TAXING MANUFACTURING

Examining the Impact of President Obama's Proposed Tax Increases on the Manufacturing Sector in Pennsylvania and the United States

A Report by Senator Pat Toomey

Also available online at www.toomey.senate.gov

Staff contact: Rick Morgan

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Introduction

Despite a struggling economy and unemployment hovering at about 8 percent, President Barack Obama and nearly all congressional Democrats have made raising taxes a core plank of their re-election efforts. In July, Senate Democrats voted to raise marginal rates, limit itemized deductions, phase out personal exemptions for some taxpayers, increase the tax burden levied on capital gains and dividends, and raise the death tax burden imposed on family-owned businesses. At a time when the top priority of Congress and the White House should be to create jobs and boost economic growth, these misguided attempts to raise taxes could not be more poorly timed.

Recent research, including a study released earlier this year by the accounting firm Ernst & Young, has detailed the harmful macroeconomic effects of President Obama's tax policies. While that report sheds light on the broader problems of raising taxes during a time of weak economic growth, the devastating consequences of the Democrats' tax policies on American manufacturing have received little attention.

Although the Democrats misleadingly claim to be raising taxes only on certain individuals, namely "the rich," most manufacturers organize as "pass-through" businesses that pay income taxes at individual rates, not corporate ones. In fact, about 80 percent of manufacturers are pass-throughs.[1] These businesses, many of which are small to mid-size companies, are already struggling due to economic stagnation and increased foreign competition. If President Obama and congressional Democrats implement their policies, American manufacturers will be at a competitive disadvantage against their competitors overseas and forced to operate under an even more burdensome tax regime. The result will be slower economic growth, a loss of jobs, and less investment in American manufacturing.

President Obama and the Democrats' Tax Increases

Senate Democrats, with the support of President Obama and Democratic leadership in the House of Representatives, proposed a broad array of tax increases that would confiscate an additional $800 billion from the private sector over the next 10 years.[2] Senate bill 3412 contains the following tax changes:

- Increases the 33 percent tax bracket to 36 percent on income more than $250,000 for a married couple.
- Increases the effective top tax rate from its current level of 35 percent to 40.9 percent. This figure includes the effect of imposing a limitation on itemized deductions, which would add about 1.3 percentage points to the official marginal rate of 39.6 percent.[3]

[1] Robert Carroll and Gerald Prante, "Long-run macroeconomic impact of increasing tax rates on high-income taxpayers in 2013," Paper prepared by Ernst & Young, July 2012. p.6.

[2] This figure is based on the revenue estimates contained in President Obama's FY 2013 budget request, adjusted to allow for policy differences regarding the tax treatment of dividends.

[3] Carroll and Prante, "Long-run macroeconomic impact of increasing tax rates," p. 5

- Phases out personal exemptions for middle and upper income taxpayers, a policy which disproportionately punishes larger families.
- Curtails the amount upper income taxpayers can itemize (Pease limitation).
- Increases the tax rate on investment income from the current rate of 15 to 24.7 percent when Pease and the surtax created by Obamacare take effect in 2013.[4]

Tax Hikes Hurt Economic Growth

There are two basic reasons why tax increases reduce economic growth and restrain job creation. The first is that when the government raises the tax burden borne by the private sector, consumers have less money to spend, and businesses have fewer resources to use to expand their operations and hire additional workers.

The second reason relates to what economists call the "substitution effect." By raising marginal rates, the government increases the relative price of working and conducting business. As a result, some individuals will choose to work less. Others considering starting their own business will conclude that the risk and enormous effort needed to be an entrepreneur are simply not justified. Additionally, a company planning to construct a new factory might decide that America is no longer a cost-effective place to do business as a result of higher taxes.

Put simply, companies will be more likely to substitute building a new factory in America with a new factory in China instead.

Unfortunately, it is difficult to quantify the impact changes in tax policy have on economic growth due to the complexity and number of variables involved. However, a wide range of research demonstrates the damage that can be wrought by tax increases. Work by economists Robert Barro and Charles Redlick illustrates that the economic harm caused by tax hikes can outweigh the potential revenue raised for the government. In their report, "Macroeconomic Effects from Government Purchases and Taxes," Barro and Redlick argue that the multiplier effect of tax increases is -1.1.[5] In other words, every dollar of additional revenue raised by the government, through an increase in marginal rates, shrinks the economy by $1.10. Separate research conducted by economists David and Christina Romer, the former chair of President Obama's Council of Economic Advisors, estimated that tax increases have a multiplier of -3, indicating "a tax increase of one percent of GDP reduces output over the next three years by nearly three percent."[6]

Further compounding the damaging effect of President Obama's tax policies is the manner in which he wants to raise revenue - namely through increases in marginal tax rates. A wide range of economists have testified before Congress that it is essential to enact tax reform that lowers

[4] Ibid., 5, but rate modified to incorporate differences between S. 3412 and President Obama's budget proposal.
[5] Robert Barro and Charles Redlick, "Macroeconomic Effects from Government Purchases and Taxes," National Bureau of Economic Research, working paper 15369 (September 2009): 28.
[6] Christina Romer and David Romer, "The Macroeconomic Effects of Tax Changes: Estimates based on a New Measure of Fiscal Shocks," American Economic Review, 100 (June 2010): 764.

marginal rates and broadens the tax base. Although liberal and conservative economists differ on whether tax reform should decrease revenue, raise revenue, or be revenue neutral, there is broad consensus that lower marginal rates are good for the economy. Professor Rosanne Altshuler, the former director of the Tax Policy Center, argued in testimony before the House Ways and Means Committee that attempting to raise significant revenue from the current tax structure by increasing marginal tax rates is both "politically and economically infeasible."[7]

Left-of-center economist Leonard Burman noted in his testimony before the Senate Budget Committee that if lower marginal rates are achieved in a fiscally responsible manner, "they produce tangible economic benefits."[8] Former Treasury Secretary and Obama administration economist Larry Summers wrote in the *Financial Times* that "employers who know that their workers face high tax rates endeavor to find ways of providing compensation in the form of tax-free prerequisites, rather than money income."[9]

Not surprisingly, the National Commission on Fiscal Responsibility and Reform (often referred to as Bowles-Simpson), commissioned by President Obama, recommended that Congress enact comprehensive tax reform that would lower rates and broaden the tax base by scaling back deductions, credits, and exclusions that cost the government revenue and create economic distortions within the tax code. The Bowles-Simpson commission recommended that the top individual rate be lowered to 23-28 percent, depending on how many tax expenditures Congress wished to maintain.[10] Instead of embracing bipartisan calls for pro-growth tax reform, President Obama instead wants to move the country in the opposite direction, toward an uncompetitive top tax rate of 41 percent.

The failure of the president to make job creation his top priority will have serious consequences for the American economy. Research conducted by Ernst & Young indicates that the president's proposed tax increases will reduce long-run economic growth by as much as $200 billion, eliminate 710,000 jobs, reduce investment by 2.4 percent, and decrease after-tax wages by 1.8 percent.[11]

President Obama's Tax Increases & American Manufacturing

The broad macroeconomic effect of President Obama's proposed tax increases will inflict unnecessary harm on the American economy and American workers. Unfortunately, U.S. manufacturing will bear a large portion of the burden caused by these tax increases.

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[7] Congress, House of Representatives, Committee on Ways and Means. Prepared testimony of Dr. Rosanne Altshuler for "Hearing on Tax Reform" (July 26, 2011), p. 2.
[8] Congress, United States Senate, Budget Committee. Prepared testimony of Leonard Burman for hearing on "Tax Reform to Encourage Growth, Reduce the Deficit, and Promote Fairness" (March 1, 2012), p. 3.
[9] "The US Tax System Needs Rebuilding," *Financial Times*, February 26, 2012, http://www.ft.com/cms/s/2/38274f48-5e4f-11e1-8c87-00144feabdc0.html#axzz24wnEV9yX.
[10] The National Commission on Fiscal Responsibility and Reform, p. 28-31.
[11] Carroll and Prante, "Long-run macroeconomic impact of increasing tax rates," p. 4.

In a global economy, manufacturing faces particularly fierce competition from foreign companies, and it is a simple reality that certain business operations can be outsourced more easily than others. A retail outlet, for example, must have a physical presence that is convenient for consumers. Likewise, a health care provider must be geographically accessible to its patients. In contrast, the remarkable advancements in shipping and logistics technology over the past several decades have made it increasingly possible for a company to produce steel products in Pennsylvania and ship those components to customers in Europe, Asia, and elsewhere. It is not uncommon for American products to include components from several different countries.

This globalized economy offers enormous opportunities, particularly for a nation like America with a motivated, educated, creative, and entrepreneurial workforce. However, the extremely competitive nature of the globalized economy can also magnify the damage caused by reckless government policy. Governments are finding it far more difficult to hold businesses captive to excessive regulation and corrupt policies.

President Obama's tax policies are particularly disturbing when examined in the context of the increasingly competitive environment in which American manufacturers must operate. According to tax expert and former deputy Social Security commissioner, Jason Fichtner, "to increase employment and expand their economies, most developed countries are both reducing their corporate tax rates and restructuring their corporate tax systems to make them simpler. The United States appears to be taking the opposite approach."[12]

Economist Kevin Hassett of the American Enterprise Institute noted that "the relatively unfavorable position of the U.S. relative to the rest of the world is a significant competitive disadvantage. The harm caused from suboptimal taxation is magnified significantly when capital is mobile, and alternatives to location in the U.S. exist…. High tax rates encourage firms to locate elsewhere."[13]

The chart on page 6 demonstrates that the United States already has the highest business tax rate in the world. If Democrats have their way, the marginal tax rate paid by most small and mid-size manufacturers will jump from 35 percent to nearly 41 percent.[14] This rate, of course, would just be the federal tax rate. State and local taxes push this rate even higher.

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[12] Congress, United States Senate, Finance Committee. Prepared testimony of Jason Fichtner for hearing on "Extenders and Tax Reform: Seeking Long-Term Solutions" (January 31, 2012) p. 1.

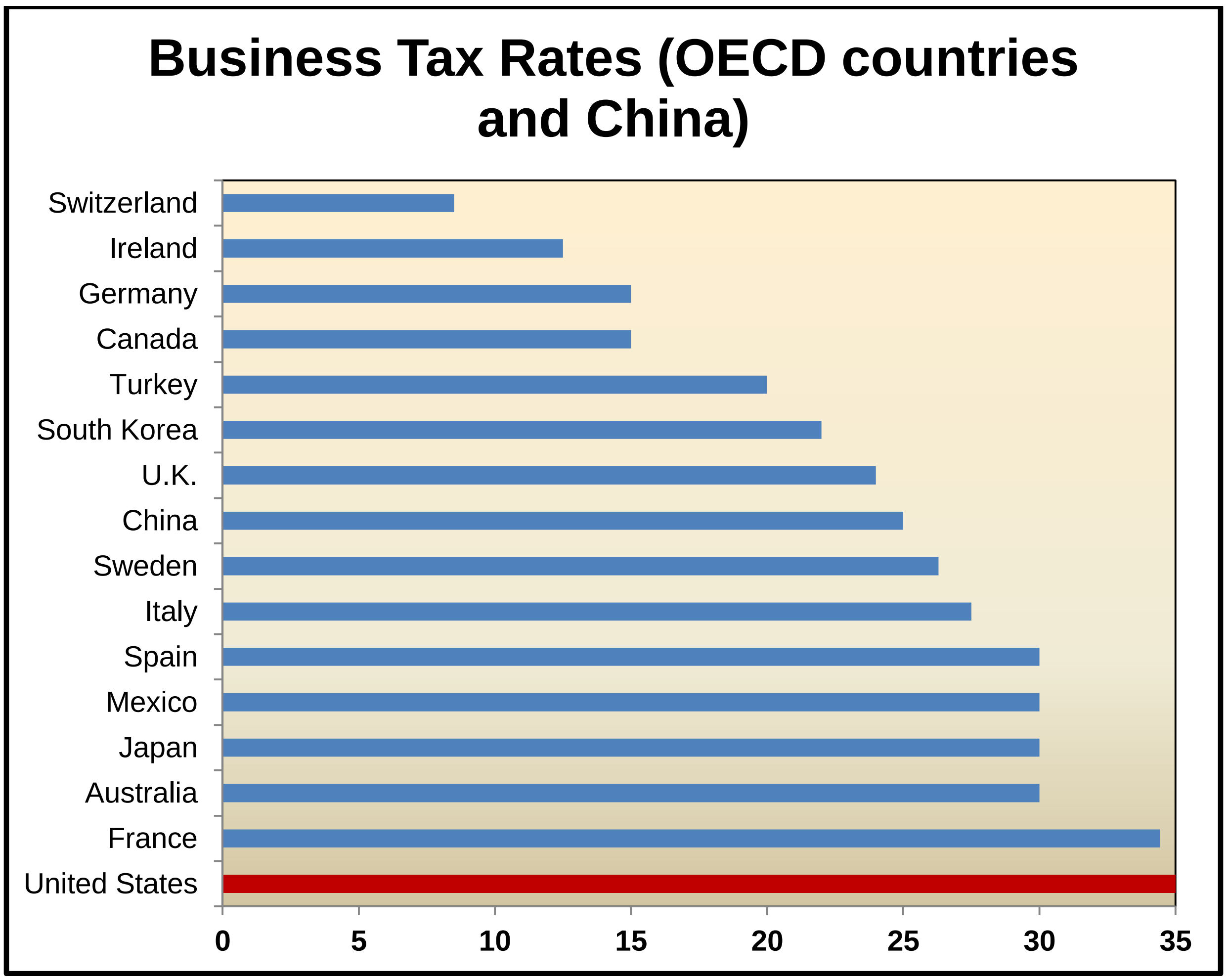
[13] Congress, The Joint Economic Committee. Prepared testimony of Kevin Hassett for hearing on "How the Taxation of Capital Affects Growth and Employment" (April 17, 2012) p. 5.

[14] *It should be noted that American manufacturers can often times take advantage of the Sec. 199 domestic production deduction. This provision allows business to deduct nine percent of qualified income from their taxable income. Factoring this deduction into the federal marginal tax rate reduces the rate from 35 percent to about 31.85 percent. However, there are restrictions and complexities involved with claiming this deduction, and even with this deduction, U.S. manufacturers are still taxed at a higher rate than nearly all of their competitors. Factoring in the Sec. 199 deduction to President Obama's proposed tax increase would lower the marginal rate on most manufacturers from 41 percent to about 37 percent, excluding state level taxation. While this mitigates some of the damage caused by the Democrats' tax policies, it still leaves American manufacturing at a significant competitive disadvantage.*

There are two countries on this chart that deserve close attention. Canada, our neighbor to the north, imposes a marginal business tax rate on its companies of only 15 percent (26 percent when sub-national rates are factored in). Canada's geographical proximity, as well as its highly-educated and productive workforce, makes this enormous discrepancy in tax rates particularly glaring.

Also on the list is China, which competes with American manufacturers on a wide range of products, and has a business tax rate of only 25 percent (or 15 percent for certain favored industries). At a time when we already have a less competitive tax code for manufacturing than all of our economic competitors, it is simply inexcusable that President Obama is attempting to place the bulk of U.S. manufacturers at an even more severe disadvantage.

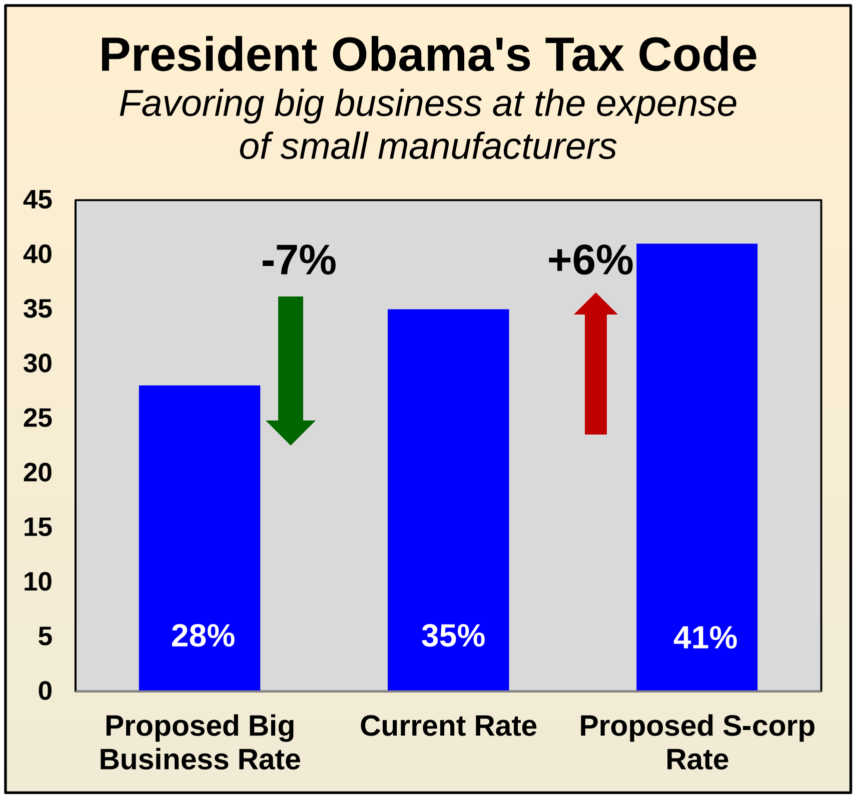
Adding to the challenges posed by globalization, manufacturing is inherently more vulnerable to tax increases than are most sectors of the economy because it tends to be capital intensive. Since factories usually need a long time to recover the costs of their investments in machinery, equipment, and facilities, changes in cash flows caused by tax policies can be more detrimental to manufacturing than to other sectors.



Note: The rates listed are federal level tax rates that do not include sub-national business taxes. Including state and local taxes changes these numbers, but the United States still has the highest business tax rate.

Tax Fairness

Another problematic aspect of the president's proposals that has largely been overlooked is the unfair manner in which he singles out pass-through manufacturers for tax hikes, while shielding larger c-corporations from any increase. While not always the case, companies organized as c-corporations tend to be larger than s-corporations and partnerships. The tax policies advocated by most Democratic officials would allow large multinational companies to keep the 35 percent rate they currently enjoy, while placing small and mid-size manufacturers at a competitive disadvantage by imposing a significantly higher marginal rate on their operations.



Further compounding this unfair tax hike is the fact that in early 2012, President Obama released a modest corporate tax reform proposal that would lower the marginal rate paid by c-corporations to 28 percent. It is dubious to assert that the president's desired tax code is fair when it lowers the rate for large corporations to 28 percent while raising the tax burden borne by small manufacturing companies to 41 percent.

Finally, it is important to ask a more fundamental question regarding the fairness of the president's tax policy. Is it truly fair for the federal government to confiscate 41 cents of every dollar that a small business owner or family-run factory earns above an arbitrary threshold? Many small business owners take out personal loans, borrow money from friends and family, and dedicate an enormous amount of time, energy, and effort into making their businesses successful. At the same time, the federal government has spent taxpayer money with reckless abandon, allowing outlays to more than double since 2000. As a result, the federal debt now stands at $16 trillion. President Obama and the Senate Democrats who recently voted to raise taxes have refused to pass a budget for the past three years in order to avoid taking politically tough positions on how best to address America's fiscal challenges. These same politicians even acknowledge that the long-term drivers of the deficit - the entitlement programs - must be reformed or we will risk bankruptcy, yet they propose no solutions and deploy political demagoguery against those that do.

The Impact on Pennsylvania

President Obama's proposed tax increases pose a serious threat to the long-term health of Pennsylvania's economy and will likely cost the state nearly 31,000 jobs.[15] While it is difficult to predict exactly how many of these lost jobs will be in manufacturing, it is necessary to remember just how important this sector is to Pennsylvania's economy.

In 2010, more than 560,000 Pennsylvanians worked in manufacturing, and the sector as a whole represents about 12 percent of the state's entire economy.[16] These figures exclude indirect jobs created by businesses that are dependent on manufacturing. Additionally, manufacturing jobs tend to pay relatively well, offering, on average, annual compensation of nearly $65,000 in 2009.[17] Moreover, many workers who cannot afford or are unable to complete college fill these jobs.

Though the Democrats understandably want to avoid this discussion, the consequences of their proposed tax hikes on Pennsylvania's manufacturing sector will be severe. In an analysis conducted by the non-partisan Joint Committee on Taxation, the tax increases in the president's budget will hit 53 percent of pass-through business income. Examining the Statistics of Income tables released by the IRS shows that manufacturing will be negatively impacted in a similar manner. In 2008, the IRS reported that the average net income for a manufacturer structured as an s-corporation was $471,000.[18] This figure is well above the $250,000 threshold created by the president and his Democratic allies. Ultimately, the policies proposed by Democrats would raise taxes on about half of the income earned by an average Pennsylvania manufacturer.

America's economy is struggling. Despite President Obama's promises that a massive stimulus and more government spending would foster a robust recovery, unemployment remains stuck at about 8 percent, and 23 million Americans are either out of a job or underemployed. If we are to put these Americans back to work, we need a recovery in which manufacturing leads the way. This cannot happen if manufacturers are subject to a 41 percent marginal tax rate on any effort to expand their factories and create new jobs.

America needs pro-growth policies that make our nation the best place to start and expand a business. This is why it is critical that we overhaul our tax code, control spending, responsibly reform our entitlements, and gradually bring our budget back into balance. With the right policies, U.S. manufacturing can be the envy of the world and help spark a roaring recovery that creates jobs and brings prosperity to Pennsylvania and every corner of America.

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[15] Carroll and Prante, "Long-run macroeconomic impact of increasing tax rates," 20.
[16] "Pennsylvania Manufacturing Facts," compiled by the National Association of Manufacturers using data from the U.S. Bureau of Economic Analysis.
[17] Ibid.
[18] IRS Statistics of Income, table 2, "S- Corporation Returns with Net Income." This figure was calculated by dividing the total net income of s-corp manufacturers by the total returns. 2008 is the most recent year for which data has been published.

CASE STUDIES

Richardson Cooling Packages

Employees: 80
Location: New Castle, PA (Lawrence County)

Dave Richardson, president of New Castle based Richardson Cooling Packages, is proud that his company is bucking the national trend of tepid hiring and stagnant growth. Originally founded in 2002, the company has spent about $1 million in the past 18 months constructing a new facility, invested another $1 million in capital purchases, and expanded from 45 employees to 80.

Richardson is unequivocal about the negative effect President Obama's tax hikes would have on his manufacturing business. While they might appear wealthy on paper, most successful small business owners, particularly in a capital intensive sector such as manufacturing, devote a large portion of their profits to improving their business. Richardson Cooling Packages financed its expansion and equipment upgrade with $2 million of working capital - profits the company has accumulated over time.

When discussing the 35 employees they have hired recently, Richardson noted that "there is no way we could have done this if the president's tax policies had been enacted. He talks about how we need to pay our 'fair share,' but if you look at all forms of taxation [state, local, and federal], we pay about 40 percent in taxes. That is money that we cannot use to grow. We need our working capital to remain competitive."

A worker operates machinery at Richardson Cooling Packages in New Castle, PA

Richardson Cooling is part of an encouraging trend that economists refer to as "insourcing." Before 2002, these jobs were based in Turkey. Richardson relocated his operations to western Pennsylvania in part because the tax cuts enacted in 2001 and 2003 made the U.S. a better place to do business. However, his industry is fiercely competitive, and he must constantly strive to make sure his business stays ahead of rivals from Germany (top marginal business tax rate of 15.8 percent), Turkey (20 percent), China (25 percent), Korea (22 percent), and elsewhere.

For small and mid-size manufacturers such as Richardson Cooling Packages, President Obama's tax policies are simply not competitive.

Weiler Corporation

Employees: 430
Location: Cresco, PA (Monroe County)

In many ways, Monroe County based Weiler Corporation represents the American dream. The company was founded by German immigrant Karl E. Weiler in 1944 with just $200 in capital. Currently operated by the founder's grandson, Chris, Weiler Corp. now employs 430 people and recently opened up a sales office in Sao Paulo, Brazil, to boost exports of its American made power brushes and maintenance products.

Like many manufacturers, Weiler Corporation was hit hard during the financial crisis and recession. Fortunately, following the economic turbulence of 2009, the company has bounced back and has added 79 employees in the past two years. Weiler Corp. now spends $2 to 3 million each year purchasing and upgrading equipment, most of which is made in America, to run its factory.

Weiler Corporation chairman Karl Weiler

However, this family-owned business cannot afford to rest on its laurels. As in most manufacturing sectors, competition, particularly from China, is fierce. In addition to the Chinese government's tolerance of patent violations committed by its domestic companies, Chinese manufacturers are only taxed at a rate of 25 percent. American manufacturers, in contrast, are taxed at a top marginal rate of 35 percent, a rate that is the highest in the world and 40 percent higher than what their Chinese competitors face. The Democrats' proposed top marginal tax rate of 41 percent would be more than 60 percent higher than what Chinese companies pay.

According to company chairman Karl Weiler, President Obama's desire to raise taxes on most American manufacturers will make it harder for his company to expand and place U.S. companies at a disadvantage. "It is very simple. When the government raises taxes on businesses, there is less money left over to invest in equipment, grow the business, and create jobs. The president should be focused on making America the best place to do business rather than raising taxes and making it harder for American manufacturers to compete."

American Bar Products

Employees: 10
Location: Warminster, PA (Bucks County)

In 2003, William Marsh purchased the assets of a defunct steel maker based in Trenton, N.J. and founded American Bar Products in Warminster, Pennsylvania. In founding his new company, Marsh took an 80 percent pay cut and spent the next three years working 12 hours a day, seven days a week to make sure his business survived. Even though American Bar Products is a small manufacturer with only 10 employees, the company is able to compete globally and sells specialized steel to customers in the United States, Mexico, and Canada.

William Marsh repairing equipment at American Bar Products

Success in the world marketplace is possible because American Bar Products is constantly innovating and improving its production techniques. However, innovation is not easy to pull off and it is certainly not cheap. Each year, Marsh spends more than $500,000 to upgrade and re-tool his equipment to maintain his company's competitive edge. These capital expenditures benefit not just Marsh, but his employees and local manufacturers as well. Since American Bar Products produces specialized steel products, most of the equipment it uses is custom made. Marsh works with local companies to design equipment that will increase his productivity as much as possible. It is this increased productivity that allows Marsh's employees, none of whom have a college education, to out compete foreign rivals.

Marsh believes there is potential for his company to expand. Unfortunately, the policies of Washington are standing in the way. "I would be able to hire more people if Washington wasn't threatening to impose more regulatory burdens and tax increases on our company," says Marsh.

The tax hikes proposed by President Obama won't just halt future expansion; they could potentially depress his workers' wages. As Marsh notes, "labor wages are tied to productivity. The more productive a worker is, the more I can pay them. Advanced machinery is what allows us to beat Chinese companies who pay their employees far less than what I pay mine."

But this high-tech equipment is costly, particularly for a small business such as American Bar Products. "The president's tax hikes are particularly harmful for capital formation. By taxing my company's working capital, it will be harder for me to increase productivity. If we can't increase productivity, we can't increase wages."

Keystone Profiles

Employees: 60
Location: Beaver Falls, PA


Sen. Toomey meeting with workers at Keystone Profiles

Mark Breedlove, the president of Beaver Falls based Keystone Profiles, describes the key to business success simply - "better, cheaper, faster." While this might be easy in theory, it is difficult to execute. In reality, it means that Keystone Profiles and other American manufacturers must constantly innovate and improve their businesses every year to stay on top. As Breedlove notes, "if we are not better, cheaper, and faster this year vs. last year, someone else will be."

Originally founded in 2003, Keystone Profiles produces precision steel and metal products and is now a $20 million company with about 60 employees. Breedlove is constantly improving his business to stay competitive, expand his operations, earn a profit, and create jobs. He spends considerable time and effort training employees, installing new equipment, upgrading and repairing existing machinery, even re-designing his shop layout to increase his factory's productivity. All of this costs money, and Breedlove usually spends hundreds of thousands of dollars each year in capital expenditures and repairs.

Running a successful factory is difficult under the best circumstances. Unfortunately, President Obama's plan to raise tax rates is making it even harder. Breedlove explains that essentially all small manufacturers are part of what many Democrats refer to as the "one percent," yet this fails to take into consideration the fact that pass-through businesses draw from their business income to finance capital expenditures and expand their businesses. President Obama's efforts to raise the tax rates paid by most manufacturers would significantly reduce the pool of working capital companies need to create jobs.

There is no doubt that the U.S. economy has struggled over the past few years. However, Breedlove believes America has the ability to bounce back and grow again. Sadly, the policies formulated in Washington and the tax and debt uncertainty looming on the horizon are holding his company back. "I cannot risk investing in a major expansion of my business if I do not know what my tax rate will be next year. It simply does not make sense that politicians in Washington are trying to raise taxes and prevent me from creating jobs when so many millions of Americans are unemployed," Breedlove says.

Weatherly and Hazleton Casting Companies

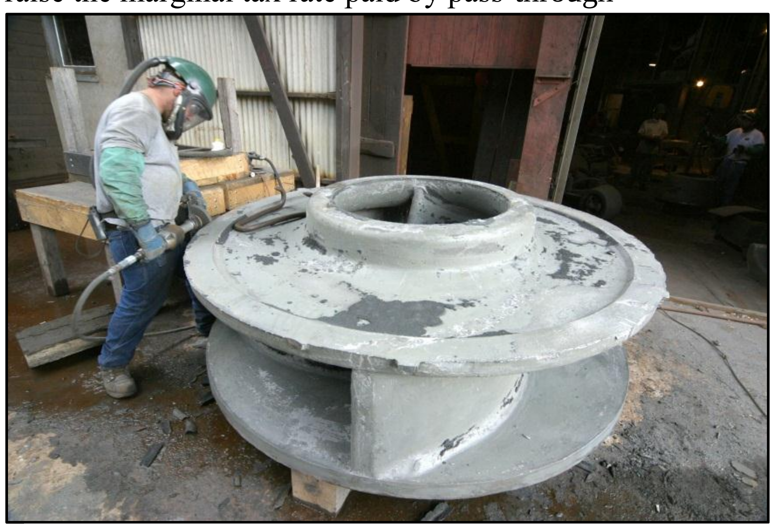
Employees: 119
Location: Hazleton, PA (Luzerne County)

In the 23 years Michael Leib has run his companies, the most difficult economic circumstances he has faced was 2009-2010. Fortunately, Weatherly and Hazleton Casting weathered the economic turmoil. Since these companies produce specialty iron and steel casting products that are used in mining and energy development, Leib's companies are poised to not just survive, but thrive in the coming American energy boom.

However, President Obama and congressional Democrats seem to be doing everything they can to stifle this energy renaissance and make it harder for companies such as Weatherly and Hazleton Casting to expand. If President Obama had not shut down construction on a critical section of the Keystone Pipeline, Leib would have hired additional workers to meet the increased demand for construction, extraction, and processing equipment.

To make matters worse, the tax increases President Obama is threatening to impose on most American manufacturers will be particularly harmful for small capital intensive businesses such as Weatherly. Every year, Leib devotes at least half a million dollars toward capital expenditures to upgrade and replace equipment. These capital expenditures are financed by the profits the companies earn and help keep them productive, efficient, and competitive. Without constant upgrades to his equipment, Leib would not be able to maintain his edge against foreign rivals from China and elsewhere that generally pay their workers far less than the wages Americans earn. President Obama's proposal to raise the marginal tax rate paid by pass-through manufacturers from 35 percent to 41 percent will make it that much harder for companies that need to constantly innovate to compete in the global marketplace.

Leib recalls that he "took incredible risks, including taking out a second mortgage, to get my company off the ground. If both the tax hikes and regulatory burden Obama is threatening to impose on us had existed when I founded my company in 1989, I would not have been able to build my business."



A worker at Weatherly Casting produces a dredge impeller ordered by the city of Portland, OR

Even though the Democrats' proposed tax increases have not yet taken effect, they are already having a chilling impact on his business. "Manufacturers have to plan for the long term. It is simply not possible for me to commit the capital necessary to expand my business if there is a likelihood that I will face a significant tax increase next year. For the time being, I have put my plans on hold."

Fralo Industries

Employees: 60
Location: Erie, PA

For Frank Victor, the chief executive officer of Erie based Fralo Industries, the economic recession of 2008-2009 forced him to make tough choices to ensure his business survived. As a company that produces fabricated metal, Fralo is particularly sensitive to cyclical economic patterns. The fact that 35 percent of the company's sales originate from foreign countries has been both a blessing and a curse. While exports have diversified Fralo's customer base and served as a cushion against the U.S. downturn, many of the company's customers in Mexico are plagued by gang violence that is endemic to the northern part of the country.

By early 2009, when it became clear that the American economy was not going to recover quickly, Fralo Industries was forced to lay off employees and drastically slash salaries (particularly for management) in order to weather the storm. Victor even accepted temporary losses in order to avoid further layoffs, a decision that caused banks to cut off his access to capital and forced him to rely on accumulated cash to meet payroll.


Fralo's facility in Erie, PA

Fortunately, these tough choices and Victor's faith in his employees paid off. The company has now returned to pre-recession levels and its CEO sees the potential for possible expansion in the future. For the past few years, Victor has spent hundreds of thousands of dollars purchasing new equipment, much of which is made by American manufacturers. Although these equipment purchases have allowed Fralo Industries to make up lost ground, Victor believes the policies of the current president are preventing a full recovery.

To begin, despite President Obama's promise to lower health care costs, Fralo's health insurance premiums increased by 20 percent this past year, even though its workforce is young and healthy. Adding to this burden is the uncertainty of punishing tax increases looming on the horizon.

"Our industry is fiercely competitive," notes Victor. "I have to compete against Mexican companies that have a lower tax rate and pay their workers far less, and Canadian companies that benefit from a much lower business tax rate than what we have here."

According to Victor, "not only will President Obama's proposed tax hikes on American manufacturing reduce the available capital I have to reinvest in my business, it puts my factory at a huge competitive disadvantage against foreign companies. If these tax hikes go into effect, it will mean zero hiring and drastic reductions in new equipment purchases."

Worth & Company, Inc.

Employees: 500
Location: Pipersville, PA and Bethlehem, PA

Pennsylvania based manufacturer Worth & Company specializes in mechanical contracting services and the production of custom components for mechanical systems. Founded in 1976, Worth & Company has successfully found its niche in the construction and contracting industry. Today, the company has more than $130 million in sales and 500 employees.

Worth and Company's manufacturing facility in Pipersville

Worth & Company's success is based on two fundamental factors. The first is combining highly skilled engineering expertise with a unique and world-class employee training apprenticeship program that teaches new, often young, employees the best practices of the industry. According to company president Stephen Worth, "Worth & Company's in-house apprentice program not only gives young people on-the-job training and a wealth of experience; the program fosters the future of the mechanical contracting industry." The second is a constant drive to innovate and invest in the newest tools, machinery, and equipment to make the company's manufacturing plants and employees as productive as possible.

"We are building the future success of Worth & Company on our capabilities to be the most technologically advanced company in the mechanical contracting industry," says Worth. However, "Obama's tax plan will limit the dollars we will have to invest in this goal."

The recent threats by Democrats to increase the tax rate paid by most American manufacturers from 35 percent to 41 percent means the company will have fewer resources to reinvest in improving the business. The ultimate result is less money for hiring new employees or purchasing machinery. It will also drain resources away from the apprentice program which is an investment in the future of both the company and its employees. "To be competitive, we must be innovative. Obama's proposal to increase marginal tax rates will limit Worth & Company's ability to grow and compete using innovative technology."

While the financial benefits of running a successful company are evident, Worth believes that living the American dream and operating a thriving family-owned business has a larger meaning. "I work hard every day to keep this company operating because it feels good to help employees take care of their families. If Obama's tax plan is accepted, the days of being rewarded for hard work and the potential to prosper are over."

Precision Medical Products

Employees: 100
Location: Lancaster, PA

Precision Medical Products is a global leader in the field of medical device production. CEO Doug Yocom believes that his company can play a key role in providing affordable health care to America's aging population. Unfortunately, the policies of the Obama administration are making it difficult for his company to realize its full potential. "It is extremely difficult to budget for the future when there is so much uncertainty with respect to where tax rates will or will not be in 2013 and in the future. The fact that we have gotten this far through 2012 without knowing what to expect in 2013 is disappointing."

Precision Medical Products in Lancaster, PA

The Lancaster based manufacturer has to contend with two major tax hikes looming on the horizon. First, President Obama is threatening to raise the company's marginal tax rate from the current level of 35 percent to 41 percent. Second, starting next year, Obamacare will impose a 2.3 percent levy on all revenue earned by medical device companies. While that tax will not directly impact the company, it will hit Precision Medical's customers, adding another strain for a company that is trying to fend off fierce competition from overseas rivals.

The tax hikes advocated by President Obama and his congressional Democratic allies threaten the ability of Yocom's business to remain competitive in the global marketplace. First, like many small and mid-size manufacturers, Precision Medical reinvests much of its profits back into the business. Last year, the company spent about $750,000 upgrading its existing equipment and purchasing new machinery. These investments allow Precision Medical to remain competitive and allow this American factory to out compete its Chinese rivals.

According to Yocom, "if tax rates increase, small businesses that pass income through to their owners (as most small business do), will need to set more aside to pay for taxes rather than reinvesting in machinery and equipment and growth opportunities that would lead to new jobs."

Additionally, the fact that Obama administration is raising marginal tax rates on American factories will directly hurt companies' bottom lines and hinder their ability to remain price competitive. Ultimately, taxes imposed on a business are passed on to customers and workers. While Chinese companies will only need to account for the 25 percent marginal tax rate they owe their government, Precision Medical could soon be forced to contend with a 41 percent marginal rate. This added burden will result in lost customers, fewer sales, and lower wages for the company's workers.

Glenn O. Hawbaker, Inc.

Employees: 1,285
Location: State College, PA

Glenn O. Hawbaker, Inc. is a family owned and operated excavation and asphalt production company based in State College. Founded in 1952, the business has expanded significantly and today employs nearly 1,300 people in several facilities in Pennsylvania, New York, and Ohio.

Hawbaker's future should look bright. Since 2006, the company has doubled in size, due in no small part to the opportunities and economic growth created by the natural gas boom taking place in the Marcellus Shale. Accompanying this growth has been a massive investment in machinery and equipment, on the scale of $15-20 million each year. These equipment purchases, much of which is American made, stimulate further economic growth across the state and the nation.

If it were not for the actions of politicians in Washington, company executive vice president Mike Hawbaker could get on with running the business and looking at ways to expand and support the economy rather than having to navigate a shifting tax code.

"Despite the recession, we were able to capitalize on the growth of the Marcellus Shale," Hawbaker notes. "Now, even though the economy is struggling and growth is weak, the president is trying to raise taxes. This will make it harder for our company to expand and create jobs."

A construction crew uses Hawbaker equipment to pave a road

President Obama's proposed tax increases on American businesses impacts companies like Hawbaker's in a variety of ways. First, and most noticeably, the added tax burden directly impacts the company's bottom line, reducing growth and hiring in the process. Second, it imposes an added cost on most of Hawbaker's customers, reducing their ability and willingness to purchase equipment and supplies from the State College based manufacturer. Third, the uncertainty it creates makes it difficult for businesses to plan for the future. This is particularly problematic for manufacturers, since they generally need many years to recoup the full cost of their investments.

At a time when companies such as Glenn O. Hawbaker, Inc. should be focused on meeting the expanding needs of the American energy boom, President Obama's tax hike on manufacturers is threatening to stifle an already weak economic recovery.

Anonymous

Employees: 40
Location: Southeastern PA

For this company, which gave us information but wanted to remain anonymous, the future tax code proposed by President Obama is ominous. They are a manufacturer based in southeastern Pennsylvania that specializes in making medical equipment used by doctors and hospitals. Not only must this family-owned company navigate the higher marginal tax rates proposed by President Obama, but it must overcome the burdensome medical device tax created by Obamacare as well.

Unlike most business taxes, which are calculated as a percentage of profit, the medical device tax is levied on a company's revenue. The nature of this tax makes it possible for a company that is losing money or breaking even to owe the federal government considerable sums. Out of necessity, companies such as this one are forced to pass most of the costs associated with this tax on to the hospitals and doctors who purchase their equipment. As a result, the medical device tax will further drive up the cost of medical care in the United States.

The general manager of this company says that regulatory uncertainty combined with the prospect of future tax increases is hurting his company. "How do we plan for the future when we have regulatory burdens like Obamacare and Dodd-Frank looming on the horizon, tax hikes scheduled for 2013, and the possibility of a fiscal cliff scheduled for the end of this year?"

He notes that "the overhead and administrative costs associated with regulatory and tax compliance are enormous. The money we spend on this is money we cannot spend improving our products and hiring new workers."

While the company struggled during the 2008-2009 downturn, its orders have finally returned to pre-recession levels. The general manager believes that surviving the upheaval of the past few years has made the company stronger and more efficient, placing it in a position to help ensure that America can provide affordable and quality medical care to its aging population. While the future of the medical device industry should be bright, the regulatory and tax burdens imposed on businesses by Washington are putting that future in jeopardy.