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February 8, 2018

The Honorable John Thune
Chairman
The Honorable Bill Nelson
Ranking Member
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Lamar Smith
Chairman
The Honorable Eddie Bernice Johnson
Ranking Member
Committee on Science, Space, and Technology
House of Representatives

Innovative Manufacturing: Commerce Has Continued Efforts to Create a Loan Guarantee Program, but Future Steps Are Uncertain

Manufacturing plays a key role in the U.S. economy as a source of economic growth, high-paying jobs, and innovation. According to a 2014 report by the President’s Council of Advisors on Science and Technology, small- and medium-sized manufacturers are particularly important to U.S. competitiveness because they represent a majority of manufacturers in the country.¹ To invest in innovation, improve U.S. competitiveness, and help address the capital needs of small- and medium-sized manufacturers, the America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education, and Science Reauthorization Act of 2010 (COMPETES 2010), among other things, directed the Secretary of Commerce to establish the Federal Loan Guarantees for Innovative Technologies in Manufacturing (ITM) program.² The ITM program is to support loan guarantees for small- and medium-sized manufacturers for the use or production of innovative technologies. Ultimately, the Economic Development Administration (EDA) within the Department of Commerce (Commerce) was assigned responsibility for implementing the ITM program.

COMPETES 2010 also included a provision for us to conduct a biennial review of the Secretary of Commerce’s execution of the program. We previously issued two reports pursuant to this provision. In our first report on the program, issued in July 2013, we found that EDA had taken preliminary steps to implement the program but had not yet issued any loan guarantees.³ In our

¹Executive Office of the President, President’s Council of Advisors on Science and Technology, *Report to the President: Accelerating U.S. Advanced Manufacturing* (Washington, D.C.: October 2014).

²Pub. L. No. 111-358, § 602, 124 Stat. 3982, 4026 (2011) (codified at 15 U.S.C. § 3721). This law reauthorized and amended the America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education, and Science (COMPETES) Act. Pub. L. No. 110-69, 121 Stat. 572 (2007).

³GAO, *COMPETES Reauthorization Act: Federal Loan Guarantees for Innovative Technologies in Manufacturing*, [GAO-13-717R](#) (Washington, D.C.: July 2013).

second report, issued in February 2016, we found that EDA had taken additional steps to implement the program, but several key tasks—such as issuing program regulations, hiring additional staff, developing marketing materials, and conducting outreach—remained before EDA could begin issuing loan guarantees.⁴ We also found that EDA had coordinated with other federal agencies, such as the Small Business Administration (SBA) and the National Institute of Standards and Technology (NIST), but had not clearly differentiated ITM from other programs, which could result in duplication.⁵ We recommended that EDA work with SBA and NIST to further identify any gaps in capital access that the program could fill and conduct outreach to help target those gaps. This third report examines the steps EDA has taken to implement the ITM program since we issued our February 2016 report, and the extent to which EDA has addressed our recommendation.

To examine the steps EDA has taken to implement the ITM program, we analyzed applicable laws, such as the COMPETES 2010 Act and laws providing appropriations for the program, as well as program documents. We also interviewed EDA officials to learn about EDA's efforts to implement the program and address the recommendation from our February 2016 report. Additionally, we collected information from SBA and NIST officials to learn about their interactions with EDA.

We conducted this performance audit from April 2017 to February 2018 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Commerce's EDA Has Taken Additional Steps to Implement the ITM Program and Has Begun to Address Our Recommendation, but the Future of the Program Is Uncertain

Since our February 2016 report, EDA has taken additional steps to implement the ITM program and has begun to address our recommendation. Specifically, EDA has taken the following steps:

- **Issuing a proposed rule.** EDA issued a proposed rule for the ITM program in September 2016.⁶ According to the preamble to the proposed rule, the ITM program would be similar to SBA's 7(a) loan guarantee program, although there would be differences attributable to EDA's statutory requirements and policy priorities.⁷ The proposed rule would, among other things; provide definitions for small- and medium-sized businesses; outline core programmatic elements, such as borrower eligibility

⁴GAO, *Innovative Manufacturing: Commerce Should Target Program Outreach to Address Capital Access Gaps*, [GAO-16-271](#) (Washington, D.C.: February 2016).

⁵As we reported in February 2016, a key issue debated during consideration of COMPETES 2010 was whether the ITM program would duplicate existing loan guarantee programs at other federal agencies. See [GAO-16-271](#). COMPETES 2010 provides that, to the maximum extent practicable, the Secretary of Commerce shall ensure that the activities carried out under the ITM program are coordinated with, and do not duplicate the efforts of, other loan guarantee programs within the federal government. 15 U.S.C. § 3721(o).

⁶81 Fed. Reg. 64,787 (Sept. 21, 2016).

⁷SBA's 7(a) program provides loan guarantees to small businesses for a variety of purposes, such as acquiring land and buildings; purchasing inventory, supplies, and raw materials; and providing working capital. SBA's 7(a) program is authorized by Section 7(a) of the Small Business Act, codified as amended at 15 U.S.C. § 636(a).

criteria, types of ineligible businesses, and permissible uses of loan proceeds by borrowers; and describe the application process for the ITM program.

- **Developing a program manual.** EDA continued working with a contractor to develop a program manual for the ITM program that includes standard operating procedures for interacting with clients once the program begins issuing loan guarantees, among other things. EDA officials told us that they expected the program manual to be completed in December 2017, although they noted some aspects of the manual would need to be updated as EDA takes further steps to implement the program.⁸
- **Consulting with other agencies.** EDA officials told us that they had begun to address the recommendation from our February 2016 report by consulting with SBA officials on several occasions to discuss (1) the capital access needs of small- and medium-sized businesses, (2) how SBA structured outreach for its 7(a) program, and (3) how EDA could implement the ITM program in a way that does not overlap with the 7(a) program.⁹

However, EDA's future steps to implement the program and address our recommendation are uncertain because of a perceived lack of demand for the program among small- and medium-sized businesses, competing regulatory priorities within Commerce, and reductions in available appropriations for the program. Specifically:

- **Perceived lack of demand for the ITM program.** EDA officials told us that the technologies and small businesses that would be eligible for loan guarantees through the ITM program could also be served by the SBA 7(a) program, which has more available funding and longer-standing relationships with the financial sector. EDA officials said that under the current proposed design and ITM's statutory requirements, the main factor that differentiates the ITM program from SBA's 7(a) program is that EDA can serve medium-sized manufacturers. EDA officials told us that previous inquiries by EDA to assess demand for the ITM program among medium-sized businesses found little, if any, demand.¹⁰ For example, in the preamble to the 2016 proposed rule for the ITM program, EDA specifically requested public comments on several questions to assess potential demand for the program.¹¹ These questions included, among others, whether there is an existing market for loans to small- to medium-sized business in the innovative manufacturing sector that is not currently being met. According to EDA officials, EDA only received one comment on its proposed rule that was not about the potential demand for the program. NIST officials told us that they believe both small- and medium-sized manufacturers do experience challenges gaining access to capital to, for example, finance new product development, which the ITM program could help

⁸For example, the EDA officials said that the agency has not yet procured an information technology system for the ITM program since it is not ready to implement the program. If the agency procures an information technology system, the program manual would need to be updated with specific information related to that system.

⁹[GAO-16-271](#).

¹⁰As we noted in our July 2013 report ([GAO-13-717R](#)), EDA had published a "Request for Comments on Developing a Program to Provide Loan Guarantees to Small or Medium-Sized Manufacturers" in the *Federal Register*. 78 Fed. Reg. 22,801 (Apr. 17, 2013).

¹¹81 Fed. Reg. 64,787, 64,789 (Sept. 21, 2016).

address.¹² However, the NIST officials said that EDA may need to do more to differentiate the program, such as targeting higher-risk small businesses than are typically served by SBA's 7(a) program.

- **Competing regulatory priorities.** EDA officials also told us that, as of December 2017, Commerce had not set a timetable for finalizing the ITM program's regulations, in part, because the department has prioritized other regulatory actions. EDA officials said that before Commerce can finalize a regulation for the ITM program, it must consider Executive Order 13771, which provides that, unless prohibited by law, whenever an agency proposes or otherwise promulgates a regulation, it must identify at least two existing regulations to be repealed.¹³ Furthermore, under this Executive Order, the cost of a new regulation shall, to the extent permitted by law, be offset by the elimination of existing costs associated with at least two prior regulations.
- **Reduced available appropriations.** From fiscal year 2012 through fiscal year 2015, Congress appropriated \$19 million for the ITM program.¹⁴ EDA officials said they had obligated approximately \$494,000.¹⁵ The Consolidated Appropriations Act of 2017 required a \$10 million rescission of unobligated balances from prior year appropriations from EDA's Economic Development Assistance Programs account.¹⁶ EDA chose to apply this rescission to the unobligated balances for the ITM program. EDA officials said that this reduced the amount of appropriated funds available to implement ITM by more than half, to about \$8.5 million. For fiscal year 2018, the President's Budget and both House and Senate appropriations bills propose further rescissions for EDA's Economic Development Assistance Programs account. As of January 2018, EDA was operating under a continuing resolution for fiscal year 2018, so its full-year appropriation had not yet been finalized.

Agency Comments

We provided a draft of this report for review and comment to the Secretary of Commerce and the Administrator of the Small Business Administration. Commerce and SBA provided technical comments, which we incorporated as appropriate. SBA's comments also included some comments of a more general nature. For example, SBA noted that small- and medium-sized

¹²NIST last reported on small- and medium-sized manufacturers' capital access needs in 2011. National Institute of Standards and Technology, Hollings Manufacturing Extension Partnership, *Connecting Small Manufacturers with the Capital Needed to Grow, Compete, and Succeed: Small Manufacturers Capital Access Inventory and Needs Assessment Report* (Gaithersburg, MD: November 2011).

¹³Executive Order 13771, Reducing Regulation and Controlling Regulatory Costs, § 2, 82 Fed. Reg. 9339, 9339 (Jan. 30, 2017).

¹⁴Congress did not appropriate new funds for the ITM program in fiscal years 2016 and 2017.

¹⁵According to EDA officials, these obligations were used to hire (1) a contractor to help with program implementation activities, such as developing standard operating procedures, and (2) an attorney to assist with program implementation, who has since left EDA. Other EDA salaries and expenses used on ITM implementation have come out of the agency's regular salaries and expenses account rather than the ITM appropriations. EDA indicated that it continues to charge such expenses, including legal counsel, to the agency's regular salaries and expenses account.

¹⁶Pub. L. No. 115-31, § 524(a)(1), 131 Stat. 135, 225 (2017). A rescission is legislation enacted by Congress that cancels the availability of budget authority previously enacted before the authority would otherwise expire. See GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

manufacturers continue to experience challenges in accessing capital, and that its 7(a) program provides guaranteed loans to many small businesses that qualify under the ITM program.

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We are sending copies of this report to the appropriate congressional committees, the Secretary of Commerce, the Administrator of the Small Business Administration, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-3841 or neumannj@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 major contributions to this report include Christopher Murray (Assistant Director), Perry Lusk (Analyst-in-Charge), Mark Braza, Ellen Fried, and Patricia Moyer.

A handwritten signature in black ink, appearing to read "John Neumann", with a long horizontal flourish extending to the right.

John Neumann
Director, Natural Resources and Environment

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