

**The Limits of Federal Block Grants: The Effect of Governmental Capacity and Decentralized Allocation Institutions on County Access to Non-Entitlement Community Development Block Grants.**

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**Abstract:** The main argument of this paper is that variation in state level institutions and local government administrative capacity help explain the distribution of non-entitlement Community Development Block Grants (CDBG) in states. More specifically, we argue that local government capacity is positively associated with access to non-entitlement CDBGs, and decentralized state-level allocation institutions enhance access to federal funds as well. This paper provides a comparative institutional analysis of the allocation of non-entitlement Community Development Block Grants across four states: Texas, California, Kentucky, and Utah. We use logit, Poisson, and OLS models to determine whether access to non-entitlement CDBGs is a function of variance in local government capacity and state-level institutional variation. We find that from 1999-2001, state institutions influence the odds of receiving a grant and the number of grants, but not the funding levels in dollars. These findings raise important questions about whether state administration of the non-entitlement CDBG program prevents local governments most in need of federal assistance from receiving federal assistance.

The main argument of this paper is that variation in state level institutions and local government administrative capacity help explain the distribution of non-entitlement Community Development Block Grants (CDBG) in states. The non-entitlement Community Development Block Grant program enables state governments to allocate federal funding to eligible small cities and counties. Program objectives are broadly defined at the federal level, but like other block grant programs, but states have substantial discretion regarding the allocation of non-entitlement CDBG funds. State governments allocate funds that are most commonly used for local level infrastructure, economic development, and housing.

We argue that state-level institutions can enhance local governments' access to non-entitlement CDBG funding by decentralizing the allocation process. As a general principle, the allocation of grants is a function of competition between local governments for the limited funds. This competition is structured by state-level institutions and the ability of local governments to compete for grants. Local governments with greater grant competition capacity should have greater access to non-entitlement CDBG funds, but state-level institutions can facilitate a more broad distribution of funding by adopting a more regional allocation process. Explaining variance in access to CDBG funding as a function of state institutions has important implications for improving the efficiency and effectiveness of intergovernmental administration in general and the impact of the non-entitlement CDBG program on issue areas such as rural development policy in particular.

This paper provides a comparative institutional analysis of the allocation of non-entitlement Community Development Block Grants (CDBG hereafter) across four states: Texas, California, Kentucky, and Utah. We examine the impact of institutional arrangements used to allocate grants and local government capacity on the allocation of non-entitlement CDBGs. We find that from 1999-2001, state institutions influence the odds of receiving a grant and the number of grants, but not the funding levels in dollars. These findings raise important questions about whether state administration of the non-entitlement CDBG program prevents local governments most in need of federal assistance from receiving federal assistance.

### **State Administration of Non-Entitlement CDBG Programs**

The Department of Housing and Urban Development administers the Community Development Block Grant program which is divided into entitlement and non-entitlement programs (US Department of Housing and Urban Development, 2004). Entitlement funds are allocated on a formula basis to central cities, metropolitan cities with populations of at least 50,000, and qualified urban counties with populations of at least 200,000. In contrast, the non-entitlement program provides block grants to cities with less than 50,000 in population and counties with less than 200,000 residents. The FY2004 appropriation to the non-entitlement program was just under \$1.3 billion. The largest state recipient was Texas at close to \$200 million.

Since 1981, state governments have had the opportunity and substantial discretion to administer the non-entitlement program. Administration entails that state governments establish objectives for the block grant program, determine a means for distributing the funds, and ensure

that local government recipients comply with federal requirements.<sup>1</sup> Yet, the level of state discretion varies across these administrative responsibilities. For example, HUD strictly regulates the procedures for ensuring compliance with federal regulations. State discretion to establish objectives for the block grant program is constrained by federal requirements that grants should be targeted toward activities which benefit low- and moderate-income families or assist in the prevention or elimination of slums or blight.<sup>2</sup> States commonly identify infrastructure provision, economic development, and affordable housing as objectives. Previous research focused on the impact of state-level discretion on the redistributive nature of the non-entitlement program. Herzik and Pelissero (1986) argue that states exercise discretion in the definition of objectives to maintain the redistributive character of the program.

This paper focuses upon the discretion to determine how the block grant funding is allocated within the state. HUD requires citizen and government participation in the development of an allocation process, but there are no procedural mandates for allocation decision-making.<sup>3</sup> In general, states rely upon competitive proposal processes to allocate grants. Local governments submit proposals that are reviewed by state officials and prioritized according to state-defined objectives and quality of the program. The level of funding for individual projects is usually capped at a state-defined level. Once programs are prioritized, states award grants until the funding is exhausted.

The use of these competitive proposal systems can create substantial barriers to non-entitlement funds. Researching, writing, and submitting competitive grants require a non-trivial commitment of resources from local governments. If local governments lack the resources to prepare grant applications or make those applications competitive, then the process limits access to funds for lower capacity local governments. Ironically, local governments least likely to prepare competitive grant proposals are probably also those governments most in need of federal assistance. Therefore, we will test the hypothesis that local governments with less grant application capacity will have less access to non-entitlement CDBGs, all else equal.

The state-defined institutions that define the competitive process may also mitigate potential barriers to access, however. At a general level, for example, states choose between centralized and decentralized allocation processes. A centralized process entails state-wide competition between local governments in which a state agency reviews and prioritizes applications for all state non-entitlement funding. A centralized approach is likely to create a competitive advantage for local governments with the capacity to prepare highly competitive grants as previously discussed. In contrast, a decentralized process typically entails a distribution of funding and decision-making authority at a regional level within the state. For example, states like Texas and Utah distribute funding across regional planning areas and give them consequential discretion in the allocation of non-entitlement funds. This regional approach reduces competitive disadvantages by placing local governments with similar resource levels in

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<sup>1</sup>Hawaii is the only state that has not opted to administer the non-entitlement CDBG program, and hence HUD administers their program.

<sup>2</sup> Funds may also be used for emergency situations that directly threaten the health and welfare of a community such as disaster relief.

<sup>3</sup> HUD requires that the overall process achieve a 70% annual fund disbursement rate, but this is an output indicator more than procedural requirement.

the same competitive arena. Moreover, each region is guaranteed to have access to a specified level of funding. The only question is which local government within a region will receive grants. Therefore, we expect that local governments in states with decentralized decision-making institutions have fewer barriers to non-entitlement CDBGs, all else equal.

In sum, we propose to test two hypotheses regarding local government access to non-entitlement CDBGs. First, we expect that local government capacity is positively associated with access to CDBGs. Second, we expect that state level institutions that decentralize allocation decisions will be positively associated with access to non-entitlement CDBGs. The following section describes the research design for an empirical analysis that tests these propositions.

## Data and Methods

For this analysis, we collected data about counties in Texas, Kentucky, Utah, and California for the period 1999-2001.<sup>4</sup> Counties provide a unit of analysis with accessible data that facilitates comparison more than other possible units of analysis. Data on small cities is either non-existent or so irregular that valid comparison is seriously compromised. Moreover, we maintain that county level observations can provide effective proxies for the focus variables as discussed below. We collected data on every county from the four states above because they provide cases of decentralized and centralized allocation institutions in states with different population characteristics as seen in Table 1 below. A more detailed discussion of the operational definitions follows.

**Table 1. Sample Selection**

	<i>Centralized Allocation</i>	<i>Decentralized Allocation</i>
<i>Large population</i>	California	Texas
<i>Small population</i>	Kentucky	Utah

### Dependent Variable: Access to non-entitlement CDBGs

The dependent variable in this analysis is access to non-entitlement CDBGs. In this context, access is not conceptualized as opportunity, but realized allocations. The theoretical assumption is that local governmental units want these funds, but cannot access them because of competitive disadvantages arising from relative differences in grant application capacity and state-level allocation institutions that may mitigate these differences. All counties are included in this analysis. If a county has a population greater than 200,000, then the county government is ineligible for non-entitlement CDBGs; however, such counties are likely to contain small cities which are eligible for and receive non-entitlement CDBGs.

<sup>4</sup> Data for the CDBG projects were collected from each state's non-entitlement CDBG agency.

We provide three operational definitions of access to cover multiple dimensions of access as defined by realized grant allocations. The first indicator of access is whether the county government or any local government within the county received a non-entitlement CDBG during the period under review. The variable is called RECIPIENT, and it is coded 1 if any government in the county obtained a grant and zero otherwise. The second indicator is a count variable, NUMBER, that indicates the number of grants obtained by the county government or local governments within the county during the period. The final indicator, DOLLARS, is the total amount of grant funding awarded to governments in the county during the period. A summary of the data can be found in Table 2 below.

### **Explanatory Variables: Local Government Capacity and Allocation Institutions**

Directly measuring local government capacity to construct competitive grants is difficult, but effective proxies exist at the county level. Our strategy is to tap into the broad capacity differences between metropolitan counties and non-metropolitan counties, which are commonly referred to as rural counties. The literature has historically identified a large capacity gap between the two types of counties which is associated with both resource differences and levels of professional administration (Brown 1980, Florestano and Gordon 1980, Giles et al 1980, Zody 1980). We use a dummy variable, METRO, which is coded 1 for metropolitan counties as proxy of governmental capacity. There should be a positive relationship between this variable and each measure of access.

A second indicator of local government capacity, GOVTEMP, is the number of local government employees in the county. This count includes employees in county government, municipalities, and special districts. We presume that an increase in the number of local government employees within a county is a proxy for capacity to construct competitive grant applications. An increase in this variable should be associated with increased access to non-entitlement CDBGs.

We use a dummy variable, DECENT, to indicate centralized versus decentralized allocation institutions. States using decentralized allocation institutions are coded 1 and zero otherwise. In this sample, we code Utah and Texas as states with decentralized allocation institutions. Both states use regional decision-making to allocate non-entitlement CDBGs. Both Utah and Texas allocate an equal portion of non-entitlement funding to regional governments or planning associations. Only local governments within these boundaries are eligible to compete for grants, and thus competition is limited. Moreover, regional governments conduct the initial evaluation of grant proposals. The governing state agencies in Utah and Texas review proposals and officially award grants with substantial weight given to the preferences of the regional governments. Kentucky and California operate under centralized allocation institutions. Each state has a single state agency that administers the competition for non-entitlement CDBGs. These state agencies process and review all grant applications. Each local government applicant is in competition with local governments from across the state. Therefore, counties in these two states are coded zero. Our expectation is that counties in the decentralized states should have greater access to non-entitlement CDBGs.

**Table 2. Data Summary**

<b>Variable</b>	<b>N</b>	<b>Mean</b>	<b>Std.Dev.</b>	<b>Minimum</b>	<b>Maximum</b>
<b>Dependent</b>					
RECIPIENT	461	0.67	0.47	0.00	1.00
NUMBER	461	3.39	5.77	0.00	43.00
DOLLARS	461	900,502.30	1,719,463.00	0.00	18,768,029.00
<b>Explanatory</b>					
METRO	461	0.26	0.44	0.00	1.00
GOVTEMP	461	4,865.89	19,816.94	16.00	341,941.00
DECENT	461	0.61	0.49	0.00	1.00
INCOME	461	43,552.00	12,187.84	21,840.00	101,876.00
TAX per cap	461	951.18	1,193.85	124.00	12,289.00
UNEMPLOY	461	5.14	3.25	1.30	27.60
COUNTY (log)	461	5.02	0.67	3.37	5.54

## Models and Controls

We use a variety of estimation procedures to model the relationship between the access variables and explanatory variables. The RECIPIENT variable is dichotomous and we use logit models with robust standard errors to estimate the odds of a county receiving a grant during the period as a function of the explanatory and other control variables. A Poisson model with robust standard errors is used to estimate the number of grants awarded to a county as a function of the explanatory variables and other controls. An OLS model with robust standard errors is used to model DOLLARS as a function of explanatory and control variables.

We include several control variables to more fully specify the models. The log of the number of counties in each state is included to control for the level of potential competition among counties (COUNTY). We also include a set of variables that indicate the demand for non-entitlement grants. The primary justification for these grants is to benefit low to moderate income residents. Economic indicators such as the year 2000 unemployment rate (UNEMP) and average household income for the year 2000 (INCOME) provide useful proxies for a county's demand for non-entitlement CDBGs. The year 2000 per capita tax revenues (TAX) for all local governments in the county are also included as a proxy for the ability of the county to meet its needs without federal grant funding.

## Findings

Table 3 reports the results from the models for each dependent variable. In general, the model results support the hypothesized positive association between local government capacity and access to non-entitlement CDBGs. The logit model provides no support for the hypothesis that local government capacity is positively associated with the odds of a county receiving a grant, but the metropolitan county variable exhibits a strong association with the number of grants a county received and the dollar amount of those grants. In short, metropolitan counties are likely to receive almost two more grants relative to non-metro counties and \$711,000 more than non-metro counties over the three year period under review. The number of local government employees is not related to the number of grants awarded to a county, but there is a negative association with the dollar amount of grants awarded to a county. This finding contradicts the hypothesized relationship which is a puzzle addressed below.

The findings also support the hypothesized positive relationship between decentralized allocation institutions and access to non-entitlement CDBGs. According to logit and Poisson models, counties in a decentralized state are about 7 times more likely to receive a grant and are awarded almost 2 grants more than counties in centralized states during the period under review. In the OLS model of dollar amounts, however, there is no relationship between states with decentralized and centralized allocation.

**Table 3. Models of Access to Non-Entitlement CDBGs, 1999-2001.**

Variable	Odds Ratio for RECIPIENT (Logit Model)	Incidence Rate Ratio for NUMBER (Poisson) <sup>A</sup>	Coefficients for DOLLARS (OLS)
METRO	1.428, [.427]	1.919, [.332]***	711659, [259376]**
GOVTEMP	0.999, [.00001]	0.999, [.000003]	-4.03, [1.64]**
DECENT	6.834, [4.22]**	1.822, [.267]***	59875, [131171]
INCOME	0.999, [.00001]	1.000, [.000001]	3.558, [8.316]
TAX per cap	0.999, [.00012]	0.999, [.00007]***	-74.28, [38.2]*
UNEMPLOY	1.007, [.039]	1.110, [.019]***	199897, [74905]**
COUNTY (log)	0.228, [.137]**	0.526, [.040]***	-262538, [109459]*
N	461	461	461
Model statistic	$\chi^2_{(7)} = 15.22^*$	$\chi^2_{(7)} = 182.48^{***}$	$F_{(7,453)} = 4.77^{***}$
* p<=.05, **p<=.01, ***p<=.001			
<sup>A</sup> The incidence ratio assumes exposure is one three year period.			

The models fail to find a positive relationship between local government employees and access to non-entitlement CDBGs, but this may be a function of how the model is specified. More specifically, the metropolitan county government and local government employee

variables are tapping into the same underlying concept of capacity, but the actual effect of local government employees may be contingent upon whether the county is designated metropolitan. In other words, the impact of the number of local government employees may be confounded with the resources available in a metropolitan county. We check this conjecture by creating an interaction between metropolitan county and the number of local government employees. This will enable us to examine whether the relationship between local government employees and access to grants is contingent upon metropolitan county designation.

Table 4 below reports the results of models of the three dependent variables that include the interaction variable defined above. The interaction effect and composite variables are statistically significant in each model. Although the detailed reports are not presented in this paper, the models suggest that there is a positive relationship between the number of local government employees and access to grants for non-metropolitan counties. There is no relationship between local government employees and access for metropolitan counties. In the dollar amount of grants, for example, an increase of one local government employee in the county is associated with an increase of \$473.92.

**Table 4. Models of Access to Non-Entitlement CDBGs with Interactions, 1999-2001.**

Variable	Odds Ratio for RECIPIENT (Logit Model)	Incidence Rate Ratio for NUMBER (Poisson) <sup>A</sup>	Coefficients for DOLLARS (OLS)
METRO	2.59, [.946]***	2.720, [.469]***	1263225, [291266]***
GOVTEMP	1.001, [.0002]***	1.0002, [.00005]***	473.92, [214.56]*
METRO*GOVTEMP	0.999, [.0002]**	0.999, [.00005]***	-478.42, [214.56]*
DECENT	5.96, [3.24]***	1.857, [.259]***	29269, [123193]
INCOME	0.999, [.00001]*	1.000, [.000007]	-4.09, [7.45]
TAX per cap	0.999, [.0001]	0.999, [.00007]***	-6.68, [41.66]
UNEMPLOY	0.982, [.042]	1.076, [.019]***	168155, [62126]**
COUNTY (log)	0.255, [.135]**	0.521, [.039]***	-265156, [103429]**
N	461	461	461
Model statistic	$\chi^2_{(8)} = 22.44^*$	$\chi^2_{(8)} = 267.58^{***}$	$F_{(8,452)} = 5.16^{***}$

\* p<=.05, \*\*p<=.01, \*\*\*p<=.001  
<sup>A</sup> The incidence ratio assumes exposure is one three year period.

## Discussion

The generalizability of these findings should be considered in light of the data limitations and the sample. Although counties are the unit of analysis, the data do not allow inferences to be made about particular governments, whether county or municipal. Moreover, our sample accounts for counties in states with different populations and different allocation institutions.



Although this sample is representative of many states, not all states have counties and some use formulaic allocation institutions. Hence, a more comprehensive sample would improve generalizability, but the current sample is illustrative of current non-entitlement CDBG administration.

Despite these limitations, there is evidence that local government access to non-entitlement CDBGs is a function of local government capacity and state-designed allocation institutions. Unlike the entitlement program for central cities, small local governments generally need to muster resources for competitive grant proposals. Local governments with greater capacity have a competitive advantage over governments with fewer resources that is observed in the models above. This disadvantage may be partially mitigated if state governments institute allocation mechanisms that reduce the competitive disadvantage for lower capacity local governments. In this study, the mitigating institutional arrangement is a decentralized allocation mechanism that first allocates funds to regions and then provides a more localized competition for grants. Counties operating under these conditions are more likely to receive grants and receive more grants than counties under more centralized allocation.

The state administration of the non-entitlement CDBGs may have created the unintended consequence of limiting access to the program. First, local governments that may have the greatest need for federal funding may have the least capability of obtaining them. This is a particular problem for rural governments, which are typically identified as non-metropolitan counties. For example, a small city in a wealthy county is likely to have a competitive advantage over an equally sized small city in a poorer rural county. This scenario helps explain why the county with the highest average household income in Texas (Colin) received 11 projects worth almost \$3 million during the period under investigation, but at least fourteen rural counties in Texas received no grants (Collins and Gerber 2002). In short, local government characteristics and state-level institutions can limit access to federal funds.

This disparity raises the more general question of whether the competitive grant process generates sufficient benefits relative to a more formula-based distribution of funds. Ultimately, the competitive grant process acts as a screening process, but the benefit of screening is not clear. The competitive process does force local governments to present well-developed plans that are in conformance with federal guidelines. This process forces local governments to provide evidence of their need for and ability to administer the grant, but entitlement cities must provide similar information for monies they receive directly from the federal government. The dilemma once again is that many local governments lack the capacity to obtain the funds in the first place. However, if local governments were systematically allocated federal funds, like larger local governments, they could spend their resources on implementing programs and projects with the funds rather than competing for them.

## Conclusions

The non-entitlement CDBG program is an important external funding resource for small cities and counties across the United States. Yet, this research suggests that the competitive grant process can make it more difficult for many local governments to access these funds. State-level

institutions can reduce barriers, however. Our study examines this issue from a very broad perspective, but further investigation into the impact of more specific allocation institutions is warranted. These studies will enhance our understanding of federal block grant administration and policymaking. Moreover, we can gain a better understanding of how state-level institutions impact the ability of local governments to foster economic development and to provide basic services such as infrastructure.

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