes had a quantifiable benchmark against which project success could be measured quantitatively.

- ARC funding was critical for 67 percent of the projects which indicated that they would never have been implemented without their ARC award.

- ***Recommendations:*** A key recommendation of the report was the need to clarify and expand upon the performance goals for assessing improvements through education and non-workforce training projects that target individual or families, and develop methods to gauge wider economic benefits of educational programs.

IV. An Early Stage Evaluation of ARC's Entrepreneurship by Regional Technology Strategies by Regional Technology Strategies.

This study, issued in March 2001, provided an early evaluation of the Appalachian Regional Commission's Entrepreneurship program. The report evaluated 24 entrepreneurship projects that were complete or nearly completed during the 1997-2000 period. The sample was generally representative of the project mix and participation rates by state as drawn from the 48 projects that were complete or nearly complete. Total ARC funding for these 24 projects was $2,124,700 which leveraged another $1,412,000 in funding from other sources. When the evaluation began there had been 133 projects funded. Through November 2000, the total universe of projects was 169, representing a total ARC investment of $17.6 million, which leveraged $13.9 million from other sources.

The study found that three-quarters of the projects had assisted firms to develop new products or upgrade new technologies. In addition, half of the projects reported starting new businesses which led to the creation of 304 new firms—46 new firms with employees and 258 firms that were sole proprietors. There were 377 new jobs created according to the survey, with 69 jobs in new firms, 50 in existing firms, and 258 through self-employment. Furthermore, there were 74 jobs reported to be saved by project interventions. Of client businesses or entrepreneurs served by the project, 70 percent reported being highly satisfied by the services they received, 17 percent were satisfied, 8 percent were dissatisfied, and the balance did not respond.

Thirty-six percent of the businesses reported that their business strategies were oriented to expand or grow the business and its market share, while 55 percent viewed their business as stable "lifestyle businesses," and the balance saw their businesses as a response to local economic decline.

The study recommended that the program increase the amount of technical assistance provided to grantees, support the development of more internal evaluation and self-monitoring systems within the projects and businesses served, make fewer small grants, recognize the risk inherent in the program and seek to replicate the successful projects. Finally, the report recommends that a broader regional economic impact from the program will require greater scale and more focus on growth-oriented businesses.

V. External Evaluation of ARC's Vocational Education and Workforce Development Projects

In fiscal year 2002, the Appalachian Regional Commission issued its report on **Evaluation of the Appalachian Regional Commission's Vocational Education and Workforce Training Projects** by the Westat Corporation. The study examined 92 representative projects started and completed during the 1995-2000 period. The sample constituted about one-third of the universe during period, after adjusting for continuation projects. A mail survey collected data on implementation, monitoring and impact. In addition, five case study site visits were conducted. A two-tier sample of projects was developed to assess the impact *before* and *after* full implementation of ARC's performance measurement system: Cohort 1 selected 67 projects from the 1995-1999 period; and Cohort 2 selected 25 projects funded in 2000.

Types of Performance Measured

- Obtained skills, e.g.: basic skills, academic skills, vocational skills, or employability habits;

- Individual employment gains, e.g.:

    - helped laid-off workers or underemployed obtain new work;
    - helped those without full-time job experience gain initial full-time jobs;
    - helped employed individuals increase skills, responsibilities, wages and position.

Project Outcomes

- A clear majority of Cohort 1 projects reported achieving all of their objectives (45%) or all but one objective (27%).

- Only 9% reported achieving less than half of their objectives (six projects).

- The vast majority of projects had quantifiable output measurements, but a higher proportion of Cohort 2 projects had clear and quantifiable outputs.

Assessment of ARC's Performance Measurement

- Results from comparison of Cohorts 1 & 2 indicate that the quality of project application and implementation has increased.

- Many of Cohort 2 projects are planning to collect some new data through mail or telephone surveys.
- The key issue is how to collect data on long-term employment impacts without placing undue burdens and high overhead costs on project grantees.

Recommendations

- Realign designations used to classify vocational education and workforce training projects.
- Disseminate information on best practices.
- Enhance quality of final reports.
- Require each project to have at least one numeric outcome and output.
- Develop application materials on each project type.
- Meet with other federal agencies to better understand their funding and reporting requirements.
- Assess common reporting practices among states
- Use project approval process to reinforce performance measurement criteria.
- Provide additional evaluation training and technical assistance to project grantees and ARC staff.

VI. External Evaluation of ARC's Telecommunications Projects

ARC issued its report a *Program Evaluation of the Appalachian Regional Commission's Telecommunications Projects* by the Westat Corporation. This program evaluation examined 70 projects that were started and completed between 1995 and 2001, including project investments in various types of information technology-based training, e-learning and distance learning, e-commerce, telemedicine, network and infrastructure projects, and community access center projects.

Methodology:

- Reviewed project documentation and examined the accomplishments and outcomes of 70 representative telecommunications projects;
- Measured the extent to which the projects enhanced access to telecommunications services and improved the use of these services to meet communities' needs;

- Assessed the degree to which projects involved and served multiple community stakeholders;

- Conducted a telephone survey of the 70 projects;

- Conducted 16 in-depth case studies, and;

- Provided a summary literature review of best practices in the telecommunications and community development field.

Project Types:

- Projects were most frequently designed to improve skills training and educational opportunities (87 percent), and to enhance economic development (74 percent).

- Nearly two-thirds of the 70 projects aimed to enhance community development, long-term telecommunications capabilities, and/or the coordination of community-wide information (66 percent for each).

- Forty-two of the 70 projects (60 percent) aimed to improve delivery of and access to government services, and 35 projects (50 percent) aimed to enhance employment opportunities.

Project Accomplishments and Impacts: Most projects reported fulfilling their goals to the same or greater extent as projected. For example:

- ***Skills training and educational applications***, 69 percent indicated that their success was the same as expected, 23 percent indicated that it was more than expected, and 8 percent reported that it was less than expected.

- ***Economic development applications***, 71 percent reported their success to be the same as expected, 14 percent indicated that it was more than expected, and 15 percent indicated that it was less than expected.

Performance Measurement: The report examined 16 projects to evaluate how the projects anticipated results were ultimately measured at the end of the project. While this sample does not reflect the overall outcome reports for all 70 projects, it did provide a more detailed picture of how ARC’s performance measurement system was implemented for telecommunications projects in the late 1990s. An analysis of the 16 final reports revealed that two-thirds of the projects expected outputs and outcomes were addressed in the final reports, but 20 percent of project outputs and 55 percent of project outcomes failed to provide adequate information or data supporting their claims that these results had been met.

Recommendations:

- Provide more feedback to projects during the application review process.
- Provide prospective applicants with examples of telecommunications outputs and outcomes.
- Encourage applicants to describe how technology will affect residents and organizations in participating communities.
- Reinforce ARC's reporting structure.
- Continue to disseminate information about innovative telecommunications practices to prospective grantees.
- Provide projects with written materials on high-quality evaluation practices.

VII. Health Studies on Health Disparities in Appalachia and the Financial Conditions of the Health Care Institutions in Appalachia.

A. ***An Analysis of the Financial Conditions of Health Care Institution in the Appalachia and their Local Economic Impacts*** by the Center for Health Affairs of Project Hope was published the ARC in January, 2003.

This report describes the availability of health care services in Appalachia, the financial stability of Appalachian health care institutions, and the effect of hospital closures on Appalachian counties.

- An important overall finding of the report is that core of the Appalachian health care infrastructure has been getting stronger. There has been an expansion in the number of primary-care physicians per capita in Appalachia. Even distressed counties are attracting more primary care physicians.
    - Physician supply increased from 1990-1999
    - Distressed counties attracted increasing numbers of primary-care physicians
    - The number of skilled nursing facilities increased through 1999
    - Profits at Appalachian skilled nursing facilities were above national averages
    - Most county economies were resilient to the closure of hospitals
- In counties that lost a hospital, income per capita grew at rates similar to the average for Appalachia.
- Counties that lost their only hospital experienced a rate of population growth that was similar to average for rural Appalachia.

- Counties that lost their only hospital usually experienced employment growth, though the long-term rate of job growth tended to be slightly lower than Appalachian averages.

The analysis of Appalachian hospitals based on American Hospital Association (AHA) data revealed weakness in access to certain services that fall outside the core functions of primary-care physicians, rural hospitals, and skilled nursing care facilities. Most Appalachian counties have not been successful at improving access to dentistry, outpatient alcohol treatment, outpatient drug treatment, and outpatient mental health services.

- Low levels of dentists per capita, particularly in distressed counties. The supply did not improve from 1987 through 1998

- A lack of hospital-affiliated substance abuse treatment services, particularly in distressed counties

- A lack of hospital-affiliated psychiatric services, particularly in distressed counties

- Lack of obstetric care in economically distressed counties

B. ***Health Disparities in Appalachia***

The Commission issued a contract in FY 2001 to the Office of Social Environment and Health Research at West Virginia University to analyze of the health status and disparities in Appalachia so that policy makers and regional public health practitioners can identify their health-related priorities for health surveillance and research, health education, and investments to improve the delivery of health care, and health outcomes.

A draft report has just been submitted for 3 of the 4 chapters. The research covers the following topics:

- A regional, national and county-level analysis of morbidity and mortality rates, and risk factors adjusted for age, sex and race.

- Identification of specific disparities in morbidity or mortality rates (particularly excess rates) within the region, and any apparent clusters of incidence within the region.

- Analysis of risk factors to assess any apparent excess behavioral health risks.

- Measure the accessibility to health care within the region, such as insurance coverage by households, location of health care, limitations on available transportation, or health services received.

- Analysis of the influence of socioeconomic factors on health status.

- Finally, the report analyzes the public health policy implications of the findings.

VIII. An Evaluation of ARC's Civic Capacity and Leadership Projects.

A forthcoming evaluation report examines ARC's leadership and civic capacity-building projects including adult and youth leadership programs, civic leadership, development of community-capacity projects and organizations, community revitalization, education projects, and technical assistance. From a functional perspective these projects are more usefully classified in terms of the nature of the interventions they support including: conveners that provide technical assistance; community initiative projects; leadership training; strategic planning, and the provision of a variety of community "tools." Each of these functional investments is targeted to meet the leadership or capacity-building needs of groups of individuals, organizations, and/or the community at large. Since 1995 nearly $12.5 million has been invested in 168 projects, excluding continuations. ARC expects a draft final report by April of 2004.