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Testimony

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Before the Joint Economic Committee

On Unleashing America's Economic Potential

April 11, 2018

COMMENTS OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

BEFORE THE

JOINT ECONOMIC COMMITTEE

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Chairman Paulsen, Vice Chairman Lee, Ranking Member Heinrich and members of the Joint Economic Committee, thank you for the opportunity to testify on the economic impacts of tax reform. I will be tackling these issues from a manufacturing perspective.

The National Association of Manufacturers (NAM) is the nation's largest industrial trade association and voice for 12.6 million men and women who make things in America. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturers very much appreciate your interest in, and support of, the manufacturing economy.

I. Recent Economic Trends for Manufacturers

The latest NAM Manufacturers' Outlook Survey, released in December, showed a manufacturing sector with levels of optimism at unprecedented heights. In fact, 94.6 percent of respondents to our quarterly survey said they felt positive about their own company's outlook, the highest in the survey's 20-year history. Moreover, optimism has been at historically high levels across the past year, averaging 91.8 percent in the four quarters of 2017. To put that number in perspective, the average was 64.3 percent in 2016. In the December survey, respondents anticipated both sales and capital spending to increase over the next 12 months at the fastest rates since mid-2011, and employment continues to trend strongly upward.

What's behind those historic levels of manufacturer optimism? Primarily, pro-growth policies emanating from Washington—policies that would allow manufacturers to better compete in the global marketplace: smarter regulatory policies, for one, and the expectation that Washington would succeed in enacting historic tax reform.

Well, Congress did succeed in passing a historic package of tax reforms, which the president signed into law. We've seen the positive effects of this law throughout the economy already. And, while I cannot get into specifics right now, the NAM will release an update to its quarterly survey shortly, and from what we've seen already, it is safe to say that manufacturers remained very upbeat in the first quarter.

Indeed, the manufacturing economy has hit its stride over the past year, with solid growth in demand, output and hiring and a healthy outlook moving forward. Manufacturing production rebounded in February, up 1.2 percent for the month or 2.5 percent over the past 12 months. That was the best year-over-year rate since July 2014. Similarly, manufacturing capacity utilization jumped to 76.9 percent in February, a reading not seen since April 2008. At the same time, total industrial production rose 1.1 percent in February, or 4.4 percent, the highest rate since March 2011.

Improvements in the global economy have also helped to boost manufacturing in the United States, and trade volumes have risen significantly over the past year on the better outlook. In fact, international demand has started 2018 on a positive note, extending the rebound in 2017. U.S.-manufactured goods exports in January and February are 5.0 percent higher than at the same point last year, building on the 4.7 percent increase in 2017 as a whole. That turnaround is certainly an improvement from the declines of 6.2 percent and 4.0 percent in 2015 and 2016, respectively. Manufacturers have also benefited from a weaker dollar, which has boosted export demand.

With a brighter economic outlook, hiring has accelerated. Manufacturers added 22,000 workers in March, with employment in the sector rising by a rather robust 18,733 per month on average since the end of 2016. That is quite a turnaround from the sluggish job growth in 2016. Indeed, manufacturers cited the inability to attract and retain a quality workforce as the top concern in December's survey—the first time it has topped the list since the question was added in 2011. Since the end of the Great Recession, manufacturing employment has risen by 1,179,000 workers, with 12.63 million employees in the sector in March. That is the highest level of manufacturing employment since December 2008.

In my view, the U.S. economy should expand by 3.0 percent in 2018, the fastest pace of growth since 2005. Manufacturers should benefit from stronger economic growth globally, but it is also clear that businesses are responding positively to the passage of tax reform and the changed regulatory environment. In my own estimation, fixed investment in the manufacturing sector should rise by $55 billion this year, with employment increasing by another 104,000.

The rest of my testimony delves into those impacts and includes some examples about how tax reform is enabling manufacturers to invest more in their businesses and their people, helping to stimulate more economic growth.

II. Manufacturing Response to Tax Reform

As I will outline in more detail shortly, the recent tax reform law contained several provisions that provide significant benefits for many manufacturers, primarily:

- A corporate tax rate of 21 percent;
- A reduced tax burden on pass-through business income;
- A move toward an international territorial tax system;
- Robust rules for capital cost recovery; and
- A permanent R&D tax credit.

Prior to the passage of tax reform legislation late last year, U.S. corporations faced one of the highest statutory tax rates in the world. At 35 percent, the statutory rate was the highest in the Organisation for Economic Co-operation and Development (OECD) and the fourth highest in the world.[1] Public Law 115-97 **reduced the statutory corporate rate to 21 percent,** making the United States more competitive by bringing the top rate below the average of the G7 (29.57 percent), G20 (28.04 percent), OECD (24.18 percent) and the European Union (21.82 percent).[2]

[1] *See* Tax Foundation, Corporate Income Tax Rates around the World, 2017 (Sept. 7, 2017).
[2] *Id*.

In addition, the tax reform legislation included two provisions aimed at **reducing the tax burden on pass-through businesses, particularly those engaged in manufacturing.** The bill reduces the top individual income tax rate from 39.6 percent to 37 percent. Moreover, the legislation creates a new 20 percent deduction for pass-through business income. The ability to claim this deduction is limited based on the trade or business in which a taxpayer is engaged. The text of the bill indicates that manufacturers are not engaged in a "specified service" and are therefore eligible to claim the deduction. Moreover, as a taxpayer's income surpasses $157,500 ($315,000 in the case of taxpayers who are married and filing jointly), the ability to utilize the deduction turns either on wages paid or a combination of wages paid and basis in capital equipment. Capital-intensive industries, such as manufacturing, are uniquely positioned to benefit from this provision.

The tax reform legislation **moved the United States away from its decades-old "worldwide" system for taxing international income.** Under the old system, all earnings of a U.S. company were subject to U.S. tax, irrespective of the country in which it was earned. The old system allowed taxpayers to defer the imposition of this tax until earnings were brought back to the United States and allowed for a foreign tax credit to prevent double taxation. However, our high federal rates imposed a significant U.S. tax charge on repatriated earnings, resulting in what is often referred to as a "lockout" effect. The tax reform bill addressed this issue by moving toward a territorial tax system, in which foreign earnings are not subject to additional tax when brought to the United States. In transitioning to this new system, the bill imposes an immediate tax on previously unrepatriated foreign earnings. Moreover, the legislation imposes several anti-base erosion provisions to prevent taxpayers from transferring property offshore to significantly reduce their U.S. tax burden. The adoption of a new system for taxing foreign income raises substantial implementation questions, and manufacturers are engaging with the Treasury Department to work through these issues.

The NAM has long called for tax reform legislation that encourages the capital investment needed to ensure durable economic growth and job creation and promote U.S. productivity and competitiveness. The most effective way to spur business investment and make manufacturing in the United States more competitive is through a strong capital cost-recovery system and a full deduction for interest expense. The tax reform bill provides for **100 percent expensing for capital equipment acquisitions through December 31, 2022,** and phases this incentive out by 20 points per year over five years. In addition, the bill imposes new limitations on businesses' ability to deduct interest expense. Companies are only allowed to deduct an amount of interest that does not exceed 30 percent of earnings. Significantly, the earnings base to which the limitation applies will change. For taxable years starting after December 31, 2017, and before January 1, 2022, the 30 percent limit applies to earnings before interest, taxes, depreciation and amortization (EBITDA). For years starting after January 1, 2022, the limit applies to earnings before interest and taxes (EBIT). This shift will have the effect of further limiting interest deductions for industries that must invest in capital equipment, such as manufacturing.

Manufacturers account for more than three-quarters of all private-sector R&D in the United States. **While the tax reform bill retained the R&D tax credit, it also included provisions that will significantly diminish the value of the current deduction for R&D expenses in the coming years.** The bill would fundamentally modify the treatment of these expenses. For taxable years starting after December 31, 2021, these amounts would no longer be deductible in the year in which the expense was incurred. Rather, these costs would be required to be capitalized and amortized over a period of five years (for domestic research expenses) or 15 years (for research conducted outside of the United States).

In sum, tax reform accomplished a lot of the NAM's long-sought goals. It lowered the marginal rate, making manufacturers in the United States more competitive globally. It reduced the tax burden for many pass-through entities, which account for more than 90 percent of NAM members. It moved the United States toward a territorial tax system, much like the rest of the world. And, it should encourage more dollars flowing back into the United States, expanding fixed investment and incentivizing more private-sector R&D.

While largely positive, tax reform could have gone further to support manufacturing, and I urge you to consider the following suggestions to do so. First, implementing a more robust incentive for pass-throughs would equalize the tax treatment of business income irrespective of the entity through which it is earned. Second, as noted above, the bill phases out full expensing starting in 2023, permanently modifies the treatment of currently deductible R&D expenses starting in 2023 and increases the cost of financing equipment purchases by limiting interest deductions to 30 percent of EBIT starting in 2022. These changes would serve as a disincentive to investment and innovation and should not take effect. Third, Congress should make clear that the Treasury Department has the authority to implement this new law in a manner consistent with its intent. This need is particularly urgent with respect to complex provisions in the international area. Fourth, Congress should continue to reevaluate the international competitiveness of our tax system. As noted above, our corporate income tax rate moved from one of the highest in the world to slightly better than average. Further reductions would serve to make the United States a more attractive place to start and grow a business.

The driving purpose behind tax reform was to create more opportunities for more Americans and to benefit manufacturing workers and their families directly. President Trump called tax reform "rocket fuel" for the economy, and manufacturers strongly agreed.

Prior to passage of tax reform, we asked NAM members what they would do if tax reform were enacted. Nearly 63 percent said comprehensive business tax reform would encourage their company to increase capital spending, and more than half would expand their business (57.9 percent) and hire more workers (53.8 percent), while nearly half would increase employee wages and benefits (48.8 percent).

Now that Congress and the president have done their part to pass pro-growth tax reform and make private-sector businesses more competitive, it is on those firms to deliver as well. Many businesses, including manufacturers, are already doing so by hiring more workers, creating more well-paying jobs and putting more money in the pockets of manufacturing workers. Indeed, nearly every day since the bill was enacted, there have been positive stories that underline these facts anecdotally. Here are just a few:

- Many of you will remember Steve Staub, the president and co-founder of Staub Manufacturing Solutions in Dayton, Ohio, as President Trump mentioned him during the State of the Union address. (If you do not remember him, you likely cannot forget Corey Adams, who has become the most famous welder in the country because of his appearance during the speech.) As a result of tax reform and pro-growth policies in general, Staub Manufacturing has hired 14 new team members, given each employee a pay raise and a larger bonus and expanded its operations by acquiring a building next door to increase its square footage.

- Miles Fiberglass in Oregon City, Oregon, has raised its entry-level wage by 9 percent in 2018, gave all employees a pay bump and will nearly double the size of its workforce. It is also using tax reform savings to design a new facility that will cut back on waste and increase energy efficiency.

- Centennial Bolt in Denver, Colorado, will increase its workforce by nearly 50 percent (from 27 employees to 39) and open a new plant in the Midwest. The company gave a Christmas bonus to all hourly workers totaling about 5 percent of their annual pay, doing so specifically because tax reform had been passed. It is also planning another bonus midyear and introducing profit-sharing to further benefit its employees.

- Windham Millwork in Windham, Maine, is planning to increase its workforce by 20 percent (from 80 employees to 100) and start a $1 million expansion of its facility. It also gave an immediate bonus of $1,000 to its hourly employees and across-the-board pay increases that the company said were a "direct result" of tax reform.

The NAM has highlighted many such tax stories on its blog, Shopfloor.org, and will continue to do so in the coming weeks.

In total, the investments stemming from tax reform will have large impacts on the U.S. economy. I have been working on a model to predict these impacts on the manufacturing sector. Based on my estimates, tax reform should lead to a $55 billion increase in private investment in fixed assets in manufacturing in 2018. That would represent an 11 percent increase over 2017 levels, with manufacturing employment rising by more than 100,000 as a result. In addition, we are in the process of surveying our membership on the impacts of tax reform, and we will release the findings of that analysis in the coming days.

III. Regulatory Relief

Executive Order 13771, often referred to as President Trump's "one-in, two-out" or "net-zero regulatory budget" order, has now been in effect for a little over a year. This executive order marks a significant change in regulatory philosophy compared to that of past presidents from both parties. In President Trump's first year, according to the Federal Register, federal agencies issued roughly half as many rule documents deemed significant under Executive Order 12866 than Presidents Bush and Obama issued in their respective first years.

In President Trump's first year in office, the administration published 23 deregulatory actions with estimated annualized cost savings, excluding those nullified under Congressional Review Act resolutions. Through the end of fiscal 2017, the administration completed 67 actions classified as deregulatory, including rules without estimated annualized cost savings. While these numbers are dramatic, they do not indicate a slash-and-burn approach to deregulation. Instead, they indicate a more methodical approach taking place through the rulemaking process. Perhaps the most noteworthy number through the end of fiscal 2017 is three: the number of new final rules with more than $100 million in burdens on the industry—a historic low.

This methodical approach, and dramatic slowdown in new rulemaking, has likely been an important component in record-high manufacturing optimism. Manufacturers do best when regulatory conditions are certain and stable, because fast-paced and dramatic regulatory or deregulatory actions may introduce new variables and risks into their operations. Simply slowing down discretionary agency actions appears to have had a greater impact than the projected net decrease in per-capita regulatory burdens.

In the NAM's Manufacturers' Outlook Survey, the business climate has continued to diminish as a top concern. This reordering of top concerns mainly reflects manufacturers' recognition that a dramatic change in the policymaking environment has occurred in Washington since the 2016 election. In addition to tax reform, there was a regulatory moratorium last year—a dramatic shift in the federal rulemaking process and one that manufacturers see widely as a positive development.

Manufacturers believe that regulation is critical to the protection of worker safety, public health and our environment. At the same time, our regulatory system needs improvement. We need smarter regulations that minimize unnecessary burdens and better balance benefits and costs, eliminating redundancies wherever possible. Regulations can accumulate with no real effort to evaluate or clean up the outdated and obsolete rules already on the books. It is imperative that policymakers and regulators understand the cumulative burdens that their rules are placing on businesses and enact policies that minimize those costs that do not contribute to the realization of regulatory objectives.

One of the reasons to reform the regulatory process is to acknowledge that burdens are not evenly distributed. Certain sectors, such as manufacturing, bear a sizeable portion of overall regulatory costs in the economy. In addition, small and medium-sized manufacturers experience the burdens of regulation that are significantly greater than their larger counterparts. They lack the economies of scale that larger businesses rely on to spread the costs of compliance. Each dollar that a small or medium-sized manufacturer spends on regulatory compliance is a dollar that the company cannot spend to grow its business or expand its workforce.

We asked our manufacturing members about how the changed regulatory environment has impacted their businesses. More than 38 percent of respondents said that the better rulemaking climate will allow them to increase capital spending and expand their businesses, with roughly 35 percent noting that they could increase employee wages and benefits and hire new workers.

Moving forward, there is also a desire to further reform the way that federal rulemaking is done, hopefully streamlining the process and better including business feedback. We asked respondents if they generally have enough time to understand new regulations before those rules become effective or mandatory, and 54.6 percent said they did not. Nearly 19 percent noted they had been accused of violating a regulatory provision they did not realize applied to them or they did not realize existed. Beyond the awareness issue, nearly 47 percent indicated they have delayed an investment due to uncertainties related to regulations.

IV. Start-Up Rates and the Business Climate

Beyond these issues, I know this committee has focused heavily in recent hearings on declining entrepreneurship rates. I should note that I used to be the chief economist at the Office of Advocacy for the U.S. Small Business Administration, and as such, this is an issue that I care about greatly. Like the broader economy, new manufacturing establishment start-up rates have fallen since the 1990s, and in my view, the business environment plays a large role in helping to explain firm formation rates, especially for those start-ups with employees.

The best way to increase firm formation is to have a growing economy. Policymakers need to adopt pro-growth measures that will enable manufacturers and other businesses to expand, to hire more workers and to invest in more capital spending. A healthy economy will encourage more participants, and that should spur more entrepreneurship and innovation. The recently enacted tax changes and the improved regulatory climate should help to enhance firm formation moving forward. With that said, there is still more that can be done, including adopting other pro-growth measures.

The NAM continues to push for more infrastructure investment, to have a fully functioning Export-Import Bank and for more avenues to enhance workforce development. At the same time, we also do not want to discourage growth by creating economic uncertainties in the marketplace, including on trade matters. The main goal for international trade negotiations should, first and foremost, be to increase opportunities wherever we can, raise standards and ensure strong and binding enforcement tools.

Along those lines, with NAFTA, we have a critical opportunity—depending on the choices we make, we can either boost this growth further or put it all at risk. That is why it is so important to get NAFTA modernization done the right way. President Trump is correct that it is time to make NAFTA better. We at the NAM have put forward a 10-point plan to improve market access, raise standards to improve our competitiveness and strengthen enforcement tools to hold our trading partners accountable. He knows the stakes for the economy, jobs and the stock market if we get this wrong.

V. Conclusion

Chairman Paulsen, Vice Chairman Lee, Ranking Member Heinrich and members of the Joint Economic Committee, thank you for your leadership on the economy and business competitiveness and for holding this hearing.

Manufacturers are benefiting from a growing U.S. and global economy, and strong expansions in demand, output and hiring in 2017 have carried over into 2018—at least so far. The NAM's quarterly survey has recorded its highest levels of optimism in the economic outlook in its 20-year history, and manufacturing production has risen 2.5 percent year-over-year, the fastest rate since July 2014. Workforce challenges top the list of primary concerns for firms of all sizes across the country. Indeed, nearly every manufacturer that I talk to tells me that they are having difficulties finding talent. Along those lines, there were 427,000 job openings in the sector in January—not far from an all-time high.

Pro-growth policies—including tax reform and a changed regulatory climate—have helped to boost economic growth. Manufacturers are benefiting from the improved business environment, which is helping to make the sector more competitive globally. Congress and the president did their part when it comes to tax reform, and the NAM continues to strongly urge its members to continue doing their part as well. Fortunately, we continue to hear positive stories about how tax reform has helped businesses invest more, hire more and pay more to their employees. From my own analysis, I expect fixed investment in the manufacturing sector to rise by $55 billion this year because of the tax law changes.

Therefore, these policies have also enhanced the outlook for a stronger macroeconomy, and I remain bullish about the prospects for growth in the manufacturing sector and for the larger economy. It is important for the president and Congress to look for other ways to enhance competitiveness and pass other pro-growth policies to ensure that our bright prospects can come to fruition. That is—I know—the goal of this committee as well.