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April 4, 2011

The Honorable John D. Rockefeller, IV
Chairman
The Honorable Kay Bailey Hutchison
Ranking Member
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Ralph M. Hall
Chairman
The Honorable Eddie Bernice Johnson
Ranking Member
Committee on Science, Space, and Technology
House of Representatives

Subject: Factors for Evaluating the Cost Share of Manufacturing Extension Partnership Program to Assist Small and Medium-Sized Manufacturers

U.S. manufacturing plays an important role in the nation's economy, producing about \$1.6 trillion of value each year—11.5 percent of the U.S. gross domestic product (GDP)—and accounting for over 13 million jobs in the United States in 2008, according to the Department of Commerce. However, over the past decade, increased competition abroad and the migration of manufacturing overseas have led to declines in U.S. manufacturing. To support the manufacturing sector, the federal government has undertaken efforts, including creating programs that are partly funded by the federal government and partly funded by nonfederal entities such as state and local governments. However, according to the Bureau of Labor Statistics, from 2008 to 2009, following the beginning of the recent economic downturn, the United States lost 1.5 million manufacturing jobs.

One federal effort aimed at helping manufacturers is the Hollings Manufacturing Extension Partnership (MEP) program. The MEP program was established in 1988¹ through Commerce's National Institute of Standards and Technology (NIST) to enhance productivity and technological performance, and strengthen the global competitiveness of small and medium-sized U.S. manufacturers,² helping them create and retain jobs. Under this program, NIST has established relationships with 60 nonfederal organizations throughout the United States and Puerto Rico—called MEP centers. NIST enters into annual cooperative agreements with each of the 60 MEP centers whereby federal funding is provided to the centers subject to the centers providing matching funds and meeting performance measures.

¹Pub. L. No. 100-418, § 5121(a) (Aug 23, 1988)(codified at 15 U.S.C. § 278k).

²NIST defines small and medium-sized manufacturers as those with fewer than 500 employees.

These centers provide services to small and medium-sized manufacturers to help them develop new customers, expand into new markets, and create new products.³ MEP centers focus on helping manufacturers in five key areas—technology acceleration, supplier development, sustainability, workforce, and continuous improvement. Specifically, MEP centers enter into contracts with companies to deliver technical assistance to improve their manufacturing processes and productivity, expand capacity, adopt new technologies, utilize best management practices, and accelerate company growth.

According to NIST, the MEP program has been very helpful to the manufacturers it serves. In fiscal year 2009—the last full year for which data on MEP impacts were reported—NIST reported that these centers provided assistance to more than 32,000 manufacturers, with more than 7,100 manufacturers receiving in-depth technical assistance. According to NIST reports, federal spending on the MEP program—\$530 million from fiscal years 2006 through 2010—has had positive effects. From 2006 through 2009, the most recent years that data is available, MEP clients reported that they had a total of \$15.8 billion in new sales, \$19 billion in retained sales, \$5.2 billion in cost and investment savings, and \$7.5 billion in new investments in their companies, and had created and retained 234,687 jobs.⁴ The MEP centers' specific activities with manufacturers span a wide range, and NIST has reported a number of successes. For example, one MEP center consulted with a manufacturer of environmental equipment and materials to identify opportunities for improving the manufacturing process and how supplies are planned and used. According to NIST, this analysis helped the company improve efficiency in several of its key manufacturing operations, increasing productivity by 25 to 30 percent, reducing inventory by \$3 million, and reducing lead time by 44 percent. Another MEP center provided training to the staff of a logistics company focused on improving efficiency and reducing waste, leading the company to reorganize its packaging operation, which, according to NIST, led to cost savings of \$1.36 million, increased productivity by 25 percent, increased sales by \$52 million, and retained \$26 million in sales.

The MEP program has changed over the years. As implemented during the 1990s, the MEP program provided federal funding to reimburse each \$1 of nonfederal contributions with no more than \$1 of federal funding—referred to as a 1:1 cost share—for the first 3 years that a center operated. For the fourth year of operation, every \$3 of nonfederal contributions were reimbursed with \$2 of federal funding—referred to as a 3:2 cost share. For the fifth and sixth years of operation, every \$2 of nonfederal contributions were reimbursed with \$1 of federal funding—referred to as a 2:1 cost share. Under the original legislation, federal funding was scheduled to end once a center had operated for 6 years. In 1998, Congress passed legislation changing the program to, among other things, provide for continued federal funding and set the cost share at 2:1 for all centers that had been in operation for at least 6 years.⁵ More recently, there have been a number of legislative and executive proposals to further alter the program. The America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education, and Science (America COMPETES) Reauthorization Act of 2010 includes provisions requiring GAO to report to Congress on the MEP program's cost share

³MEP centers are structured in various ways. Most MEP centers are not-for-profit corporations (501(c)(3)), affiliated with state governments, or affiliated with universities.

⁴These data reflect information provided by the manufacturers served by the MEP centers. We did not evaluate the survey used to collect this information, or the data it produced, for reliability or accuracy. Therefore we cannot verify the extent to which these outcomes are the result of involvement with the MEP program.

⁵Some centers may still be subject to a lower cost share because they have been in operation for less than 3 years.

requirements within 90 days of enactment.⁶ Our objectives for this review were to (1) provide information on various cost share structures in the MEP program, including the cost share structure in place prior to such date of enactment; (2) identify the effect of such cost share structures on individual centers and the overall program; and (3) provide recommendations, if possible, on how best to structure the cost share requirement to provide for the long-term sustainability of the program.

To provide information on various cost share structures, we reviewed relevant documentation, including legislation, regulations, and two NIST annual cooperative agreements from MEP centers in Alabama and California. We also interviewed officials at NIST, two MEP centers, and an association representing the MEP centers. We also received data from NIST, which we analyzed to determine the total federal and nonfederal cost share for fiscal years 2007 to 2010. We interviewed knowledgeable agency officials about the source of the data and the controls NIST had in place to maintain the integrity of the data and determined that the data were sufficiently reliable for the purposes of our report. To identify the effect of such cost share structures on individual centers and the overall program, we distributed and received questionnaires from all 60 MEP centers, and spoke with officials at 2 MEP centers—one of the largest MEP centers and one that relies heavily on client fees—and an association that represents them. We did not seek to verify the extent to which these effects for individual centers could be confirmed with data. To determine how best to structure the cost share requirement, we (1) sought criteria for an optimal cost share, and (2) identified factors to consider in determining an appropriate cost share. To identify criteria for an optimal cost share, we examined relevant laws, conducted a limited literature search, and consulted internal experts on government program design. To identify factors to consider in determining an appropriate cost share, we reviewed prior GAO reports, Congressional Research Service (CRS) and Congressional Budget Office (CBO) reports, and documentation from the Office of Management and Budget (OMB). One limitation of note is that because of the limited time the legislation provided for this review, we did not undertake a comprehensive assessment of the MEP program or cost share structures. In addition, we did not evaluate Commerce's authority to alter the cost share structure. Also, during the course of our work, we were notified of allegations of potential improprieties related to administration of the program. We referred these allegations to Commerce's Inspector General.

We conducted our work from January through April 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this product.

Results in Brief

Of the 60 current MEP centers, 57 are required to meet a 2:1 (nonfederal: federal) cost share; the others are required to meet a 1:1 cost share because they are in their first 3 years of operation since their contracts were awarded to new operators. From fiscal years 2006 through 2010, NIST received over \$530 million in appropriations for the MEP program. In fiscal year 2010, NIST received \$124.7 million in appropriations for the MEP program, allocating \$87.4 million to the MEP centers. NIST used the remainder to administer and

⁶Pub. L. No. 111-358, § 404(d) (Jan. 4, 2011). Congress passed the America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education, and Science (America COMPETES) Act of 2007 with the overall goal of increasing federal investment in scientific research to improve U.S. economic competitiveness. Pub. L. No. 110-69, 121 Stat. 572 (Aug. 9, 2007).

support the program and, in 2010, for competitive grants it awarded to MEP centers. MEP centers meet their nonfederal cost share using various resources, including cash and in-kind contributions—goods or services provided in lieu of cash. These resources are provided by a range of entities, including state and local governments, associations, and user fees provided by manufacturers who use the MEP centers' services.

In response to our request for information, MEP centers identified both positive and negative effects of the current cost share structure on individual centers and the overall program. Among the positive effects, some MEP centers reported that it encourages them to leverage resources and improve partnerships with other organizations, to find clients willing to pay fees and take a stake in the program, to emphasize services that are relevant to manufacturers, and to avoid duplication. Among the negative effects, some MEP centers reported that they are spending more time and effort seeking funds, seeking projects outside their mission, shifting their focus to larger clients who can pay higher fees, focusing more on multiple projects with repeat clients, and focusing less on rural clients. To date, most centers have been able to meet their portion of the cost share, but some noted that they are concerned about their continued ability to meet the cost share requirement and remain eligible to receive federal funding in the future because the economic downturn is hurting them, state funding may become more limited, and manufacturers are becoming less willing to pay client fees.

We were unable to provide recommendations on how best to structure the cost share requirement to provide for the long-term sustainability of the program because we could not identify criteria or a basis for determining the optimal cost share structure for this program. Instead, we have identified a number of factors that could be taken into account in considering modifications to the current cost share structure. Among other things, past GAO work has found that cost share structures should promote equity by assigning costs to those who both use and benefit from the services. As it applies to the MEP program, manufacturers, state and local governments, and the nation may all benefit from the program to varying degrees, requiring an evaluation of the relative benefits and aligning cost shares to reflect who receives the benefits. NIST also commissioned a study of the MEP program and its cost share mechanism that recommended that the cost share requirements should be consistent with those of other economic development programs—which it noted, in Commerce, had 1:1 or lower cost shares—and should provide flexibility to alter the cost share requirement in response to economic conditions. Finally, OMB, CBO, and others have examined the MEP program and have raised questions about the need for any federal funding. Among other things, in 2009 and 2011, CBO identified the MEP program for potential elimination from discretionary spending, stating that the program's enhancement of U.S. productivity is questionable.

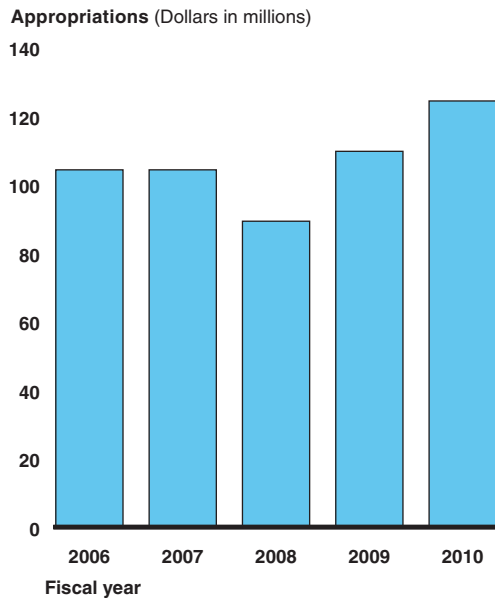
MEP Centers Are Required to Meet a Cost Share to Qualify for Federal Funding

Of the 60 current MEP centers, 57 are required to meet a 2:1 cost share. Three centers—Arizona Manufacturing Extension Partnership, Illinois Manufacturing Extension Center-Chicago, and Pennsylvania's Industrial Modernization Center—are required to meet a 1:1 cost share because they are within their first 3 years of operation; centers had previously existed

in these states but their contracts were awarded to new operators.⁷ Enclosure II provides a list of the 60 MEP centers.

From fiscal years 2006 through 2010, NIST received approximately \$530 million in appropriations for the MEP program, having witnessed increases in recent years rising to \$124.7 million in fiscal year 2010, as shown in figure 1. Not all funding for the MEP program is allocated to MEP centers. In fiscal year 2010, MEP centers received \$87.4 million in federal reimbursements for their activities. In addition, in fiscal year 2010, NIST competitively awarded \$12 million outside of the annual cooperative agreements it has with the 60 MEP centers. These awards were made to 22 MEP centers for undertaking new activities consistent with NIST's mission. NIST used the remaining \$25.3 million to administer and support the program.⁸

Figure 1: Federal Funding for the MEP Program, Fiscal Years 2006-2010



Source: GAO analysis of data provided by NIST.

⁷Arizona MEP was awarded to a new operator because the center wanted to be a state-based center (it had previously been run out of the Maine MEP center). The Illinois center was awarded to a new operator because the previous operator could not draw down the full federal funds because it could not raise enough nonfederal funds to meet cost share requirements. Additionally, the center was not achieving required metrics after being notified during annual performance reviews conducted by NIST. Annual reviews of MEP centers are required. 15 C.F.R. § 290.8 outlines performance standards and other related requirements for MEP centers. The Pennsylvania MEP in Central Pennsylvania was awarded to a new operator in order to split an existing MEP service area into two distinct service areas.

⁸According to NIST, these activities included a client impact survey, information and knowledge management for the MEP system, centralized tools and service development, and MEP center staff training and professional development.

To meet the nonfederal cost share, centers use various resources, including cash and in-kind contributions⁹—goods or services provided in lieu of cash, such as donated resources or staff time, or use of a facility or office space—as well as interest and dividends and user fees.

Specifically,

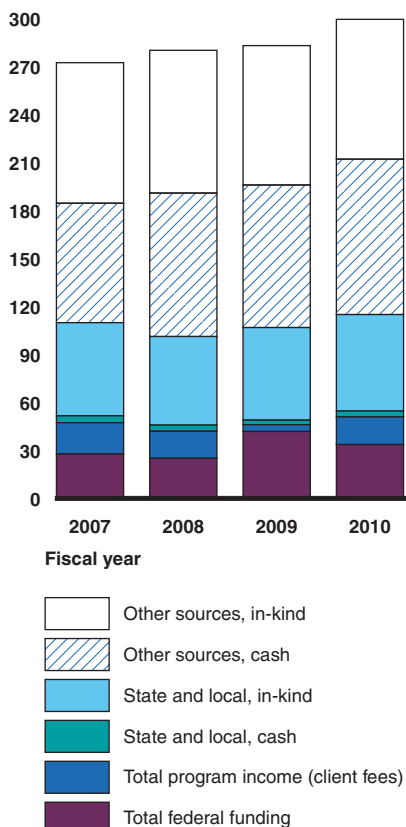
- Manufacturers pay fees for services provided by the MEP centers.
- State and local governments provide cash or in-kind contributions.
- Nonfederal entities such as trade associations, community colleges, and economic development organizations provide cash or in-kind contributions.
- MEP centers earn interest and dividends on nonfederal money in their accounts.

Figure 2 shows federal funding and the nonfederal cost share contributions for MEP centers from fiscal years 2007 through 2010.

⁹According to the NIST Hollings MEP General Terms and Conditions, third-party in-kind contributions of part-time personnel, equipment, software, rental value of centrally located space (office and laboratory), and other related contributions have historically been limited to 50 percent of the nonfederal cost share. *See* 15 C.F.R. § 290.4(c)(5). Some MEP centers believe that this limitation is inconsistent with the program’s statutory requirements, specifically language in section 3003(a) of the America COMPETES Act of 2007—which these centers asserted allows for in-kind contributions to comprise up to 100 percent of the support used to meet the nonfederal cost share. We did not evaluate this issue; however, a federal court recently found that the section 3003(a) of the America COMPETES Act of 2007 “does not invalidate the in-kind contribution cap” established in section 290.4(c)(5). *Massachusetts MEP et al., v. Locke*, 723 F. Supp. 2d 27, 34 (D.D.C. 2010).

Figure 2: Federal Funding and Nonfederal Cost Share for MEP Centers, Fiscal Years 2007-2010

Total MEP center funding, including federal and nonfederal contribution (Dollars in millions)



Source: GAO analysis of data provided by NIST.

^aNIST's financial data are based on data the MEP centers report, which vary. Specifically, some centers provided additional information on nonfederal contributions beyond what is required to receive the full federal reimbursement.

^bOther sources include contributions from third parties, subrecipients, and interest and dividends earned by the centers themselves.

^cThis figure excludes NIST funding awarded through the fiscal year 2010 competitive process.

In fiscal year 2010, the largest source of nonfederal contributions was fees for services paid by the manufacturers who used the MEP centers. As reported to NIST, these client fees totaled \$97.1 million in fiscal year 2010. The portion of nonfederal cost share made up of client fees varies across MEP centers. For example, in fiscal year 2010, 26 MEP centers reported to NIST that they received 50 percent or more of their nonfederal contributions from client fees, while 2 reported they received less than 10 percent of the nonfederal contributions from client fees.

State and local support for MEP centers was the second largest source of nonfederal contributions in fiscal year 2010. These contributions totaled \$64.0 million in fiscal year 2010, as reported to NIST. Again, the level of this support varies across MEP centers. For example, in fiscal year 2010, 15 MEP centers reported to NIST that they received more than half of their nonfederal cost share from state funding each year, while 7 reported that they received no state funding.

Nonfederal in-kind contributions reported to NIST totaled \$37.3 million in fiscal year 2010. The types of in-kind contributions MEP centers receive also vary.¹⁰ For example, the MEP center in Colorado received human resources services from the University of Colorado, while a MEP center in California provided training to community colleges and local associations who then passed on services to small manufacturers. These in-kind contributions were both used to meet the nonfederal portion of the cost share.

MEP Centers Reported That the Current Cost Share Structure Has Positive and Negative Effects and Expressed Concerns about Their Future Ability to Continue to Meet the Nonfederal Portion

MEP centers have identified both positive and negative effects of the cost share structures on individual centers and the overall program. In response to an open-ended question about the positive effects of the current MEP cost share structure, 14 MEP centers reported that there were none. Nonetheless, some MEP centers identified positive effects of the current cost share.¹¹ Specifically,

- *Centers are encouraged to leverage resources and improve partnerships with other organizations.* Officials at several centers reported that they value the relationships with partnering organizations required to obtain the nonfederal portion of the cost share. For example, one center reported that “it increases the leveraging of federal and nonfederal dollars ensuring that more investors are involved in manufacturing extension other than just the federal government.”
- *The need to collect client fees gives manufacturers a stake in the program.* Eight centers reported that the cost share mechanism increases manufacturers’ buy-in and their commitment to making their partnership with the center productive. For example, one center reported that “clients have a vested interest in the outcome as demonstrated by their commitment of fees,” and that it “encourages other commitments and partnerships.” Another MEP center reported that “companies recognize value when they have to pay for the services they get. Many studies have shown that free services are perceived as [having] very low or no value by companies.”
- *Centers emphasize services that are relevant to manufacturers.* Seven centers reported that they are focusing on manufacturers’ needs because manufacturers are more willing to pay for services that they value. For example, one center told us that the cost share “helps drive appropriate client services because clients need to be willing to pay.” Other centers reported that it ensures “more focus on results” and leads them to “put a premium on continuing to provide a value proposition to manufacturers.”
- *Centers avoid duplication.* Five MEP centers reported that the cost share helps keep them informed of other programs and avoid duplication of efforts. For example, one center reported that “the cost share requirement has made it imperative that we find

¹⁰15 C.F.R. § 290.4(c) outlines categories of contributions that a center can count toward fulfilling its cost share requirement.

¹¹In our data collection instrument, we specifically asked MEP centers to identify the positive effects of the current cost share structure. However, we recognize that these positive effects may also apply to the requirement for nonfederal cost share. We did not evaluate the degree to which some of these benefits were the result of the specific 2:1 cost share requirements faced by most MEP centers.

partners within the economic development community. We have built a network of partners and affiliates that help us defray the costs of marketing, outreach and service delivery. Because of these partnerships, we tend not to duplicate services available elsewhere and to leverage and build on programs that already exist.” Another center reported that “the process of identifying potential partners that could provide cost share led to an increased awareness of multiple resources in the state that could provide assistance to manufacturers. This resulted in less duplication of services in the state.”

In responding to our questionnaire, the MEP centers cited more negative than positive effects of the current MEP cost share structure. Specifically,

- *MEP centers are spending more time and effort seeking funds.* Some MEP centers reported that, in recent years, they are spending more time and effort identifying and formalizing arrangements to meet the cost share in lieu of providing services to manufacturers. In response to an open-ended question seeking to identify negative effects of the current cost share, 15 of the 60 MEP centers reported that the current cost share mechanism requires them to spend more time and resources establishing and maintaining partnerships and accounting for in-kind contributions. According to some of the MEP centers, these administrative efforts can detract from serving clients. For example, one center responded, “The greater administrative burden in managing the formal partnerships has sometimes decreased staff time available for direct manufacturing client engagement.”
- *MEP centers are seeking projects outside their mission.* Fourteen of the 60 centers reported that the need to procure large amounts of nonfederal money leads them to prioritize revenue-generating projects rather than projects that fulfill the program’s mission. For example, one center reported, “Available money for cost share has all but dried up, and we now spend even more time in its pursuit. With limited numbers of partners and scarce in-kind matching funds, we sometimes use available match as a criterion for selecting partners, and this can cause us to deviate from our mission.”
- *MEP centers report shifting their focus to larger clients who can pay higher fees.* Eighty percent of the MEP centers reported that they are very likely or somewhat likely to shift their focus toward larger clients. When asked to explain its answer, one center reported, “We have to focus more of our efforts on companies with more than 150 employees. We have had to focus on companies who could afford to pay the increased rates. We are less able to serve the smaller companies, who most need our services, because they cannot afford to pay the increased rates.”
- *MEP centers report focusing more on multiple projects with repeat clients.* More than two-thirds of respondents reported that they were very likely or somewhat likely to shift to multiple contracts with the same company. NIST has emphasized the need for centers to reach out to clients not currently served. When budgets are constrained, maintaining current clients and finding new clients may be at cross purposes. Almost all of the MEP centers expressed concern about limiting how long they can serve existing clients. In particular, 90 percent disagreed or strongly disagreed that there should be a time limit on the number of years that a manufacturer can use their services.
- *MEP centers report focusing less on rural clients.* One of the core principles of the MEP program is to support underserved communities—those that may not be economical clients for private consultants. For example, one center told us, “We have

had to significantly reduce our personnel support in the rural areas, thus leaving potential manufacturers unserved.” Another center reported, “The 2:1 cost share requirement forces [our] MEP [center] to expend valuable time to develop more partnerships. The high level of the cost share requirement burdens our partners with the required paperwork... [and] makes it more difficult to serve the small, rural manufacturers.”

Many MEP centers noted that they are concerned about their continued ability to meet the cost share requirement to obtain all federal funding in the future. To date, most centers have been able to meet their portion of the cost share. However, some MEP centers have expressed several concerns about whether they can continue to do so. Specifically,

- *Economic downturn hurting MEP centers.* In response to a question about challenges caused by the 2008 economic downturn, many centers noted that the economic downturn has compounded difficulties meeting the cost share. The number of MEP centers who reported that it was very challenging to meet the nonfederal cost share has increased from 11 to 32 since the onset of the economic downturn in 2008.
- *Limited availability of state funding.* Some MEP centers reported that the limited availability of state funding has undermined their ability to meet the nonfederal cost share, and that such pressures may continue or worsen for the next few years. To date, according to NIST data, the total amount of state funding provided to MEP centers has not changed significantly from 2006 to 2010; however, some state funding has varied and many centers have expressed concerns that state funding may decline. For example, one center reported that “it has not been a problem in the past but I am aware that it has been an issue with other states. I am concerned as the state reduces funding in [my state], that federal MEP dollars will not be fully drawn down by the center.”
- *Manufacturers are less willing to pay client fees.* Fifty-two of the 60 centers reported that, since 2008, their ability to meet the nonfederal cost share has been negatively or very negatively affected by manufacturers’ ability to pay fees. NIST data show that, from fiscal years 2006 to 2010, the amount of client fees—as well as the portion of the nonfederal share made up of client fees—actually increased. However, some centers expressed concerns that clients may not be willing to pay fees in the future. For example, one MEP center reported that “with a downturn in the economy, companies are concerned about cash and reluctant to pay.” Another MEP center reported that “it has been very difficult to get companies to commit to large projects and even more difficult collecting fees [in a timely manner].”

Key Factors We Identified May Aid Considerations of Cost Share Structures for the MEP Program

We were unable to provide recommendations on how best to structure the cost share requirement to provide for the long-term sustainability of the program because we could not identify criteria or another basis for determining the optimal cost share structure for this program. Instead, we have identified a number of factors that could be taken into account in considering modifications to the current cost share structure.

Our past work identifies two general principles to consider when setting cost share that may aid considerations of the MEP program’s cost share structure. Specifically,

- *All approaches involve trade-offs.* We found that no single strategy or combination of strategies for providing federal financial assistance could fully meet the varied economic needs of all states at all times. In past work on Medicaid—a program funded by states and the federal government according to a statutory formula—we reported that strategies to help states cope with increased costs during economic downturns require trade-offs.¹² In that report, we concluded that as Congress seeks to provide assistance to states that have the greatest financial need and the least capacity to meet those needs, those expenditures must be balanced against the federal government’s own long-term fiscal challenges. As applied to the MEP program, there could be trade-offs between lowering the cost share requirement and the total amount of funding available to help manufacturers. Specifically, reducing the requirements for nonfederal cost share could result in less resources being available to MEP centers (the total of federal funding and nonfederal funding and resources) because MEP centers could have less incentive to secure nonfederal funds beyond those required to meet the reduced cost share.
- *It is important to identify the beneficiary and allocate costs accordingly.* Our past work has identified the “beneficiary-pays principle”—that is, that cost share structures should promote equity by assigning costs to those who both use and benefit from the services.¹³ As applied to the MEP program, benefits may be received by manufacturers, and state and local governments and the nation may benefit to varying degrees. For example, some of the services that the MEP centers provide to small and medium-sized manufacturers are focused on reducing the cost of manufacturing—an important benefit for the manufacturer. As such, manufacturers may be willing to pay a larger share of these services. In addition, improving the competitiveness of manufacturers may benefit federal, state, and local governments in terms of potentially increasing employment and tax receipts, which may justify some government contribution—though to a lesser extent than the direct benefits to the manufacturers. In contrast, some projects may predominantly provide benefits to society. For example, MEP projects that focus on pollution abatement may provide environmental benefits for society as a whole. In this case, it may make more sense for the federal government to fund a larger portion of the cost. Irrespective of who benefits, it can be difficult to quantify the relative levels of benefits each entity may receive.

During this review, we identified a number of factors specific to the MEP program that could be useful in making decisions about the future of the program, including the program’s cost share structure. Specifically,

- *Many MEP centers, a NIST study, and a number of legislative proposals support lowering the current nonfederal cost share.* In response to an open-ended question requesting suggestions or recommendations related to the cost share mechanism that would improve the MEP program, 36 MEP centers supported a reduced cost share, with 30 supporting a 1:1 cost share. Many MEP centers reported that a reduced cost share would allow them to focus on core activities serving manufacturers. In particular, they reported that seeking out and accounting for in-kind contributions is burdensome and diverts resources from supporting small manufacturers. Additionally, a study prepared for NIST examining the future of the program

¹²GAO, *Medicaid: Strategies to Help States Address Increased Expenditures during Economic Downturns*, GAO-07-97 (Washington, D.C.: Oct. 18, 2006).

¹³GAO, *Federal User Fees: A Design Guide*, GAO-08-386SP (Washington, D.C.: May 29, 2008).

recommended that the cost share requirements be changed to a 1:1 cost share, noting that the MEP program was the only Commerce program exceeding a 1:1 cost share.¹⁴ We did not compare the nature of the work done in the MEP program to the nature of the work done in these other cost share programs and, as such, cannot comment on the appropriateness of their individual cost share structures. In 2009, two bills were introduced in Congress that would have, among other things, reduced the nonfederal cost share to 1:1.¹⁵

- *Some MEP centers and a NIST study support providing more flexibility on how centers meet the nonfederal cost share.* In response to an open-ended question requesting suggestions or recommendations for changes to the current cost share, 9 MEP centers supported a more flexible cost share arrangement, such as one based on economic conditions or the size of the MEP center. The study prepared for NIST noted that the cost share could be changed to allow flexibility to respond to varying economic conditions. For example, the cost share requirements could be temporarily reduced during times of economic distress to give states flexibility to respond to economic challenges. However, some MEP centers reported that such flexibility could make it difficult to plan their budgets. It is also unclear what criteria should be used to determine when flexibility should be allowed.
- *MEP centers differed on the role of in-kind contributions.* In response to an open-ended question requesting suggestions or recommendations for changing the current cost share, some MEP centers expressed support for allowing a greater role for in-kind contributions, while others expressed support for limiting the amount of nonfederal cost share provided by in-kind contributions. The study prepared for NIST noted, in changing cost share requirements, that in-kind contributions should be more “severely restricted,” noting that in-kind contributions may not substantially add to the capacity of the system to serve clients.
- *Questions exist as to the need for the MEP program.* We identified three key concerns about the MEP program that other entities have raised. Specifically,
 - The need for a federal program is in question. In 2002, OMB found the MEP program to be effectively managed, but raised questions about its need.¹⁶ OMB concluded that it is “not evident that there is a clear need for the federal government to fill this role—i.e., a national need does not necessarily require a federal response.”
 - Similar services may be available elsewhere. In 2009 and 2011, CBO listed the MEP program as one option for elimination, noting that proponents of eliminating

¹⁴Stone & Associates and the Center for Regional Economic Competitiveness (CREC), “Re-examining the Manufacturing Partnership Business Model: Alternatives for Increasing the Program’s Impact on U.S. Manufacturing Sector Performance,” a report prepared at the request of the NIST Manufacturing Extension Partnership, National Institute of Standards and Technology, Department of Commerce (Washington, D.C.: October 2010).

¹⁵S. 695, 111th Cong. (2009); H.R. 4393, 111th Cong. (2009).

¹⁶Office of Management and Budget, *Program Assessment Rating Tool (PART), Detailed Information on the Manufacturing Extension Partnership Assessment*, (Washington, D.C.: 2002), www.whitehouse.gov/omb/expectmore/detail/10000040.2002.html (accessed March 8, 2011).

the MEP program question whether the federal government should provide the services the MEP program provides because similar services are provided by the private sector.¹⁷ OMB similarly noted that about half the MEP program's clients believe the services they obtained from the MEP program are available other places, although at a higher cost. In a draft document from November 2010, the co-chairs of the National Commission on Fiscal Responsibility and Reform also noted that programs similar to the MEP program are provided in the private sector.¹⁸

- The program's impact is unclear. According to CBO, federal spending for the MEP program may allow some inefficient companies to remain in business, tying up capital, labor, and other resources that could be used more productively elsewhere. Similarly, the co-chairs of the National Commission on Fiscal Responsibility and Reform noted in a draft document that some argue that the MEP program supports inefficient companies that would otherwise go out of business.

Agency Comments and Our Evaluation

We provided Commerce with a draft of this report for review and comment. Its written comments are reprinted in Enclosure I. Commerce did not specifically state whether it agreed or disagreed with our findings. Commerce emphasized that it considers the MEP program a vital program that helps the Department improve the competitiveness of manufacturers and increase U.S. exports. Commerce also noted that this report will greatly assist the Department as it assesses alternative cost share structures for the MEP program. However, Commerce raised two concerns: (1) that the absence of specific GAO cost-share requirement recommendations might undercut the Department's authority under 15 U.S.C. § 278k(c)(8)¹⁹ to revise its cost-share structure, and (2) that, in several instances, the report includes information that, in Commerce's opinion, is beyond the scope of GAO's mandate.

With respect to Commerce's concern that our report does not contain recommendations, as noted in our draft report, within the statutory timeframe, we could not identify a basis to recommend a specific cost-share or to recommend criteria by which Commerce could develop a specific cost-share. Rather, we identified factors that could be taken into account in considering changes to the current cost-share structure. As such, this report constitutes GAO's submission under 15 U.S.C. § 278k(c)(7)(B).

Regarding the scope of our report, in its attached technical comments, Commerce cited two instances in the report that, in its opinion, were beyond the statutory requirements of this report, including, (1) allegations of potential improprieties reported to us and (2) our mention

¹⁷Congressional Budget Office, *Budget Options Volume 2* (Washington, D.C.: 2009); Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options* (Washington, D.C.: 2011).

¹⁸Co-Chairs of the National Commission on Fiscal Responsibility and Reform, *\$200 Billion in Illustrative Savings*, a supplement to a draft proposal by the co-chairs. (Washington, D.C.: 2010).

¹⁹15 U.S.C. § 278k(c)(8) states, "If consistent with the recommendations in the report transmitted to Congress under paragraph (7), the Secretary shall alter the cost structure requirements specified under paragraph (3)(B) and (5) provided that the modification does not increase the cost share structure in place before the date of enactment of the America COMPETES Reauthorization Act of 2010, or allow the Secretary to provide a Center more than 50 percent of the costs incurred by that Center."

of legislative and executive proposals and options to change the program. Regarding the overall scope of the report, we believe that the information included in our report provides an overall understanding of the MEP program and is relevant to considerations of the future of the MEP program. Specifically, regarding the allegations we received, we properly referred these allegations to Commerce's Inspector General and understand Commerce's concerns about including them in our report. However, because these allegations were received in conjunction with our request for information from MEP centers, we believed it was appropriate to mention that they had been received and referred so as to avoid the implication that we had ignored these allegations. As such, we did not make a change. Regarding the legislative and executive options to change the program, we appreciate Commerce's perspective, but we believe it is important to acknowledge that there are a variety of views about the program. As such we are including this information in our report, but have provided additional details to improve its clarity.

Commerce also provided updated information and technical clarifications that we have incorporated, as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Commerce, Director of NIST, and other interested parties. In addition, this report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

Should you or your staff have questions concerning this report, please contact me at (202) 512-3841 or ruscof@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Jon Ludwigson, Assistant Director; Jeffrey Barron; Lee Carroll; Jonathan Kucskar; David Messman; Jacqueline Nowicki; Alison O'Neill; Lesley Rinner; Kelly Rubin; and Jack Wang. Important assistance was also provided by Casey Brown, Courtney LaFountain, Jennifer Leone, and Kristen Massey.



Frank Rusco
Director, Natural Resources and Environment

Enclosures

Enclosure I: Comments from the Department of Commerce



UNITED STATES DEPARTMENT OF COMMERCE
The Secretary of Commerce
Washington, D.C. 20230

March 22, 2011

Mr. Frank Rusco
Director, Natural Resources and Environment
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Rusco:

Thank you for the opportunity to comment on the draft report from the U.S. Government Accountability Office (GAO) entitled "Factors to Consider When Evaluating Cost Share Arrangements for Commerce's Manufacturing Extension Partnership Program to Assist Small Manufacturers" (GAO-11-437R).

The Hollings Manufacturing Extension Partnership (MEP) works with small and mid-sized U.S. manufacturers to help them create and retain jobs, increase profits, and save time and money. The nationwide network provides a variety of services, ranging from innovation strategies to process improvements to "green" manufacturing. MEP partners with programs at the state and federal levels to develop and deliver services that put manufacturers in positions to develop new customers, expand into new markets, and create new products. The MEP program helps manufacturers identify and expand business opportunities and navigate the challenges of economic uncertainties. MEP is a vital Department of Commerce program, responding to high Departmental priorities in the areas of sustainability (including green manufacturing) and partnering with other Commerce programs to support our focus on increasing exports.

We fully appreciate that GAO faced a tight timeframe for completing this study and further challenges in collecting and analyzing information to develop recommendations for how best to structure the cost share requirement to provide for the long-term sustainability of the MEP program. The information in the report will greatly assist the Department as we assess alternative cost share structures for the program as required by section 404(d)(8) of the America COMPETES Reauthorization Act of 2010, P.L. 111-358, codified at 15 U.S.C. § 278k(c)(7) and (8).

NIST has reviewed the draft report and provided detailed comments and recommendations in the attached document. I urge you to incorporate those comments and recommendations in a revised final report. I direct your attention to two issues of particular concern. First, as the Agency that has been administering the MEP program for more than 20 years, we fully understand the difficulties hindering GAO from recommending any specific cost share ratio. We are concerned, however, that the report as presently drafted may provide an insufficient basis to allow the Department of Commerce to alter the cost structure requirements as contemplated in section 278k(c)(8). Second, in several instances the draft inappropriately

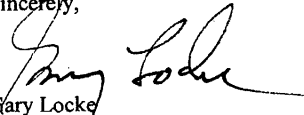
Enclosure I

Mr. Frank Rusco
Page 2

includes information that is beyond the scope of GAO's statutory charge. I am confident you will be responsive to these concerns in the final report.

Please contact Rachel Kinney, NIST management and program analyst, on (301) 975-8707 if you have any questions regarding this response.

Sincerely,



Gary Locke

Attachment

Enclosure II: List of 2010-2011 Manufacturing Extension Partnership Program Centers

State	Manufacturing Extension Partnership Center Name
AK	Alaska Manufacturing Extension Partnership
AL	Alabama Technology Network
AR	Arkansas Manufacturing Solutions
AZ	Arizona Manufacturing Extension Partnership
CA	California Manufacturing Technology Consulting Corporation for Manufacturing Excellence
CO	Colorado Association for Manufacturing and Technology
CT	Connecticut State Technology Extension Program
DE	Delaware Manufacturing Extension Partnership
FL	Florida Manufacturing Extension Partnership
GA	Georgia Manufacturing Extension Partnership
HI	Hawaii HTDC-MEP
IA	Iowa Center for Industrial Research and Service
ID	Idaho TechHelp
IL	Illinois Manufacturing Extension Center-Chicago
IL	Illinois Manufacturing Extension Center-Downstate
IN	Indiana MEP - Purdue Technical Assistance Program
KS	Mid-America Manufacturing Technology Center
KY	Kentucky Manufacturing Assistance Center
LA	Manufacturing Extension Partnership of Louisiana
MA	Massachusetts MEP
MD	UMD - Manufacturing Assistance Program
ME	Maine Manufacturing Extension Partnership
MI	Michigan Manufacturing Technology Center
MN	Enterprise Minnesota
MO	Missouri Enterprise
MS	Mississippi Technology Alliance
MT	Montana Manufacturing Extension Center
NC	North Carolina MEP
ND	North Dakota Manufacturing Extension Partnership
NE	Nebraska Manufacturing Extension Partnership
NH	New Hampshire MEP
NJ	New Jersey Manufacturing Extension Partnership
NM	New Mexico MEP
NV	Nevada Industry Excellence
NY	New York MEP
OH	Ohio Manufacturing Extension Partnership
OK	Oklahoma Manufacturing Alliance
OR	Oregon Manufacturing Extension Partnership
PA	Catalyst Connection
PA	Delaware Valley Industrial Resource Center
PA	Industrial Modernization Center-IMC
PA	MANTEC
PA	Manufacturers Resource Center
PA	Northeastern Pennsylvania Industrial Resource Center, Inc.-NEPIRC
PA	Northwest Pennsylvania Industrial Resource Center
PR	Puerto Rico Manufacturing Extension Inc.-PRiMEX
RI	Rhode Island Manufacturing Extension Services
SC	South Carolina MEP
SD	South Dakota MEP

TN	Tennessee MEP
TX	Texas Manufacturing Assistance Center
UT	Utah Manufacturing Extension Partnership
VA	GENEDGE ALLIANCE
VT	Vermont Manufacturing Extension Center
WA	Impact Washington
WI	NW Wisconsin Manufacturing Outreach Center
WI	Wisconsin Manufacturing Extension Partnership
WV	West Virginia MEP
WY	Manufacturing-Works

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