Review of: "Using Taxes to Attract the Creative Class in the Presence of a Region-Specific Rent"

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The paper touches on an important topic, as tax policy is an often-used tool to attract mobile individuals, which in the present case may be of particular interest to local regions because of spillovers/creative class aspects. I focus in my comments on the relation to other literature and modeling aspects.

1. Over recent years a literature on optimal taxation and tax competition for mobile individuals has developed that would be worth connecting to. For example, Simula and Trannoy (2010), Lehmann et al. (2014) and Janeba and Schulz (2023) consider optimal non-linear income taxation when individuals choose between different locations. At first glance, it may look as if these papers differ from the present work because in that literature there are no differences in location rents for the individual choosing the location, while this is a central aspect in the present paper. Note, however, that the assumed cost differences in locating in countries in that literature is conceptually like the rent differences here. What is needed is a factor that drives the location decision either on the benefit or cost side of the individual. What is more, the above-mentioned papers are quite general by allowing for many individuals (not only one), who differ in relocation cost between countries, and income taxation is non-linear.

2. Regarding modeling, I didn't quite see why it is assumed that the rent in country A is not certain, but rather stochastic. Under a stochastic rent, the key location condition for the entrepreneur is (6), which states that the entrepreneur locates in A if the expected rent is higher than the tax differential between A and B. In my view, the same condition would hold if the rent was certain. Intuitively, there is no risk aversion in the model, so uncertainty doesn't matter. In my view, what is driving the results is the difference in taxes and the difference in spillovers into the local economy, IA and IB, not the uncertainty per se.

3. In the payoff function of governments tax revenues and spillover benefits are perfect substitutes (so that the sum is maximized). Typically, these two are not perfect substitutes, as raising tax money involves a deadweight loss. I don't think that this assumption is crucial for the overall message of the paper, but it could be discussed.

4. The main point of the paper is to argue that region A does not always attract the entrepreneur even though the entrepreneur enjoys a rent advantage in A over B. It happens when the spillover in B is sufficiently large relative to A (for a given location rent advantage), see condition (13). In other words, it is a situation where the private rent advantage of the entrepreneur and the spillover advantage go in opposite direction. Besides discussing this result a bit more, it would be interesting to have some (anecdotal) evidence where this may occur in practice.

5. It is argued that when (13) holds, the firm ends up in B despite the location rent advantage in A. I think this claim is too strong. What is shown is that the proposed tax pair given in (9) and (10), and the firm going to A, is not an equilibrium.

To conclude that B attracts the firm, requires the existence of a different tax pair that forms a Nash equilibrium, and the firm finds it attractive to go to B given taxes. This step is perhaps not trivial, because in games with a discrete location choice of one player a problem of non-existence of pure-strategy equilibrium may arise. Most likely a mixed-strategy equilibrium exists, in which B attracts the firm with some probability. In this sense, the message of the paper would be sustained, in that A does not always attract the entrepreneur despite its locational advantage. If a pure-strategy equilibrium with B attracting the entrepreneur exists, it would be nice to see it explicitly though.

Simula, L. and A. Trannoy (2010): Optimal income tax under the threat of migration by top income earners, Journal of Public Economics 94(1), pp.163-173.

Lehmann, E., Simula, L. and A. Trannoy (2014): Tax me if you can! Optimal Nonlinear income tax between competing governments, Quarterly Journal of Economics 129(4), pp. 1995-2030.

Janeba, E. and K. Schulz (2023): Nonlinear Taxation and International Mobility in General Equilibrium, Journal of Public Economics 218, Article 104811.