Project Syndicate

The Stampede from Silicon Valley

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STANFORD – The news out of Silicon Valley is that some of America's most dynamic businesses are pulling up stakes and leaving. Hewlett Packard Enterprise, the firm started by Bill Hewlett and David Packard in a Palo Alto garage in 1939, is moving its headquarters to Houston, Texas, and the software giant Oracle has already relocated its headquarters from Redwood City, California, to Austin, Texas. Likewise, Elon Musk, the CEO of Tesla and SpaceX, has announced that he, too, is moving to Texas, as is Joe Lonsdale, the founder of the data-analytics company Palantir, who is bringing his entire venture-capital firm, 8VC, along with him. Lonsdale is so disenchanted with the Golden State that he announced his move publicly in an op-ed for the *Wall Street Journal* headlined "California, Love It and Leave It."

Of course, many economic observers had noticed this exodus long before it became a stampede. The talks I give for supporters of Stanford University's Hoover Institution all used to be held in California, whereas now I find myself often traveling to Dallas or other cities, because that's where many people have gone.

There are plausible explanations for these moves, with an obvious one being high state-level taxes. The top personal income-tax rate levied by the state of California is 13.3%, and 8% for taxable income between $45,753 and $57,824 (for single filers). In contrast, Texas has no personal income tax. Similarly, whereas California's corporate tax rate is 8.84%, Texas has no corporate tax, opting instead to charge a franchise tax of around 1%, on average (based on gross receipts). Finally, California has a 7.25% state sales tax, compared to Texas's 6.25% rate.

Moreover, while California's average effective property tax rate is lower than that in Texas, its housing prices more than offset the difference. The average property tax rate with parcel taxes and fees reaches about 1% in California, and about 1.9% in Texas. But with house prices in California averaging approximately $450,000, the average property tax is in the range of $4,500 per year, compared to less than $2,800 in Texas, where house prices average roughly $146,000.

Regulatory differences also factor into location decisions. According to the Pacific Research Institute, California has the second-highest regulatory burden on employment of all 50 states. The ranking is based on a composite score of seven labor regulatory categories: worker compensation, occupational licensing, the minimum wage, lack of right-to-work laws, mandatory medical benefits, unemployment insurance, and short-term disability regulations. Each regulation – even hidden ones like occupational licensing – creates compliance costs, the burden of which is relatively greater for small start-ups.
There are also big differences in regulations that restrict how land may be used for residential, commercial, or recreational purposes. Specifically, land-use regulations (which are often determined by city or county governments) prevent or restrict housing construction and thereby make housing more expensive. Published research by economists Kyle Herkenhoff, Lee Ohanian, and Edward Prescott shows that California has one of the most restrictive set of land-use regulations in the country, whereas "Texas has the lowest level of land-use regulations."

The COVID-19 pandemic has magnified the impact of these tax and regulatory-cost differences by demonstrating that many people (especially those in the technology sector) do not need to live near their place of work. The stampede out of Silicon Valley therefore owes something to telecommunication innovations such as video conferencing services. Oracle stated in a recent Securities and Exchange Commission filing about its move that "many of our employees can choose their office location as well as continue to work from home part-time or all of the time."

In any case, driving around Silicon Valley, I see that the employee parking lots at Google, Facebook, and Apple are now empty. Regardless of whether these firms join others in moving their headquarters, it is already clear that a much larger share of their employees will work at a distance in the "new normal" following the pandemic. Facebook has already said that it expects around half of its employees to telecommute in the future.

Will California's state and local governments reduce burdensome taxes, regulations, and other barriers to stop the outbound stampede? Key decisions by voters this past November offer hopeful signs that changes may be on the way. For example, Californians approved Proposition 22, which classifies drivers on ride-hailing platforms as independent contractors. In doing so, voters nullified part of Assembly Bill 5 (AB 5), which since September 2019 had restricted app-based drivers' opportunities by classifying them as employees.

In another good sign, California voters rejected Proposition 15, which would have initiated a constitutional amendment to raise taxes on commercial and industrial properties. Voters could see that this was a swipe at the 1978 ballot initiative Proposition 13, which has long helped keep property tax rates down. Despite Governor Gavin Newsom's support for Proposition 15, a majority of Californians knew that higher tax rates would ultimately compound their state's problems.

And the underlying forces of dynamism remain. A Silicon Valley firm, Zoom Video Communications, is fueling the growth of telecommuting. Still, this is no time to be complacent. Even if parking lots start filling up again as COVID-19 vaccines are distributed, many firms will continue to leave the state unless the burdens of doing business are cut. Worse, instead of addressing the exodus, state lawmakers in Sacramento are now talking about a new wealth tax – another measure that would surely make things worse.

With policymakers having failed to deal with the growing problem of homelessness in San Francisco and Los Angeles, or even with the forest fires raging across the state, California’s ability to offer a high quality of life is under threat. But as one of the distinguished business leaders who has departed recently told me, “I still love California and hope to help fix it.” It is time to get to work.

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