TESTIMONY OF DAVID FARR, CHAIRMAN AND CEO, EMERSON

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

HEARING ON

TAX REFORM: GROWING OUR ECONOMY AND CREATING JOBS

MAY 16, 2018

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.

A. Introduction

My name is David Farr, and I have been involved in manufacturing my whole life – first, with my Dad, who had a career of over 30 years with Corning Glass Works, and now with my own career of 37 years with Emerson.

I currently serve as chairman and CEO of Emerson in St. Louis, Missouri. Emerson is a $17.5 billion global manufacturing and technology company founded 127 years ago. Emerson has more than 80,000 employees and operations in more than 150 countries. <u>We have over 23,000 employees in the USA, with a U.S. payroll in excess of $1.4 billion</u>. Emerson provides innovative products and solutions for customers in industrial, commercial and residential markets. Our Automation Solutions business helps process, hybrid and discrete manufacturers to maximize production and to protect personnel and the environment while optimizing their energy and operating costs. Our 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 to benefit our customers. I am proud to say that more than 80 percent of the 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.

I also serve as the chairman of the Board of Directors of the National Association of Manufacturers (NAM). The NAM is the nation's largest industrial trade association and the unified voice for the more than 12 million men and women who make things in America. We at the NAM are deeply committed to achieving a policy agenda that helps manufacturers grow, create jobs and spread more opportunity and prosperity throughout the broader economy, which is exactly why we are so appreciative of this committee's work to advance pro-growth, pro-competitive and pro-manufacturing tax reform. Thank you!

Tax reform is already giving a significant lift to the American economy. It is already helping the manufacturing industry significantly expand. Its positive effects are helping all manufacturing sectors, industries and regions. As we see in example after example these days, tax reform is helping strengthen communities, build new career opportunities and increase paychecks for the men and women of America's manufacturing workforce.

These are early days still, but I am encouraged by what we've seen thus far. I'm excited about what tax reform can help bring about tomorrow. But as you know, this magnitude of tax reform will be fully felt in the years to come as the industry re-evaluates all of their global investments and capacities to account for America's enhanced competitiveness.

B. Overview

Almost exactly one year ago today, on May 18, I appeared before you to make the case for tax reform. Manufacturers of all sizes, I noted then, had struggled for years under an outdated tax system with its arcane rules for taxing international income, significant compliance burdens and extremely high tax rates (particularly when compared with the rates of other developed countries). This strained our ability to compete and win overseas. It cost our country jobs. It sapped the strength of our economy and held our workers back. But it seemed obvious that it didn't have to be like this. This is the United States, after all. This is American manufacturing. Lift the burden from the shoulders of American enterprise and you'll see what happens. Put the United States on a level playing field with other countries and watch us take on any challenger. Deliver on permanent tax reform – real, pro-growth reform that slashes rates for both large and small businesses, moves us toward a territorial tax system, includes robust incentives for capital equipment purchases, plus the retention of the R&D tax credit – and watch us be fiercely competitive, grow, hire and invest as the benefits of reform spread far and wide.

Well, you delivered. The tax reform bill you passed represents the most comprehensive rewrite of our tax laws in more than 30 years. It also does the things I just mentioned. No, it isn't perfect. Look closer at my testimony and you'll see several areas in which I argued for tax reform to go much bolder, and we, of course, will continue to advocate for these things too – but let's not lose sight of the big picture. Manufacturers have been urging Congress to reform our tax code for decades. When the moment came, you heard the voice of America's manufacturers – through the NAM – and you got it done. Many in this town, perhaps most, thought it simply wasn't possible. They were wrong. Thank you!

Now, the spotlight appropriately turns to us in the private sector. We rallied for tax reform's passage. We should rightly be expected to come through on tax reform's promise. As NAM President and CEO Jay Timmons told more than 200 manufacturing leaders at the NAM Board of Directors meeting this past February, "Now, it's our responsibility to deliver for America." That's why, just last month, the NAM launched a new national campaign – "Keeping Our Promise" – that is helping tell the story of how, after manufacturers called for tax reform and Washington delivered, manufacturers are already taking up the mantle to help improve lives and livelihoods. I'm sure you've seen many stories that underscore those ideas yourself. For example, it's been mere months since the passage of tax reform, and manufacturers across the country have already increased hiring, raised wages, purchased new equipment, expanded their facilities and invested in their communities – sometimes all of these things at once. NAM members have great stories to tell, and some examples are included later in my testimony.

So that's what's happening already, but what can we expect moving forward? What does tax reform mean for 2018 as a whole? Well, manufacturers have good news there as well. We recently polled NAM members on the impact of tax reform for their own companies, and the responses we heard back were almost uniformly positive:

- 86 percent said they would increase investments.
- 77 percent said they planned to increase hiring.
- 72 percent said they planned to increase wages or benefits.

This is new data that has not been publicly released anywhere else until right now. It's encouraging, it's in line with the anecdotes we've been hearing already, and it's with me at all times these days – on a nice, new palm card I keep in my pocket (and there are plenty more of these cards if you'd like one yourself).

Before I dive deeper into the specifics of tax reform, I want to call your attention to one additional number on that card in my pocket. It's 93 percent.

President Trump referred to tax reform as "rocket fuel" for the economy when he addressed the NAM last year. We certainly agree. For the past five quarters, the optimism levels recorded in the NAM's quarterly Manufacturers' Outlook Survey have reached the highest readings in the survey's 20-year history. In the first results since enactment of tax reform, 93 percent of respondents registered a positive outlook for their company, the second-highest level recorded in the survey's 20-year history – with the highest level reached in the previous quarter, during the midst of the tax reform debate.

In other words, just the *anticipation* of tax reform's passage was enough to foster record-setting optimism among manufacturers. Additionally, optimism this quarter among small manufacturers registered its highest level ever recorded (94.5 percent). The "rocket fuel" of tax reform clearly is continuing to energize manufacturers today with the kind of optimism we have not seen in a very long time.

C. Tax Reform: Provisions That Support Manufacturing Growth

The enactment of tax reform last year represents the culmination of decades of work by policymakers and manufacturers alike. As members of this committee know well, it had been more than 30 years since we last reformed our tax code. During that period, other countries acted decisively, lowering their rates and adopting structural tax system changes that allowed them to better compete for capital and jobs. To put it bluntly, the United States fell behind. American companies desperately needed systemic change to effectively compete in the global economy.

This committee achieved what eluded so many lawmakers over the years. You developed and enacted a pro-growth tax reform bill. I'd like to highlight a few key provisions from that bill that are particularly important to manufacturers:

- **Lowering the corporate rate,** so manufacturers in the United States can better compete globally

- **Reducing the burden on many small and medium-sized companies,** which account for more than 90 percent of NAM members

- **Encouraging more dollars to flow back into the United States by moving us toward a territorial tax system,** much like the rest of the world

- **Setting the stage for growth in the United States,** with robust rules for capital cost recovery and a permanent R&D tax credit

While no bill is perfect – and indeed, tax reform could have gone further – these are substantial changes that put U.S. companies in a much stronger position to compete globally.

Lowering the corporate rate: 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).[1] Prior to the passage of tax reform, U.S. corporations faced one of the highest statutory tax rates in the world. At 35 percent, the statutory rate was the highest among industrialized countries and the fourth highest in the world.[2]

Reducing the burden on many small and medium-sized companies: 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.

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

Encouraging more dollars to flow back into the United States by moving us toward a territorial tax system: 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 includes several new anti-base erosion provisions that increase compliance burden and raise substantial implementation questions. I would urge you to expedite guidance that reflects Congress’s intent of moving to a territorial tax system and encouraging U.S. manufacturing and U.S. jobs. In addition, any expedited guidance should focus on reducing uncertainty, be implemented in the least-onerous manner possible and most importantly, reflect Congress’s intent to make the U.S. more competitive. Manufacturers continue to evaluate these complex provisions.

Setting the stage for growth in the United States: Manufacturers have 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. 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 and a full deduction for interest expense. The tax reform bill provides for 100 percent expensing for capital equipment acquisitions through Dec. 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. The earnings base to which the limitation applies will change significantly. For taxable years starting after Dec. 31, 2017, and before Jan. 1, 2022, the 30 percent limit applies to earnings before interest, taxes, depreciation and amortization (EBITDA). For years starting after Jan. 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. For non-public manufacturers that may not have access to the capital markets, debt is the only source of financing for growth in U.S. manufacturing and increasing U.S. jobs.

Research and development is the lifeblood of manufacturing in the United States. As an industry, our constant innovation yields new processes and products that are widely used around the globe. At Emerson, we have invested nearly $1 billion in R&D over the past three years. <u>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</u>. The bill would fundamentally modify the treatment of these expenses. For taxable years starting after Dec. 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). I would urge you to rethink this change, which makes it costlier to undertake research activities. For the United States to remain the world's most vibrant economy, it is critical that we continue to incentivize R&D.

<u>In sum, tax reform accomplished a lot of manufacturers' long-sought goals</u>. It lowered the marginal rate, making manufacturers in the United States more competitive globally. It reduced the tax burden for many pass-through entities, the entity of choice for many small manufacturers. It encouraged more dollars flowing back into the United States by moving the United States toward a territorial tax system, much like the rest of the world. And it sets the stage for growth, expanding fixed investment and incentivizing more private-sector R&D (at least in the short term).

While largely positive, tax reform could have gone further to support manufacturing, and I urge you to consider the following suggestions.

First, <u>implementing a more robust incentive for pass-throughs</u> would further reduce the tax burden on small businesses, which form the backbone of the manufacturing supply chain.

Second, <u>the bill contains several changes that would serve as a disincentive to investment and innovation and should be repealed</u>, as noted above, such as phasing out full expensing starting in 2023, permanently modifying the treatment of currently deductible R&D expenses starting in 2022 and increasing the cost of financing equipment purchases by limiting interest deductions to 30 percent of EBIT starting in 2022.

Finally, Congress should continue to re-evaluate 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.

More broadly, I urge you to commit to ensuring that our tax system remains globally competitive, both in rates and structure. Manufacturers make investment decisions that have implications over an extended period – decades, in some cases. These investments spur job creation and help sustain local communities. Knowing that members of Congress are committed to ensuring that we have a fiercely competitive tax code would be a very positive factor in investment decisions. Conversely, a willingness to adopt anti-competitive policies, such as rate increases or reducing capital expenditure incentives, would have a negative impact on domestic investment.

D. Manufacturers' Response to Tax Reform

For manufacturers, tax reform represents a new day in America.

As I said earlier in my testimony, we are seeing unprecedented levels of optimism in the industry. This feeling of optimism ripples up and down the supply chain. The combination of lower rates, incentives to upgrade capital equipment and the move toward a territorial system has primed small and large companies for growth, and it has started. Emerson's year-to-date USA sales are up more than 8 percent in our fiscal 2018.

Immediately after the passage of tax reform, I asked all members of the NAM to provide feedback on their response to the bill. The results, as I noted earlier in my testimony, were overwhelmingly positive:

86 percent said they would increase investments.

77 percent said they planned to increase hiring.

72 percent said they planned to increase wages or benefits.

But the impact goes far beyond the numbers. Manufacturing provides a path to greater prosperity for millions of Americans. The average manufacturing worker earns more than

$82,000 a year in wages and benefits, which is nearly 27 percent higher than nonfarm workers as a whole. Manufacturers' commitment to hiring more workers and making the investments necessary for future growth means that more of these well-paying jobs will be available.

And manufacturers are often key anchors of their community. Even though we're only months from passage of the bill, we're already seeing how manufacturers are responding locally. At Emerson, we are investing in our people and our U.S.-based manufacturing. In addition to a 2.9 percent general wage increase worth $42 million, we enhanced our benefits, retirement fund contributions and charitable contributions by nearly $40 million. We'll continue to evaluate future additional employee benefits as we move into fiscal 2019. We have also increased our U.S. capital spending plan by 20 percent to $350 million from our past three years' average capital spend of $290 million.

Here are some more NAM member examples:

Ariel Corp. of Mount Vernon, Ohio gave an across-the-board raise of 13 percent to its employees and plans additional performance-based raises of 4.25 percent this year. It is also helping to revitalize the downtown area of this small community and funding a workforce development initiative that recently saw its first class of 22 students graduate.

Centennial Bolt of Denver, Colorado gave a 5 percent bonus to its employees in December and will provide another bonus this summer. The company is also growing its workforce by 30 percent, completely overhauling its production, expanding to a new location in the Midwest (which will make a product that's currently manufactured in China) and is supporting a new 150-bed women's shelter to serve Denver's homeless population.

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.

And, of course, there is **Staub Manufacturing Solutions in Dayton, Ohio.** Some of you may remember Steve Staub, the co-owner of this small manufacturing company, who was a guest of the First Lady at this year's State of the Union address. As Steve explained in his own Hill testimony this month, small companies like his are roaring back and growing at a rapid clip – thanks in many ways to pro-growth policies out of Washington, like tax reform. At Staub, they have already hired 14 new team members, given each employee a pay raise and a larger bonus and are expanding their capacity for further growth by acquiring a building next door.

These are just a few of the many examples we're seeing around the country of how businesses are investing more, growing more, hiring more and paying more – of how manufacturers are already improving lives and livelihoods thanks to tax reform. It's what the NAM calls "Keeping Our Promise." It's what manufacturers in the United States intend to continue doing. And, if you're interested in finding out more, go to **NAM.org/taxstories.**

E. Conclusion

I am passionate about growing U.S. manufacturing. I am passionate about making sure the United States wins on the global playing field. And, when I sat here a year ago, our country had a tax code that made these things harder. That's why I advocated for the passage of pro-growth tax reform. I said that tax reform would 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. You did your part to deliver a pro-growth tax code — thank you. Now manufacturers are doing their part to expand, hire and grow.

The benefits of tax reform are already spreading to large and small manufacturers alike, with the NAM recording record-setting levels of optimism for each of its quarterly surveys.

The benefits of tax reform are already helping to improve the lives of the men and women who make things in America, with example after example across the country, plus the new survey numbers I released today, underlining this encouraging trend.

And this is just a few months after tax reform was signed into law. There is good reason to be even more optimistic about what we can expect tomorrow. I know I certainly am. I know the men and women at Emerson feel that way. I'm sure colleagues at the NAM feel the same.

Manufacturers called for the passage of tax reform for many years. Now, it has finally happened. Was it perfect? No. Did it represent the type of "rocket fuel" our country needed anyway? Absolutely. It's a great achievement for our country. We thank you for your dedication to getting it done. And, I thank you for inviting me to testify before you today. I am happy to answer your questions.