Senate Committee on Finance
U.S. Senator Orrin Hatch (R-UT), Ranking Member
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HATCH STATEMENT AT FINANCE COMMITTEE HEARING EXAMINING EFFECTIVE WAYS TO PROMOTE AMERICAN INNOVATION THROUGH TAX REFORM

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining a variety of tax incentives and their impact on innovation and economic growth:

Thank you, Chairman Baucus, for holding this hearing. It could not come at a better time. The economic growth that will ultimately drive lasting job creation lags behind that of previous recoveries, and economists increasingly fear that we are at risk for a double-dip recession.

In response to the increasingly dire economic picture, the President recently urged Congress to take up and pass legislation that would promote job growth. For reasons that I will not get into here, individuals from both parties have objected strongly to the President's jobs proposal. However, there are steps that this Congress could take today to start turning the economy around and create American jobs, and those steps begin with the promotion of innovation.

The importance of innovation to job creation is not just a belief of mine. It was a central teaching of the early 20th Century economist Joseph Schumpeter. Schumpeter argued that innovation is essential to economic change and growth.

Of course, research is essential in discovering innovations.

So then the question becomes, how can we be assured that research and development is occurring at a pace that insures innovation and economic growth?

Generally speaking, the answer is by promoting a vibrant free market. A private sector fortified by economic liberty and the rule of law is our strongest engine of economic growth — not the federal government. With a robust private sector, capital flows to innovations and technologies that will profit not only those who invest in them, but society as well.

However, there can be cases where those performing R&D create significant *positive externalities*. Those investing in and performing R&D may create great benefits for society at large. Yet they are not always able to capture much benefit for themselves through increased profits. Though an innovation might be quite valuable for society, researchers and developers are not always able to capitalize on those innovations.

To correct this problem of positive externalities, the government does act to promote research and development in certain limited contexts. One way the government steps in is by awarding inventors patents that give them an exclusive right to sell their invention for a certain set number of years. Sometimes, the government directly funds R&D. This has proven particularly useful with respect to national security.

In addition, for decades the government has also provided tax incentives to promote and reward R&D. Since 1954, there has been a deduction for R&D expenditures. This is a permanent feature of the tax code. The deduction for R&D expenditures is an incentive to perform R&D. It has also proven to be a significant simplification, saving taxpayers and the IRS from having to debate the useful life of intellectual property resulting from R&D.

Since 1981, there has also been a credit for R&D expenditures. The United States' R&D Credit has always been *incremental* in nature. One cannot claim a credit based on all R&D expenditures, but only to the extent one's R&D expenditures exceed a certain base amount. The rationale for this has been that there is no need for the government to give a credit for R&D that would have been done even in the absence of a credit. Instead, the R&D credit has always been focused on the margin, on the increment above and beyond R&D that would have been performed anyway.

This is not the way that all countries structure their R&D tax incentives. Some grant an R&D tax benefit for any and all R&D expenditures.

One of the keys to successful tax policy is permanence. The tax policy goal of economic growth is undercut by temporary provisions. Unfortunately, the R&D credit has always been temporary. It has sunset numerous times over the course of the last 30 years, and is currently scheduled to sunset yet again in a mere three months — at the end of 2011. The temporary nature of the credit significantly undermines its incentive effect.

I am pleased, Chairman Baucus, that you and I introduced a bill just yesterday to extend permanently the R&D credit. I am glad to be joined in this effort not only by Chairman Baucus, but also by a number of our colleagues on the Finance Committee.

As Congress contemplates actions to stimulate job growth, it would do well to start with this hearing today. Reauthorizing the R&D credit, and making it permanent, would be a real lift for our economy.

Again, Mr. Chairman, thank you for scheduling this important and timely discussion.

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