Tax Reform Must Promote Innovation, Production, and Job Creation in America

ALLIANCE FOR american manufacturing

AAM Framework for Action on Tax Reform:

The Alliance for American Manufacturing (AAM), representing both management and labor, urges the Congress to make the goals of economic prosperity and growth the central focus of the tax reform process.

The tax code has a significant impact on the operations of U.S. companies and their decisions as to where to invest, innovate, produce and create jobs. The goal of tax reform must not simply be a broadening of the tax base to lower tax rates. Tax reform should, more importantly, have the goals of enhancing economic growth, improving the climate for our nation's productive sector and creating a long-term path to future prosperity for companies which operate in the United States, their workers and the communities in which they work and live.

Manufacturers have a particular stake in the shape of the corporate tax code for several reasons:

- Manufacturers face competitive pressures from overseas in a way that many service providers do not. Most of America's global competitors provide rebates for their exporters through a valued-added tax (VAT) system that may confer as much as a 17% tax benefit and they apply the VAT to our exports into their markets. Since our low tariff rates and foreign investment guarantees make the relocation of manufacturing activity increasingly attractive, our tax code should be structured in such a way to incentivize manufacturing activity here in the United States.

- Manufacturing is capital intensive, which often requires substantial borrowing and a long-term horizon for a return on investment. The existing tax code recognizes this through accelerated depreciation and other cost recovery mechanisms.
- Manufacturing activity ebbs and flows along with the business cycle, which means the tax code should include mechanisms for allocating losses in a reasonable manner.

There is also compelling evidence suggesting that the productive sectors of our economy provide substantially more beneficial impacts on our overall economy than certain other forms of economic activity. For example, manufacturing jobs offer more middle-income opportunities for American workers. The "multiplier" factor of manufacturing activity—the number of additional jobs created by each primary job in manufacturing—far exceeds other types of business activity. The relationship between the location of manufacturing and associated research and development is well established: innovation and manufacturing go hand-in-hand and if we want to continue to lead on innovation, we must ensure the strength of domestic manufacturing. Goods production accounted for 71 percent of America's exports last year. Put simply, manufacturing activity cannot be replaced by any other type of economic activity.

Manufacturing is the foundation upon which a country's economic strength and national security depends.

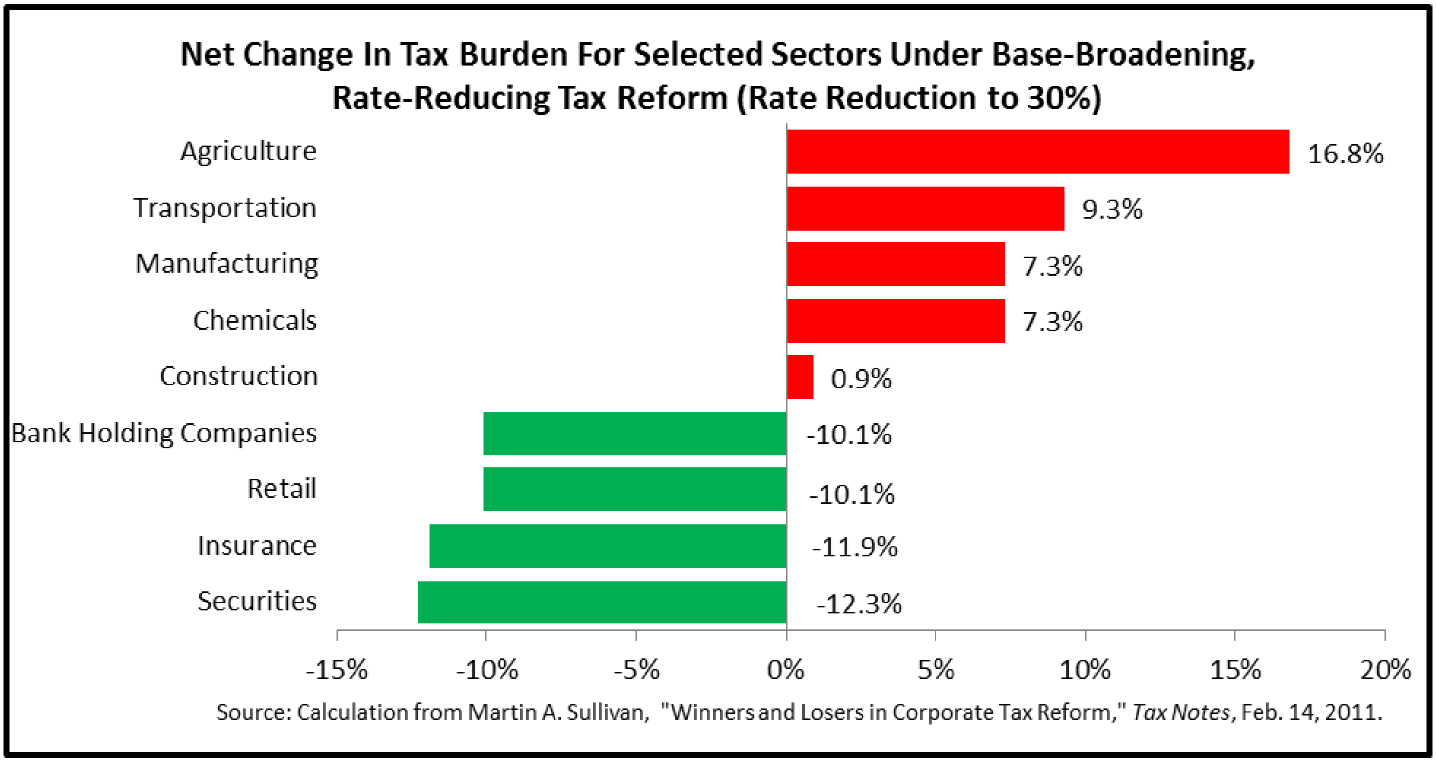
For that fundamental reason, previous Congresses and Administrations, led by both parties, have worked diligently to support manufacturing in a fair way through the tax code. Those leaders recognized that America increasingly faces global competition, and for our workers to be able to succeed against that competition in the free and open trading system that the United States stands for, the American tax system must incentivize investment and production. The sentiments that have driven this pro-jobs thinking are as correct today as in the past.

In fact, faced with growing subsidization from trading competitors around the world and the rise of "state-capitalism", those incentives are even more critical than ever. So the first goal of corporate tax reform should be: "Do no harm!"

An approach based on the goal of reducing overall corporate rates while "paying" for those reductions through the elimination of long-held incentives creates winners and losers.

Simple rate reduction and base broadening would result in severe damage to manufacturing and would primarily benefit less productive and lower hourly-wage employment industries.

A study published in the respected journal *Tax Notes* identified the following representative industries in terms of the benefits of a simplistic base broadening, rate reduction effort that would slow depreciation, repeal the domestic production and research credits, and set the new rate target at 30%. The chart below demonstrates the expected percent change from their tax burden:



Source: Calculation from Martin A. Sullivan, "Winners and Losers in Corporate Tax Reform," *Tax Notes*, Feb. 14, 2011.

Based on these compelling numbers, simply reducing rates and broadening the base will result in a significant tax increase on some of the most productive, job intensive sectors of our economy.

The lingering impact of the financial crisis and subsequent recession has left America with a lackluster recovery. While manufacturing employment has increased slightly, it is still on somewhat of a month-to-month rollercoaster and, over the last decade is still facing a deficit of more than 5 million workers. Over that same period, more than 63,000 factories have been shuttered, resulting in the downsizing, offshoring and outsourcing of countless products, and incalculable damage to families and communities throughout the country. Further, according to an official study prepared by the Department of Commerce's Bureau of Economic Analysis, multinational firms over the ten-year period ending in 2009 reduced their employment in the United States by 2.9 million workers while increasing their overseas employment by 2.4 million workers.

Tax reform must support rather than undermine domestic production. As the facts above show, manufacturing, agriculture and other industries that actually produce things would see their tax burden increase significantly if tax reform simply eliminated deductions and credits and used the resulting revenues to lower tax rates. America's long-term economic success and the future opportunity for our workers depend on a tax code that supports and promotes investment in innovation, production and job creation in the United States. Tax reform must be focused on achieving those goals.

To achieve the goals of job protection and creation supported by both political parties, any tax reform effort must preserve and/or strengthen:

- A capital cost recovery system that promotes domestic investments in plant and equipment such as the current accelerated cost recovery system (ACRS);
- The Section 199 manufacturing credit that stimulates domestic investments tied to domestic-job creation criteria. Some proposals have suggested deepening this credit, which AAM supports;
- The ability of companies to use the last-in/first-out inventory accounting methodology so that they are best able to manage their changing input costs with the customers to whom they sell;
- The ability of companies to continue to deduct the interest they incur in borrowing to invest in ensuring the success of their business. Just like a homeowner who must borrow to afford the house in which they will raise their family, to succeed companies must borrow to buy plant and equipment and farmers must borrow to buy implements and seed. Robbing producers of the ability to deduct the interest they must pay on borrowed funds would decimate our economy.
- The ability of companies to use tax attributes such as net operating loss and minimum tax credit carryovers. The size of the investments that companies make in plant and equipment, in addition to other factors, may subject a company to a loss thereby jeopardizing their ability to fully recoup the value of their investments. These investments are critical to promoting innovation, production and job creation here and the full value should be eligible to offset income in future years.
- The ability of companies to plan for the future. Existing investments must not be penalized and uncertainty must be minimized. Large capital investments are made not on the basis to recoup those investments in the next quarter, but over a multi-year period. Tax reform must promote long-term investment and success.

It is highly likely that an exercise of lowering the corporate tax rate in a revenue-neutral manner through eliminating credits and deductions utilized by goods-producing industries would result in more offshoring, reduced incentives for manufacturing activity in the United States, and as a result, the loss of innovation, know-how, and a solid driver of economic growth. The public is interested in job creation and reclaiming the American Dream. That requires that America's productive sectors—manufacturing and agriculture—succeed. Investments in ensuring the success and growth of those sectors must be the key goal and should drive decision-making.

Congress and the Administration should pursue tax reform not as a "bookkeeping" exercise but with serious consideration as to its consequences on people and the productive segment of America. Tax reform should continue the efforts of both parties to create jobs, further competitiveness, and assure a bright future for those engaged in making the things that make America great.

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