Stanford University • January 2011

SIEPR policy brief

Stanford Institute for Economic Policy Research

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LeBronomics: Do Taxes Really Affect Location Decisions of High-Paid Workers?

By Camille Landais

Tax-induced mobility of superstars has recently been the subject of heated discussion after NBA free agent superstar player Lebron James decided to leave the Cleveland Cavaliers to play for the Miami Heat. Florida, many commentators objected, does not have any state income tax. His home state of Ohio, on the other hand, does and its highest individual income tax rate is about 6 percent. For the press, the diagnosis was clear: "We feel for Cleveland fans, but maybe they should allocate some of their wrath to the state politicians who keep driving high-income individuals and their businesses to financially sunnier climes[1]". The same type of heated debate took place this year in the United Kingdom in connection with the increase in the top marginal tax rate from 40 percent to 50 percent.[2] Arsene Wenger, the emblematic manager of Arsenal FC, commented on the UK tax reform by saying that "with the new taxation system, (...), the domination of the Premier League will go, that is for sure" (*The Sunday Times,* April 25, 2009).

Besides its obvious importance for sports fans, the broader question of tax-induced international mobility of talent is a crucial public policy issue, especially when tax rates differ substantially across tax jurisdictions and migration barriers are low as in the United States or across countries in the European Union (EU). High tax rates on high-paid workers may indeed induce such workers to migrate to tax jurisdictions where the tax burden is lower. Therefore, mobility may severely

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1 "Lebron's Tax Holiday: Another Reason to Play in Miami," *The Wall Street Journal,* July 10, 2010.

2 Supposedly, the star player Cristiano Ronaldo moved from Manchester United to Real Madrid in 2009 partly to avoid the announced 50 percent tax in the UK and instead benefit from the so-called "Beckham Law" in Spain, a preferential tax scheme offering a flat tax of 24 percent to foreign residents. Incidentally, the nickname for this tax scheme was coined a few years earlier when another star player, David Beckham, also moved from Manchester United to Real Madrid to benefit from the scheme.

About The Author

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limit the ability of authorities to redistribute income through highly progressive taxation. Moreover, concerns have been raised that the mobility of skilled workers is generating harmful tax competition driving down the progressivity of state income and property taxes in the USA and in the EU. As a result, the mobility response to high tax rates perhaps looms even larger in the policy debate on tax progressivity than traditional labor supply responses.

While an enormous empirical literature has studied standard labor supply responses to taxation, there is very little empirical work on the effect of taxation on the geographical mobility of people, especially among high-skilled workers. The first reason for this is a lack of micro data containing both mobility and tax information. The second is the complexity in properly identifying the causal effects of taxes on migration and disentangling them from other aspects that may affect location decisions. In some sense, Lebron James might well have chosen Florida because of its sunnier climate. How can we tell? In a recent paper (Kleven, Landais, and Saez 2010), we take a first step to fill this gap in the literature by focusing on a specific labor market, the market for professional football players in Europe. The football market offers three important advantages for the study of mobility from a research perspective.

First, mobility is very common in the professional football market since the Bosman ruling,[3] making it a valuable laboratory to begin the study of tax-induced mobility across tax jurisdictions. The game is the same everywhere and involves very little country-specific human capital, which induces a high degree of cross-border mobility. Therefore, football players provide an upper bound estimate on the migration response to taxation for the labor market as a whole. Obtaining an upper bound estimate is crucial to gauge the potential importance of this policy question, especially in the long run as labor markets become more integrated.

Second, extensive data on the careers and mobility of professional football players can be gathered for most countries over long time periods. For this project, we have collected exhaustive data on the career paths of all first-league football players for 14 EU countries over the past 30 years, as well as performance data for all first-league teams.

Third, and most importantly, there are many sources of variation in both tax policy and labor market regulation, which can be exploited to identify the causal effect of taxation on mobility in the football market. In particular, a number of countries have experimented with special tax schemes offering substantially lower tax rates to immigrant football players.[4] Analysis of these tax schemes produces convincing evidence that, indeed, international mobility patterns respond to taxation. For example, when Spain introduced the "Beckham Law" in 2005, the fraction of foreigners in the Spanish league immediately and sharply started to diverge from the fraction of foreigners in the comparable Italian league. Moreover, exploiting the specific eligibility rules in the Beckham Law, we show that the extra influx of foreigners in Spain is driven entirely by players eligible for the scheme with no effect on ineligible players (Figure 1). This implies that the change in migration was not driven by non-tax related aspects (quality of the league, wage levels, etc.) coinciding with the implementation of the Beckham scheme.

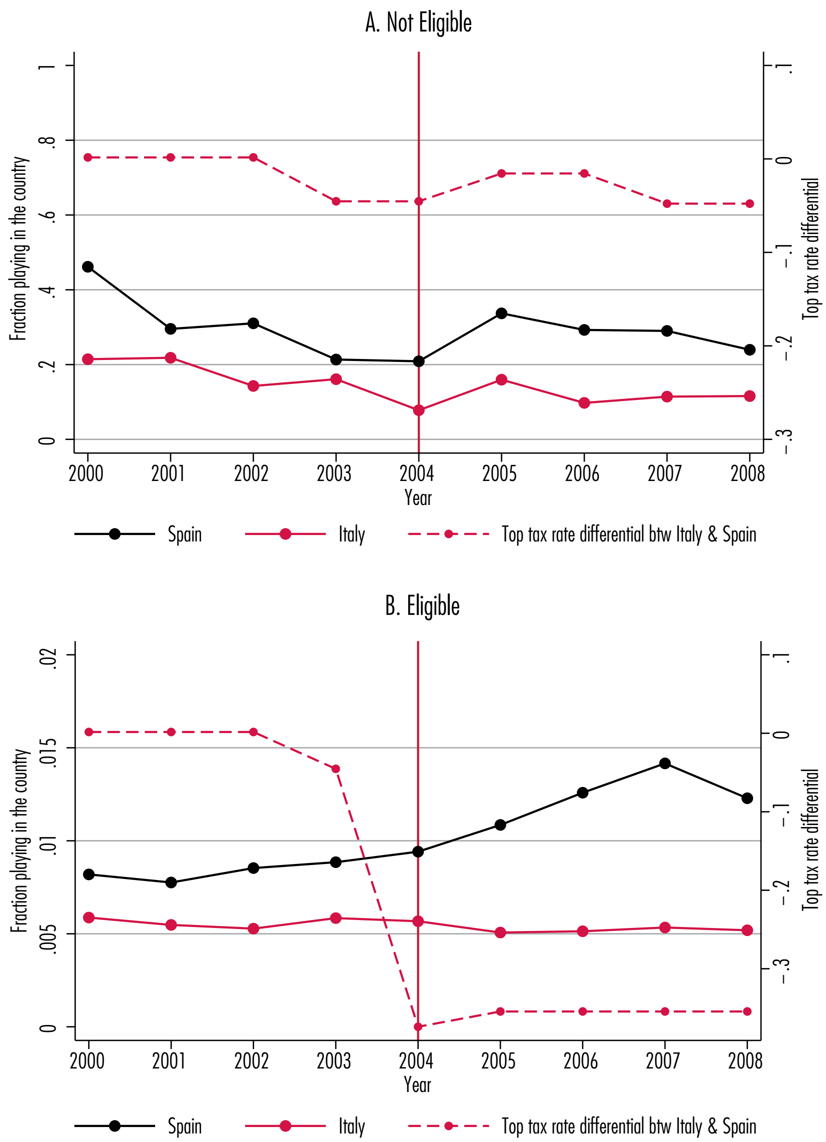
Combining all the evidence, we find that location decisions of players are very responsive to tax rates. But because labor demand by football clubs is relatively rigid—there can only be so many players in a club and so many clubs in each national league—we also find strong evidence of sorting effects. Top-quality players are much more responsive than other players. A large tax cut in a given country attracts top-quality foreign players and ends up crowding out lower-quality foreign players and displacing some domestic players to other European countries.

How and why do these results matter for public policy? Well, for at least three reasons. First, they clearly identify for the first time the effects of taxes on location decisions of high-paid workers. Even though some

3 The Bosman ruling (1995) by the European Court of Justice liberalized the football market by lifting pre-existing restrictions on player mobility.

4 Preferential tax schemes to foreigners were enacted in many different countries such as Belgium (2002), Denmark (1991), and Spain (2004).

Figure 1
Effects of the Spanish Beckham Law on the Probability of Playing in Spain by Eligibility Status.



Note: A 2004 tax reform ("Beckham Law"), depicted by a vertical line, introduced a preferential tax treatment for foreign players. Panel A focuses on non-Spanish players having played in Spain (resp. non-Italians having played in Italy) from 10 to 5 years before year n and therefore not eligible for the Beckham tax regime in Spain after 2004. We plot the fraction of these players playing in Spain (resp. Italy) in year n and the differential in top tax rates between Spain and Italy. Panel B focuses on non-Spanish players who never played in Spain (resp. non-Italians who never played in Italy) before year n and therefore eligible for the Beckham tax regime after 2004. We also plot the fraction of these players playing in Spain (resp. Italy) and the top tax rate differential.

politicians have tried to deny it, taxes do have an effect on location decisions. But contrary to what a lot of commentators tend to think, this effect is in general small, even for a highly mobile and highly paid fraction of the labor market.

Second, our results also demonstrate that the benefits of lower tax rates critically depend on the characteristics of the labor demand. When labor demand is very rigid (there is a fixed number of jobs), lower tax rates may attract high-skilled labor, which brings in new tax revenue. However, because of displacement effects, part of that new revenue is lost as other individuals are forced to leave or lose their jobs or experience a wage decrease.

Finally, and more importantly, our results show that a minimal level of tax coordination might be beneficial in federal unions like the United States. The reason is that lower tax rates in one state create tax revenue losses in other states, which lose their high-paid workers. In the absence of coordination, and in the extreme case where taxes only affect where you work but not how much you work, then tax competition is a zero-sum game. As many more states enact preferential tax treatments, the positive effects of having low tax rates tend to disappear in a pure race to the bottom, detrimental to all. Therefore, some minimal form of coordination might prove more efficient than the poorly targeted, arbitrarily enforced, and unrealistically burdensome "jock taxes" enacted by many states to cope with the issue of tax-induced mobility of high-paid workers.

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SIEPR *policy brief*

A publication of the
Stanford Institute for Economic Policy Research
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Stanford, CA 94305
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