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MARYLAND'S LESSONS LEARNED FROM THE AMAZON HQ2 RACE

BY CAROL PARK

BACKGROUND

On November 13, 2018, Amazon finally announced its choice of Long Island City in New York and Crystal City in Northern Virginia as homes for the company's second headquarters, officially ending the intense public contest that had lasted almost a year.[1]

Amazon initially began its search for HQ2 in September 2017 by inviting cities across North America to apply, and promising over 50,000 jobs and a $5 billion investment in the city that would be selected.[2] In January 2018, Amazon announced 20 cities as finalists among 238 cities that had applied, creating an unprecedented race among top contenders.

Jeff Bezos, chief executive of Amazon, said he ultimately chose New York and Virginia for the pool of available talent. "These two locations will allow us to attract world-class talent that will help us continue inventing for customers for years to come." He also explained that talent was the reason for picking two locations for

HQ2: "People who want to work at Amazon will now have three cities to choose from rather than one or two."[3]

For many of the 20 finalists, the lack of world-class talent pool may therefore provide a satisfactory explanation for not being selected. A talent disparity, however, cannot explain Amazon's choice of Crystal City over Maryland's Montgomery County, as the two candidates are geographically close. According to CNBC's 2018 ranking of workforce quality, both Maryland and Virginia offer some of the best talent in the country.[4]

Maryland had offered Amazon an incentive package that would have cost the state around $8.5 billion. As one of the 20 finalists, Maryland decided to bid $6.5 billion in tax incentives and another $2 billion in infrastructure updates to bring Amazon to Montgomery County,[5] while Northern Virginia, New York, and Tennessee had offered combined incentives totaling less than $3 billion.[6]

MARYLAND'S BUSINESS CLIMATE

Since available talent does not explain Amazon's choice of Northern Virginia over Maryland, an alternate explanation lies in another criterion for selection that was described in the RFP: "A stable and business-friendly environment and tax structure will be high-priority considerations for the Project. Incentives offered by the state/province and local communities to offset initial capital outlay and ongoing operational costs will be significant factors in the decision-making process."[7]

Historically, Northern Virginia and Maryland have long competed with each other to attract new businesses. Northern Virginia, however, is widely perceived as more business-friendly than Maryland. For example, in 2010, Northrop Grumman chose to move its headquarters to Virginia over Maryland, citing a better business climate as the reason.[8] In 2011, Bechtel moved more than 600 jobs from Frederick, Maryland to Reston, Virginia.[9]

This year, Maryland fell six spots to number 31 in CNBC's annual ranking. One of the categories that undermined Maryland's overall ranking was its 45th ranking out of 50 states regarding the "cost of doing business," which includes the state's tax structure and cost of inputs, such as wage. Another category where Maryland ranked poorly—35th out of 50 states—was "business friendliness," which looks at the state's regulatory environment.[10]

Meanwhile, Virginia once again ranked as one of the top 5 states for doing business in the nation in 2018—4th best out of 50 states. Even New York, not typically perceived as business-friendly, rose 11 spots to number 27 in 2018.[11]

PROBLEMS OF TARGETED SUBSIDIES

It is no wonder that Amazon chose Northern Virginia, despite Maryland's offer of $8.5 billion. For Maryland and many other states that offered the company billions in tax breaks and incentives, Amazon's final decision is a cautionary tale. Businesses are less likely to move to a state with a bad business climate just to bank on short-term benefits.

Maryland has a long history of providing subsidies to attract companies. In 2016, Maryland offered $62 million in tax breaks and grants to Marriott International to keep its headquarters in Bethesda.[12] In 2016, Maryland handed Northrop Grumman $57.5 million from the state's Sunny Day Fund.[13]

However, Maryland cannot continue with business as usual and forever rely on its Department of Commerce to strike a deal with every company that might want to do business in Maryland. Such a strategy is not sustainable. Losing the Amazon HQ2 race was a wake-up call to remind Maryland that different approach is needed.

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A growing body of academic literature explains why targeted subsidies do not lead to sustainable economic growth. According to Brookings Institution scholar Amy Liu, "Economic development is most effective—and cost-effective—when it focuses on improving the shared assets that support clusters and advanced industries, rather than providing subsidies and solutions to individual firms."[14]

Targeted subsidies also hurt taxpayers by redirecting public funds away from public services. According to professor Richard Florida of the University of Toronto, tax giveaways and other incentives offered by local governments are "often wasteful and counterproductive" and can divert funds from "schools, housing programs, job training, and transportation, which are more effective ways to spur economic development."[15]

POLICY RECOMMENDATIONS: HOW TO BRING BUSINESSES TO MARYLAND

Although Maryland lost the Amazon race, it can learn from the experience to transform the state's business climate going forward. Instead of relying on targeted subsidy schemes to attract companies, there are three main policy reforms Maryland should consider to help encourage more companies to settle in the state.

Lower Corporate Income Tax Rate

Corporate income tax rate is an important measure of a state's business climate because most states levy a corporate income tax on a company's profits. Since 2008, Maryland had a flat corporate income tax rate of 8.25 percent, among

the highest in the country. In comparison, Virginia's corporate income tax rate is just 6 percent.

One of the most effective ways to improve Maryland's business climate would be by gradually reducing its corporate income tax rate to match Virginia's rate of 6 percent. A study by the Maryland Public Policy Institute found that lowering Maryland's corporate income tax rate to 6 percent would actually improve Maryland's real per capita corporate income tax revenue by approximately 7.4 percent, if everything else remains constant.[16]

Meanwhile, a lower corporate income tax rate would upgrade Maryland's overall business climate so that it would be attractive to all large and small corporations looking for a place to grow. According to a study by the National Bureau of Economic Research, the negative relationship between corporate taxes and entrepreneurship is statistically significant: a 10 percentage point increase in the first-year effective corporate tax rate reduces the average entry rate of firms by 1.4 percentage points.[17]

By welcoming more businesses to Maryland, a lower corporate income tax would also boost Maryland's job growth. There's some evidence that every 10 percent reduction in corporate taxes boosts employment by 2 percent.[18] In addition, reducing corporate income tax will benefit workers through wage growth. According to the Heritage Foundation, U.S. workers pay about 75 percent of the corporate tax through reduced wages.[19]

Overall, a reduced corporate income tax would not only encourage entrepreneurs to come to Maryland but also encourage existing businesses to hire new workers and invest in innovation. Therefore, a sensible corporate income tax reform would act as an engine of Maryland's sustained economic growth. In turn, a solid economy would make Maryland even more desirable for investors and entrepreneurs.

Judicious Regulatory Reform

Despite Maryland Governor Larry Hogan's tremendous progress in improving the state's overall regulatory environment during his first term, onerous business regulations still drag down the business friendliness ranking, deterring small and new businesses from coming to Maryland and thriving once they are here.

Therefore, a second policy option that would make Maryland more business-friendly would be to eliminate state regulations that are burdensome for businesses. Mandated benefits and sharing economy regulations are just a few among many policies that Maryland should consider abandoning in order to improve the state's economic competitiveness.

In January 2018, Maryland became the ninth state in the country to require paid sick leave. Hogan campaigned hard to persuade Democrats to abandon the General Assembly's sick-leave legislation, which would hurt businesses and potentially invade workers' privacy. Nevertheless, the bill passed, leaving Maryland's small businesses less competitive compared with businesses in surrounding states where governments do not meddle in hiring practices.[20]

State legislators also passed Senate Bill 743 this year, making Maryland one of the first states to regulate peer-to-peer car sharing. The bill not only mandates a sales tax of up to 11.5 percent on car-sharing services but also stipulates that peer-to-peer car sharing companies operating at airports be subjected to airport fees. Meanwhile, jurisdictions such as Montgomery County[21] and Prince George's County[22] have also passed local legislations to regulate short-term housing rentals. Penalizing the pioneers of a sharing economy is one way Maryland impedes innovative companies.

All of these onerous regulations are the bane of businesses. Judicious regulatory reform would encourage businesses to come to Maryland and stay there.

Stable Minimum Wage

Wages, or labor costs, are an important component of the cost of doing business. Small businesses in particular rely on an affordable labor supply for growth.

In 2017, Montgomery County passed a $15 minimum wage law to take effect for large businesses by July 2022 and smaller businesses in 2023 and 2024.[23] In 2018, groups have been pushing "Fight for 15" to also increase state-wide minimum wage to $15 an hour. SB 1094, SB 5434, and SB 3684, which would have eventually increased Maryland's minimum wage to $15 an hour, did not pass in the legislature in 2018.[24]

Although these bills failed in 2018, they are likely to be revived in the coming years. Maryland can encourage businesses to stay in Maryland by rejecting the "Fight for 15" movement.

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A new study by Harvard Business School found that a $1 increase in the minimum wage leads to 14 percent increase in the likelihood of closure for an average restaurant.[25] After the $15 campaign succeeded in California, over 60 restaurants closed in the winter of 2017, claiming high labor cost as a deciding factor.[26]

A $15 mandate will also hurt workers by forcing businesses to cut jobs and workers' hours to survive, which would lead to job losses and higher unemployment. A

National Federation of Independent Business Research Foundation report estimates that $15 minimum wage will reduce Maryland's private sector employment by around 99,000 jobs over a decade.[27]

By not passing legislation to mandate a higher minimum wage in 2018, Maryland's legislators took a positive step to protect Maryland's business climate. Amid the pressure of a national movement for a $15 minimum wage, Maryland can ensure that its businesses remain competitive by keeping Maryland's minimum wage stable.

CONCLUSION

Although the national competition for HQ2 has often been criticized for spurring brazen corporate welfare, legislators and policymakers from around the country can draw important policy lessons.

For Maryland, the most important lesson from losing Amazon's headquarters race is that Maryland needs to improve its overall business climate instead of relying on targeted subsidies and tax incentives to attract companies.

According to Christopher Summers of the Maryland Public Policy Institute and Professor Stephen J.K. Walters of Loyola University Maryland, "Amazon didn't get into retailing by opening another shopping mall. It reinvented how people shop. To think that repackaging tired incentives will work for a company of its ambition is to fail before starting."[28]

It is time for Maryland to truly reinvent the way it attracts businesses. This study recommends that in the coming years, Maryland officials should focus on improving the state's business climate through a corporate income tax cut, judicious regulatory reform, and a stable minimum wage.

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