PIONEER OPPORTUNITY

The Big Lure

Interstate Competition Exacerbates the Economic Fallout from Telecommuting Trends

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PIONEER INSTITUTE
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Introduction

It is a uniquely good time to leave Massachusetts. Not only are many taxpayers struggling to emerge from a devastating pandemic-induced recession, but that recession has also given other states and localities more reasons to try to lure away jobs and residents from booming coastal metropolises. Many residents have a newfound ability to telecommute into their workplace from just about anywhere. With historically low mortgage rates and savvy government programs aimed at attracting new residents to once-neglected corners of the country with offers of free real estate and generous other subsidies and benefits, reasons abound for leaving expensive job centers.[1] Household spending also remains below pre-COVID numbers, reducing cash flow in the economy.[2] Whether the main culprit is low consumer confidence because of the pandemic or a glut of tax incentives from other jurisdictions, higher tax and regulatory burdens could turn a temporary economic stall into a long-term reckoning with the state's high cost of living and fiscal burdens.

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This paper explores how the heightened prevalence of tax and regulatory competition among states could exacerbate the economic impact of an unfriendly business environment. At the crux of the issue is that, if employers leave the state, it will be easier than ever for workers to do the same, potentially leading to long-term fiscal and economic problems in the Commonwealth. As Pioneer has argued before, state lawmakers should be especially cautious going forward about policies that would further lower the "barrier to exit" for households and firms alike.[3]

The (Tax) Competition Heats Up

In recent years, there have been numerous high-profile examples of governments using considerable tax breaks and other benefits packages to lure major corporations across state and even national lines. To cite a couple of examples, the 2018–2019 sweepstakes to determine the home of Amazon's second headquarters and Wisconsin's grant of $4.1 billion in incentives for Foxconn come to mind. A 2020 Princeton study found that U.S. state and local governments use tax incentives to lure companies worth at least $30 billion annually.[4]

Tax incentives are seen as a way of getting a leg up on other places with desirable qualities for employers

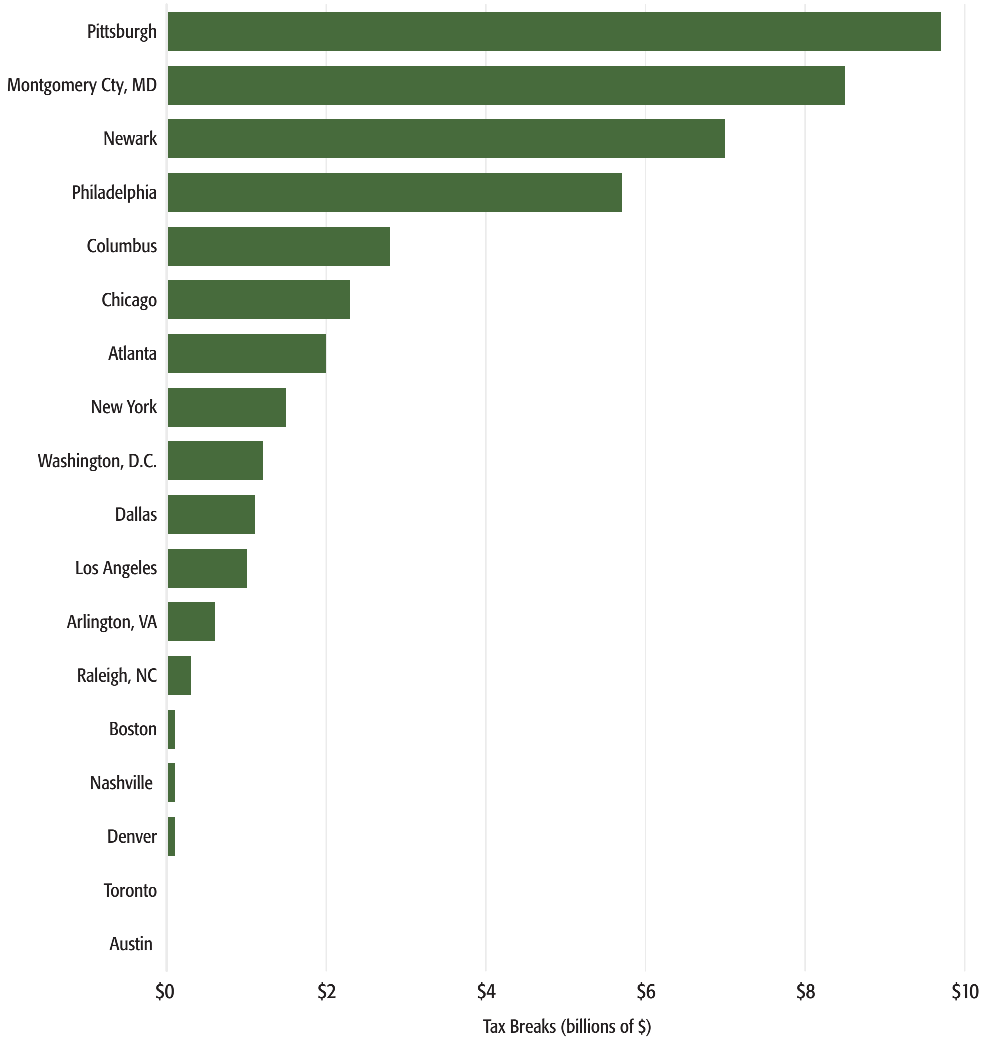
Ultimately, even places with strong business environments want to attract more economic activity, and tax incentives are seen as a way of getting a leg up on other places with desirable qualities for employers. This logic helps explain why, perhaps contrary to intuition, many large coastal cities with booming economies offered Amazon *more* in tax breaks than many smaller middle-American cities during its second headquarters sweepstakes (see Figure 1). A Brookings Institution postmortem on the Amazon sweepstakes even argued that the amounts of the tax breaks were "largely based on a region's ability to offer incentives," as opposed to the amount needed to attract Amazon to the location.

Regardless of the case-specific justifications cities and states have for competing with each other, the overarching reason is clear: in an increasingly globalized world, capital and people are highly mobile. A 2018 Urban Institute analysis shows that the three-year migration rate among large firms in particular has almost doubled, from 3 percent to nearly 6 percent, between the late 1990s and early 2010s.[5] While this analysis only included select metropolitan areas in the U.S., it also predates the COVID-19 pandemic, which has been a notable catalyst for business relocations.[6]

In recent years, corporate tax competition has taken on an international scale. Examples abound of corporate inversion, in which companies use a merger with a foreign business to change their tax residence to a lower-tax country like Ireland or Switzerland. While this method of tax avoidance was relatively uncommon before the 1990s, many high-profile American companies have performed inversions since 2013, including AbbVie, Medtronic, Chiquita, Pfizer, Apple, Burger King, and Coca-Cola.[7] In addition, Pfizer, one of the largest pharmaceutical companies in the U.S., operates at least 128 foreign subsidiaries in tax havens as of 2013.[8]

The increasing magnitude of this international tax competition even prompted Treasury Secretary Janet Yellen to propose a "global minimum corporate tax rate," to be enforced by the OECD, in April 2021.[9]

Figure 1: Combined value of state and local tax incentive packages for select Amazon HQ2 location proposals[10]



Many public agencies now also pay individual households to relocate, not just firms. As remote work's rising popularity makes it easier for telecommuters to live anywhere, areas that previously struggled to attract new residents have resorted to subsidizing moving costs. Tulsa, Oklahoma; Chattanooga, Tennessee; Baltimore, Maryland; and the entire state of Vermont are prime examples.[11] All of these programs, including Vermont's subsidies specifically for new residents who work remotely, predate the pandemic, and a central selling point of many of them is a lower cost of living than exists in much of urban America.[12]

Of the 37 cities currently paying residents to move there, 28 have median housing prices less than half that of Massachusetts, according to MakeMyMove.com.[13] Massachusetts had the third highest home prices in the country in 2020, after California and Hawaii, and Zillow estimates that home prices in the Commonwealth grew by 12.0 percent during the year ended March 2021.[14] Massachusetts is also one of the most expensive states for childcare, which is important considering the widespread school closures during the pandemic. Overall, reasons abound why individual households would find it especially appealing to move away from Massachusetts in the near future, even as the pandemic subsides.

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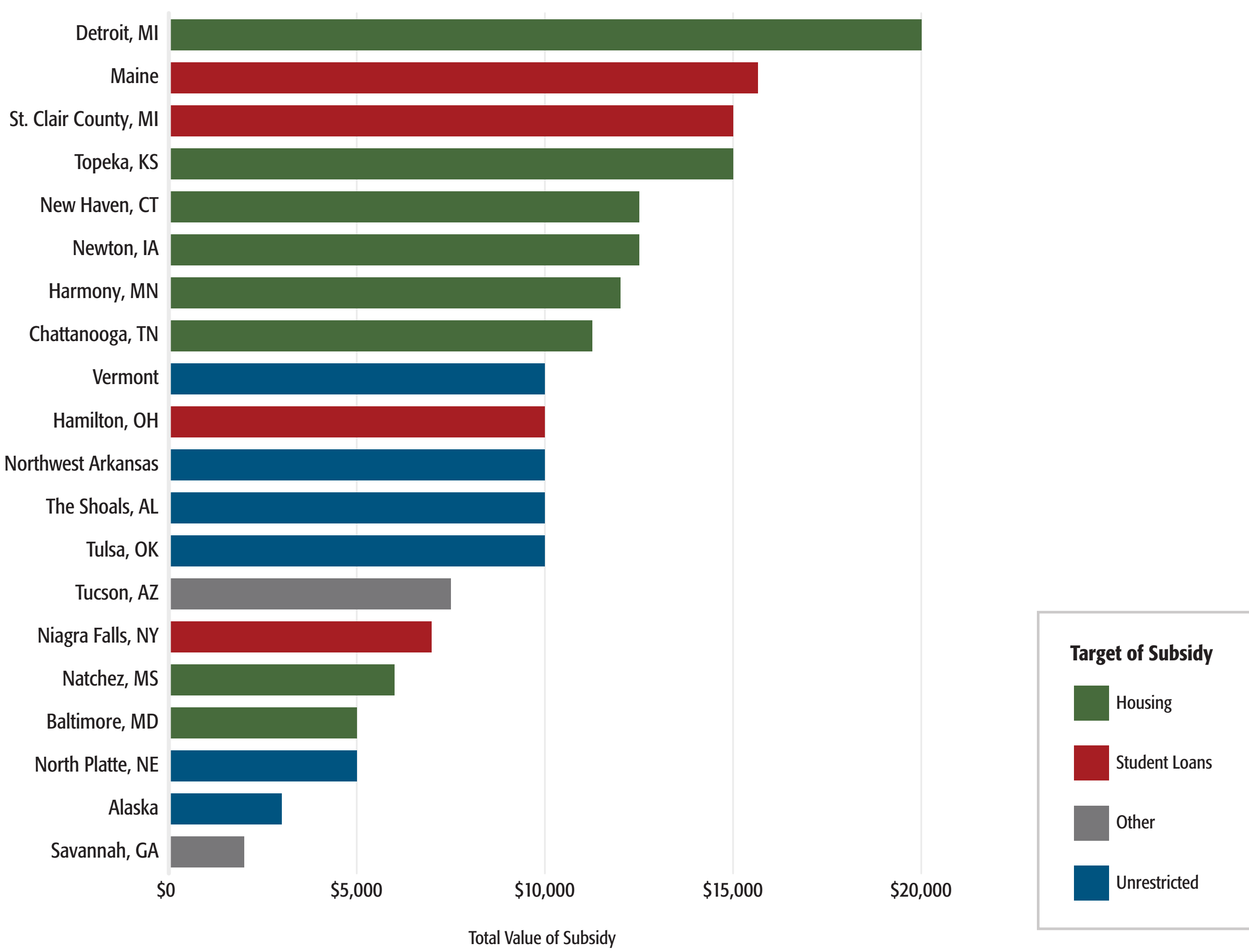
Many government programs aimed at attracting new residents also seem to be working. In 2019 alone, at least 290 people took advantage of Vermont's subsidy plan, which awards up to $10,000 to new residents who work remotely from the state.[15] That's a sizable share of Vermont's overall population change for the year, which the U.S. Census Bureau estimates at a loss of 699 residents between July 2019 and July 2020.[16] While these figures can't definitively prove that the new residents wouldn't have moved to Vermont without the subsidies, Vermont was also one of the few states to either grow more quickly or lose population less quickly in 2019–2020 than in 2018–2019.[17] The subsidies, combined with Vermont's low COVID infection rates and high prevalence of vacation homes, may have induced more people to become permanent residents amid the pandemic.[18]

In many cases, interest in these relocation incentive programs far outstrips the number of people who actually receive the relocation subsidies. For example, Tulsa, Oklahoma, a city of 400,000 people, has received more than 20,000 applications for its relocation incentive program since 2018.[19] Northwest Arkansas, population 530,000, has received more than 24,000 in total, and Topeka, Kansas, population 130,000, received over 3,500 within its program's first 30 days.[20]

Vermont and Tulsa are far from the only examples of publicly funded programs to attract residents who are "voting with their feet." In recent years, there has been significant media attention to the large and growing array of such programs around the country, especially in places where the low cost of living may be a particular draw. Figure 2 describes almost two dozen of these programs, the maximum subsidy per household, and the target of the subsidy (student loans, housing, etc.).

Figure 2: Maximum value of select state and local incentive packages to attract new residents in the U.S.[21]



In addition to directly subsidizing moving or housing costs, some cities also offer special products or services to new residents, such as free internet (Tucson), a brand new mountain bike (Northwest Arkansas), or special deals at local businesses (Topeka, Kansas).[22] Many small towns in the Midwest are offering to give newcomers plots of vacant land for free, including Manilla, Iowa; Marne, Iowa; Claremont, Minnesota; and Lincoln, Kansas.[23] Some cities and states, such as Maine; Kansas; and Hamilton, Ohio, have programs designed to attract young professionals in particular by subsidizing new residents' student loan payments.[24]

A Push and a Pull in the Same Direction

Even while many Midwestern, southern, and Rust Belt areas are redoubling efforts to attract new people and firms, many coastal cities and states have recently doubled down on policies that have sent capital fleeing to greener pastures.

The academic literature shows that incentive packages are seldom enough to create measurable business migration trends by themselves. Some studies conclude that large companies often receive tax breaks for jobs they would have created regardless.[25] In these cases, it's hard to discount the effect of policies that stifle business activity in corporations' former homes which, combined with efforts other places make to attract these companies, can greatly influence migration decisions.

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For example, healthcare corporation McKesson, ranked number 8 on the Fortune 500 as of 2020, moved its global headquarters from California to Texas in 2018, reportedly because of California's high tax rates.[26] An official statement detailing McKesson's move cited Texas's "tremendous support since we opened our Las Colinas campus last April," likely referencing a nearly $10 million grant from the Texas Enterprise Fund to help expand its presence in the state.[27] It's uncertain whether McKesson still would have moved from California to Texas without the grant, but their official statement also said the move would promote "efficiency, collaboration and cost-competitiveness," implying that the business climate of the two states influenced their decision.[28] Such robust investment from the Texas state government also speaks to the lengths to which some states are willing to go to attract economic activity.

The ultimate consequences of an expensive, business-unfriendly environment are clear. In 2020, for the first time in its history, California lost a seat in Congress due to a stagnating population. While there are various causes of this slower growth in California, many observers have cited the state's exorbitant housing costs and economic competition from Texas and other places.[29]

In an example that may hit closer to home in Massachusetts, General Electric moved its headquarters from Fairfield, Connecticut to Boston in 2016 after a $700 million tax hike targeted large corporations and wealthy individuals in the Constitution State.[30] State and local governments in Massachusetts offered GE $145 million in tax breaks as part of the deal, which amounts to over $180,000 per promised job.[31] While GE paid back the state's $87 million in tax breaks after failing to create enough jobs, the initial offer may have helped push the company to choose Boston over New York, which is 50 miles from its former headquarters and where many of its "peer enterprises" are located.[32]

Public agencies are also taking out advertisements in expensive urban enclaves to try to lure people and jobs out-of-state. A recent billboard campaign by JobsOhio, a state-affiliated economic development group, advertised Ohio's non-existent corporate income tax rate and low cost of living near Fenway Park.[33] Similar digital ad campaigns are becoming common on social media.

This highly competitive atmosphere for attracting businesses is an insidious backdrop for Massachusetts

Even expensive, high-tax areas are trying to appeal to corporate migrants with targeted advertisements emphasizing their quality of life, amenities, and existing concentration of talent. In January 2021, Middlesex County, New Jersey launched an ad campaign targeting innovative life science, autonomous vehicle, and food companies looking to relocate from Boston.[34]

While it's too early to assess whether this sort of ad campaign is effective at bringing investment to New Jersey, whose corporate tax rate is the highest in the nation, this highly competitive atmosphere for attracting businesses is an insidious backdrop for Massachusetts, which has historically ranked low on tax and business competitiveness indicators.[35] With cities and states, including other "high-tax, high-talent" ones, throwing billions of dollars into corporate subsidies and advertising each year, the last thing Massachusetts needs is to give its major businesses another reason to leave the state.

Conclusion

In an increasingly nationalized and globalized economy, cities and states will go to great lengths to attract firms, capital, and people to their jurisdiction. But failing to maintain a pro-business climate would be making a dangerous wager on the opposite approach: that the appeal of Massachusetts as a place to live, work, and do business should be taken for granted.

As traditional job centers like Boston and Springfield are facing a renewed vulnerability to out-migration from companies and individuals alike, such an approach is nothing short of irresponsible.

Among the reasons that it is already a particularly good time to move out of Massachusetts are as follows:

- Pandemic-related mandates, accommodations from employers, and new technologies have made it as feasible as ever for many employees to work remotely
- Rising costs of living, especially home prices, have strained the wallets of the middle class and created an unfriendly environment for young people looking to set down roots
- Other, especially non-metropolitan, cities and states have redoubled efforts to lure residents and employers away from major job centers with tax breaks and subsidy packages

Failing to maintain a pro-business climate would be making a dangerous wager that the appeal of Massachusetts as a place to live, work, and do business should be taken for granted

On top of these challenges Massachusetts is already facing in trying to maintain talented workers and innovative companies, passing irresponsible tax and regulatory policies would induce even more people and businesses to move elsewhere. Ultimately, this impacts not only the people and businesses who choose to leave but also the workers employed at these businesses. The recent proliferation of relocation incentive programs and subsidies targeted at both families and businesses signifies a direct incentive for the middle class to leave as well.

While Massachusetts can't stop other states from creating subsidy programs, it can create a tax and regulatory environment that is more attuned to the needs of "Main Street" businesses and individual households throughout the Commonwealth. Fundamentally, this means rejecting tax hikes and business restraints that will play right into the hands of those trying to lure people and jobs out-of-state.

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