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TESTIMONY

ASSESSING THE DEPARTMENT OF ENERGY LOAN GUARANTEE PROGRAM

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In his famous book *Economics in One Lesson*, economist Henry Hazlitt wrote, "Government encouragement to business is sometimes as much to be feared as government hostility."[1]

In 2009, renewable energy company Solyndra received $535 million through the federally backed 1705 loan guarantee program of the Department of Energy (DOE). Two years later the firm filed for bankruptcy and had to lay off its 1,100 employees, leaving taxpayers bearing the cost of the loan.

For obvious reasons, more than any other recent events, the waste of taxpayers' money due to Solyndra's failure has attracted much attention. However, the problems with loan guarantees are much more fundamental than the cost of one or more failed projects. In fact, the economic literature shows that (1) every loan guarantee program transfers the risk from lenders to taxpayers, (2) is likely to inhibit innovation, and (3) increases the overall cost of borrowing. At a minimum, such guarantees distort crucial market signals that determine where capital should be invested, causing unmerited lower interest rates and a reduction of capital in the market for more worthy projects. At their worst, they introduce political incentives into business decisions, creating the conditions for businesses to seek financial rewards by pleasing political interests rather than customers. This is called cronyism, and it entails real economic costs.[2]

Yet, these loan programs remain popular with Congress and the executive. That's because in general most of the financial cost of these guaranteed loans will not surface for many years. That means that Congress can approve billions of dollars to benefit special interests, with little or no immediate impact to federal appropriations in the short term, because they are almost entirely off-budget.

HOW DO THESE LOAN GUARANTEES WORK?

The DOE Loan Programs Office (LPO) administers three separate loan programs: (1) Section 1703 loan guarantees, (2) Section 1705 loan guarantees, and (3) Advanced Technology Vehicle Manufacturing (ATVM) loans. Here are descriptions of the three loan programs, as explained by DOE:[3]

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1. Henry Hazlitt, *Economics in One Lesson*, in Chapter VI Credit Diverts Production, Laissez-Faire Books, Benicia, CA, 1946, p. 27.

2. Matt Mitchell, The Pathology of Privileges (working paper, Mercatus Center at George Mason University, July 2012).

3. United States Department of Energy, accessed June 13, https://lpo.energy.gov/.

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