TESTIMONY OF JAY TIMMONS, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF MANUFACTURERS

BEFORE THE U.S. SENATE COMMITTEE ON FINANCE

Hearing on

"Made in America: Effect of the U.S. Tax Code on Domestic Manufacturing"

MARCH 16, 2021

Good morning Chairman Wyden, Ranking Member Crapo and distinguished members of the Committee. Thank you for the opportunity to appear before you and for holding this hearing today on manufacturing in America.

A. Introduction

My name is Jay Timmons. I was raised in the manufacturing town of Chillicothe, Ohio, where my grandfather worked at the Mead plant for nearly four decades. I have seen firsthand how manufacturing raises the quality of life for families and communities.

I currently serve as president and CEO of the National Association of Manufacturers (NAM). The NAM is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector. At the NAM, we advocate policies that would help grow domestic manufacturing and improve the lives of the more than 12 million men and women who make things in America.

The manufacturing sector is vitally important to American prosperity. It accounts for 11% of U.S. GDP, driving more than $2.3 trillion in economic activity in the most recent quarter for

which data is available. The industry provides financial security to working families, paying wages averaging $88,406, including pay and benefits – nearly 24% higher than the average pay and benefits in all nonfarm industries. Moreover, 84% of manufacturing employees have access to a workplace retirement plan, helping to ensure families' financial stability for years to come.

Through The Manufacturing Institute, the workforce and education partner of the NAM and an entity for which I serve as chairman of the board, manufacturers are also running innovative programs to recruit and train the next generation of manufacturing workers. Our FAME program provides education, training and certification with respect to core industry skills in 13 states. And our Heroes Make America program has had the privilege of partnering with the Army for several years to provide on-base manufacturing training for service members nearing the end of their enlistment period.

I am joining you virtually because of the pandemic that this country has endured for more than a year now. But this pandemic is far more than a story of economic hardship and painful loss. It is also a story of communities and companies rising to the challenge.

During this crisis, America's manufacturing workers mobilized in ways reminiscent of their resolve during World War II, when manufacturers became the arsenal of democracy. The companies joining me today are part of this effort. Ford remade shopfloors to make ventilators and face shields. Intel accelerated access to technology to combat the pandemic. From iconic global brands to family-owned shops, manufacturers answered the call. I am pleased to share just a few of their stories:

- Behlen Manufacturing, a global leader in steel fabrication based in Nebraska, organized local school labs with 3D printers to develop printable protective gear for health care workers.

- A team at AAON, a commercial heating and cooling equipment manufacturer based in Oklahoma, worked around the clock to make heating and cooling units with HEPA filtration systems for use in temporary hospitals in New York City.
- Acuity Brands, based in Atlanta, produces lighting and lighting control technology for buildings. This company squeezed a development process that usually takes up to a year into two weeks to create a sophisticated, portable health care lighting stand for temporary hospitals.

Today, one year after stay-at-home orders and health restrictions began, the light at the end of the tunnel is growing brighter by the second—thanks to the innovation and dedication of pharmaceutical manufacturers who are making vaccines to stop the spread of the virus. Their heroic work, combined with the previous Administration's Operation Warp Speed, this Congress and this administration's focus on and investment in vaccine distribution, is now saving about two million American lives every single day.

B. A Tax Policy Framework for Growing Manufacturing in America

Manufacturing workers' incredible achievements during this crisis are all the more impressive when you consider the disruptions and challenges they had to overcome. This pandemic exposed and exacerbated serious supply chain issues that we now must address as we work to build the next post-pandemic world.

It was a challenge the NAM recognized early on. In spring 2020, we released our plan for strengthening manufacturing supply chains. I've had the chance to discuss it directly with some of you, and I know our plan has been shared with this committee. Our goal is your goal: Ensuring that the next dollar invested in manufacturing is invested in America. The plan is

comprehensive—ranging from tax code recommendations to workforce innovations. The central premise, though, is that the successful path is to incentivize investments. Incentives—not punitive measures—will allow us to achieve our shared goal.

The NAM's *Strengthening the Manufacturing Supply Chain*[1] was motivated in part by an anticipated global competition for new industrial investment as countries emerge from the worldwide economic slowdown, that was identified in a study by The Manufacturing Institute and KPMG[2]. The long productive lifespan of new manufacturing investments makes one thing clear – countries that attract the next wave of investment will be positioned for decades of industrial growth, job creation and innovation. Those that fail to capitalize on this moment face the prospect of falling behind as new advancements are researched and produced elsewhere.

While I would love for every product in the world to be made in the United States, it's simply not feasible or practical to expect all global manufacturing to relocate to America. In fact, attempts to quickly and radically upend global supply chains can create risks for consumers and increase the cost of manufactured goods for end-users. We must recognize that manufacturers in America benefit from foreign customers and foreign investment. The vast majority of customers are located outside our borders. In 2020, according to the United Nations, 95.75% of the world's population lived outside of the United States. Moreover, the Bureau of Economic Analysis estimates that in 2019, the most recent year for which data is available, foreign direct

[1] NATL' ASSOC. OF MANUFACTURERS, STRENGTHENING THE MANUFACTURING SUPPLY CHAIN (2020), https://documents.nam.org/COVID/NAM%20-%20Strengthening%20the%20Manufacturing%20Supply%20Chain.pdf.
[2] KPMG, COST OF MANUFACTURING OPERATIONS AROUND THE GLOBE (2020), https://www.themanufacturinginstitute.org/wp-content/uploads/2020/10/cost-manufacturing-operations-globe.pdf.

investment in U.S. manufacturing reached nearly $1.8 trillion, and U.S. affiliates of foreign multinational enterprises employed nearly 2.5 million manufacturing workers in America.[3]

The NAM believes that a focus on making the United States the destination of choice for **new** industrial investment would strengthen domestic manufacturing. There are several steps that members of this Committee can take to meet that goal.

First, policymakers must recognize the importance of predictability and stability in the tax code. Large up-front costs accompany the required investments in the cutting edge factories, machinery and equipment modern manufacturing demands. The useful life of these capital assets is often measured in years, or decades for the most significant investments. A competitive tax regime that provides predictability can weigh in favor of U.S. investment.

The data support a relationship between manufacturing growth and competitive tax rates. As members of this committee know, the NAM advocated tax reform in the decades following the Tax Reform Act of 1986. Our view was that reforming the tax code would allow manufacturers to hire more workers, raise wages and benefits and grow their businesses. For our sector, that promise is being fulfilled. Consider the following:

- In 2018, manufacturers added 263,000 new jobs. That was the best year for job creation in manufacturing in 21 years.[4]
- In 2018, manufacturing wages increased 3% and continued going up—by 2.8% in 2019 and by 3% in 2020. Those were the fastest rates of annual growth since 2003.[5]

[3] BUREAU OF ECON. ANALYSIS, DIRECT INVESTMENT BY COUNTRY AND INDUSTRY, 2019 (July 23, 2020), https://www.bea.gov/news/2020/direct-investment-country-and-industry-2019.
[4] BUREAU OF LABOR STATISTICS, CURRENT EMPLOYMENT STATISTICS, MANUFACTURING EMPLOYMENT, SEASONALLY ADJUSTED (last visited Mar. 5, 2021), https://www.bls.gov/ces/data/.
[5] BUREAU OF LABOR STATISTICS, CURRENT EMPLOYMENT STATISTICS, AVERAGE HOURLY EARNINGS FOR PRODUCTION AND NONSUPERVISORY EMPLOYEES, MANUFACTURING, SEASONALLY ADJUSTED (last visited Mar. 5, 2021), https://www.bls.gov/ces/data/.

- Manufacturing capital spending grew by 4.5% and 5.7% in 2018 and 2019, respectively.[6]
- Overall, manufacturing production grew 2.7% in 2018, with December 2018 being the best month for manufacturing output since May 2008.[7]

But these numbers don't tell the full story. I have heard from manufacturers around the country about the impact of the more competitive tax system that was enacted in 2017. Here are just a few examples:

- Jamison Door in Hagerstown, Maryland, gave their 120 employees special bonuses in anticipation of tax reform and again after the law took effect. They then offered raises and announced plans to add 50,000 square feet of new manufacturing space, with investments in new, state-of-the art equipment. With these investments, they aim to increase their workforce by 115%.
- Marlin Steel Wire Products, a small wire products manufacturer in Maryland, has invested more than $1.5 million in new technology since 2018, increasing their full-time workforce by 30%, given two rounds of raises, enhanced employee benefits, and as of last month, added 56% more factory floor space. They credit all of this to the tax cut and instant expensing.
- Carpenter Technology Corporation, credits tax reform for making possible a $100 million investment in soft magnetics capabilities and a new, precision strip hot rolling mill in its Reading, Pennsylvania, facility to help meet customer demand.
- Glier's Meats in Covington, Kentucky, delivered multiple wage increases for its 29 employees in 2018 alone after the tax reform law was passed. They've also been able to

[6] U.S. CENSUS BUREAU, ANNUAL SURVEY OF CAPITAL EXPENDITURES, TABLE 2A, MANUFACTURING (last visited Mar. 5, 2021), https://www.census.gov/data/tables/2019/econ/aces/2019-aces-summary.html.
[7] FEDERAL RESERVE BOARD OF GOVERNORS, INDUSTRIAL PRODUCTION, MANUFACTURING (SIC), SEASONALLY ADJUSTED (last visited Mar. 5, 2021), https://www.federalreserve.gov/releases/g17/Current/default.htm .

invest in new machinery that helps the business serve more customers, and they have continued hiring since 2018.

Those are some examples of small companies, but the large firms that employ 57% of the manufacturing workforce have also been growing in the United States. When a Midwest manufacturer announced a $400 million investment in a new campus in late 2019, the company's leadership explicitly credited tax reform. The investment was slated to create 100 jobs directly with hundreds of more jobs created indirectly by supporting projects. In mid-2019, a manufacturer of components for nuclear power plants announced it was going on a hiring spree in Indiana and Ohio, as it expanded three facilities. And not only was the company creating 170 jobs in the two states, it was also investing in workforce development programs, including partnerships with K-12 schools. That expansion, they said, was possible because of tax reform. And, just last month a manufacturer in the food and beverage industry committed to investing more than $1 billion in its U.S. operations over the next two years, a decision that was made easier thanks to tax reform.

Reducing tax rates drove historic growth in the manufacturing sector. It is clear that increasing taxes – whether by increasing the corporate tax rate, increasing the tax burden on small and medium manufacturers who are organized as pass-through entities, expanding the scope of income earned abroad that would be captured by the U.S. tax net, or allowing the tax code to increase the cost of items critical to manufacturing, such as investing in new machinery or cutting-edge research – would inhibit growth in the sector. In our most recent Manufacturers' Outlook Survey,[8] 87.4% of respondents said that their company would find it more difficult to hire more workers, invest in new equipment or expand their facilities if the tax burden on manufacturing income were increased. In addition, attempts to eliminate liquidity provisions

[8] NATL' ASSOC. OF MANUFACTURERS, NAM MANUFACTURERS' OUTLOOK SURVEY: FIRST QUARTER 2021 (2021), https://www.nam.org/wp-content/uploads/2021/03/NAM-Outlook-Survey-Q1-2021.pdf.

designed to help businesses through the COVID-19 crisis would amount to a retroactive tax increase on struggling firms.

Notably, tax reform only moved our combined federal and state corporate tax rate to slightly higher than the OECD average.[9] Merely maintaining our current tax system is not enough to drive new investment in the United States. Additional tax incentives should be a critical part of a national strategy to grow manufacturing.

Among manufacturers' most urgent needs is a tax code that encourages investment in research and development. Manufacturers account for 62% of all private-sector R&D. The new technologies, materials and processes developed by manufacturers make modern life possible. Unfortunately, a looming change to the treatment of R&D spending could decrease American innovation by driving up the after-tax cost of research spending.

For more than six decades, Section 174 of the Internal Revenue Code provided businesses the ability to deduct R&D expenses in the year incurred. However, the Tax Cuts and Jobs Act substantially altered the provision. Starting in 2022, companies will no longer be allowed to immediately deduct these research costs. Rather, they will be forced to amortize the costs over a period of years.

This modification of the tax treatment of R&D expenses will negatively impact U.S. jobs, wages and investment. A recent study[10] by Ernst and Young found that in the first five years

[9] GARRETT WATSON & WILLIAM MCBRIDE, TAX FEDERATION, EVALUATING PROPOSALS TO INCREASE THE CORPORATE TAX RATE AND LEVY A MINIMUM TAX ON CORPORATE BOOK INCOME(2021), https://taxfoundation.org/biden-corporate-income-tax-rate/ ("The TCJA brought the U.S. statutory corporate tax rate down from a federal-state combined rate of 38.9 percent in 2017—then the highest in the OECD—to 25.8 percent in 2020, slightly above the current OECD average (excluding the U.S.) of 23.4 percent.").

[10] Ernst & Young, IMPACT OF THE AMORTIZATION OF CERTAIN R&D EXPENDITURES ON R&D SPENDING IN THE UNITED STATES (2019), https://investinamericasfuture.org/wp-content/uploads/2019/10/EY-RD-Coalition-TCJA-R-and-D-amortization-report-Oct-2019-1.pdf.

after amortization takes effect U.S. research spending would be reduced by $4.1 billion annually, the U.S. would lose 23,400 R&D-related jobs annually and labor income related to R&D would be reduced by $3.3 billion annually. After the first five years, research spending would be reduced by $10.1 billion annually, 58,600 research-related jobs would be lost each year and labor income would be reduced by $8.2 billion annually. Note that these are merely direct job losses; if indirect effects are taken into account, the U.S. would lose 67,700 R&D-related jobs in each of the first five years after amortization takes effect and 169,400 annually in each subsequent year.

Manufacturers are grateful to Senators Hassan and Young for introducing bipartisan legislation to stop R&D amortization from taking effect. We respectfully urge the Committee to expedite consideration and approval of this important bill. Without it, the innovation that has so long characterized manufacturing in America stands at risk.

The ability to efficiently finance equipment and machinery purchases is critical to growing domestic manufacturing. Small and medium manufacturers are the backbone of America's supply chain. To effectively grow manufacturing in the United States, these firms must be able to expand their facilities, purchase new equipment and hire more workers. Small firms typically lack access to public equities markets and may take out business loans to afford these purchases. Yet a coming tax law change will make this financing option more expensive.

Under current law, the maximum amount of deductible interest on a business loan is limited to 30% of a company's EBITDA (earnings before interest, taxes, depreciation and amortization). Starting in 2022, the limit will be 30% of EBIT (earnings before interest and taxes). Removing depreciation and amortization from the base upon which the limit is calculated would disproportionately harm manufacturers, as capital equipment purchases and other acquisitions can require significant amounts of depreciation and amortization.

Research indicates that even under the more generous 30% of EBITDA standard, manufacturers are disproportionately subject to disallowance of interest deductions – when analyzed by industry, manufacturers bore 61% of potentially disallowed interest deductions.[11] Importantly, this recent research reflects the operation of the provision in a "normal" business environment, only examining debt and earnings levels prior to 2020. The impact of the provision during the pandemic highlights the perverse nature of the interest restriction. As earnings are reduced in a challenging economy and more debt is incurred to keep businesses afloat, an increasing amount of interest deductions are disallowed.

The tax burden shouldered by manufacturers under an EBITDA standard should not be exacerbated by a shift to an EBIT standard. Allowing this change to take effect would run counter to the goal of increasing domestic manufacturing capacity by increasing the cost of financing equipment purchases, facilities expansions and other activities that are necessary to grow the sector.

Similarly, the ability to immediately deduct the cost of capital equipment purchases makes such transactions more attractive on an after-tax basis. For small and medium manufacturers, the tax savings from so-called "full expensing" can make these purchases more affordable. Unfortunately, the ability to immediately deduct these expenses begins to phase out in 2023.

The NAM respectfully urges this Committee to ensure that manufacturers in America can meet the challenge of growing the sector by keeping business loans and capital equipment purchases affordable. Preventing changes to interest deductibility and full expensing from taking

[11] Ernst & Young, ECONOMIC IMPACTS OF ONE-YEAR EXTENSION OF CARES ACT 163(J) COVID RELIEF (2021), https://www.nam.org/wp-content/uploads/2020/12/EY-CARES-Act-163j-COVID-relief-economic-analysis.pdf (this analysis also finds that a one-year extension of the temporary 50% of EBITDA limit included in the CARES Act would increase U.S. GDP by up to $11 billion and create up to 100,000 jobs).

effect would ensure that the tax code supports the need for new industrial investments required by a growth in manufacturing.

In addition, **members of this Committee should consider the adoption of a broad-based investment tax credit to spur growth in the manufacturing sector**. As noted at this hearing, several bipartisan bills have already been introduced to stimulate investment in critical industries, including semiconductors and batteries. The NAM applauds Senators Stabenow, Cornyn, Warner and Daines for their leadership in crafting proposals that utilize the tax code to encourage investment in modern manufacturing. As the Committee examines investment tax credit proposals, I urge you to consider the following principles:

- Broad applicability – the NAM believes that any investment tax credit must be available to all companies that invest in manufacturing activities in the United States, irrespective of the current location of their operations or place of organization. Any expansion of the U.S. industrial base should be encouraged. As noted above, foreign direct investment plays a key role in supporting the U.S. manufacturing base.
- Stimulate new investments – The activities to which the credit attaches should be broad in scope. Investments in workforce, machinery, equipment and innovation are all key to the long-term success of manufacturing. Each of these items should be given consideration as eligible expenses. Moreover, the amount of the credit should be tied to any cost differential that could sway an investment decision in favor of the United States. For example, recent research indicates that primary costs associated with U.S. manufacturing (labor, real estate, financing and utilities) are approximately 16% higher than the same costs in

other countries that export to America.[12] A broad-based credit that seeks to equalize the core cost of operating domestically with our foreign competitors would match the amount of this differential.

- Seamless integration into existing law – To be effective, any investment tax credit must be as simple as possible to calculate, easy to claim and complement existing tax incentives that are available to all manufacturers, irrespective of size or form.
- Time-limited – A broad-based investment tax credit should be available for a limited number of years. The time to act is now. We must encourage immediate investment in America. Limiting the availability of the credit to investments made in a reasonable period of years after enactment (recognizing the long lead time associated with planning and executing a major industrial project) would send a signal to our competitors that we are ready to secure our supply chains and grow our manufacturing base.

C. Other Policies that Support Domestic Manufacturing

While tax is the focus of today's hearing, other policy changes are needed to spur growth of manufacturing in America. The key priorities of the NAM over which this Committee has jurisdiction include, but are not limited to:

Addressing the workforce challenge. Our industry continues to suffer from a shortage of skilled workers. There have been roughly 500,000 job openings in the manufacturing sector

[12] KPMG, COST OF MANUFACTURING OPERATIONS AROUND THE GLOBE (2020), https://www.themanufacturinginstitute.org/wp-content/uploads/2020/10/cost-manufacturing-operations-globe.pdf.

on average over the past six months, including a record high in October. Moreover, research in 2018 from The Manufacturing Institute and Deloitte noted that 2.4 million job openings would go unfilled by 2028 due to the skills gap,[13] and in our most recent Manufacturers' Outlook Survey, nearly 66% of respondents said that the inability to find talent was a top concern for their business.[14] Tax incentives that support programs to build a pipeline of manufacturing employees are critical to the sector's long-term growth. While outside of this Committee's purview, comprehensive immigration reform is also critical to building the workforce of tomorrow, and I urge members of this Committee to review the NAM's immigration proposal.[15]

Investing in infrastructure: The NAM has called for an investment of at least $1 trillion in our nation's infrastructure to upgrade the systems that support modern manufacturing and increase safety by adopting the benefits of innovative transportation in infrastructure systems. Our *Building to Win* plan provides details on the types of investments needed.[16]

A stable trade regime: Manufacturers of all sizes need U.S. trade policies that allow them to grow operations and jobs here at home, increase business predictability and enhance their ability to reach new customers around the world. Negotiating cutting-edge trade agreements, ensuring commercial enforcement of existing trade agreements (including full implementation of the USMCA), ensuring that China fulfills its obligations under the "Phase One" trade deal, reforming international trade rules and institutions, including the World Trade

[13] DELOITTE AND THE MANUFACTURING INSTITUTE, 2018 DELOITTE AND THE MANUFACTURING SKILLS GAP AND FUTURE OF WORK STUDY (2018), https://www.themanufacturinginstitute.org/research/2018-deloitte-and-the-manufacturing-institute-skills-gap-and-future-of-work-study/.
[14] NAT'L ASSOC. OF MANUFACTURERS, NAM MANUFACTURERS' OUTLOOK SURVEY: FIRST QUARTER 2021 (2021), https://www.nam.org/wp-content/uploads/2021/03/NAM-Outlook-Survey-Q1-2021.pdf.
[15] NAT'L ASSOC. OF MANUFACTURERS, A WAY FORWARD (2019), https://www.nam.org/wp-content/uploads/2019/05/IIHR.ImmigrationReform.Report.2019.FINAL_.pdf.
[16] NAT'L ASSOC. OF MANUFACTURERS, BUILDING TO WIN (2019), https://www.nam.org/wp-content/uploads/2019/05/IIHR.BTW_.2019.v08.pdf.

Organization, and modernizing the U.S. tariff code by enacting a new Miscellaneous Tariff Bill, would all support domestic manufacturers.

Provide regulatory certainty: A stable, tailored regulatory regime is also necessary to support the industry. On average, manufacturers pay $19,564 per employee to comply with federal regulations, or nearly double the $9,991 per employee costs borne by all firms as a whole.[17] This burden falls heavily on small businesses; of the 248,039 firms in the manufacturing sector in 2017, all but 3,914 had fewer than 500 employees, with three-quarters of these firms having fewer than 20 employees.[18] For the smallest firms (i.e., those with fewer than 50 employees), regulatory costs equal $34,671 per employee.

Addressing many other policy matters will be critical to encouraging growth in domestic manufacturing. For example, with respect to highly regulated industries, speeding the required validation of new facilities, processes and ingredients would make the U.S. a more feasible location for investments in new production capacity.

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Thank you for inviting me to testify today. I look forward to continued engagement with members of this Committee as we work to grow jobs, wages and investment in manufacturing.

[17] CRAIN & CRAIN, THE COST OF FEDERAL REGULATION TO THE U.S. ECONOMY, MANUFACTURING AND SMALL BUSINESS (2014), https://www.nam.org/wp-content/uploads/2019/05/Federal-Regulation-Full-Study.pdf.
[18] *Id*.