Pennsylvania Manufacturers' Association

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Pennsylvania Business Competitiveness

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Thank you, Madam Chair Donna Oberlander and members of the Pennsylvania House Majority Policy Committee for allowing me to join you today.

I'm David N. Taylor, President and CEO of the Pennsylvania Manufacturers' Association, the century-old, Harrisburg-based, statewide trade organization representing the people who make things here in the commonwealth. Manufacturing is the engine that drives Pennsylvania's economy, adding over $87.5 billion in gross state product each year, directly employing more than a half-million Pennsylvanians on the plant floor, and sustaining millions of additional Pennsylvania jobs through supply chains, distribution networks, and vendors of industrial services. These high-value, family-sustaining manufacturing jobs have above average wages and benefits, which is why Pennsylvania's decision-makers should keep in mind the effect policy changes would have on this sector of our economy.

PMA's mission is to improve Pennsylvania's economic competitiveness by advancing pro-growth public policies that reduce the baseline costs of creating and keeping jobs in the commonwealth, including spending restraint, tax relief, limits on lawsuit abuse, regulatory reform, and ensuring a prepared workforce.

These tenents of competitiveness are what we advocate for because with sound public policies in these areas, business investment will flow to our commonwealth because it will be the smart business decision to locate, hire, and expand here rather than in one of our competitor states.

However, competitiveness does not happen in a vacuum. Other states are competing for business investment and are constantly legislating, changing, and innovating to bolster their state's economy.

Spending restraint

When government grows faster than the private sector it's difficult to attract business investment. The reason is simple: there is a high level of uncertainty and unpredictability in regard to tax policy. Almost as important as the tax rate itself, tax predictability is paramount to a business's operation. When siting business development, the financial health of the commonwealth will surely be assessed, and issues such as a $70 billion public pension liability are surely noticed.

Less than a year ago, the Mercatus Center at George Mason University ranked Pennsylvania's overall fiscal health at 35th in the nation. The topline from this report states, "On the basis of its solvency in five separate categories, Pennsylvania ranks 35th among the US states for fiscal health. Pennsylvania has between 0.69 and 1.39 times the cash needed to cover short-term obligations, well below the US average."[1] Details further explaining the ranking are cause for concern.

- Cash solvency measures whether a state has enough cash to cover its short-term bills, which include accounts payable, vouchers, warrants, and short-term debt. (Pennsylvania ranks 47th.)
- Budget solvency measures whether a state can cover its fiscal year spending using current revenues. Did it run a shortfall during the year? (Pennsylvania ranks 31st.)

[1] Norcross, Eileen. (October 9, 2018) "#35 – "Ranking the States by Fiscal Condition: Pennsylvania." Mercatus Center at George Mason University. https://www.mercatus.org/statefiscalrankings/pennsylvania

- Long-run solvency measures whether a state has a hedge against large long-term liabilities. Are enough assets available to cushion the state from potential shocks or long-term fiscal risks? (Pennsylvania ranks 37th.)
- Service-level solvency measures how high taxes, revenues, and spending are when compared to state personal income. Do states have enough "fiscal slack"? If spending commitments demand more revenues, are states in a good position to increase taxes without harming the economy? Is spending high or low relative to the tax base? (Pennsylvania ranks 23rd.)
- Trust fund solvency measures how much debt a state has. How large are unfunded pension liabilities and OPEB liabilities compared to the state personal income? (Pennsylvania ranks 24th.)[2]

Rightsizing state government and realizing the importance of the overall fiscal health of the commonwealth is the only way to ensure tax stability and predictability into the future.

Tax Relief

There are several policy changes that ought to be made to Pennsylvania's business taxes to maximize business investment. First, Pennsylvania's highest-flat-rate-in-the-nation corporate net income tax (CNI) rate of 9.99 percent must be lowered. Second, the 40 percent cap on net operating loss (NOL) must be lifted. Third, that the continuous push by the Wolf Administration to make Pennsylvania a mandatory unitary combined reporting (MUCR) state cease. And fourth, enacting legislative oversight on Pennsylvania Department of Revenue rulemaking is needed.

The sticker shock of Pennsylvania's 9.99 percent CNI is enough to make site selectors render Pennsylvania uninvestable. High performing states such as Utah are lowering corporate and individual tax rates seeing that the Federal Tax Cuts and Jobs Act will bring enhanced revenue to state coffers through overall economic growth. In 2018 analysis by the American Legislative Exchange Council, it was stated that, "The tax reform legislation signed into law weeks later addressed this problem by reducing the individual and corporate income tax rates by 0.05 percent. This cut represents nearly $84 million in tax revenue, more than covering the windfall amount from federal reforms."[3]

Only two states, Iowa and New Jersey, have corporate tax rates higher than Pennsylvania's 9.99 percent, but those states have a tiered/bracketed system of taxation. Only the top tier in both aforementioned states exceeds Pennsylvania's rate.

On the issue of NOLs, Pennsylvania is one of only three states to enforce a cap at all, the other two states being New Hampshire and most recently, Illinois. Industries that have large, upfront investments are at a disadvantage when locating in Pennsylvania compared to our competitor states because of this policy. The industries that are most impacted by NOL caps require large upfront investments such as: manufacturing, life sciences, and high technology (server warehousing, software development).

The Wolf Administration continuing to push for Pennsylvania to become a MUCR state limits business competitiveness. Report after report and study after study shows that Mandatory Unitary Combined

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[2] Ibid.
[3] Griffith, Joel. (2018). Utah State of the State: Acting today with the Future in Mind. ALEC.org. Retrieved from: https://www.alec.org/article/utah-state-of-the-state-acting-today-with-the-future-in-mind/

Reporting adds complexity and compliance costs but generates no windfall for state revenues – especially in states that already have add-back provisions, such as Pennsylvania.

MUCR permits a state to tax income earned outside of its boundaries. This would surely result in tax returns to the Department of Revenue turning into a highly litigious and overly complex activity. Add to this the fact that in order to appeal the tax assessment, the payment must be first put into escrow by the corporate party in dispute. California is still litigating MUCR cases from the 1980's.

Experts are skeptical of this change from separate-combined reporting to unitary-combined reporting.

The American Legislative Exchange Council (ALEC) has published that MUCR creates additional administrative burdens for reporting corporations and state tax administrators by creating an economic drag on the state economy and an instills unneeded increase in state government bureaucracy. They argue that states generally compute taxable income separately for each corporation that has taxable presence in the state, which is what separate reporting already does, ensuring that only income earned in the state is taxed in the state. MUCR would subject corporate income earned in the state to tax but may also subject income earned by related, out-of-state corporations to tax. This results in an unjust and overreaching increase to the state's overall tax base.[4]

The Council on State Taxation (COST) argues that MUCR is not the right solution for the problem of how to accurately determine multistate business income attributable to economic activity in a state. MUCR may have a negative impact on a state's overall economy, through fewer jobs or by higher prices for goods and services. COST also argues that MUCR will lead to a significant administrative burden. The first major burden is that a "unitary business" group is universally poorly defined. Although unitary businesses are constitutional, under due process, the concept looks at the business as a whole rather than individual separate entities or separate geographic locations. Another burden is that auditors must annually determine how a taxpayer and its affiliates operate at a fairly detailed level to determine if affiliates are unitary. Determining the scope of a group is complicated, subjective, and costly. Under separate reporting states, this process is not required, and unitary reporting often results in expensive, time-consuming litigation.[5]

Keep in mind that the Pennsylvania Department of Revenue already possesses add-back provisions that allows the department to pursue financial transactions that it deems suspect to avoid tax liability.

Lastly, because of recent decisions by the Pennsylvania Department of Revenue, it's clear that legislative oversight on department rulemaking is necessary.

In the afternoon of the Friday before the Christmas holiday of 2017, Governor Wolf's Department of Revenue unliterally made a rule stating employers could not depreciate an asset until it was sold or decommissioned. This change was made retroactively, back to September 27, 2017. This put Pennsylvania businesses at a unique competitive disadvantage, was stunningly punitive, and rendered Pennsylvania uninvestable. Moreover, Pennsylvania was the only state to implement such a change. And though this rule was fixed by the legislature with the passage of the Fiscal Year 2018-19 budget, we'll never know how much potential business investment Pennsylvania missed out on while the rule was in

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[4] American Legislative Exchange Council. (2014) "Resolution in Opposition of Mandatory Unitary Combined Reporting." https://www.alec.org/model-policy/resolution-opposition-mandatory-unitary-combined-reporting/

[5] Council on State Taxation, Ernst & Young LLP. (2011) "Understanding the Revenue and Competitive Effects of Mandatory Unitary Combined Reporting." www.cost.org

place. Therefore, one of PMA's calls to action in this hearing is that there ought to be legislative review of the rulemaking by the Pennsylvania Department of Revenue.

As stated before, we often hear from companies that more important than the tax rate itself is the predictability of tax rates, treatments, and processes. The erratic rulemaking by the department in this instance calls for legislative review of future rule changes so that employers have more predictability and certainty in their state tax planning in the future.

Limits on Lawsuit Abuse

Philadelphia has been perpetually ranked amongst the nation's top "judicial hellholes" for its penchant to allow frivolous lawsuits to go forward while juries give super-sized damage awards. Pennsylvania's problems, however, are not limited to the confines of the City of Brotherly Love.

Lawsuit abuse and a runaway legal system is a hidden cost of doing business in Pennsylvania. To be competitive, Pennsylvania must enact reforms to make the state's legal system fair, predictable, and even-handed. True, permanent, and comprehensive legal reform would create jobs and stimulate investment in the commonwealth while actually reducing the expenses of state, municipal, and school district governments. Injured parties must be treated fairly, but justice doesn't have to come at a price that threatens innovation, competition, and profitability.

PMA is a proud and founding member of the PA Coalition for Civil Justice Reform (PCCJR). The PCCJR is a statewide, nonpartisan group of organizations and individuals representing businesses, health care, public service, taxpayers, and other perspectives. We are dedicated to bringing fairness to our courts by elevating awareness of civil justice issues and advocating for legal reform in the legislature.

Pennsylvania's civil justice system faces increasing challenges – with a lack of balance in certain laws, legal precedents, and courtrooms. These challenges affect all Pennsylvanians, as an unfair lawsuit system raises consumer prices, takes away good jobs, and reduces our access to health care. The top issues being followed by PMA and the coalition are: asbestos trust transparency, limiting runaway state and federal false claims acts, stopping venue shopping, transparency in private attorney hiring, innocent seller provisions, updating outdated statute of limitations provisions, and many other critical and needed reforms.

Regulatory Reform and Resource Availability

It is imperative that Pennsylvania not enact laws or regulations that place Pennsylvania at a competitive disadvantage to our competitor states. Laws and regulations should not be more stringent than federal regulations or laws unless there is a compelling reason that is unique to our commonwealth. Pennsylvania is fortunate to have abundant natural resources. Individuals have been and continue to be attracted to the Keystone state because of the vast choices for outdoor recreation and quality of life. Likewise, many of those natural resources have been the source of prosperity for the state throughout different points in our history.

Members of the business community recognize that without a healthy and sustainable natural environment, it is difficult to maintain and attract high quality employees. It is equally important to ensure that environmental regulation is approached on sound scientific evidence to ensure that regulations are reasonable and within technological limits. It is likewise prudent that these regulations actually achieve real environmental benefits and do not advantage one sector of the economy to the detriment of another.

We continuously hear from our members that permitting processes in Pennsylvania are much slower than the national average. Having to wait months and sometimes years to begin to develop a project means opportunity costs that will never be recouped. This is a hidden but significant added cost of doing business in our commonwealth and it's completely avoidable.

However, there is an enormous opportunity in front of us if we choose to adopt a pro-production, pro-development agenda in Harrisburg.

No matter what product is being made, manufacturers are taking raw materials or component parts and managing a multi-state process to yield a finished good. In doing so, they are almost always deploying some kind of chemical process and consuming a large amount of energy. For some manufacturers, energy is their most expensive cost input, which is why manufacturers require available, affordable, and reliable energy.

Pennsylvania's manufacturers need energy to power our facilities. Pennsylvania's manufacturers want Marcellus Shale feedstocks of ethane, butane, propane, and natural gasoline for petrochemical manufacturing. We have these resources in Pennsylvania but because of an outmoded pipeline system that is pointed toward the Gulf of Mexico, we can't get the volumes we need from one part of Pennsylvania to another.

Additionally, the natural gas byproducts of ethane, butane, propane, and natural gasoline are the building blocks of modern manufacturing and yield a wide spectrum of consumer goods. For example, ethane becomes ethylene, which then can become plastics, rubbers, textiles which are then turned into electronics, cosmetics, pharmaceuticals, auto and aero parts, paints, solvents, glazes, sanitary products, and countless other products that we utilize every single minute of every day. This is just one component of natural gas and one manufacturing input, so it's clear that the opportunities are limitless. Consider the fact that butane becomes butylene, propane becomes propylene becomes polypropylene, and the opportunity for Pennsylvania to be the epicenter for manufacturing inputs, feedstocks, and ultimately consumer goods is here and now. These feedstocks are themselves manufactured goods, but they also represent the beginning of the value chain for almost all of modern manufacturing.

In December of 2017, Braskem USA chose Texas over southeastern Pennsylvania for a $500 million capital investment because of a lack of pipeline capacity to access those natural gas byproducts AND a lack of confidence in DEP's willingness to approve a new pipeline within a reasonable time period. We missed out not only on a half-billion dollars of production capacity but all of the economic dynamism that would have come from it in the years ahead. In fact, new capital investment in American energy production is proceeding at a very rapid rate, with tens of billions of dollars going into the Gulf Coast states. But that investment is not coming to Pennsylvania.

At PMA, we are not shy about what we want: we want every last rivet of infrastructure, every last BTU of energy, and every dollar of investment and economic growth for this industry here in Pennsylvania. Because if we can maximize domestic energy production and connect it to our industrial, commercial, and residential consumers, it can be Pennsylvania jobs all the way down. Jobs on the well-pad, jobs at the steel mills making the plate that goes to the pipe-making facility to be made into pipeline, jobs for the operating engineers and steamfitters and boilermakers who assemble and service those pipelines, jobs at the manufacturing plants, jobs at the refineries, even potentially jobs at the shipyard making the vessels that would carry Pennsylvania energy products and manufactured goods to new markets overseas.

Now is not the time to impose new taxes and fees on Pennsylvania's energy industry. Even the perpetual threat by Governor Wolf's administration, year after year, to introduce new, additional taxes on Pennsylvania energy production is enough to turn investment away from our commonwealth. New taxes and fees kill jobs. New taxes hurt business and could result in higher prices to consumers. Higher taxes and fees are a burden felt throughout the economy and discourage business expansion, investment, and job creation. Now more than ever our nation needs to move away from the energy politics that have failed so badly over the past decades and put our nation's own resources to work for American consumers.

While Pennsylvania does not have a severance tax, we do have an impact fee, and the impact fee has distributed over a billion dollars to communities across the commonwealth. But as mentioned before, the more important question is the total cost of doing business. While Texas has a severance tax, Texas has no corporate net income tax and no personal income tax. Texas also has in place a vast modern network of pipelines, an expedited permitting process, meaningful limits on lawsuit abuse, and other pro-growth, pro-production policies.

If we want to bring manufacturing jobs back from China and complete with other states for investment, Pennsylvania needs to bring to bear the maximum advantage of domestic energy and petrochemical manufacturing inputs. We can realize new businesses investment, higher earnings, additional jobs, and rising wages will bring in the money state government needs at existing rates if we optimize policy for economic growth and prove to investors that we want them to come here.

Prepared Workforce

Nationally, manufacturers are facing an alarming problem: our workforce is aging and retiring and there is a shortage of skilled hands to succeed them. Pennsylvania is no exception to this problem. According to our sources at the Manufacturing Institute, in 2018, there were 71,607 manufacturing job openings in the state of Pennsylvania. On a consistent basis, there are approximately 6,000 job openings in the sector in the state.[6] Couple the current shortage with the fact that some companies have more than half of their current workforce within just a few years of retirement and we could consider this workforce gap problem a workforce gap crisis. The manufacturing industry and the workforce at large face an increasingly pressing problem: the glut of unfilled jobs due to a skills gap.

According to a recent study by the Manufacturing Institute, 51 percent of manufacturers report difficulty in maintaining or increasing production levels to satisfy growing customer demand.[7] This challenge is systemic. This 2018 study remains one of the paramount publications on the topic and in the report, they came to five main conclusions:

1. The hardest jobs to fill are those that have the biggest impact on performance.

[6] Mortay, Chad. Manufacturing Institute. Personal communication, February 12, 2019
[7] Manufacturing Institute. "2018 Skills Gap Report." National Association of Manufacturers. November 2018. https://operationalsolutions.nam.org/mi-skills-gap-study-18/

2. While they recognize the importance of recruiting and developing talent, many manufacturers depend on outdated approaches for finding the right people, developing their employees' skills, and improving their performance.
3. Computer skills, programming skills, digital skills, working with tools, and critical thinking are needed to be successful, but are lacking in today's workforce.
4. The changing nature of manufacturing work is making it harder for talent to keep up.
5. The national skilled job shortage will result in 2.4 million vacant jobs in the next decade.

The numbers speak for themselves – there are more manufacturing jobs available in Pennsylvania than the qualified individuals our state's education system is able to produce. The past academic year (2018-2019), only 81.4% of seats available to high school students were utilized in career and technical education facilities (CTE).[8] I have visited, firsthand, some of the finest manufacturing training institutions in the United States that just happen to be right here in Pennsylvania. On a recent visit to the Pennsylvania College of Technology in Williamsport, Pennsylvania, an instructor in the Mechatronics Engineering Technology Department told me that they held a job fair for their two-year, Associate of Applied Science degree students. In total, there were 479 job opening and they had twelve graduates. These are good paying, family sustaining, meaningful, collaborative, problem-solving, highly fulfilling jobs and 467 of them will go unfilled. When asked what the biggest challenges are when recruiting students, CTE directors and program directors of Associate/Certificate programs have continuously stated perception of CTE education or a lack of manufacturing career opportunity awareness. Additionally, there are anecdotal stories of high-scoring students being steered away from CTE opportunities because the home school district wants that student to complete standardized tests, often associated with state funding, at their school rather than the CTE.

Unfortunately, this is not an anomaly. Program after program at institutions such as Pennsylvania's highest performing CTEs, the Pennsylvania College of Technology, and Thaddeus Stevens Institute of Technology share the same story – the demand for their graduates is staggeringly higher than the students graduating from their institutions.

There are manufacturers that will train or pay for training for new hires. However, in visiting with manufacturers throughout the commonwealth we often hear that they can't find new hires that are trainable. The soft skills of arriving on time, being engaged throughout the workday, basic manners, and even the ability to take and/or pass a drug tests all act as barriers to employment. One major reason for this is the rate that young adults are entering the workforce. According to the Bureau of Labor statistics, in 1978 the percentage of the workforce ages 16-24 was 24.5 percent.[9] In 2018 that same age demographic only makes up an estimated 12.5 percent. The reasons for this are complex, but one undisputed issue is the red tape and regulations often associated with hiring entry-level workers. Factors like Governor Wolf's call for an increase to government mandated wags would only exacerbate this problem. Manufacturers often need a step or several steps beyond entry-level, but with increasing barriers to the workforce, those skilled workers have become difficult to find.

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[8] Pennsylvania School Board Association. "2018 State of Education" 2018. https://www.psba.org/wp-content/uploads/2018/04/2018-StateofEducation.pdf

[9] Toossi, Mitra and Torpey, Elka. Bureau of Labor Statistics. "Older Workers: Labor Force Trends and Career Options." May 2017.

Workforce development is a difficult policy issue to tackle. We all know there is a problem and there are hundreds if not thousands of people, firms, institutions, agencies, and programs out there to mitigate it, but the problem still perpetuates. There are best practices out there that are operational today. We know we have some of the best institutions such as the Pennsylvania College of Technology and Thaddeus Stevens College of Technology. We know of some of the best programs such as the Your Employability Skills (YES) Program headed by the Northeast Pennsylvania Manufacturers and Employers Association, the Challenge Program in Western Pennsylvania, the "What's So Cool About Manufacturing" contest originated in the Lehigh Valley by the Manufacturers Resource Center. This is just a small sampling of the vast array of programs that are making a difference. However, a concerted effort to analyze, streamline, and execute a 21st Century workforce is desperately needed here in Pennsylvania and across the nation.

Year over year, the commonwealth spends many hundreds of millions of state and federal taxpayer dollars on job training and workforce development programs. There are dozens of programs that are administered by multiple state agencies including Labor & Industry, Education, and Aging. Because federal taxpayer dollars are involved, these programs must follow federal requirements. If Governor Wolf were to request a waiver from the federal government, the Commonwealth could move dollars between programs and create a workforce development system that better served the needs of Pennsylvania workers and employers. Such an initiative would also help taxpayers by redirecting existing funding to more effective programs that would deliver better results.

The Pennsylvania Manufacturers' Association applauds the Pennsylvania House of Representatives on the passage of a package of bi-partisan legislation, GoodJobs4PA, aimed at filling the workforce gap crisis in our commonwealth. A concerted effort to analyze, streamline, and execute a 21st Century workforce is desperately needed in Pennsylvania. Though there is still more work to be done, these bills represent a leap forward.

Summary

Business capital is more mobile than it has ever been – both domestically and internationally. There are more ancillary factors that come into play when attracting business investment than ever before; factors such as, high-speed internet accessibility, proximity to market, tax breaks and incentives, transportation availability, industry clusters, and much more. However, in the absence of strong fundamentals on spending restraint, tax relief, limits on lawsuit abuse, regulatory reform, and ensuring a prepared workforce, these ancillary issues become less relevant. Business investment is like water – it will flow to the path of least resistance.

Pennsylvania businesses operate in a highly regulated environment where lawmaker decisions directly impact the commonwealth's economy. The goal of Pennsylvania policymakers should be to make it the smart business decision for employers to locate, expand, and hire here in this commonwealth rather than in one of our competitor states. Our state government cannot tax-and-spend the way to good fortune for all; but we can grow the private sector by attracting new business investments and expanding the tax base, then prosperity will surely follow.