

## **Statement of Senator Orrin G. Hatch**

### **Before the United States Senate**

#### **Introduction of "Research Credit Improvement Act of 2007"**

**October 19, 2007**

Mr. HATCH. Mr. President, I rise today to join with my friend and colleague from Montana, Senator Baucus, to introduce the Research Credit Improvement Act of 2007. We are joined by a bipartisan group of our Finance Committee colleagues: Senators Cantwell, Crapo, Kerry, Smith, Lincoln, and Snowe. As its title suggests, the purpose of this legislation is to extend permanently and to improve the research credit, which is set to expire in just a short time, at the end of 2007.

Our Nation has benefited greatly in recent years from strong economic growth. I believe it is vital for all Americans to realize that this economic growth did not just happen by accident. Rather, it is based on several factors, and one of the more important of these is innovation.

Innovation certainly does not just happen either. It is the result of several specific ingredients. And chief among those ingredients is the amount of research and development occurring in the economy. Where does R&D come from? It comes from individuals, companies, and governments who are willing to invest time and money.

Research and development is very expensive for companies to undertake. By its very nature, research activities seldom result in success immediately. There are many dead ends and much frustration on the way to the discovery of a product that can lead to profits.

Moreover, many times a firm's efforts to find innovative solutions to life's problems result in good discoveries for mankind, but little or no immediate or even intermediate rewards for the company undertaking the research. For this reason, most economists agree that even private research and development activities can create a common good, and one that should be partially subsidized by the public.

The original research credit was enacted over 25 years ago to encourage an increase in R&D activity and to help subsidize the common good that often is derived from research and innovation.

Just as today's economic health is a byproduct of the innovation that came from yesterday's investment in R&D, our future economic health will depend on the amount of innovation we harvest from our investment in research activities today, tomorrow, and into the future.

Years ago, our country had the clear edge on the rest of the industrialized world when it came to having the most nurturing environment to foster research and development. We had more than our share of the scientists, researchers, and other skilled workers to engage in R&D. We had plenty of capital. We had world-class facilities. And we had the biggest market for products right here in the U.S. All the ingredients for innovation were right here, and few other countries could match our research environment. Thus, there was little thought of going anywhere else to perform research.

Sadly, this is no longer the case. Many of our trading partners now possess equal, and sometimes, superior environments to promote research to those we have to here in the U.S. More importantly, many of these trading partners now offer strong tax and other incentives designed to lure research to those nations and away from our shores.

Without a strong and effective research incentive of our own, I fear that the United States is at risk of losing its leadership position in innovation. The consequences of this could be very serious for our future economic growth and job creation, as well as for long-term prosperity and national security.

Unfortunately, as I mentioned earlier, our research credit is set to expire in just a few weeks, at the end of December. Once again, American businesses are finding themselves in the all-too familiar position of wondering if the Congress is going to extend the research credit, and if so, when and for how long.

This perennial guessing game that we force our research-intensive firms to play every year or two is getting old. Moreover, it makes the research credit far less effective than it would otherwise be if it were a constant. While it is true that there is some level of confidence among the users of the research credit that this incentive will be extended, everyone knows that the chances of the credit's renewal are not certain, especially in today's volatile legislative climate.

Therefore, the legislation we are introducing today once again provides for the credit to be made permanent. A permanent credit can help our economy develop the new technologies that will enhance existing capital inputs and make workers more productive. The result will be a stronger economy at home, and a more competitive nation abroad.

In assessing the health of our economy, we find an important correlation between economic growth and inflationary pressures. One sure way to have strong economic growth without the pain of inflation is to increase productivity. And most productivity gains are derived from technological advances, which reduce the cost of producing goods and services, and thereby help maintain low consumer prices.

An additional benefit of productivity growth is a corresponding increase in corporate profits. Such increases lead to higher returns on savings and investment, and higher wages for workers. I believe the greatest benefit of increased R&D is productivity growth, which in turn forms the foundation of higher living standards.

Productivity growth also largely determines our society's long-term economic welfare. Our ability to deal with budgetary challenges, such as Social Security, Medicare, and other entitlements, depends critically on the future direction of our productivity.

My home State of Utah is a good example of how important research and innovation is to state economies, and to our future prosperity. Utah is home to various firms that invest a high percentage of their revenue in R&D. There are thousands of employees working in Utah's technology based companies, with thousands more working in other sectors that engage in R&D.

According to a recent article in one of Utah's major newspapers, the Deseret Morning News, the number of Utah high tech and life sciences companies grew at the astonishing rate of more than 10 percent – from 3,900 to 4,300 – over the period of September 2005 to September 2006. These industries in Utah employ more than 62,000 workers, with average pay that is 66 percent higher than the statewide average non-agricultural wage. About 3,000 of these jobs are new ones added in the past year.

These are the kinds of jobs and the kind of job growth that Utah, and all of the United States, needs for this new century. The jobs and companies in the high tech and life sciences sectors in Utah and around America are diverse. But they have several things in common. They are clean, they are high-paying, and they require an educated workforce. The vast majority of these companies export products, helping to offset our trade imbalance. Most importantly, however, is the fact that all of these jobs depend on innovation as their lifeblood. R&D is in the very DNA of these companies.

One more thing all these highly desirable high tech jobs have in common is that America is at risk of losing them if we are not careful to maintain an environment that nurtures innovation and the other vital ingredients that gave rise to these jobs in the first place. To my way of thinking, keeping a strong and viable research credit is a key part of this environment.

Since 1981, when the research credit was first enacted, the Federal Government has joined in partnership with large and small businesses to ensure that research expenditures are made in the United States. This enhances domestic job creation, and helps the United States to internalize more of

the economic benefits from the research credit.

It seems clear that to continue to grow our economy we must maintain and enhance our position as the world leader in technological advances. The worst thing we could do is to let it slip. Consequently, robust R&D spending should permeate our economy. We simply must continue to invest in research and development, and the Federal Government needs to reaffirm its role as a partner with the private sector.

While the research credit has proven to be a powerful incentive for companies to increase research and development activities, it unfortunately does not work perfectly. There are several reasons for this, but a major one is that the original, or traditional, credit is calculated using a base period from the mid-1980s. This reference period is becoming more distant and thus less relevant to the business operations of more companies each year. For example, many companies have had major changes in their business models over the past two decades. Yet, the traditional credit still requires a calculation that references revenue from this set of years from two decades ago.

This has been a growing problem for a number of years. To address it, Congress last year included an alternative to the traditional credit that instead of referencing the old base period, is based on the taxpayer's most recent three years of research activity. This credit, known as the simplified alternative credit, has provided a meaningful tax incentive for firms with significant and growing amounts of research expenditures that were not getting much, if any, benefit from the traditional credit.

Based on many discussions with companies that use the research credit, it appears that the alternative simplified credit is now being used by more companies than is the traditional credit. This is true even though the alternative simplified credit is set at 12 percent, while the traditional credit is set at 20 percent.

Therefore, Senator Baucus and I have decided to introduce a change in the research credit that would phase out the traditional credit, even as we increase the benefits of the alternative simplified credit. Specifically, our bill would continue the traditional credit for two more years, and then would eliminate this method of computing the research credit, beginning in 2010. At the same time, however, the bill would increase the alternative simplified credit from the 12 percent current rate to 16 percent in 2008, 18 percent in 2009, and 20 percent for 2010 and thereafter.

We believe this gradual transformation from the increasingly obsolete traditional credit to a single more relevant and strong alternative simplified credit should create a smooth and generous transition, both for traditional credit companies and for firms that find the new alternative simplified credit to be more beneficial.

I urge my colleagues on both sides of the aisle to join us in this effort. We have had widespread bipartisan support for extending the research credit here in the Senate. In fact, the Senate in 2001 passed a permanent research credit, but its permanence unfortunately was downgraded to another extension in conference with the House bill.

I believe that if we allow the research credit to expire, we will see the negative effects manifest in lower economic growth, fewer jobs created, fewer innovative products created, and lost opportunities as research activities move to other countries with more attractive incentives. Again, we should never forget that our nation's future economic health is dependent on the innovations of today and tomorrow.

The United States needs to continue to be the world's leader in innovation. We cannot afford to allow other countries to lure away the research that has always been done here. We cannot afford to have the lapses in the research pipeline that would result if we fail to extend this credit before it expires on December 31. We need to make the credit permanent so we can increase the growth rate of our economy. And, we need to improve and simplify the credit so that it is more effective.

Enacting this legislation would mean more and better jobs for American workers. Innovation and new technology resulting from American research and development will continue to improve the

standard of living for every person in the U.S. and around the world. I ask unanimous consent that a copy of the bill be placed in the Record at the conclusion of my remarks.