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U.S. House of Representatives
Committee on Ways & Means

Hearing on the Need for Comprehensive Tax Reform to Help
American Companies
Compete in the Global Market and Create
Jobs for American Workers

Thursday, May 12, 2011
1100 Longworth House Office Building
Washington, D.C.

Chairman Camp, Ranking Member Levin and Members of the Committee:

I am Ed Rapp, Group President and Chief Financial Officer of Caterpillar Inc. based in Peoria, Illinois. Thank you for the opportunity to present our views on corporate tax reform. It's truly a critical topic that needs to be addressed when considering how to make the United States a more attractive place to invest and create jobs and how to help keep U.S.-based businesses competitive in the global economy.

For more than 85 years, Caterpillar Inc. has been making sustainable progress possible. Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives. The company also is a leading services provider through Caterpillar Financial Services, Caterpillar Remanufacturing Services, Caterpillar Logistics Services and Progress Rail Services. We are headquartered in Peoria, Illinois and have manufacturing facilities, distribution facilities and offices across the United States. In 2010, Caterpillar's sales and revenue totaled $42.6 billion, and we expect that number to exceed $50 billion in 2011.

Much of our success stems from our ability to successfully compete globally from a significant U.S. production base. Approximately 70 percent of our 2010 sales were outside the United States, and we had $13.4 billion in export sales, roughly equal to our U.S. sales. Our global business supports our operations and people in the United States. We directly employ 47,000 people in the United States, our dealer network employs an additional 34,000. We've added more than 7,000 people to our U.S. workforce in the past year. In 2010, we purchased nearly $4 billion from more than 4,900 small and medium-sized businesses[i] in the U.S., making them a key part of our global supply chain. This year, we estimate that we will purchase closer to $5 billion from these firms, making them significant contributors to our exports.

**Competing and Winning from the United States**

The fundamental question at hand for Congress is this: how do we advance the long-term global competitiveness of the United States? For Members of the Ways and Means Committee, I believe that requires making long overdue reforms to the U.S. tax code.

Before I explain more, let me say I did not come to Washington to ask for a free lunch. I am not asking for special treatment, but am simply asking for a level playing field versus our foreign competitors.

As a business, we've had to adapt to effectively compete in today's fast changing global economy. We are constantly improving how we design, build and support our products to compete with strong global competitors. Everything we have done in the past has to be evaluated through a new lens, and policy decisions need to be looked at differently too.

We believe one of the keys to our nation's competitiveness is the success of worldwide American companies. Furthermore, we believe that Americans cannot enjoy a high standard of living without manufacturing being a pillar of the U.S. economy.

From the earliest days as a company, Caterpillar's success has been built upon our ability to compete in markets at home and abroad. We decided more than 60 years ago not to give any competitor free rein in its home market. That decision led us to build the global manufacturing footprint that continues to serve us well today. While our business has grown globally, at the same time we firmly believe that manufacturers can compete and win from a strong U.S.-base. In fact, we are heavily investing to expand U.S. capacity. In 2011, we'll invest roughly $3 billion in our facilities, with $1.5 billion of that in the United States. This has a multiplier effect when you consider the significant investments also being made by our suppliers and dealers from across America to support our plans for growth. We want to continue to invest more here at home and, with your help, we are convinced we can carry the philosophy forward.

Caterpillar's story is not unique. By every important measure, U.S.-based companies with worldwide operations are vital to the U.S. economy. Roughly 25 percent of the U.S. Gross Domestic Product (GDP) comes from these firms and, when you include their U.S. supply chains, it is nearly 50 percent of the U.S. GDP. Worldwide American companies and their suppliers also comprise nearly 42 percent of the jobs in the U.S. and 46 percent of payroll. U.S. multinationals also create jobs that pay nearly 24 percent better than U.S. companies with domestic-only operations.[ii] Worldwide American companies alone account for more than 74 percent of the research and development done by U.S. firms, worth more than $200 billion in 2007.[iii]

The numbers are clear—U.S.-based companies with worldwide operations are critical to the health and growth potential of the U.S. economy. The fact that you called this hearing demonstrates to me the commitment of Congress to help these companies compete through good economic and tax policy.

## Global Competition for Capital

Mr. Chairman, you and I have similar challenges. As a company, we have strong and emerging global competitors. As we work hard to compete, we have to provide our customers with a competitive mix of a great product supported by outstanding service. To the degree we do this successfully, we attract capital to our business which leads to growth, profitability and jobs. As a country, our position relative to the rest of the world has changed and we too have strong and emerging global competitors. Since the end of World War II, the U.S. share of GDP fell from 40 percent to 20 percent in purchasing power parity terms. There are emerging countries that want our jobs and our standard of living.

At the same time, those emerging countries and their billions of people represent potential customers for Caterpillar and other U.S.-based firms. We are in those overseas markets because of the growth potential that it represents for Caterpillar sales. If we cannot compete in those foreign markets, our competitors will gain an advantage they will use to attack us here in the United States.

Again, this is no free lunch. We know we will have to continue to work hard to compete and, to the degree we do this successfully, we can attract capital to our company, which will lead to growth, prosperity and jobs. The same opportunity exists for our country.

**Tax Code Hinders U.S. Companies**

For Caterpillar to continue to be able to compete and win in markets around the world, we need a level playing field. Unfortunately, the U.S. tax code too often tilts the field to the advantage of our growing foreign competitors.

In 1986, the United States took a major step forward when we established a competitive corporate tax rate relative to other countries around the world. However, while we have done little to change since the mid-1980s, other nations of the Organisation for Economic Co-operation and Development (OECD) have dropped their tax rates an average of 19 percentage points during that time.[iv] In 2011, the U.S. maintains one of the highest corporate tax rates in the world and is one of the few remaining countries with a worldwide tax system.

What does that mean for Caterpillar? The high tax rate and worldwide system puts us at a competitive disadvantage against foreign competitors in markets both at home and abroad. It also creates inefficiencies in the way we allocate capital in the United States and around the world. The temporary nature of important tax provisions like the R&D tax credit, active financing exception and look-through also makes it difficult to make long-term business investments with any certainty of our future cost of taxes.

Let me give you some examples.

- In China, the corporate tax rate is 25 percent. If Caterpillar earns $1,000 there, we pay $250 to China. If we bring that money back to the U.S., we must pay another $100 to the U.S. Treasury, bringing the total tax rate to 35 percent. However, if a competitor from the U.K. earns $1,000 in China, it pays only the $250 Chinese tax. The U.K., with its territorial system, taxes only the corporate income earned inside its borders. Thus our competitor has $100 more of profit that can be used for price discounts to grow market share or to invest in capacity or R&D.

- Caterpillar Financial Services Corporation provides financing for Cat equipment all over the world, including products exported from the United States. We've found that Cat Financial gives us an important competitive edge in the market place because they better understand the value of our equipment. The active financing exception allows us to defer the U.S. tax on income earned on financing Cat sales in foreign markets in order to be competitive with local financing options. However, the exception has lapsed and, even when extended, it is only for a couple of years at a time. On a five-year financing contract, we cannot predict whether the exception will be in place over the life of the deal.

- Given the global markets Caterpillar is serving, we need to be able to move capital around the world to meet business needs. Unfortunately, moving cash from a German subsidiary to a French subsidiary, or back to the United States, could cause a U.S. tax. While look-through and foreign tax credits can mitigate that tax hit, it requires implementing complicated and costly monitoring and plans. Conversely, our competitors from countries with territorial systems can deploy capital around the world as needed without the added costs of taxes, or complicated and costly planning.

- Caterpillar spent a record $1.9 billion on R&D in 2010 and will spend more than $2 billion in 2011. But the U.S. R&D tax credit is a temporary provision that has been extended 14 times over the past 30 years, often retroactively. This lack of predictability means we cannot include the benefit of the credit in our business plans. Instead, the credit ends up working like a surprise tax refund. Officials from taxing authorities all around the world regularly visit our offices to offer more generous and predictable tax incentives to do research in their country.

As Caterpillar's CFO, I am not a tax expert, but having lived and worked around the world I do understand global competitiveness. I know if Caterpillar doesn't adapt to meet changing market conditions, we won't attract capital to grow our business and create new jobs. The same is true for the United States and our economy.

**Recommendations for Tax Reform**

I'd like to provide an outline of what we consider a viable way forward. We believe the U.S. economy would benefit tremendously from the right kind of corporate tax reform. While the United States doesn't need to model its tax system on any one country, we do need a tax system that looks more like the rest of the industrialized world.

In our business, when we want to assess our competitiveness versus a key competitor, we take a very simple approach. We buy one of their machines, take it to a test facility and tear it down. As our technicians dismantle the machine, they learn how it compares to a similar Cat product. If we find our competitors have better features or a lower cost, we go back and make improvements to our own machines in order to maintain our competitive edge.

Mr. Chairman, as your Committee continues its work on tax reform, I would encourage you to do a foreign tax code tear down. There are valuable lessons to be learned from tax reform efforts undertaken by other nations in recent years that would be instructive as you look to make improvements to the U.S. system.

As we've looked at tax systems around the world, we see common characteristics we believe ought to be part of any tax reform in the United States.

First, lower the corporate tax rate. As other nations have realized, a significant cut to corporate tax rates would encourage businesses both at home and abroad to invest in the United States.

Second, do away with the worldwide structure and implement a territorial tax system like those in most other industrialized nations. This would provide a level playing field for American companies competing in markets at home and abroad.

Third, provide incentives for the development and retention of intellectual property. By enhancing and making permanent the R&D tax credit, the United States could have a world-class research incentive.

Lastly, give thought to the type of jobs you want in the United States. Other countries have given this serious consideration and built their tax structures around a desire to maintain a manufacturing base versus moving strictly to services-based economies. You need to think this through.

Comprehensive tax reform that addressed these four issues would give us the level playing field we need. Furthermore, making these reforms permanent would give us stability and predictability needed to make long-term plans and investments in the United States.

**Conclusion**

Mr. Chairman, Caterpillar and its employees, dealers, suppliers and investors are betting on you and your colleagues to get this right. Although we have opportunities around the world, we've invested heavily in the United States through bricks and mortar, research and development and, most importantly, our American workforce. We believe that we can win in global markets and compete with any competitor—foreign or domestic. We just need the level playing field that only you can provide.

Thank you for the opportunity to present my views. I look forward to the discussion and questions from Members of the Committee.

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[i] Businesses with 500 or fewer employees.

[ii] Business Roundtable, *The United States Economy Depends on Worldwide American Companies*, July 2009.

[iii] Matthew J. Slaughter, *How U.S. Multinational Companies Strengthen the U.S. Economy*, March 2010.

[iv] PricewaterhouseCoopers LLC, *International Comparisons of Statutory and Effective Corporate Tax Rates*, April 27, 2011.