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Report to the Chairman, Subcommittee
on Interstate Commerce, Trade, and
Tourism, Committee on Commerce,
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ECONOMIC DEVELOPMENT

Formal Monitoring Approaches Needed to Help Ensure Compliance with Restrictions on Funding Employer Relocations





Highlights of [GAO-07-1005](#), a report to the Chairman, Subcommittee on Interstate Commerce, Trade, and Tourism, Committee on Commerce, Science, and Transportation, U.S. Senate

Why GAO Did This Study

Congress imposed restrictions on some federal programs to prevent funding of business relocations. You expressed concerns about state and local governments using federal funds to attract jobs to one community at a loss of jobs to another and about compliance with relocation restrictions. This report (1) identifies large federal economic development programs that state and local governments can use as incentives, (2) identifies which programs contain statutory prohibitions on funding relocations, and (3) assesses whether federal agencies had established and implemented procedures to help ensure compliance with prohibitions. To address these objectives, GAO searched federal databases, reviewed relevant statutes and regulations, and conducted limited testing of agency procedures.

What GAO Recommends

To improve the management of federal economic development grant programs, GAO recommends that the Departments of Labor, Agriculture, and Housing and Urban Development develop (or finalize the development of) and implement formal and structured approaches to monitor compliance. The Departments of Labor and Agriculture concurred with the recommendation and reported taking steps to implement it. Each of the three agencies provided technical comments that were incorporated into the report as appropriate.

www.gao.gov/cgi-bin/getrpt?GAO-07-1005.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

ECONOMIC DEVELOPMENT

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What GAO Found

GAO identified 17 large federal economic development programs that offer financial assistance and services that state and local governments can use as incentives to attract and retain jobs. While academic studies indicate that it is difficult to quantify the funds used as incentives, particularly given differing definitions of incentives, the use of federal funds for such purposes appears to be more limited than the use of state and local funds. Although academic studies question the overall role and significance of incentives in firms' decisions to (re)locate, researchers with whom GAO spoke noted that incentives could influence firms that already had narrowed their choices.

Nine of the 17 large federal economic development programs restrict the use of program funds to support employer relocation. Seven are grant programs, and two are loan guarantee programs. In many grant programs, initial recipients of funds (states and local governments) provide funds to others (e.g., businesses) to facilitate economic development; in loan guarantee programs, third-party lenders approve businesses for eligibility to receive funds. All nine programs prohibit using federal funds to support a business relocation that causes unemployment, but the thresholds for job loss differ. For example, a single lost job would trigger the provision for six programs, but for the other three programs, the job loss threshold is higher.

Federal agencies administering the nine programs with a nonrelocation provision used various procedures, including screening applicants and monitoring recipients, to help ensure compliance, but the extent to which these procedures specifically addressed nonrelocation provisions was limited. The two loan guarantee programs emphasized screening procedures to help ensure compliance, and both programs had written guidance and other mechanisms that specifically addressed nonrelocation provisions. Screening may be effective for helping to ensure compliance in loan guarantee programs because federal agencies know at the time of initial application which businesses are requesting funds and how they plan to use them. In contrast, because of the way grant programs are structured, at the time of initial application, grant applicants do not always know which businesses later will apply for or receive assistance. As a result, officials administering grant programs relied more extensively on monitoring than screening to help identify instances of potential noncompliance. Despite this greater reliance on monitoring, only one of the grant programs GAO reviewed had written monitoring guidance that specifically addressed business relocation restrictions. Without formal policies and procedures, federal agencies have limited assurance that grant recipients and subrecipients are complying with statutory requirements that restrict the use of program funds to support employer relocations.

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Abbreviations

BLS	Bureau of Labor Statistics
B&I	Business and Industry Guaranteed Loan program
CBO	Congressional Budget Office
CDC	certified development company
CDBG	Community Development Block Grant
CFDA	Catalogue of Federal Domestic Assistance
CRS	Congressional Research Service
EDA	Economic Development Administration
EC	Enterprise Community
EZ	Empowerment Zone
EZ/EC	Empowerment Zone/Enterprise Community
GSA	General Services Administration
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
NETS	National Establishment Time Series
SBA	Small Business Administration
USDA	U.S. Department of Agriculture
WIA	Workforce Investment Act

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United States Government Accountability Office
Washington, DC 20548

September 10, 2007

The Honorable Byron L. Dorgan
Chairman
Subcommittee on Interstate Commerce,
Trade, and Tourism
Committee on Commerce, Science, and
Transportation
United States Senate

Dear Mr. Chairman:

State and local governments are estimated to spend billions of dollars annually in business incentives—financial assistance, tax concessions, and other benefits—in an effort to attract and retain jobs. State and local governments can directly or indirectly use funds and program services from a variety of federal, state, and local programs to induce individual businesses to relocate, expand, or maintain their operations in a state or community’s jurisdiction. In response to concerns about state and local governments using federal funds to attract jobs to one U.S. community at a loss of jobs to another community, Congress began to impose restrictions in the 1950s on some federal programs to prevent funds from being used to relocate businesses.

In 1997, we provided an overview of eight major federal programs that states and localities used at that time for economic development purposes.¹ However, relatively little is known about how many other federal economic development programs state and local governments currently use as incentives to attract employers or about the extent to which restrictions exist against using funds to support an employer’s relocation. You noted that in recent years the controversy about the costs

¹GAO, *Economic Development Activities: Overview of Eight Federal Programs*, [GAO/RCED-97-193](#) (Washington, D.C.: Aug. 28, 1997). In the absence of a standard federal definition to describe economic development, for this 2007 report we used a list of activities from another GAO report, *Rural Economic Development: More Assurance is Needed That Grant Funding Information Is Accurately Reported*, [GAO-06-294](#) (Washington, D.C.: Feb. 24, 2006). Thus, economic development as we define it includes the construction and repair of infrastructure, such as buildings and roads; direct financial support and technical assistance to businesses, including job-training assistance; and tax expenditure programs that support these activities.

and benefits of using limited government funds to recruit businesses has been growing and expressed concerns about efforts to help ensure compliance with restrictions on the use of federal funds. The objectives of this report are to (1) identify large federal economic development programs that state and local governments can use as incentives to businesses for attracting new jobs into their jurisdictions, (2) identify which of these programs contain statutory prohibitions on using program funds to relocate businesses, and (3) assess whether federal agencies had established and implemented procedures to help ensure compliance with these provisions.

To identify large federal economic development programs that state and local governments can use in incentive packages for businesses, we searched the General Services Administration's (GSA) online *Catalog of Federal Domestic Assistance (CFDA)* for economic development programs that *CFDA* reported as having budget obligations of at least \$500 million.² We also searched the Congressional Research Service's (CRS) *2006 Tax Expenditure Compendium* for economic development tax expenditure programs with reported estimated tax revenue losses of \$500 million or more for fiscal year 2006.³ We then narrowed the list according to criteria that enabled us to identify the largest programs most likely to be candidates as a business incentive. Further, we reviewed the Web sites for each of the 50 states' economic development agencies to identify federal programs typically marketed as business incentives. To identify the programs with nonrelocation provisions, we reviewed relevant statutes and regulations and focused on those programs that we identified as the largest based on our review of *CFDA* and the CRS *Tax Expenditure Compendium*. To assess the completeness of our search results, we interviewed representatives of selected federal agencies, economic development trade associations, and policy groups. To assess the extent to which federal agencies had procedures in place to help ensure compliance

²The General Services Administration and Office of Management and Budget maintain the *CFDA* database, which lists federal programs available to state and local governments (including the District of Columbia); federally recognized Indian tribal governments; territories (and possessions) of the United States; domestic public, quasi public, and private for-profit and nonprofit organizations and institutions; specialized groups; and individuals. See appendix I for more information on *CFDA* and how we used it in this report.

³The *Tax Expenditure Compendium* is a biennial publication that provides CRS estimates of revenue costs of individual tax provisions for the U.S. Senate's Committee on the Budget. We used the 2006 Report (CRS, 109th Congr., 2nd sess.; S. Prt. 109-072).

with nonrelocation provisions, we obtained documents from federal agencies that described the procedures for helping to ensure compliance and then conducted limited testing of these procedures (typically a nongeneralizable sample of 10 cases for each program) to determine their implementation. We did not conduct an overall evaluation of the programs, evaluate how well the programs served their intended purposes, or evaluate how nonrelocation provisions affect the relative success of the programs in achieving their intended purposes. We also did not address the impact these programs had on development efforts by state and local governments. We interviewed representatives of six federal agencies—Department of Labor (Labor), Department of Housing and Urban Development (HUD), Department of Agriculture (USDA), Small Business Administration (SBA), the Department of Commerce’s Economic Development Administration (EDA), and the Department of the Treasury’s Internal Revenue Service (IRS). In addition, we interviewed academics, researchers, representatives of economic development trade groups, and consultants that businesses hire to identify and select new business locations (site-selection consultants). We conducted our work in Washington, D.C., and San Francisco and Fresno, California, from October 2006 through August 2007 in accordance with generally accepted government auditing standards. Appendix I provides a more detailed description of our scope and methodology.

Results in Brief

We identified 17 large federal economic development programs that state and local governments can use to attract and retain jobs. The 17 programs—which include grants, direct loans and loan guarantees, and tax incentives for job training, infrastructure development, and business financing—are administered by five agencies—HUD, Labor, USDA, SBA, and IRS. State and local governments could combine federal economic development funds from various programs with their own resources to attract businesses. Based on our review of state economic development Web sites, the programs that appear to be marketed more than others were HUD’s Community Development Block Grant (CDBG), SBA’s 7(a) and 504 loan guarantee programs, and IRS’s tax-exempt private activity bond programs (at least 19 states advertised each of these as incentives). The results of our state Web site reviews were largely consistent with the comments of the site-selection consultants with whom we spoke. While academic studies indicate that differing definitions of incentives and the ability to interchange funds at the state and local level make it difficult to quantify the amount of federal, state, and local funds spent on business incentives, the use of federal funds as incentives appears to be more limited than the use of state and local funds. However, state and local

governments could use federal economic development funds to attract additional investment or to free up their own funds for other purposes. Academic researchers with whom we spoke estimated that state and local governments spend from \$20 billion to \$50 billion annually on business incentives, mostly in the form of tax incentives, such as property and sales tax abatements. But the discretion that state and local governments have over the use of federal economic development funds varies. For some programs, such as SBA's 7(a) and 504 programs, third-party lenders and nonprofit development corporations make funding decisions. Others, such as Labor's Workforce Investment Act (WIA) and industrial development bond programs, provide state and local governments with more control over how to allocate resources to businesses. Finally, academic studies we reviewed questioned the importance of business incentives in firms' decisions to relocate, but according to the studies we reviewed and consultants with whom we spoke, state and local incentives could influence relocation decisions after businesses already had narrowed their choices.

Nine of the 17 programs that we identified prohibit using program funds to relocate a business if the move would cause unemployment in the original location. They are the two HUD CDBG programs, three Labor WIA programs, a HUD Empowerment Zone (EZ) program, a USDA Empowerment Zone/Enterprise Community (EZ/EC) program, a USDA Business and Industry (B&I) Guaranteed Loan program, and SBA's 504 program (see app. II for a more detailed description of the nine programs). The first seven are grant programs in which a federal agency provides funds to recipients, such as state or local governments, that, in turn, may provide funds to other entities, which we refer to as subrecipients, to facilitate economic development.⁴ The remaining two programs guarantee loans that third-party lenders and nonprofit development corporations make. All prohibit the funding of relocations that result in unemployment, but the amount of job loss that triggers the nonrelocation provision differs by program. For example, in six programs, a single loss would trigger the provision, but in the other three programs, higher thresholds trigger the provision. The three programs with higher thresholds also require applicants to exceed other thresholds before triggering the provision, such as requiring that relocations occur across defined geographic areas. For example, HUD's CDBG program, consistent with its statutory requirement, prohibits funding for a business that relocates to a different labor market.

⁴For purposes of this report, subrecipients include nonprofit organizations and businesses.

Recently, USDA, for its B&I program, has requested but not obtained congressional removal of the nonrelocation provision, saying enforcement of the provision was not cost-effective given the few complaints received over the course of many years.

Federal agencies administering the nine programs with nonrelocation provisions used various procedures, including screening applicants and monitoring recipients, to help ensure compliance, but the extent to which these procedures specifically addressed nonrelocation provisions was limited. The two loan guarantee programs—USDA’s B&I and SBA’s 504 programs—emphasized screening procedures to help ensure compliance. For example, both programs had written guidance and other mechanisms that specifically addressed nonrelocation provisions. The emphasis on screening for loan guarantee programs seemed appropriate given the structure of these programs. While agencies administering the seven grant programs with nonrelocation provisions also screened applicants, agency officials noted inherent limitations in using screening mechanisms for grant programs. For example, under grant programs, applicants (such as state and local governments) do not always know at the time they apply for funds which specific businesses later will seek and obtain assistance through the program. Because of the inherent limitations of screening procedures for grant programs, agencies administering grant programs primarily relied on monitoring to help identify instances of potential noncompliance. However, only one of the seven grant programs we reviewed—HUD’s EZ program—had developed written monitoring guidance specific to the nonrelocation provision. Officials at all agencies stated that they have received few or no complaints of noncompliance with nonrelocation provisions, and some officials said that they do not consider noncompliance to pose a significant risk to the programs. However, without structured guidance and procedures in place to monitor compliance, agencies have limited assurance that grant recipients and subrecipients are complying with statutory and regulatory requirements and spending funds on allowable activities.

We are making recommendations in this report intended to provide Labor, USDA, and HUD with greater assurance that fund recipients and, where applicable, subrecipients are complying with nonrelocation provisions and spending federal economic development funds on allowable activities. We provided a draft of this report to Labor, USDA, HUD, SBA, Commerce, and IRS for review and comment. Labor provided written comments that are reprinted in appendix III. USDA’s Acting Assistant Deputy Administrator for Cooperative Programs provided oral comments on August 8, 2007. In its written comments, Labor stated that the department concurred with

our recommendation and described actions to implement it. Specifically, Labor said that the department is implementing two complementary strategies. First, Labor said that it is developing a formal policy guidance letter that will clarify allowable and unallowable uses of WIA funds for economic-development-related activities. This guidance will specifically address prohibitions related to the nonrelocation provision. Second, Labor said that its draft *Formula Grant Supplement* to its *Core Monitoring Guide* includes indicators of compliance along with each governor's responsibility to determine which costs are allowable or unallowable under WIA, including prohibitions against using WIA funds to encourage business relocation and related restrictions. Labor stated that regional office reviewers have extensively tested the draft *Formula Grant Supplement* and that it expects the supplement to enter the final clearance process shortly and be completed by December 31, 2007. In oral comments on our report, USDA's Acting Assistant Deputy Administrator for Cooperative Programs stated that USDA concurred with our recommendation and provided us with documentation showing that the department is taking initial steps to implement the recommendation. Labor, USDA, HUD, SBA, and IRS provided technical comments that we have incorporated in the report where appropriate. Commerce did not provide comments on the draft report.

Background

In 2000, the Council of State Governments reported that more than 40 states offered tax and financial incentives to businesses for activities such as relocating, expanding, buying equipment, or creating and maintaining jobs. The use of incentives to attract and retain businesses has been an issue of debate for many years. Proponents maintain that economic development incentives are an effective means by which states and communities can compete for jobs. Opponents contend that the dollars spent to provide incentives would be better used to support activities believed to have more impact on a community's economic development, such as improvements to infrastructure and investments in education to develop a competitive labor pool.

While states and localities compete with one another to attract businesses, some states and localities have attempted to curtail the use of economic development funds to relocate jobs. According to two policy groups promoting accountability in economic development, three cities—Austin, Texas; Gary, Indiana; and Vacaville, California—and nine states—Alabama, Connecticut, Florida, Iowa, Maryland, New Mexico, New York, Ohio, and Wisconsin—prohibit using city and state resources, respectively, to relocate jobs within their boundaries. For example, both policy groups

state that the Gary, Indiana, city ordinance prohibits tax abatements for the relocation of existing jobs from outside the corporate limits of the city. One of the groups also said that in Puerto Rico, the governor may refuse any business application for tax incentives if doing so would adversely affect the business' employees in any state in the United States. Regional entities also have established formal and informal agreements to curtail the competition for businesses and jobs within their boundaries. These entities include the Metro Denver Economic Development Corporation; the tri-county region comprising Broward, Miami-Dade and Palm Beach counties in Florida; and Contra Costa and Alameda counties in California.

In 2006, the total number of unemployed workers was 6.8 million in the fourth quarter, compared to 145.6 million employed. According to the Bureau of Labor Statistics (BLS), employers reported that a total of 894,739 workers lost their jobs because of extended layoffs in 2006 that resulted from a variety of economic factors, such as bankruptcy and reorganizations.⁵ A BLS survey of employers found that 20,199 of these losses (about 2 percent) occurred because of business relocations within the United States, the majority across state lines. Another source—the National Establishment Time Series (NETS)—uses proprietary Dun & Bradstreet data on U.S. companies to track business relocations. According to a representative of the company that maintains the NETS data, more than 2.8 million businesses have relocated since 1990 and about 100,000 of these (or almost 4 percent) occurred across state lines.

A number of federal programs fund or support economic development activities. In prior work, we identified activities that are directly related to economic development—planning economic development activities; constructing or renovating nonresidential buildings; establishing business incubators; constructing industrial parks; constructing and repairing roads and streets; and constructing water and sewer systems.⁶ These programs typically are available to applicants that include individuals; local, state,

⁵BLS collects these data under its Mass Layoff Statistics program using each state's unemployment insurance database. Extended mass layoff events consist of 50 or more initial claims for unemployment insurance from an establishment during a 5-week period, with at least 50 workers separated for more than 30 days. According to BLS, establishments with at least 50 workers represented 4.6 percent of all U.S. establishments and 56.5 percent of all U.S. workers in 2006. We consider the BLS data to be reliable based on our use of the data in prior reports.

⁶GAO, *Economic Development; Multiple Federal Programs Fund Similar Economic Development Activities*, [GAO/RCED/GGD-00-220](#) (Washington, D.C.: Sept. 29, 2000).

territorial, and tribal governments; and nonprofit organizations through loans, loan guarantees, and project and formula grants. Appendix II provides a description of the nine federal economic development programs that we identified as having nonrelocation provisions, including information about program funding and how the programs operate.

State and Local Governments Can Use a Variety of Large Federal Programs to Attract Businesses

We identified 17 large federal programs that state and local governments can use to attract businesses. These programs offer assistance to businesses in the form of loans and loan guarantees, grants, job-training services, and tax benefits as incentives to businesses. Of the 17 economic development programs, states appear to have marketed 14 as incentives for businesses. However, according to academic experts who study economic development incentives and site-selection consultants, the amount of federal funds used as incentives is likely more limited than the amount of state and local funds used as incentives. State and local governments have varying discretion over the use of the federal funds, but can leverage federal funds to free their own resources for incentives or for other purposes that support businesses. Finally, academic studies on incentives and site-selection consultants have questioned whether incentives offered by state and local governments influence a business' decision to relocate or expand operations.

State and Local Governments Can Use Various Types of Federal Programs as Business Incentives

We identified 17 large federal economic development programs that state and local governments can use as incentives to attract and retain businesses, based on a search of the *CFDA* database, *Tax Expenditure Compendium*, and state economic development Web sites. As shown in table 1, five agencies administer the 17 programs, which offer a range of assistance or services (such as loans, grants, tax benefits, and training programs) to businesses.

Table 1: Description of 17 Large Federal Economic Development Programs That Offer Financial Assistance or Services That Can Be Used as Business Incentives

Agency	Program	Program Description
HUD	CDBG Entitlement	Grants to large cities and urban counties to benefit the community development needs of low- and moderate-income people
HUD	CDBG State	Grants to states to benefit the community development needs of low- and moderate-income people living in non-entitlement areas
HUD	EZ (urban)	Grants, loans, and tax relief to federally designated urban areas to help them overcome economic and social problems
HUD	Renewal Communities	Tax incentives and regulatory relief for federally designated urban and rural areas to help them overcome economic and social problems
IRS/Treasury ^a	New Markets Tax Credit	Tax credits for investments in qualified community development entities that make investments in designated low-income communities
IRS	Private activity bonds	Tax incentives for construction of public airports, docks, and mass-commuting facilities
IRS	Private activity bonds	Tax incentives for the construction of sewage, water, and hazardous waste facilities
Labor	WIA Adult	Employment and training services to adults ages 18 years and over
Labor	WIA Dislocated Workers	Employment and training services to dislocated workers
Labor	WIA Youth	Employment and training services to economically disadvantaged youth ages 14 to 21 possessing specific barriers to employment
SBA	Certified Development Company 504 Loans	Loans that development companies make and SBA guarantees, providing small businesses with proceeds to acquire or renovate fixed assets, including land, buildings, machinery, and equipment. This program does not cover working capital or refinancing.
SBA	7(a) Loans	Loan guarantees providing small businesses with proceeds to acquire land, buildings, machinery, equipment, furniture or fixtures, and funds to cover building renovation, leasehold expenses, working capital, and refinancing
USDA	EZ/EC (rural)	Grants, loans, tax, and regulatory relief to federally designated rural areas to help them overcome economic and social problems
USDA	B&I Guaranteed Loans	Guaranteed loans to businesses for purchasing or improving land, facilities, equipment, and certain agricultural production projects
USDA	Community Facilities Loans and Grants	Direct loans, loan guarantees and grants to rural communities to develop public facilities, including industrial park sites
USDA	Farm Ownership Loans	Direct and guaranteed loans for purchase of family-size farms
USDA	Farm Operating Loans	Direct and guaranteed loans for operation of family-size farms

Sources: GAO, GSA, and CRS.

^aIRS enforces compliance with relevant portions of the federal tax code for the New Markets Tax Credit program. The Department of the Treasury's Community Development Institutions Fund awards New Markets Tax Credit allocations to qualified community development entities.

Out of the 17 programs we identified,

- five were direct loan or loan guarantee programs: the SBA 7(a) and 504, USDA B&I, Farm Ownership Loans, and Farm Operating Loans;
- four were tax incentive programs: IRS's New Markets Tax Credit, its two private activity bond programs, and HUD's Renewal Communities;
- three were programs that support job training services: WIA Adult, Dislocated Workers, and Youth programs; and
- five were programs that offer more than one type of financial assistance (grants, direct or guaranteed loans, or tax incentives): the two HUD CDBG programs, HUD EZ, USDA EZ/EC, and USDA Community Facilities.

State and local governments also can use federal economic development resources to supplement their existing resources to attract additional investment and potentially use federal economic development funds to free up money for incentives they otherwise would have spent on economic development.⁷ For example, according to USDA officials, EZs and ECs often leverage federal program resources to obtain other funds, thereby attracting businesses. Similarly, businesses located in EZs and ECs can claim various state and federal tax credits, including IRS's Work Opportunity Tax Credit, which provides tax credits to employers hiring individuals residing in an EZ or EC. According to our January 2007 report on the New Markets Tax Credit program, these credits can be packaged with other types of incentives, such as EZ/EC incentives or state and local tax abatements, to make the investments in economically distressed communities more attractive to investors such as banks. We previously have reported that more than one-fourth of New Markets Tax Credit projects were located in federally designated EZs.⁸ State and local governments also can use federal economic development funds to support

⁷For additional information on the leveraging of federal economic development funds, see GAO, *Leveraging Federal Funds for Housing, Community, and Economic Development*, [GAO-07-768R](#) (Washington, D.C.: May 25, 2007).

⁸GAO, *Tax Policy: New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance*, [GAO-07-296](#) (Washington, D.C.: Jan. 31, 2007).

economic development activities, thereby freeing up state and local funds for business incentives or other uses.⁹

Based on our review of state economic development Web sites, states appear to market all but 3 of the 17 programs (Community Facilities Loans and Grants, Farm Ownership Loans, and Farm Operating Loans being the exceptions). The programs that appear to be marketed more than others are the CDBG programs, SBA's 7(a) and 504 loan guarantees, and private activity bonds (at least 19 states appear to advertise each of these as incentives). Benefits from EZs, ECs, or Renewal Communities, and job-training programs funded with WIA funds were the next most marketed incentives, with at least nine states offering them. This appears to be somewhat consistent with what site-selection consultants told us about the specific federal incentives they see in business incentive packages. The consultants told us that they see CDBG loans funded with Entitlement and State block grants, private activity bonds, EZ/EC benefits and, increasingly, customized job-training funds in incentive packages. In contrast to the results of our Web site reviews, the consultants did not cite SBA loans as being among federal resources included in business incentive packages.¹⁰

Use of Federal Funds as Business Incentives Appears to Be More Limited Than Use of State and Local Funds

Although federal programs are marketed as business incentives, the amount of federal funds used as incentives appears to be more limited than the amount of state and local funds used. While the precise amount of federal funds used as incentives is not available, the Congressional Budget Office (CBO) estimated that the federal government spent \$27.9 billion to support commerce and business in addition to \$2.2 billion on credit programs in 1995.¹¹ CBO also indicated that the federal government provides the bulk of its support to businesses through tax provisions. CBO estimated tax revenue losses of at least \$32.2 billion for the provision of the tax code that yielded the largest amount of direct support for businesses—depreciation of capital assets in excess of the alternative depreciation system—but did not provide total estimates of foregone

⁹[GAO-07-768R](#).

¹⁰At least 7 of the 50 state Web sites that we reviewed marketed SBA programs in the form of links to federal Web sites rather than as direct incentives for businesses.

¹¹Congressional Budget Office, *Federal Financial Support of Business* (Washington, D.C: July 1995). CBO has not updated this report since 1995.

revenue associated with all tax provisions.¹² It is not clear from the CBO report whether and to what extent state and local governments also used these programs and tax provisions as incentives. We reviewed academic studies on economic development business incentives offered from 1995 to 2005 and interviewed the authors of these studies. The academic literature on economic business incentives generally focuses on state and local government incentives rather than federal incentives. Academic studies estimate that state and local governments spent from \$20 to \$50 billion annually on business incentives.¹³ While the amount of federal funds used as business incentives has not been measured to any great extent, some researchers with whom we spoke said that the amount of federal funds used as business incentives is likely limited compared to the amount of state and local funds used as incentives.¹⁴

One limitation in developing estimates of federal, state, and local funds spent on incentives is defining what constitutes a business incentive. For example, a state or local government might offer indirect benefits, such as infrastructure improvements, to attract or retain businesses, but these might not be counted in estimates as business incentives.¹⁵ Moreover, although the amount of federal economic development funds available as incentives appears to be limited, money can be fungible, or freely interchangeable, at the state and local level. Thus, even though the amount of federal funds used as incentives might be limited, state and local governments could leverage those funds to free up their own resources for incentives or for other purposes that support businesses.

¹²CBO indicated that it is difficult to provide a total revenue loss estimate because the interactions between different provisions of the tax code do not equal the arithmetic sum of revenue losses from individual tax provisions.

¹³Tim Bartik, "Evaluating the Impacts of Local Economic Development Policies on Local Economic Outcomes: What Has Been Done and What is Doable?" *Upjohn Institute Staff Working Paper No. 03-89*, prepared for the Organization for Economic Cooperation and Development's (OECD) Conference on "Evaluating Local Economic and Employment Development" (Kalamazoo, Mich.: The Upjohn Institute, November 2002); Kenneth Thomas, *Competing for Capital: Europe and North America in a Global Era* (Washington, D.C.: Georgetown University Press, 2000); and Peter Fisher and Alan Peters, "The Failure of Economic Development Incentives," *Journal of the American Planning Association* 70, no. 1 (Chicago, Ill.: Winter, 2004).

¹⁴Bartik.

¹⁵Thomas.

Furthermore, state and local governments have less discretion over the use of federal resources than they do over their own, but the degree of discretion varies with the program. For at least four of the programs (SBA's 7(a) and 504 loan programs, USDA's B&I loan program, and IRS's New Markets Tax Credit), state and local governments have no direct role in funding decisions. For these programs, third-party lenders, development corporations, or the federal government decide which businesses receive funds. In contrast, other programs provide states with more discretion over how they can use funds. For example, under WIA, states and local areas can use the discretionary and statutory funding from Labor to develop job training and employer service programs, including customized job training, which we previously have reported can be an important factor in a company's decision to locate in a particular area.¹⁶

Finally, the academic literature we reviewed questioned the importance of incentives in location or relocation decisions. These studies, as well as published articles in site selection industry magazines, indicate that other considerations might outweigh economic development incentives when companies decide where to locate. The studies explained that the critical factors in deciding were more likely to be the size and education of the labor force; local infrastructure such as telecommunication lines; transportation options, such as access to ports, roads, and rail; and access to consumer markets. However, the studies and consultants acknowledged that the incentives state and local governments offered could influence a business' decision when the business already had narrowed its choice to three or four locations.

¹⁶[GAO-03-884T](#).

Nine Large Federal Economic Development Programs Have Nonrelocation Provisions, but Requirements Vary

We determined that 9 of the 17 large federal economic development programs that state and local governments can use as business incentives contain statutory prohibitions against using funds to relocate businesses if the relocation would cause unemployment.¹⁷ Seven of the federal economic development programs with nonrelocation provisions were grant programs, and the remaining two were loan guarantee programs. The number of job losses and other requirements needed to trigger the nonrelocation provision varied by program. Nonrelocation provisions for the nine programs were enacted over a 40-year period. Recently, one program has sought but not obtained congressional removal of its nonrelocation provision.

Nine Large Federal Economic Development Programs Contain Statutory Nonrelocation Provisions

Based on our review of laws and regulations for the 17 large federal economic development programs that state and local governments can use as business incentives, we determined that nine contain statutory prohibitions against using program funds to relocate businesses.¹⁸ (See app. II for a more detailed description of each of these nine programs.) They are the two HUD CDBG programs (Entitlement and State programs); the WIA Adult, Dislocated Workers, and Youth programs; USDA and HUD's respective EZ/EC programs (for designated rural and urban communities, respectively); USDA's B&I program; and SBA's 504 program. SBA voluntarily applies a nonrelocation provision to its 7(a) program.¹⁹

¹⁷We identified 21 additional federal programs with statutory nonrelocation provisions. We did not focus on these programs because they did not meet our minimum funding criteria of \$500 million annually or did not meet our definition of economic development.

¹⁸See appendix I for a more detailed description of our methodology for identifying the large economic development programs with statutory prohibitions against using program funds for employer relocation.

¹⁹SBA voluntarily applies a nonrelocation provision to its 7(a) loan program, which provides assistance to small businesses to purchase land and buildings. 7(a) loans also assist small businesses with support operations, such as payroll and inventory. SBA's standard operating procedures prohibit the approval of a 7(a) loan if it finances a move that would cause serious unemployment in the present location. However, SBA's procedures permit financing the relocation of an applicant's business when the relocation will accomplish a sound business purpose, such as preventing the business from closing. The remaining seven programs—HUD's Renewal Communities, IRS's New Market Tax Credit and two private activity bonds, USDA's Community Facilities Loans and Grants, USDA's Farm Ownership Loans and USDA's Farm Operating Loans—do not contain statutory restrictions on using program funds to relocate businesses.

All nine programs that we identified with statutory restrictions on employer relocations use job loss in a relocating company’s original location as the primary criterion for applying a nonrelocation provision, but the job loss threshold varies by program. As shown in table 2, the statutory language for three programs—HUD and USDA’s EZ/EC program and USDA’s B&I program—do not specify a job loss threshold, but these agencies interpret the job loss threshold as one job lost. The three WIA programs specify a job loss threshold of one job lost. The remaining three—HUD’s CDBG Entitlement and State programs and SBA’s 504 program—have higher job loss thresholds. In addition to job loss, these three programs specify other conditions for applying a nonrelocation provision, such as requiring that the relocations occur across geographically defined areas.

Table 2: Job Loss and Other Statutory or Regulatory Requirements for Nine Large Federal Economic Development Programs with Nonrelocation Provisions

Agency	Program	Job loss threshold	Other requirements	Exemptions from application of nonrelocation provision
HUD	CDBG Entitlement and State	More than 25 jobs	<ul style="list-style-type: none"> Relationship between job loss and size of labor market in originating employer’s area Relocation occurs across different labor market areas (as defined by BLS) 	<ul style="list-style-type: none"> New operations of a business that are unrelated to existing operations, even if business decides to reduce or eliminate existing operations. Nonprofit entities Indirect assistance that benefits multiple businesses Loss of 25 or fewer jobs Microenterprises Purchase of business equipment, etc. if purchase does not result in relocation of sellers’ operations
HUD	EZ (urban)	1 job ^a	None	None
Labor	WIA Adult, Dislocated Workers, and Youth programs	1 job	None	None
SBA	Certified Development Company 504 Loans	<ul style="list-style-type: none"> One third workforce reduction within a company, or substantial increase in unemployment in any area of the country 	None	<ul style="list-style-type: none"> Relocation is key to the economic well-being of the applicant Benefits to applicant and receiving community outweigh negative impact to original community.
USDA	EZ/EC (rural)	1 job ^a	None	None

Agency	Program	Job loss threshold	Other requirements	Exemptions from application of nonrelocation provision
USDA	B&I Guaranteed Loans	1 job ^a	None	<ul style="list-style-type: none"> • Business applying for \$1 million or less of assistance, or • Business applying would increase direct employment by less than 50 employees^b

Source: GAO analysis.

Note: For CDBG programs, see 42 USC 5305(h); for EZ/EC programs, see 26 USC 1391; for WIA programs, see 29 USC 2931(d); for SBA program, see 15 USC 661; and for B&I program, see 7 USC 1932.

^aNeither the statutes nor the regulations for these programs specify a job loss threshold. However, agency officials stated that the job loss threshold is one lost job for these programs.

^bBased on language contained in statute, 7 U.S.C. 1932(d)(2). The regulations for the B&I program differ from the statute in that businesses are exempt from the nonrelocation provision if they are applying for less than \$1 million in assistance “and” (as opposed to “or”) the business would increase direct employment by less than 50 jobs. 7 C.F.R. 1980.412(c); 7 C.F.R. 4279.114(b). Loans that are not exempt from the nonrelocation provision require U.S. Department of Labor involvement in reviewing certain information about these loans. USDA officials said that they are currently implementing the B&I program based on the program’s regulations. Thus, USDA sends to Labor only those loans that are for at least \$1 million and would increase direct employment by more than 50 jobs. According to USDA officials, USDA is seeking to have the statutory language changed to make it more consistent with regulatory language. The officials stated that when the B&I statute was originally enacted in 1972, loans of \$1 million and above were rare. Currently, according to USDA, if the agency were to send to Labor for review loans based solely on the amount (\$1 million and above), Labor would have to review most B&I loans.

HUD regulations for the CDBG Entitlement and State programs make business relocations ineligible for funding if they involve certain job losses. Any relocation involving the loss of 500 or more jobs is prohibited. In contrast, relocations involving the loss of 25 or fewer jobs are exempt from the nonrelocation provision. For relocations involving between 25 and 500 jobs, the nonrelocation provision applies if the number of jobs lost equals or exceeds one-tenth of one percent of the number of employed persons in the labor market experiencing the loss.²⁰ The CDBG program’s statute does not specify a job loss threshold; it only requires that the agency prohibit funding for business relocations that are likely to result in a significant loss of employment. According to a HUD official, HUD chose to exempt any relocation involving 25 or fewer jobs because losses of this magnitude likely would not significantly affect a labor market of any size. By exempting these smaller businesses from the nonrelocation provision, this official said that the CDBG program retains some flexibility for entitlement and nonentitlement communities to provide funds to businesses to promote job growth. This official further noted that HUD

²⁰See 24 C.F.R. § 570.210 (Entitlement program); 24 C.F.R. § 570.482(h) (State program).

also determined that relocations involving 500 or more jobs would be significant for labor markets of any size.

SBA's 504 program, which guarantees the portion of a business loan that nonprofit certified development companies make to businesses, features potentially higher job loss thresholds.²¹ For example, SBA regulations would require that applications for loans be denied if the relocation would result in the business's reducing its workforce by at least one-third, or serious unemployment would result in the original business location or any area of the country. SBA regulations allow for the waiver of these job loss limits if the relocations would be key to the economic well-being of the business or if the benefits to the applicant and the receiving community would outweigh the negative impact to the community from which the applicant would move.

As noted previously, three of the programs specify conditions in addition to job loss for applying the nonrelocation provision, such as relocations occurring across defined geographic areas and funding thresholds. For example, HUD's CDBG regulations for both the Entitlement and State programs prohibit funding for a business that relocates to a different labor market area.²² USDA's B&I program, through which USDA guarantees up to 80 percent of a loan that an approved third-party lender makes to businesses, statutorily prohibits program funds from supporting business relocations in cases in which USDA assistance exceeds \$1 million. Our review of congressional reports indicates that this minimum funding threshold is intended to expedite the processing of small business applications, based on the reasoning that the relocation of small businesses would pose no threat to the labor force or other businesses in the original location.

²¹Certified development companies are private, nonprofit corporations established to promote economic development within a community. 13 C.F.R. § 120.822 requires each certified development company to have at least 25 members representing the following groups: (1) government organizations responsible for economic development; (2) financial institutions that provide commercial long-term fixed-asset financing; (3) community organizations dedicated to economic development; and (4) businesses.

²²According to BLS, a labor market area is an economically integrated area within which individuals can readily change jobs without moving. According to HUD officials, HUD's regulatory approach reflects the statutory nonrelocation provision for the CDBG program, which specifies that a "relocation is likely to result in a significant loss of employment in the market area from which the relocation occurs."

Congressional approval of the nonrelocation provisions for the nine large programs was spread over a 40-year period (1958 to 1998). Table 3 shows the date on which the nine programs became subject to nonrelocation provisions.

Table 3: Timeline Showing Congressional Approval of Nonrelocation Provisions for Nine Large Federal Programs

Year ^a	Agency	Program
1958 ^b	SBA	Certified Development Company 504 Loan program
1972	USDA	B&I Guaranteed Loan program
1993	USDA / HUD	EZ/EC (2 programs)
1998 ^c	Labor	WIA Adult, Dislocated Workers, and Youth (3 programs)
1998	HUD	CDBG Entitlement and State (2 programs)

Source: GAO analysis.

^aYears listed are those in which the legislation was enacted, not necessarily the years in which the provisions took effect.

^bThe 504 loan program was enacted in 1986 as part of the Small Business Investment Act of 1958, as amended. The nonrelocation provision was established under the original 1958 act. It applied to the predecessors of the current 504 loan program and to the 504 program itself.

^cLabor's WIA was enacted in 1998, but the act's nonrelocation provisions are based on the Job Training Partnership Act, which was enacted in 1982.

One of the federal agencies has sought but not obtained removal of a nonrelocation provision from its program. USDA officials said that since 2001 the agency has sought congressional support for the removal of the nonrelocation provision for the B&I program, citing administrative burden and other problems involved with ensuring compliance. A USDA official explained that while Labor has the statutory responsibility to analyze labor market information related to B&I applications—to help ensure that funding will not result in the transfer of any employment or business activity—Labor does not receive separate funding to support analysis of this information. According to USDA, the agency has sent between 6 and 18 B&I applications to Labor for review in the past few years. Labor

confirmed that it does not receive separate funding to support its analysis, but said the agency reviews all of the applications Labor provides.²³

Extent to Which Federal Agencies Had Established and Implemented Procedures to Help Ensure Compliance with Nonrelocation Provisions Was Limited

Federal agencies administering the nine programs with nonrelocation provisions used various procedures to help ensure that program recipients complied with overall program goals and requirements, but the extent to which these procedures specifically addressed nonrelocation provisions was limited. The *Guide to Opportunities for Improving Grant Accountability* states that organizations awarding grants need effective internal control systems to provide adequate assurance that funds are properly used and achieve intended results.²⁴ The two loan guarantee programs—USDA’s B&I and SBA’s 504 programs—relied on screening mechanisms (written review guidance and eligibility checklists or third-party verification of data) to help ensure compliance with nonrelocation provisions. In contrast, officials who administer grant programs we reviewed noted inherent limitations in using screening mechanisms for grant programs, given that program recipients (states and local governments) do not always know at the time of application which businesses later will apply for and obtain assistance through the program. Because of the inherent limitations of screening, the agencies administering grant programs primarily relied on monitoring recipients and subrecipients to help identify instances of potential noncompliance. However, only one of the grant programs we reviewed had developed monitoring guidance specifically tailored to the nonrelocation provision. Without structured guidance and procedures in place, agencies have limited assurance that recipients and subrecipients are complying with

²³We identified another agency—EDA for its Public Works and Facilities Program—that did obtain congressional removal of a nonrelocation provision. According to EDA officials, the Secretary of Commerce requested the removal because the agency had detected only one violation more than 30 years ago when the provision was effective and because EDA did not receive separate funding to monitor compliance with the provision. Senate and House reports do not specifically address the rationale for removing this provision, but note that the legislative changes were being made to reflect different economic conditions and a new emphasis on innovation, productivity, and entrepreneurship. Despite the statutory removal of the provision, program officials told us they do not support the use of program funds to relocate jobs among communities.

²⁴A guide compiled by members of the Domestic Working Group (a collection of federal, state, and local audit organizations tasked by the Comptroller General of the United States) working on a Grant Accountability Project. They were tasked with offering suggestions for improving grant accountability. See Domestic Working Group, *Guide to Opportunities for Improving Grant Accountability* (Washington, D.C.: October 2005).

statutory and regulatory requirements and spending funds on allowable activities.

Agencies Had Eligibility Screening Procedures, but Focus on Nonrelocation Provision Was Limited

As stated in the *Guide to Opportunities for Improving Grant Accountability*, organizations that award and receive grants need effective internal control systems to help ensure that grants are awarded to eligible entities for intended purposes and in accordance with applicable laws and regulations. As shown in table 4, each of the four federal agencies we reviewed had screening procedures covering applicants' eligibility to receive funds. The agencies used at least one of the following mechanisms: written application or plan review guidance, eligibility checklists, self-certification forms, third-party verification of data, or business statements of compliance. However, only four of the nine programs—including both loan guarantee programs—used screening mechanisms that specifically addressed a relevant nonrelocation provision.

Table 4: Federal Agency Mechanisms to Screen for Compliance with Nonrelocation Provisions

Agency	Program	Written application or plan review guidance			Self-certification form		Third-party verification of applicant data specific to nonrelocation	Business statements of compliance
		Specific to nonrelocation provision	Not specific to nonrelocation provision	Eligibility checklist that specifically addressed nonrelocation	Specific to nonrelocation provision	Not specific to nonrelocation provision		
HUD	EZ (urban)		✓			✓		
	CDBG (Entitlement)		✓			✓		✓
	CDBG (State)		✓			✓		✓
Labor	WIA Adult		✓			✓		✓
	WIA Dislocated Workers		✓			✓		✓
	WIA Youth		✓			✓		✓
USDA	EZ/EC (rural)	✓			✓			
	B&I Loans	✓			✓		✓	
SBA	504	✓		✓				

Source: GAO analysis.

Review of Applications or Plans

All four agencies had procedures for reviewing applications or plans to help ensure that applicants were eligible to receive funds under the program.

- The two loan guarantee programs—USDA for its B&I program and SBA for its 504 program—had formal written guidance that specifically addressed the screening of applicants for compliance with the nonrelocation provision. USDA’s formal written guidance listed the nonrelocation provision as one of the ineligible purposes of a B&I loan guarantee.²⁵ SBA also incorporated specific references to its nonrelocation provision into its standard operating procedures, which are addressed to SBA personnel and lending partners who review and approve 504 loans. SBA also required its 504 lending partners to complete an eligibility checklist for each loan guarantee applicant. One of the items on the eligibility checklist seeks to determine whether 504 loan proceeds will be used to “relocate any operations of a small business, which will cause a net reduction of one-third or more in the workforce of the relocating small business or a substantial increase in unemployment in any area of the country.” In reviewing the supporting documentation for 10 approved loans, we found that certified development companies were using the eligibility checklist SBA had developed to screen 504 loan applicants for these loans.²⁶
- Each of the seven grant programs had formal written guidance covering the review of required plans but with the exception of USDA’s EZ/EC program, the guidance did not specifically address the nonrelocation provisions for each program. Under the CDBG programs, recipients (entitlement communities and states) must submit an action plan to HUD each year that broadly identifies the activities that they will undertake to meet the objectives of previously submitted consolidated plans.²⁷ Labor requires states to submit strategic plans for WIA describing how a state intends to use WIA funds. Both agencies use written checklists as guidance to determine whether the submitted plans are complete and both agencies’ guidance includes an item to determine whether applicants have assured their compliance with applicable laws and regulations. HUD

²⁵USDA RD Instruction 4279-B, section 4279.114(b).

²⁶Under the 504 program, certified development companies underwrite up to 40 percent of project financing. Thus, they are involved in screening 504 program applicants and monitoring their use of loan proceeds.

²⁷CDBG recipients submit a consolidated plan at least once every 3 to 5 years that addresses the housing, homeless, and community development needs in the recipient’s jurisdiction.

officials noted that its written guidance on review of action plans does not require analysis of the nonrelocation provision, in part because CDBG recipients generally do not know which businesses will apply for CDBG funding at the time the plans are developed and submitted to HUD. HUD officials explained that most CDBG recipients engaged in economic development activities have an “open window” approach, in that assistance is available to businesses on an “as needed” basis during the program year.

- For the EZ/EC programs, USDA had formal written guidance for reviewing required application plans that referred to the program’s nonrelocation provision, while HUD’s written guidance did not specifically address the provision. Under the EZ/EC program, communities seeking EZ or EC designation submit (1) a strategic plan outlining the community’s vision for revitalizing its distressed area; (2) a tax incentive utilization plan specifying how the community plans to use the tax benefits available under the program; and (3) an implementation plan providing detailed information on the activities and projects the community is undertaking to implement its strategic plan. HUD officials said that while the agency does not currently have review guidance specific to the nonrelocation provision, the agency has been revising a review manual to incorporate language specific to the provision and has been taking other steps, such as communicating directly with EZs regarding compliance and providing training to staff, to raise awareness of the provision and the need to comply with it. USDA officials said that EZ/EC review staff were told to reject any application for EZ/EC designation in which an applicant’s strategic plan included evidence that the community intended to lure businesses from other communities. The officials said that review staff eliminated several applications for potential program designation because intent to relocate jobs was evident in the submitted plans. However, we were not able to verify this statement because USDA officials said that the strategic plans eliminated from contention were discarded and are no longer available for review.

Some officials, particularly those who administer grant programs, noted the limitations of reviewing applications and plans to identify instances of potential noncompliance with a nonrelocation provision. As noted above, HUD CDBG officials said that action plans for its Entitlement program were unlikely to identify specific businesses receiving funds because the communities do not always know which businesses would apply for assistance when they submitted the action plans. Similarly, the officials noted that action plans for the State CDBG program do not contain a list of proposed activities, but rather a description of the methods used to distribute funds to local governments. HUD officials noted that under the

Requirements for Self-Certification of Compliance

CDBG State program, individual states implement a method of distributing funds that may or may not include economic development activities and that in most cases the states evaluate applications from local governments to determine which activities to fund.

As part of the application review process, USDA's EZ/EC and B&I programs require applicants to sign self-certification forms that included a specific reference to the nonrelocation provision for each program. For example, USDA's application for the EZ/EC program contained a form in which an applicant self-certifies that "no action will be taken to relocate any business establishment to the nominated area." According to USDA EZ/EC officials, this required certification sends a clear message to the EZ/EC community that relocation is not permitted under the program. Similarly, USDA's B&I program requires loan applicants applying for loans of more than \$1 million that will increase employment by more than 50 employees to self-certify that "it is not the intention of the applicant or any related company to relocate any present operation as a result of the proposed project."²⁸

Other agencies, such as HUD for both its CDBG and EZ programs and Labor for its WIA programs, require more general statements of compliance. For example, HUD's application for Round II of the EZ program contained a form in which an applicant self-certified that "the nominating entities shall comply with state, local, and federal requirements, and have agreed in writing to carry out the Strategic Plan if designated." Similarly, HUD's CDBG program requires applicants to self-certify their compliance with "applicable laws," which HUD officials said includes the Housing and Community Development Act of 1974, as amended, which contains the nonrelocation provision. According to the officials, HUD saw no need or statutory basis to add a special certification for the nonrelocation provision, particularly since not all states or entitlement communities use CDBG funding for economic development purposes. Labor's statement of compliance, included in WIA state strategic plans, requires the governor of each state to assure that WIA funds "will be spent in accordance with the Workforce Investment Act and the Wagner-Peyser Act and their regulations, written Department of Labor guidance implementing these laws, and all other applicable federal and state laws and regulations." Labor officials noted that this general statement of

²⁸USDA only requires an applicant to make this self-certification if the applicant or related company has a business facility at another location.

compliance covers compliance with the nonrelocation provision. During our review of 30 USDA EZ/EC, HUD EZ, and Labor WIA approved grant applications (10 applications for each program), we found that recipients had completed the required self-certifications for each of the applications we reviewed.

Pre-Approval Third-Party Verification

As part of the pre-approval process for the B&I program, USDA turns over information that certain loan applicants provide to Labor for independent, third-party verification. For guaranteed loans in excess of \$1 million that will increase employment by more than 50 jobs, USDA will send an applicant's certification of nonrelocation and the market and capacity information form to Labor for clearance. In-turn, Labor sends the form to state-level workforce agencies, where the business' competitors are located, for analysis and direct solicitation of the competitor's comments. According to USDA officials, Labor must complete this third-party verification before USDA can approve a B&I loan guarantee request. Our review of loan documentation for 10 approved B&I loan applications indicated that both USDA and Labor carried out these procedures for the applications we reviewed. As discussed earlier in this report, USDA officials have been asking Congress to remove the nonrelocation provision from the B&I program, citing an administrative burden and costs incurred in helping to ensure compliance.

Requirements for Written Statements of Compliance from Businesses

Regulations for HUD's Entitlement and State CDBG programs and Labor's three WIA programs require grant recipients (such as a state or local government) to obtain a signed written statement of compliance with the nonrelocation provision from businesses before providing direct assistance to them. For example, under the CDBG programs, there is a two-step process. First, businesses receiving CDBG assistance must submit a written statement to the recipient (entitlement community or state), subrecipient, community-based development organization, or nonprofit providing the assistance whether the activity will result in the relocation of jobs from one labor market area to another. Second, if the assistance will not result in the relocation of jobs covered by the statutory prohibition, the business must provide a certification that it has no plans to relocate jobs (in a manner that would violate the nonrelocation provision). However, these statements are not included in a recipient's application for funding (action plan), and thus HUD does not review them during the action plan review process. HUD officials noted that it would not be possible for an entitlement community to provide these statements to HUD with an action plan because, as previously noted, most entitlement communities do not know at that time which businesses will apply for CDBG assistance. Similar to HUD, Labor's regulations for WIA require that

local workforce investment boards conduct a pre-award review of businesses seeking job training funds, which includes obtaining a written certification from the business indicating whether WIA assistance is being sought in connection with past or impending job losses at other facilities.

Our review of 10 approved WIA grants indicated that businesses had completed the required statements of compliance for each of those grants. With respect to HUD's CDBG program, we did find one case in which a HUD CDBG entitlement community recipient we contacted told us that its subrecipient (a nonprofit development corporation) was not obtaining the required written statements of compliance. An official from the entitlement community said that neither the entitlement community nor the subrecipient had developed formal procedures to help ensure compliance with the regulatory requirement. In addition, neither HUD nor Labor require that recipients provide copies of completed written statements to HUD or Labor, although a HUD official noted that the written statements would be available to on-site reviewers during monitoring visits. HUD officials also said that HUD is revising a monitoring handbook to include a question addressing the business' written statements of compliance. We discuss agency monitoring procedures and guidance in greater detail in the next section.

While Monitoring Is a Key Control for Helping to Ensure Compliance with Nonrelocation Provisions, Only One Grant Program Had Written Guidance Specific to the Provision

The *Guide to Opportunities for Improving Grant Accountability* states that once grants are awarded, agencies need to ensure that grant funds are used for intended purposes and in accordance with applicable laws and regulations. The guide also states that it is critical to identify, prioritize, and manage potential at-risk subrecipients to ensure that grant goals are reached and resources are properly used. Due to inherent limitations in using the screening process to help ensure compliance with nonrelocation provisions, other procedures, such as monitoring activities, become key controls. Having established, written procedures in place helps to ensure that agencies achieve their monitoring objectives and that staff are consistently implementing monitoring procedures.

Officials at some of the agencies we reviewed told us that they rely on complaints as a mechanism to monitor compliance with the employer nonrelocation provision. A HUD official said that an employer relocation that resulted in significant job loss and involved the use of federal funds likely would result in the affected community or state raising a complaint to the federal agency or to their congressional representatives. HUD, Labor, SBA, and USDA officials all reported receiving few if any of these complaints, in some cases over the course of many years. For this reason,

some officials did not consider the risk of noncompliance to pose a significant risk to the programs. However, this complaint-based approach is reactive and does not necessarily provide reasonable assurance of compliance. *Standards for Internal Control in the Federal Government* states that an agency’s monitoring activities should be performed continually and be ingrained in agency operations.²⁹ As shown in table 5, the four agencies administering programs with nonrelocation provisions used various other mechanisms, including on-site review, to monitor fund recipients. All of the agencies had formal written guidance covering the monitoring of program participants. However, only one program—HUD for its EZ program—had a monitoring procedure that specifically addressed the nonrelocation provision.

Table 5: Status of Federal Agency Mechanisms for Monitoring Compliance with Nonrelocation Provisions, as of July 2007

Agency	Program	On-site monitoring of recipients	Written monitoring guidance	Written monitoring guidance specific to nonrelocation provision	Specific monitoring guidance has been used in a monitoring review
HUD	EZ (urban)	✓	✓	✓	✓
	CDBG (Entitlement)	✓	✓	Draft	
	CDBG (State)	✓	✓	Draft	
Labor	WIA Adult	✓	✓	Draft	
	WIA Dislocated Workers	✓	✓	Draft	
	WIA Youth	✓	✓	Draft	
USDA	EZ/EC (rural)	✓			
	B&I Loan Guarantee	N/A ^a	✓		
SBA	504 Loan Guarantee	N/A ^a	✓		

Source: GAO analysis.

^aGiven program structure and legal requirements, USDA and SBA procedures are implemented up-front, on a pre-approval rather than a post-approval basis.

To effectively leverage limited staff resources, HUD and Labor told us that their respective agencies conduct on-site monitoring reviews in accordance with risk-based procedures intended to focus monitoring

²⁹GAO’s *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999) provides an overall framework for establishing and maintaining internal control, identifying and addressing major performance and management challenges, and identifying and addressing areas at the greatest risk of fraud, waste, and mismanagement.

resources on areas requiring the most attention.³⁰ For example, HUD's procedures for the EZ program specify factors for reviewers to consider when determining the scope of a review. These factors include funding amount, outstanding complaints related to noncompliance with a legal requirement, and unresolved monitoring or assessment issues. Similarly, for the CDBG program, reviewers consider factors such as the complexity of a state or entitlement community's activities and use of subrecipients to carry out funded activities. According to HUD CDBG officials, on-site monitoring is the most effective way to identify potential violations of the nonrelocation provision for the CDBG program. Labor also conducts on-site monitoring of states and a sample of local workforce investment agencies. As part of Labor's risk-based procedures, reviewers may consider factors such as the number of federal grants a state administers, a history of disallowed costs or administrative findings in previous reviews, and percentage of grant funds subcontracted.

USDA's monitoring for the EZ/EC program involves two staff members—one in a state office and the other in the national office—reviewing requests for drawdown that EZ/ECs make several times during the year. Drawdown requests include a specification of how an EZ or EC will use its funds. Prior to disbursing requested funds, USDA staff members review the request to ensure that the funds will be used to carry out the community's strategic plan (which includes a certification form that specifically refers to the nonrelocation provision and which USDA reviews at the time of initial application). In addition to reviewing drawdown requests, USDA staff in both the state and national offices review mandatory annual reports describing a community's progress in implementing its strategic plan. According to USDA officials, the review of annual reports also includes a review of any updates to the strategic plan to ensure that no relocation support has crept into the plan since the initial review. A USDA official added that USDA staff have made on-site monitoring visits to all of the rural EZ/ECs.

Officials of SBA's 504 and USDA's B&I program told us that they do not monitor for compliance with the nonrelocation provision because, unlike federal grant programs, in loan guarantee programs, a federal agency can determine which specific businesses will receive assistance and for what

³⁰HUD CDBG program officials noted that HUD also can perform off-site monitoring of recipients if necessary. This off-site monitoring involves a remote review of files and documents in a HUD office.

purpose (relocation, equipment purchase, etc.) before an agency guarantees a loan. SBA officials explained that SBA and certified development companies (CDC) approve a project for 504 financing before construction begins, but SBA does not disburse loan funds or issue a debenture guarantee until after the project is completed.³¹ According to SBA officials, CDC staff review the completed project before closing on a loan, at which time loan funds are disbursed and a debenture guarantee issued. Similarly, USDA officials told us that their field staff verify uses for loan proceeds when they review a loan closing package, specifically the settlement statement, before guaranteeing a loan. USDA officials explained that once a loan is fully disbursed, subsequent monitoring of the use of loan proceeds for compliance focuses on other issues, such as the number of jobs created, rather than compliance with the nonrelocation provision, because the loan proceeds already have been used for their intended purposes. The emphasis on screening rather than monitoring seemed appropriate for the two loan guarantee programs since the federal agencies know which specific businesses are requesting funds and the purposes for which the funds will be used.

HUD's EZ program was the only program we reviewed that had written monitoring guidance specific to the nonrelocation provision at the time of our review. As of July 2007, HUD had used this monitoring guidance in four on-site reviews. HUD's guide for the review of Round II EZ strategic plan compliance calls for review staff to determine whether there is "any evidence to indicate that the EZ is complying with the prohibition against assisting a business to relocate." The guide did not provide specific procedures or steps that staff should follow to make the assessment of compliance, but rather referred to the program's implementing regulation for the nonrelocation provision. HUD officials said that under current procedures, on-site reviewers rely on receiving complaints of noncompliance or on information obtained by asking open-ended questions about compliance to determine whether communities are complying. For the four reviews in which HUD had used the guidance at the time of our review, the narrative supporting the reviewer's assessment of compliance indicated that approved implementation plans, discussions with EZ staff regarding standard operating procedures, and a review of loan file documents were among the bases on which HUD reviewers determined that EZs were complying with the program's nonrelocation provision. HUD officials said that for additional on-site reviews planned

³¹A debenture is a certificate acknowledging a debt.

for fiscal year 2007, the agency is considering reviewing implementation plans to specifically check for compliance with the nonrelocation provision. HUD officials said that they would focus on plans involving sites with potential for commercial development to determine whether HUD-approved activities or projects involving marketing or promotional efforts encouraged relocations to an EZ.

HUD and Labor officials told us that their agencies were developing monitoring guidance specific to the nonrelocation provision for the CDBG and WIA programs, respectively, but that such guidance is in draft form.³² As of July 2007, HUD and Labor had not finalized this guidance or used it in a monitoring review. HUD officials said that HUD expects to finalize the monitoring guidance tailored to the nonrelocation provision by December 31, 2007. The officials explained that HUD was developing monitoring guidance for inclusion in a forthcoming revision to a monitoring handbook that HUD uses for all of its major Office of Community Planning and Development grant programs, including the CDBG and EZ programs. HUD undertook the revisions because the current version of the handbook was issued prior to the promulgation of the CDBG program's nonrelocation provision in December 2005. HUD CDBG officials stated that including a question on compliance with the nonrelocation provision is intended to ensure that compliance reviews by HUD staff in this area would be consistent. Labor officials explained that their monitoring handbook for employment and training grant programs, including WIA programs, is generic and limited to examining core activities found in all of Labor's employment and training programs. In contrast, Labor's formula grant supplement to the monitoring handbook, currently under development and in draft form, will provide a more detailed examination of statutes, rules, and regulations specific to the formula-based programs once finalized. Labor officials said that the formula grant supplement has been tested in field offices and will address the nonrelocation provision. The officials said that they expect to publish the formula grant supplement in the latter half of calendar year 2007.

Conclusions

State and local governments use incentives, including funds from federal economic development programs, to attract business investment and

³²According to HUD officials, the monitoring guidance for the CDBG program, once finalized, will include a check for business statements of compliance, required under the CDBG program's nonrelocation provision. As noted previously, businesses are to complete these statements as a condition of receiving CDBG funds.

create jobs in their communities. Although it is difficult to determine the extent to which state and local governments use federal funds as business incentives, 9 of 17 large federal economic development programs contain statutory restrictions against using program funds to relocate jobs if the use of such funds creates unemployment. Thus, for these nine federal programs, the agencies charged with their administration are responsible for helping to ensure that program funds are used for intended purposes and in accordance with applicable laws and regulations, including compliance with nonrelocation provisions.

Each of the four agencies that administer the programs with nonrelocation provisions used screening and monitoring mechanisms to help ensure that fund recipients were eligible to participate in the programs, meeting program goals, and complying with legal requirements. The two agencies administering the loan guarantee programs we reviewed—SBA for the 504 program and USDA for the B&I program—relied primarily upon screening mechanisms to help ensure that applicants would not use loan proceeds to relocate businesses and jobs. For these two programs, screening mechanisms may be sufficient since the agencies can determine which specific businesses will receive assistance and how the loan proceeds will be used. In such cases, a screening process can determine if loan funds will be used to support a business relocation. In contrast, officials from the other programs we reviewed, particularly those that administer grant programs, noted limitations in using screening mechanisms for such programs. For example, with grant programs, fund recipients (e.g., states and local communities) do not always know which businesses will apply for or receive funding at the time the recipient submits an initial plan or application for funding.

Acknowledging the limitations of screening for helping to ensure compliance with nonrelocation provisions, agency officials regarded on-site monitoring as the most effective way to detect an instance of potential noncompliance in their grant programs. However, officials also noted that they targeted their limited monitoring resources on recipients that posed the greatest risk. Furthermore, they maintained that noncompliance with nonrelocation provisions did not present a significant risk to the programs they administered because they received few or no complaints over the years and regarded complaints as a barometer for undertaking monitoring activities.

We recognize that there are costs associated with monitoring program recipients for compliance with nonrelocation provisions. Nevertheless, a reactive approach in which agencies assume there are no problems

because outside parties do not report them, by itself, is an insufficient means to help ensure that problems do not exist and federal internal control standards state that monitoring should be performed continually and be ingrained in agency operations. Further, USDA EZ/EC program officials said that they have rejected applications for zone designation because intent to relocate jobs was evident in the applications, providing evidence that applicants do sometimes seek to use program funds to lure businesses away from one community to another.

Given the relatively large size of some federal grant programs and their complicated funding structure (including the number of recipients and subrecipients involved in the process), it is important that agencies develop and use cost-effective approaches to identify, prioritize, and manage potential at-risk recipients. Specific monitoring guidance and procedures would provide staff impetus and direction in their monitoring roles and help ensure consistent monitoring efforts across locations. Moreover, written guidance would provide recipients and subrecipients with specific information on the types of business support activities allowed under each program. For example, we learned that there are HUD CDBG subrecipients who may be unaware of the requirement that businesses receiving assistance under the program must provide written statements of compliance with the nonrelocation provision. Absent such guidance and related controls, agencies have limited assurance that recipients and subrecipients—which include state and local governments as well as individual business—are meeting statutory and regulatory responsibilities that restrict the use of program funds to support employer relocations.

Recommendations for Executive Action

To provide greater assurance that grant recipients and subrecipients of federal economic development programs are complying with statutory restrictions against the use of program funds to support employer relocations, we recommend that the Secretaries of Labor (for the WIA Adult, Dislocated Workers, and Youth programs); Agriculture (for the EZ/EC program); and Housing and Urban Development (for the CDBG Entitlement and State programs) direct their respective offices to develop (or finalize the development of) and implement formal and structured approaches for federal reviewers to follow when monitoring for compliance with nonrelocation provisions.

Agency Comments and Our Evaluation

We provided a draft of this report to the Secretaries of the Departments of Labor, Agriculture, Housing and Urban Development, and Commerce; the Acting Commissioner of the Internal Revenue Service; and the Administrator of the Small Business Administration. We received written comments from Labor that are summarized below and are reprinted in appendix III. USDA's Acting Assistant Deputy Administrator for Cooperative Programs provided oral comments on August 8, 2007, which are summarized below.

In its written comments, Labor stated that the department concurred with our recommendation that it develop and implement formal and structured approaches for federal reviewers to follow when monitoring compliance with nonrelocation provisions. In addition, Labor stated that it agreed that such guidance and approaches will assist states in monitoring local subrecipient compliance with these provisions. Labor stated that to support efforts to monitor and ensure compliance with nonrelocation provisions, it is implementing two complementary strategies. First, Labor is developing a formal policy guidance letter that clarifies allowable and unallowable uses of WIA funds for economic-development-related activities and that will specifically address prohibitions related to the nonrelocation provision. Second, Labor said that its *Core Monitoring Guide* and draft *Formula Grant Supplement* to the guide provide federal reviewers with tools for monitoring compliance with the nonrelocation provision. Labor said the draft *Formula Grant Supplement* includes indicators of compliance along with each governor's responsibility to determine which costs are allowable or unallowable under WIA, including prohibitions against using WIA Title I funds to encourage business relocation and related restrictions. Labor stated that its regional office reviewers have extensively tested the draft *Formula Grant Supplement* since the fall of 2006, and the supplement will enter the formal clearance process shortly. Labor said that when completed in final form, which the department expects to occur by December 31, 2007, the supplement will provide federal reviewers, as well as state review staff, with a valuable resource for assessing recipients' compliance with the nonrelocation provision under the WIA Adult, Dislocated Worker, and Youth programs.

In oral comments, USDA's Acting Assistant Deputy Administrator for Cooperative Programs stated that USDA concurred with the report's recommendation. The Acting Assistant Deputy Administrator also provided us with documentation showing that USDA is taking initial steps to implement the recommendation.

We also received technical comments from Labor, USDA, HUD, IRS, and SBA that were incorporated into the report as appropriate. Commerce did not provide comments on the draft report.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of the report. At that time, we will provide copies of this report to the Ranking Member, Subcommittee on Interstate Commerce, Trade, and Tourism, Senate Committee on Commerce, Science, and Transportation, and interested congressional committees. We will also provide copies of this report to Secretaries of Labor, Agriculture, Housing and Urban Development, and Commerce; the Acting Commissioner of the Internal Revenue Service; and the Administrator of the Small Business Administration. We will provide copies to others upon request. In addition, this report will be available at no charge on our home page at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Sincerely yours,



William B. Shear
Director, Financial Markets and
Community Investment

Appendix I: Scope and Methodology

To identify large federal economic development programs, we conducted a search of the *Catalog of Federal Domestic Assistance (CFDA)* database (using key word searches of “jobs” and “economic development”) and focused on those programs that can be used to provide assistance to businesses and that *CFDA* reported as having obligations of at least \$500 million for fiscal year 2006. In a prior report, we found inconsistencies in how agencies reported budget data for *CFDA*, resulting in potential over-reporting of data.¹ However, for purposes of this report, because we are using *CFDA* to identify large federal economic development programs, the risk is acceptably low of *CFDA* not covering large programs we would have otherwise selected. We, therefore, consider *CFDA* to be a sufficiently reliable source of data for use in this report. Because *CFDA* does not include tax expenditure programs, we searched the Congressional Research Service’s (CRS) *Tax Expenditure Compendium* (using key word searches of “community development” and “private activity bonds”) for economic development tax expenditure programs that support businesses for which CRS reported as having estimated tax revenue losses of at least \$500 million in fiscal year 2006. We also confirmed these budget figures with agency officials. We excluded programs that are only available under specific circumstances or are not available nationwide, such as regional economic development programs or those that are only available under disaster assistance designations.

In addition to these database searches, we reviewed each of the 50 states’ economic development Web sites to identify the federal programs that states marketed as incentives or financial assistance for businesses. While this search did not provide us with a comprehensive list of federal programs used as business incentives, it provided us with additional information on how the programs we identified through *CFDA* and the CRS compendium might be used as incentives.

To identify large federal programs currently or formerly subject to restrictions against use for relocating jobs among U.S. communities, we reviewed laws and regulations. Our review included the use of electronic databases. We identified relevant nonrelocation provisions for four federal agencies—the Departments of Housing and Urban Development (HUD), Agriculture (USDA), Labor, and the Small Business Administration (SBA)—and a former provision for one federal agency—the Department of

¹GAO, *Rural Economic Development: More Assurance is Needed that Grant Funding Information is Accurately Reported*, [GAO-06-294](#) (Washington, D.C.: Feb. 24, 2006), 32.

Commerce's Economic Development Administration (EDA). To assess the completeness of our search results, we interviewed representatives of select federal agencies as well as representatives of economic development trade associations and policy groups. To identify congressional purpose in adopting or rescinding restrictions, we reviewed implementing laws and their legislative histories, including congressional reports and the Congressional Record.

To assess federal agency procedures to help ensure compliance with nonrelocation provisions, we requested, obtained, and analyzed the following information from HUD, Labor, USDA, and SBA

- policies and procedures designed to ensure compliance with nonrelocation provisions;
- data on the number of complaints received regarding the provisions;
- data on the number of violations identified; and
- information about any enforcement actions taken, as well as the status of those actions.

We also conducted a limited test of agency procedures by reviewing a small and random, but not generalizable sample of case file documentation for each of the programs (generally 10 files for each program). These documents included the mechanisms agencies have developed to screen for compliance with nonrelocation provisions, including

- an eligibility checklist (SBA's 504 program);
- self-certification forms (USDA and HUD's Empowerment Zone/Enterprise Community program);
- business statements of compliance as a condition of receiving assistance (Labor's Adult, Dislocated Workers, and Youth programs under the Workforce Investment Act); and
- third-party verification of data that applicants self report (USDA's Business and Industry Guaranteed Loan program).

Further, we reviewed monitoring guidance and exhibits for each program having such guidance; completed monitoring reports; publications on effective internal control and grant management practices; and recently

issued reports we completed on the programs.² To supplement our document reviews and testing procedures, we conducted interviews with officials at each agency.

The scope of our work in this area was focused mainly on whether the agencies had screening and monitoring procedures. We did not test the effectiveness of the implementation of these procedures. Furthermore, we did not conduct an overall evaluation of the programs, evaluate how well the programs served their intended purposes, or evaluate how nonrelocation provisions affect the relative success of the programs in achieving their intended purposes. We also did not address the impact these programs had on development efforts by state and local governments.

We conducted our work from October 2006 through August 2007 in Washington, D.C., and San Francisco and Fresno, California, in accordance with generally accepted government auditing standards.

²For example, GAO, *Workforce Investment Act: Labor and States Have Taken Actions to Improve Data Quality, but Additional Steps Are Needed*, [GAO-06-82](#) (Washington, D.C.: Nov. 14, 2005); *Community Development Block Grants: Program Offers Recipients Flexibility but Oversight Can Be Improved*, [GAO-06-732](#) (Washington, D.C.: July 28, 2006); and *Empowerment Zone and Enterprise Community Program: Improvements Occurred in Communities, but the Effect of the Program Is Unclear*, [GAO-06-727](#) (Washington, D.C.: Sept. 22, 2006).

Appendix II: Description of the Nine Large Federal Economic Development Programs with Nonrelocation Provisions

The following is a description of the nine large federal economic development programs that we identified as having statutory restrictions against using program funds to relocate businesses and jobs. Seven are grant programs in which a federal agency provides funds to recipients (generally a state or local government) that, in turn, may provide funds to a subrecipient (such as a nonprofit entity or for-profit business) to facilitate economic development activities. They are

- the Department of Housing and Urban Development’s (HUD) Community Development Block Grant (CDBG) Entitlement and State programs;
- HUD and U.S. Department of Agriculture’s (USDA) Empowerment Zone/Enterprise Community (EZ/EC) programs (urban and rural respectively); and
- the Department of Labor’s (Labor) three Workforce Investment Act (WIA) programs—Adult, Dislocated Workers, and Youth.

The two remaining programs—USDA’s Business and Industry (B&I) program and SBA’s 504 program—are loan guarantee programs in which federal agencies guarantee loans that third-party lenders and nonprofit development corporations make.

HUD CDBG Entitlement and State Programs

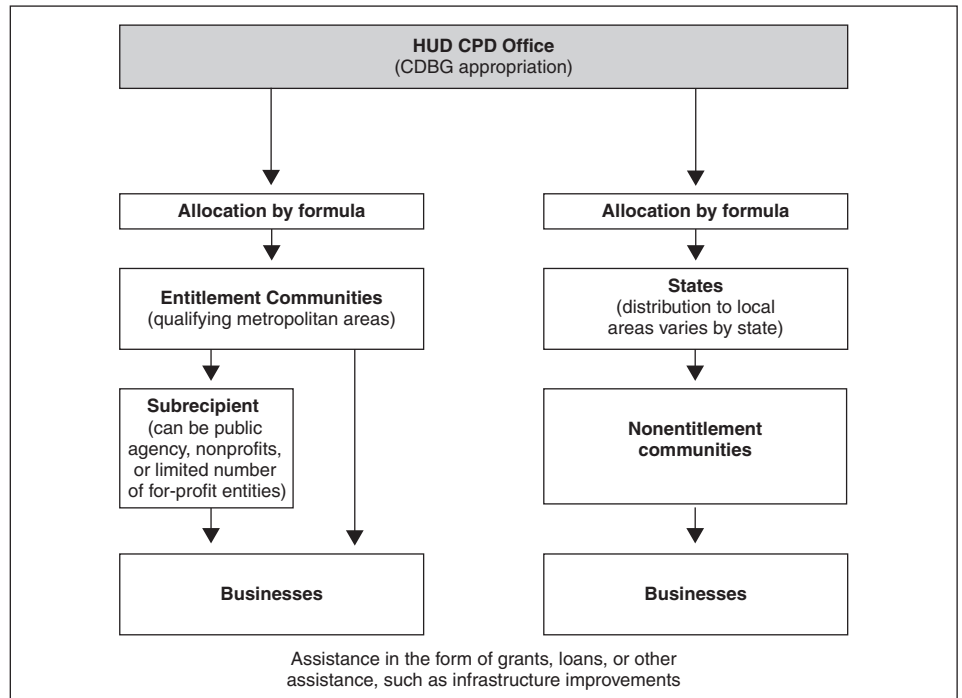
HUD’s CDBG program provides communities with grants for activities that will benefit low- and moderate-income people, prevent or eliminate slums or blight, or meet urgent community development needs. The Entitlement program provides grants to qualifying local governments. The State program provides states with grants for distribution to the smaller, nonentitlement communities. Both programs fund a wide range of activities—including those that support housing, public improvements, public services, and economic development—which involve the use of funds to assist, recruit, and retain individual businesses. According to the *Catalog of Federal Domestic Assistance (CFDA)*, fiscal year 2006 estimated budget authority for the CDBG Entitlement program was \$2.6 billion and \$1.1 billion for the State program.

HUD’s Office of Community Planning and Development (CPD) administers the CDBG program. A headquarters office sets program policy while 43 HUD field offices monitor recipients. HUD distributes funds to entitlement

communities and states based on the higher yield of two formulas.¹ See figure 1 for an overview of the funding process for economic development projects involving businesses. Entitlement communities may carry out activities under CDBG directly, or they may award funds to subrecipients, which include, as HUD defines them for the purposes of the CDBG program, governmental agencies such as housing authorities as well as private nonprofit and a limited number of private for-profit entities. Under HUD regulations, subrecipients must enter into a signed, written agreement with entitlement communities regarding compliance with laws and regulations. States distribute their funds to nonentitlement communities for activities such as business financing. The distribution mechanisms vary by state; some states set aside a certain percentage of funds for economic development while others do not take into account the category of activity. Neither HUD nor the states distribute funds directly to citizens or private organizations. Moreover, HUD does not select the business entities that receive CDBG assistance; recipients and subrecipients make these decisions.

¹The Entitlement and State programs each have their own set of formulas that take into account population, poverty, overcrowding, growth lag, and age of housing. The two formulas are similar.

Figure 1: Overview of CDBG Funding Streams for Economic Development Projects Involving Businesses



Source: GAO analysis of prior reports and HUD information.

Businesses receive assistance through the CDBG program either from a recipient (such as an entitlement community) or from subrecipients (such as designated public agencies or nonprofit development corporations). For example, once an entitlement community or a state receives its allocation, businesses may apply for economic development funding, assuming that the recipient has elected to operate an economic development program. This assistance may take the form of loans, grants, technical assistance, or infrastructure improvements. This approach assumes that the recipient’s consolidated and action plans include and authorize these types of economic development activities.

For a related GAO product on the CDBG program, see *Community Development Block Grants: Program Offers Recipients Flexibility but Oversight Can Be Improved*. [GAO-06-732](#). Washington, D.C.: July 28, 2006.

HUD and USDA EZ/EC Programs

HUD and USDA's EZ/EC program targets federal grants and provides tax relief to distressed communities in urban and rural areas, respectively, to help those communities overcome economic and social problems. EZs and ECs can use grant funds for a range of activities identified in strategic plans, which are developed in conjunction with community stakeholders. Strategic plans outline the urban or rural community's vision for revitalizing its distressed areas and the activities and projects planned to accomplish this task. These activities can include education, infrastructure development, workforce development, and assistance to for-profit businesses. According to CRS's *Tax Compendium*, estimated revenue losses for USDA's and HUD's EZ/EC program were \$1 billion combined for fiscal year 2006.²

Congress authorized three rounds of EZ designations and two rounds of EC designations. HUD and USDA have primary oversight over the program, which involves reviewing strategic plans, designating communities as EZs or ECs, and evaluating the progress EZs and ECs make in implementing their strategic plans. However, two other agencies, the U.S. Department of Health and Human Services (HHS) and the Internal Revenue Service (IRS), also have had responsibility for administering the program. For the first round of the program which began in 1993, HHS had fiscal oversight over the program, in which HHS issued grants to states, which served as pass-through entities that in turn distributed funds to individual EZs and ECs. For the second round of the program, which began in 1998, Congress appropriated grant funds through USDA and HUD, but not through HHS. For the third round, which began in 2001, Congress appropriated grant funds for rural EZs but not for urban EZs. In addition to grants, businesses that locate in an EZ or EC can claim tax benefits, such as the Work Opportunity Tax Credit, which IRS administers. Tax benefits have been available in all three rounds of the EZ/EC program, but not the EC program.

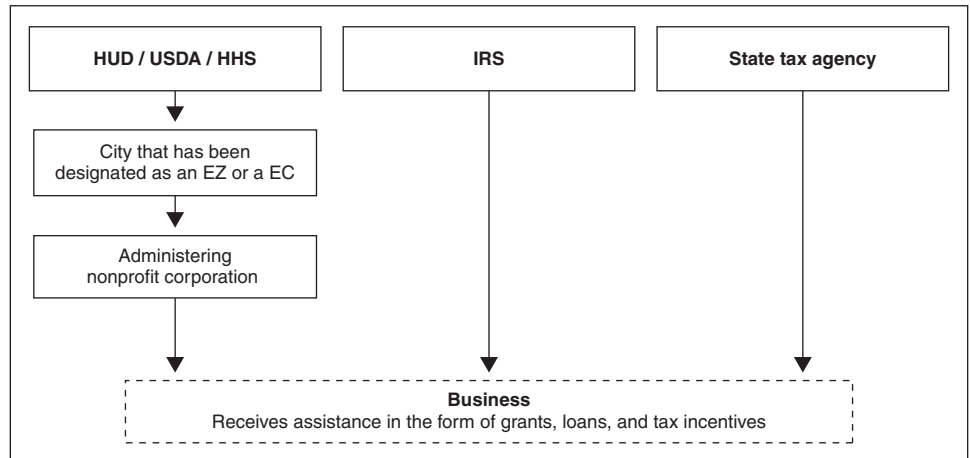
As shown in figure 2, businesses can receive funds directly from the designated EZ/EC cities or from nonprofit corporations the city establishes to administer the program. For example, EZs/ECs issue requests for proposals and review applications for EZ/EC funding, including those that businesses submit. The EZs/ECs that a corporation

²CRS's *Tax Compendium* lists one combined estimated revenue-loss figure for the EZ tax incentive program (both HUD and USDA), District of Columbia tax incentive program, and Indian Reservation tax incentive program.

Appendix II: Description of the Nine Large Federal Economic Development Programs with Nonrelocation Provisions

oversees generally have a board of directors consisting of community members who review and have final approval for funded activities (with input from advisory committees). Businesses then receive funding in the form of grants, loans, and other assistance. Businesses eligible for federal, state, and local tax benefits claim these benefits directly on tax filing forms.

Figure 2: Overview of EZ/EC Funding Streams for Economic Development Projects Involving Businesses



Source: GAO analysis of prior reports, and HUD and USDA information.

For related GAO products on the EZ/EC program, see

- *Empowerment Zone and Enterprise Community Program: Improvements Occurred in Communities, but the Effect of the Program Is Unclear.* [GAO-06-727](#). (Washington, D.C.: Sept. 22, 2006), and
- *Community Development: Federal Revitalization Programs Being Implemented, but Data on the Use of Tax Benefits Are Limited.* [GAO-04-306](#). (Washington, D.C.: March 5, 2004).

Labor WIA Adult, Dislocated Workers, and Youth Programs

The WIA Adult and Dislocated Workers programs provide a variety of services to individuals, including help with job searches, skills assessment, and occupational training. The Adult and Dislocated Workers programs provide similar services, but differ in their eligibility requirements.³ The Youth program is designed to prepare high school students for employment or postsecondary education. All three programs require that states and local areas use a one-stop center approach, which consolidates 16 categories of programs under four agencies (Labor, Education, HHS, and HUD) to provide services for several employment and training programs. In addition to employee services, state and local workforce investment boards may use WIA funds from the three programs to provide services to employers, including helping employers identify and recruit job candidates.⁴ States and local boards can also offer various job training programs, such as classroom-based, on-the-job, or customized training to meet employer needs.⁵ According to *CFDA*, fiscal year 2006 estimated obligations for the WIA Adult, Dislocated Workers, and Youth programs were \$857 million, \$1.181 billion, and \$926 million, respectively.

Labor oversees all three WIA programs, but states and local boards have flexibility over how they use WIA funds. WIA specifies a different funding source for each of the Act's main clients—youth, adults, and dislocated workers. Labor distributes WIA funds to states and states distribute funds to local areas based on specific formulas that account for unemployment (see fig. 3 below for an overview of the three WIA program funding streams). Labor allots 100 percent of the adult and youth funds and 80 percent of the dislocated worker funds to states (the Secretary of Labor sets aside 20 percent of the dislocated worker funds primarily for national emergency grants, but these funds can be used for other job training purposes).⁶ The states can then set aside up to 15 percent of the funds as discretionary funds to support state employment activities. (For the dislocated worker program, the state can set aside no more than 25 percent of the funds for rapid response activities, such as notifying

³The Adult program serves all adults over the age of 18, while the Dislocated Workers program targets adults who have been laid off from a job or are displaced homemakers.

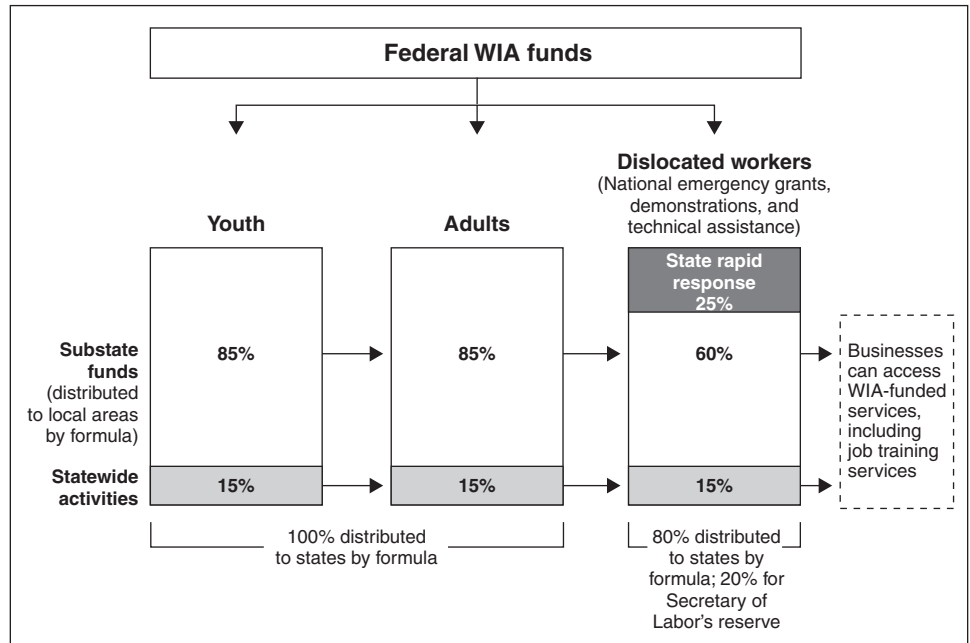
⁴Each of approximately 600 local workforce areas throughout the country has a local workforce investment board that administers WIA activities within that area.

⁵For customized job training, an employer must pay at least 50 percent of the training costs.

⁶This money also can be used for demonstrations and technical assistance, but at least 85 percent of the 20 percent set-aside must be used for national emergency grants.

workers on how to access unemployment and one-stop center benefits in the event of mass layoffs.)

Figure 3: Overview of WIA Adult, Dislocated Workers, and Youth Funding Streams



Source: GAO analysis.

The remainder of the funds are distributed to local areas based on a formula. Local workforce investment boards, in turn, may provide services to businesses. Businesses are generally connected to these services through one-stop career centers.

For related GAO products on the Workforce Investment Act, see

- *Workforce Investment Act: Labor and States Have Taken Actions to Improve Data Quality, but Additional Steps Are Needed.* [GAO-06-82](#). Washington, D.C.: November 14, 2005;
- *Workforce Investment Act: Substantial Funds Are Used for Training, but Little is Known Nationally About Training Outcomes.* [GAO-05-650](#). Washington, D.C.: June 29, 2005; and
- *Workforce Investment Act: Exemplary One-Stops Devised Strategies to Strengthen Services, but Challenges Remain for Reauthorization.* [GAO-03-884T](#). Washington, D.C.: June 18, 2003.

SBA 504 Loan Program

SBA's 504 loan program provides businesses with long-term, fixed-rate financing for major fixed assets, such as land, buildings, and machinery and equipment. To qualify for an SBA loan guarantee, a project must meet job creation or other community development goals, such as increasing the number of minority-owned businesses in an area. For the job creation requirement, a business must generally create or maintain one job for every \$50,000 in SBA assistance.

While SBA administers the 504 loan guarantee program, it relies on development companies to originate 504 loans. SBA participates in the 504 loan program by guaranteeing loans that certified development companies (CDC) make. CDCs generally are private nonprofit corporations established to contribute to the economic development of their communities. For a typical 504 loan project, the borrower (a business) must cover at least 10 percent of a project's costs, a private third-party lender provides at least 50 percent of project costs, and a CDC provides up to 40 percent of project costs. SBA guarantees 100 percent of the CDC's portion of the loan. According to SBA, in fiscal year 2006, the agency provided 504 program guarantees totaling \$5.7 billion.

USDA B&I Program

USDA's B&I program seeks to improve the economic and environmental climate in rural communities by providing guarantees on loans private lenders make to borrowers that meet certain economic development criteria, such as creating employment or encouraging the development and construction of renewable energy systems. The program finances business and industry acquisition, construction, conversion, expansion, and repair in rural areas. Loan proceeds can be used to finance the purchase and development of land, supplies and materials, and start-up costs for rural businesses.

USDA administers the B&I program through field offices located in each of the states. A borrower first secures a loan from a USDA-approved private third-party lender. The borrower then applies to USDA for a B&I loan guarantee. USDA will evaluate the application and make a determination on whether the borrower is eligible and the proposed loan is for an eligible purpose, there is reasonable assurance of repayment ability, there is sufficient collateral and equity, and the proposed loan complies with all applicable statutes and regulations. USDA will notify the lender in writing if it is unable to guarantee a loan. USDA also works with the lender to negotiate the percentage of guarantees, but USDA can guarantee up to 80 percent of loans for \$5 million or less, 70 percent of loans between \$5 and \$10 million, and 60 percent of loans exceeding \$10 million. According to

**Appendix II: Description of the Nine Large
Federal Economic Development Programs
with Nonrelocation Provisions**

USDA, in fiscal year 2006, the B&I program guaranteed 350 loans with a face-value of \$766.3 million.

Appendix III: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employment and Training
Washington, D.C. 20210



AUG 22 2007

Mr. William B. Shear
Director, Financial Markets and
Community Investment
Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Shear:

The Department of Labor's Employment and Training Administration (ETA) is in receipt of the Government Accountability Office (GAO) draft report, "ECONOMIC DEVELOPMENT: Formal Monitoring Approaches Needed to Help Ensure Compliance with Restrictions on Funding Employer Relocations," GAO-07-1005.

To ensure that grant recipients and subrecipients are complying with statutory restrictions against the use of economic development program funds to support employer relocations, GAO recommends that ETA develop and implement formal and structured approaches for Federal reviewers to follow when monitoring Workforce Investment Act (WIA) Adult, Dislocated Worker, and Youth programs for grantee compliance with nonrelocation provisions.

The Department concurs with the recommendation that formal guidance and structured approaches will assist ETA Federal reviewers in monitoring state grantee compliance with the nonrelocation provisions outlined in statute at WIA Section 181(d)(1) and in regulation at 20 CFR 667.200(c). In addition, the Department agrees that such guidance and approaches will assist states in monitoring local subrecipient compliance with these provisions. Please note that the Department has the responsibility for monitoring its direct state grantees, and state grantees have primary responsibility for monitoring their direct local sub-grantees.

To support efforts to monitor and ensure compliance with the nonrelocation provisions, ETA is implementing two complementary strategies. First, we are developing a Training and Employment Guidance Letter (TEGL), ETA's formal policy guidance vehicle, which clarifies allowable and unallowable uses of WIA funds for economic development-related activities. This policy guidance will specifically address prohibitions related to the nonrelocation provision. When published, the TEGL will provide both Federal and state monitors with explicit guidance on how the nonrelocation provision applies to grants funded under the WIA Adult, Dislocated Worker, and Youth programs. Second, ETA's Core Monitoring Guide and the draft Formula Grant Supplement to the Core Monitoring Guide provide Federal reviewers

with tools for monitoring for compliance with the WIA Title I nonrelocation provision. The Core Monitoring Guide covers the essential functions that must be in place in order for any grantee to operate an ETA grant within the boundaries of acceptable practices that are established by law, regulation, and government-wide rule. The draft Formula Grant Supplement to the Core Monitoring Guide was developed to assist Federal reviewers in monitoring for compliance based upon funds allocated by formula to states. The Supplement provides a more detailed examination of program specific statutes, rules, and regulations related to program operations.

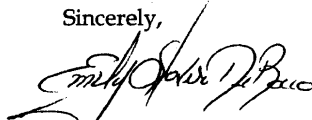
The Core Monitoring Guide's Objective 3.5, "Allowable Costs," is designed to assist Federal reviewers to determine if a grantee has a system in place to ensure that the costs incurred are necessary, reasonable, allowable, and allocable. The key indicator for Objective 3.5 is obtaining a copy of the organization's applicable Office of Management and Budget cost principles circular and ensuring that the grantee is aware of which costs are allowable, allowable under certain conditions, or unallowable.

The draft Formula Grant Supplement to the Core Monitoring Guide includes indicators of grantee compliance along with the Governor's responsibility to determine which costs are allowable or unallowable under WIA (20 CFR 667.200(e)), including the prohibitions against the use of WIA title I funds to encourage business relocation and related restrictions. The draft Supplement includes a worksheet for the Federal reviewer to determine whether a grantee's written allowable cost policy addresses the prohibitions in the WIA regulations.

The draft Formula Grant Supplement to the Core Monitoring Guide has been field-tested extensively by ETA Regional Office Federal reviewers since the fall of 2006, and will enter ETA's formal clearance process shortly. We expect that the Supplement will be completed in the first half of Program Year 2007 (by December 31, 2007). When completed in final form, the Supplement will provide Federal reviewers, as well as state review staff, with a valuable resource for assessing recipients' compliance with the nonrelocation provision under WIA Adult, Dislocated Worker, and Youth programs.

If you would like additional information, please do not hesitate to contact me at (202) 693-2700.

Sincerely,



Emily Stover DeRocco

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

William B. Shear at (202) 512-8678 or shearw@gao.gov

Staff Acknowledgments

In addition to the above contact, Harry Medina, Assistant Director; Meghana Acharya; Dianne Blank; Bonnie Derby; Ronald Ito; Terence Lam; John McGrail; Carl Ramirez; Barbara Roesmann; Paul Schmidt; Michael Springer; and Kathryn Supinski made key contributions to this report.

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