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

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This paper claims to show how city tax and incentive policies can be used to incentivize entrepreneurial entry of members of the creative class. The paper takes as given that the profession has bought into Richard Florida's argument that the presence of the creative class creates growth, but this is not established. Creative class individuals produce consumer goods (artists, performers, media) or services such as healthcare, finance, and education. All of these are luxury goods with income elasticities greater than one, and so they congregate in places with high incomes. The causality likely goes in the opposite direction: growing cities attract professions with high income elasticities of demand.

If there is any rationale to want to incentivize the entry of creative class entrepreneurs, it must be that these groups generate external benefits to other firms. This paper includes no externalities attached to the creative class. In fact, the only apparent reason cities have to attract firms is to impose taxes. Cities produce no public goods, and so they collect taxes for no purpose. Public goods do not enter the profit function for firms. There is no attempt to include a general equilibrium framework that includes externalities, as in Moretti (2004) for example. If there were really local productivity externalities generating rents, as argued by the authors, these would cause land prices and wages to be bid up so that the rents would dissipate in equilibrium.

In fact, the paper ignores the vast literature on local public goods and on local tax/incentive policies, some prominent examples of which are presented below. In their place are a large number of references to unimportant papers including 7 of the 19 citing the author's own work. There is no effort to place this work in the context of the established literature that dates back to Tiebout (1956).

The model has no specific relevance to the creative class entrepreneur. There are two locations, with A having a location-specific common profit component and B having no such added effect. The higher profit in A appears to be a known time-invariant feature that is somehow not capitalized in local property or input costs. The location-specific profits are

$$P^A = \pi - T^A + p\varsigma^H + (1-p)p\varsigma^L$$

$$P^B = \pi - T^B$$

In city A, firms get either high profit bump ς^H with probability p or low profit bump ς^L with probability $+(1-p)$. Government expenditures do not enter, so local governments collect taxes T^A in A and T^B in B and then burn the proceeds. The value for locating in A versus B (which is incorrectly derived in the paper but then the correct answer is reported) is

$$P^A - P^B = \pi - T^A + p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L - \pi + T^B = \left(T^B - T^A\right) + p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L$$

The only reason to enter B versus A is if the taxes in A are so high that

$$p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L - T^A < T^B$$

On the other hand, if $p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L - T^A > T^B$, city B can lower its net taxes by paying a subsidy, I^B so that $p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L - T^A < T^B - I^B$. Alternatively, B could just lower its taxes. Not analyzed is the fact that the firm will always have higher gross profit in A because of the higher profit bump, and so A just has to set it taxes to satisfy $p\left(\varsigma^H - \varsigma^L\right) + p\varsigma^L - T^A < T^B$. Even if B sets $T^B - I^B = 0$, city A can still set a positive tax and yet have net profit higher than in B.

The reason is that there is no equilibrium in the model. No matter how many firms enter A or leave B, the rents never go to zero.

None of this discussion has any relevance to the creative class. The creative class generates no externalities, creates no public goods, has no different profit than any other firm, or provides any positive benefit to the city in which it locates.

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