TESTIMONY OF DAVID FARR, CHAIRMAN AND CEO, EMERSON

BEFORE THE U.S. HOUSE COMMITTEE ON WAYS AND MEANS

Hearing on

"How Tax Reform Will Grow Our Economy and Create Jobs Across America"

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Good morning Chairman Brady, Ranking Member Neal and distinguished members of the committee. Thank you for the opportunity to appear before you and for holding this hearing today on the important subject of tax reform.

My name is David Farr, and I am chairman and CEO of Emerson in St. Louis, Missouri. I also serve as the current chairman of the Board of Directors of the National Association of Manufacturers (NAM). I have been involved in manufacturing my whole life – 36 years with Emerson and over 30 years with my Dad's career with Corning Glass Works.

Emerson is a $14.5 billion global manufacturing and technology company founded in the United States 126 years ago. Emerson has over 80,000 employees and operations in more than 150 countries. Emerson provides innovative products and solutions for customers in industrial, commercial and residential markets. Emerson's Automation Solutions business helps process, hybrid and discrete manufacturers maximize production and protect personnel and the environment while optimizing their energy and operating costs. Emerson's Commercial and Residential Solutions business helps ensure human comfort and health, protect food quality and safety, advance energy efficiency and create sustainable infrastructure.

Over the past 20 years, Emerson has employed a global approach to ensure that products sold in a country also are manufactured in that region as much as possible for speed and cost. I am proud to say that over 80 percent of products we sell in the United States are manufactured in the United States – a strategy we mirror across the globe and a crucial element of being a successful U.S. multinational company with deep U.S. roots and commitment.

The National Association of Manufacturers (NAM) is the nation's largest industrial trade association and a voice for more than 12 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. Both the NAM and I very much appreciate your current efforts to advance pro-growth, pro-competitiveness and pro-manufacturing tax reform – it is truly needed to accelerate U.S. economic growth.

Manufacturers like Emerson have been leading the charge for comprehensive tax reform for more than a decade. While we've seen some positive changes, manufacturers and other businesses in the United States still struggle to compete against our international competitors under an outdated tax system that includes very high tax rates for both corporate and pass-through businesses, arcane rules for taxing international income and a significant compliance burden. Tax reform is a critical issue for my company – and all manufacturers – and I believe we have the best chance in more than 30 years to advance permanent pro-growth reform. It is imperative that we take full advantage of this opportunity to improve our global competitiveness and grow the economy and increase U.S. manufacturing jobs.

An NAM study, *A Missed Opportunity: The Economic Cost of Delaying Pro-Growth Tax Reform*, released in 2015, looks at the potential impact of a tax reform plan that includes lower tax rates for businesses, a robust capital cost-recovery system, a strong research and development (R&D) incentive and a territorial tax system. The study concludes that this multipronged reform package would fuel the economy substantially and result in increased jobs and investment. Over a 10-year period, this plan would contribute more than $12 trillion in GDP, add more than 6.5 million jobs to the U.S. economy and increase investment by more than $3.3 trillion – and I believe this strongly as a CEO of a U.S. based manufacturing company.

Emerson and other NAM members are optimistic that Washington will deliver on tax reform this year. The NAM Manufacturers' Outlook Survey for the first quarter of 2017 showed that manufacturers' optimism rose to a new all-time high in the survey's 20-year history. The rising confidence stems in part from the belief that Washington policymakers will act on pro-growth tax reform as well as much-needed regulatory relief and a significant infrastructure package. Indeed, business leaders are cautiously optimistic that pro-growth policies from Washington will allow the country to emerge from the most sluggish expansion seen in the years since the Great Recession.

Lower Tax Rates for Businesses

The last major overhaul of the U.S. tax code was in 1986. Since then, manufacturers in the United States have innovated, expanded and evolved but the U.S. tax code has not kept pace. In fact, manufacturers in the United States now face higher tax rates on business income than their competitors in all relevant competitor nations. With a combined (federal and state) top statutory corporate tax rate that could exceed 39 percent, manufacturers in the United States face the highest corporate statutory tax rate among the 35 industrialized nations of the Organisation for Economic Co-operation and Development (OECD), far higher than the average OECD statutory tax rate of 23.75 percent.

Meanwhile, top statutory tax rates for some manufacturers organized as pass-throughs are even higher – in some cases, more than 40 percent.

Emerson is a large U.S. taxpayer. Over the past three years, we paid an average $1.8 billion annually in taxes worldwide. Of that, more than half (approximately $1 billion) was paid in the United States at an average effective tax rate of approximately 32 percent and with a marginal rate on each additional dollar of income we may earn of over 37 percent. These high marginal and effective tax rates, and the impact they have on our global competitiveness and ability to grow, invest and create jobs in the United States, are one of the major reasons that Emerson is so engaged in the tax reform debate – we need it to compete and win every day.

A key NAM objective in tax reform, which is shared by Emerson, is to create a national tax climate that enhances the global competitiveness of our nation's manufacturers and encourages investment and job creation in the United States. An important step to achieving this goal is to adopt a top federal statutory corporate tax rate of 15 percent, which would make our nation's manufacturers much more competitive in the global marketplace, encourage greater investment in the United States and promote U.S. job creation and overall economic growth.

Similarly, we also must lower the tax rate for the two-thirds of manufacturers that currently pay taxes at individual tax rates as pass-through entities. Indeed, pass-through companies are the most common business form in the United States and include many companies in the manufacturing supply chain as well as customers of manufacturers like Emerson.

For more than 60 years, many manufacturers and other business owners have chosen to organize as S corporations or other pass-through entities to benefit from comprehensive liability protection and a single level of federal taxation. Since pass-through business income currently is taxed at individual tax rates, many pass-through manufacturers today pay marginal tax rates upward of 44 percent, when you take into account federal, state and local taxes. A lower tax rate for pass-throughs will allow these business owners to stay competitive, reinvest at greater levels in their business and retain and create jobs and support large corporations like Emerson.

Modernizing International Tax Rules

Outdated rules for taxing international income represent another major problem with the current tax code. Emerson's business is global. More than 52 percent of our sales in 2016 were outside the United States, and most of our major competitors are domiciled abroad. Since Emerson is headquartered in St. Louis, the company pays more in taxes on worldwide earnings than our foreign competitors. This makes it harder for Emerson to compete in the global marketplace and also means we are prone to being outbid by our foreign competitors for acquisition targets due to their much lower tax rate and bills.

Despite the benefits of global competitiveness to the U.S. economy, our nation's tax laws clearly make it more difficult for global U.S. companies to thrive and compete in the worldwide marketplace. Most developed countries have territorial tax systems that enable their resident multinational companies to pay little or no additional "home country" tax when they bring back foreign earnings as a dividend to the parent corporation allowing them more funds to invest locally. In contrast, the United States has a worldwide system that taxes income regardless of where it is earned. Thus, global U.S. companies like Emerson generally are subject to taxes in the foreign countries where they are doing business and in the United States when they bring foreign earnings back home.

This added tax burden on global U.S. companies represents a significant disadvantage when U.S. companies are competing for business in a global marketplace. When U.S. companies cannot compete effectively abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from the loss of both foreign market share and the significant U.S. based jobs that support foreign operations.

Thus, any tax reform plan should include a modern territorial international tax system. Territorial systems are now the international norm. Almost all our large trading partners have territorial systems that tax income earned within their borders but do not tax foreign profits that are repatriated back into their own economies. Adopting a tax system that is comparable to tax systems in other industrial countries is critical to the ability of manufacturers in the United States to compete in the global marketplace. A territorial tax system will impact jobs at U.S. operations, increase exports from manufacturers in the United States, improve the efficiency of supply chains and make U.S. based manufacturing more competitive and better positioned to win.

In addition, a territorial system would allow for the free flow of capital back to the United States from foreign operations for reinvestment in the domestic economy. The current top federal marginal corporate tax rate of 35 percent, even though it is partially offset by foreign tax credits at lower tax rates imposed outside the United States, often results in a high U.S. tax charge on earnings repatriated from foreign subsidiaries. This additional charge causes what is often referred to as the “lockout effect” preventing foreign earnings from being brought back to the United States and encouraging investments abroad rather than in the United States.

Spurring Investment

Meanwhile, although business investment has been slowly picking up in recent months, investment levels in the United States are not where they should be. It is critical that any tax reform plan encourages the capital investment needed to ensure durable economic growth and job creation increasing U.S. productivity and competitiveness.

One of the most effective ways to spur business investment and make manufacturing in the United States more competitive is through a strong capital cost-recovery system. Recent data released by the Bureau of Economic Analysis reinforces the role that a healthy manufacturing sector plays in strengthening the nation's economy. Manufacturing in the United States is in the midst of a recovery, but for the nation to benefit fully from this resurgence, manufacturers need tax policies that promote increasing investment and allow them to compete in today's global economy.

For example, a robust capital cost-recovery system would have a very positive impact on capital spending and productivity. Indeed, the positive economic impact of expensing capital equipment is well recognized throughout economic literature. The cost of capital to a firm includes three components: the price of capital equipment, the cost of financing the equipment and the tax treatment of the investment. Expensing lowers the after-tax cost of capital and increases the number of profitable projects a firm can undertake, helping to spur investment, productivity and growth.

Manufacturers of all sizes take into account the tax impact of cost-recovery mechanisms on projected cash flows in making investment decisions. For manufacturers large and small, cash flows are managed carefully to support key growth objectives, and cash flow is critical when access to credit is difficult, especially for small and medium-sized manufacturers. Comprehensive business tax reform that includes pro-investment provisions will help drive the increased growth our economy needs.

Encouraging Innovation

As the head of a large global manufacturing and technology company, I know firsthand how important it is that any tax code overhaul maintains a robust R&D incentive to allow the United States to remain a leader in global innovation. Manufacturers account for more than three-quarters of all private-sector R&D in the United States. The United States has been a leader in promoting R&D for more than 30 years but has slipped behind in recent years as more and more countries have provided more robust R&D incentives – we must regain our global innovation leadership.

A top NAM priority, one that Emerson strongly supports, is to ensure manufacturers in the United States are the world's leading innovators. The tax treatment of R&D, including the current deduction for R&D expenses and a strengthened R&D credit, is critical to achieving this goal. A strong R&D incentive is the only way to keep the United States competitive in the global race for R&D investment dollars. The United States must maintain and expand our innovation leadership.

Conclusion

Emerson and indeed all manufacturers want the United States to be the best place in the world to manufacture and attract foreign direct investment. There is no doubt that the U.S. tax code is a significant negative drag on economic growth and competitiveness. Comprehensive, permanent business tax reform that reduces the corporate tax rate to 15 percent, provides lower rates for pass-through entities, moves to a modern territorial international tax system, maintains a strong R&D incentive, and includes a robust capital cost-recovery system will go a long way to attract this investment and economic growth and our country's competitiveness.

Manufacturers appreciate the magnitude of effort required to reform America's tax code and we are committed to working with you and your staff to advance much-needed reform as soon as possible. Making comprehensive business tax reform a near-term top priority will promote investment in America, enhance the global competitiveness of U.S. manufacturers and other businesses in the United States and ensure durable economic growth well into the future.

Thank you for inviting me to testify before you today as I am passionate about U.S. manufacturing and making sure the United States wins on the global playing field. I am happy to answer your questions.