

SITE SELECTION STRATEGY: ECONOMIC FREEDOM AND STATE GROWTH

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ABSTRACT

This paper focuses on a strategy of site selection of corporate headquarters and if economic freedom should be a consideration for such within the United States. Furthermore, this paper will consider if managers should be concerned with state economic growth before choosing a location. Based on data for all 50 U.S. states, this paper investigates if site selection strategy of company headquarters should include consideration of economic freedom and state economic growth. As far as we know, economic freedom and growth for states within the U.S. have not been presented as considerations for management in company headquarters site selection to date. If state governments display a growth mindset by promoting an environment consistent with economic freedom, then management should gravitate to these more economically attractive states for their corporate headquarters. Our research supports that management could use economic freedom of a state to expedite the decision-making process for site selection, thus saving time and money for the organization.

Keywords: Economic growth, Economic Freedom, Location Strategy, Corporate Headquarters Location, Site Selection Strategy, State Economic Growth, Gross State Product

LOCATION STRATEGY

David Tepper, the billionaire head of Appalossa Management, moved his company headquarters and personal residence from New Jersey to Florida on January 1, 2016. What is interesting about this move is that it was immediately noticed by the New Jersey Office of Legislative Services (OLS), which reported that the state would be feeling the impact of this one move on its income tax forecast for New Jersey (Dopp, 2016).

In New Jersey, the Office of Legislative Services operates under the jurisdiction of the Legislative Services Commission, a 16-member bipartisan panel that establishes general operating and budgetary policies/reports for the OLS. The state of New Jersey receives approximately 48 percent of their state revenue from personal income taxes and more than a third of that 40 percent comes from the top one percent of taxpayers. Sad to say for New Jersey, Mr. Tepper, with an estimated personal fortune of an estimate 10 billion dollars, is at the top of the one percent list. Further research shows that New Jersey has the country's third highest tax

burden as compared to Florida where there is no personal-income or estate taxes. As many others before him, and undoubtedly as more to come, David Tepper voted in the most meaningful way possible toward New Jersey's tax policies—he moved.

The anecdote here suggests that a state's policies of imposing higher individual and corporate income tax rates are impactful upon individuals, knowledge workers, businesses, industries, and said state government's ability to enact and carry-out future policy decisions, thus minimizing potential economic growth. Conversely, there is compelling evidence demonstrating states with good policies – particularly private property, rule-of-law, freedom of entry and exit into occupations, and freedom to trade – create conditions fostering economic growth and enhanced quality-of-life (Galor, 2011).

Based on the migration of organizations from states with imposing tax rates to states with more freedom, we posit that management can utilize economic freedom ratings as the first step in determining a state to relocate company headquarters. Using this as a first step in site selection can save the valuable resources of time and money. Managers may not be consciously making decisions on economic freedom, but managers do make decisions based long term survival of the organization. From the opening anecdote, it is easy to understand how policymaking drove Mr. Tepper to relocation his organization.

Both current research and that reflecting the past 25 years has provided evidence to the linkage between economic freedom, state growth and migration. Furthermore, states with lower capital and wage tax rates, fewer barriers to entry into markets, the rule of law, along with political stability and good governance, likewise tend to have higher rates of economic growth, employment, migration, and entrepreneurship (Goldsmith, 1995; Ali, 1997; Farr et al., 1998; Heckelman & Stroup 2000; Ali & Crain, 2002; Dawson, 2003; Gwartney & Lawson, 2006; Clark & Pearson, 2007; Bergh & Karlsson, 2010; Cebula & Clark, 2011; Kuckertz et al., 2016). With few exceptions, this previous research suggests economic freedom is the foundational ingredient to prosperity at the state level. Prosperity is attractive to managers seeking new headquarters locations.

What is Economic Freedom?

James Gwartney, Robert Lawson, and Walter Block (1996) defined economic freedom in *Economic Freedom of the World, 1975-1995* the following way:

Individuals have economic freedom when (a) property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and (b) they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others. Thus, an index of economic freedom should measure the extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions.

Simply put, the freer economies operate with minimal government interference, where management may rely upon choices and markets to answer basic economic questions such as

what is to be produced, how it is to be produced, how much is produced, for whom production is intended, and most importantly the corporate headquarters location where production/operations are at a comparative advantage. Put another way, economically freer businesses will be permitted to decide for themselves rather than having government and public policy impose restrictions on choices. This state economic freedom forms the foundation making new headquarters locations attractive to managers.

Corporate Headquarters and Economic Freedom

Prosperity and an enhanced quality of life are attractive qualities for organization and individual relocation. Currently, companies spend thousands of dollars on market research and this research contends that organizations should use the Economic Freedom Index (EFI) when making headquarters relocation decisions. Furthermore, this study focuses specifically on corporate headquarters relocations. The decision factors for corporate headquarters may vary from the decision factors for other organizational locations such as warehouses.

Selecting a location for a company headquarters is not a perfect science, but organizations can make well-informed decisions, which might make it closer to perfect. Organizations considering relocation must complete an external environmental scan and an internal scan to determine the needs and threats to the organization. Decisions on a headquarters location must not be made lightly, as these decisions will have a direct impact on the organization's ability to create sustainable competitive advantage and the ability to meet shareholder's needs. Managers that strategically choose a location set themselves up for success, thus maximizing shareholder value (Manning, Rodriguez, & Ghosh, 1999). Managers that seek relocation of the company headquarters for the sole purpose of lowering taxes, costs, or lease terms, are being near-sighted. Organizations must consider other factors, such as access to personnel, wage rate, unionization, taxes, business regulations, location of stakeholders, land prices, transportation, and utilities (Bartik, 1985), (Newman, 1983), (Wasylenko & McGuire, 1985), (Ho, Lee, & Ho, 2008). Organizations need access to knowledge workers, skilled workers, and customers (Dowell & Victoria-Jaramillo, 2017).

This paper is organized as follows: first, we provide a review of site selection, knowledge workers, economic freedom, and state growth. The next section will provide a description of the data and the empirical model along with a discussion of the findings. The final section concludes with limitations, applications for industry, and direction for future research.

CHALLENGES IN LOCATION DECISIONS

Location Decisions for Whose or Which Purpose?

Damron, Melton, and Smith (2015) stated that different types of businesses make location decisions for different purposes. They found industrial locations may initially make decisions based on factors such as shipping, and warehouse locations may consider speed of delivery, while revenue maximization is important to service industries. However, at the end of the day, Damron et. al (2015) found the size of the company is not of concern in relocation decisions.

In the service sector, location strategies often focus on increasing revenues, while in the industrial sector site selection focuses on lowering cost or cost savings. In selecting a location for a headquarters, it would be easy to choose the location with the lowest initial cost. The lowest cost does not mean the corporation will be able to meet the expectations of shareholders (Manning, 1999). Shareholders expect a return and making short-term profit decisions will likely have negative long-term consequences. Organizations may pursue innovations as a form of growth. Innovations can be thought of in terms of process efficiencies, new product development, technological developments and more. A key component to the identification and implementation of new innovations is access to knowledge workers.

Knowledge Workers

Many definitions of knowledge worker exist, however, for the purposes of this study; a knowledge worker is a person that uses their mind, not their body for work (Drucker, 1999). In the United States, the workforce is aging and many of the knowledge workers are retiring. The aging of the population is forcing organizations to seek out new workers to fill the knowledge void (Pobst, 2014). Jayasingam and Yong (2013) aligned with Drucker (1999) in recognizing the value of knowledge workers and the part they play in competitive advantage. Park, Howard, and Gomulya (2018) found that firms, which acquire knowledge workers, can potentially create new breakthrough knowledge.

In addition, the ability to attract and retain labor is critical to the long-term success of an organization. In 2011, Cebula and Clark stated that people relocate for two main reasons, economic conditions and/or environment and quality of life factors. This migration of people into a state increases population resulting in more knowledge workers available for work.

HOW ECONOMIC FREEDOM MAY FACILITATE DECISIONS

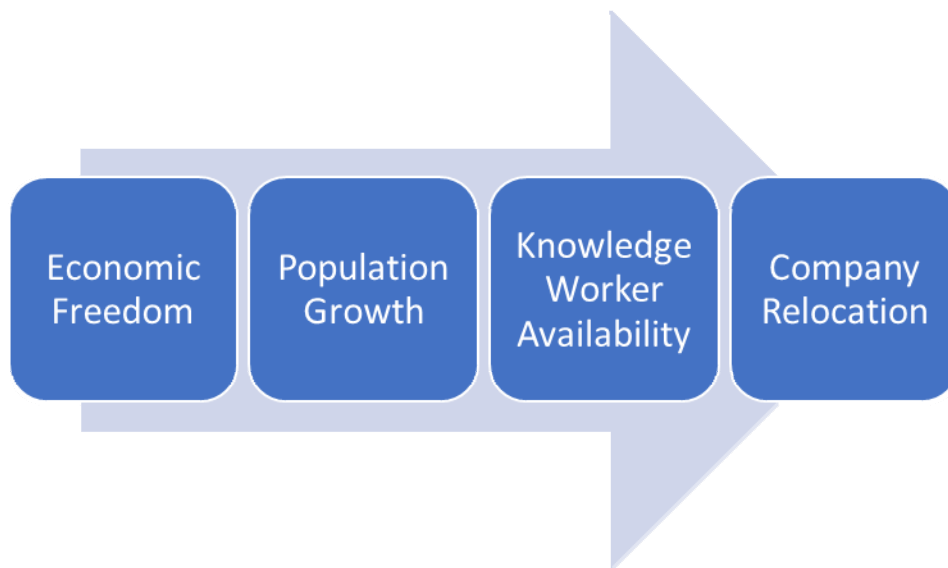
Gwartney, Lawson, and Holcombe (1999) found that increased economic freedom spurs economic growth and lack of economic freedom hinders economic growth. Furthermore, Gwartney et al. (1999) states individuals will have minimal incentive to enhance productivity if they are not given the freedom to try new processes. They further state that with economic freedom, workers collaborate and cluster in areas where comparative advantage exists. From this we can deduce that worker collaboration will result in innovations, positive net migration and possible develop of competitive advantages. Hunt (2011) found that competition created an environment consistent with innovation, and thus economic growth occurred. Milton and Rose Friedman (pg. 148, 1980) wrote:

Freedom means diversity, but also mobility. It preserves the opportunity for today's disadvantaged to become tomorrow's privileged and, in the process enables almost everyone, from top to bottom, to enjoy a fuller and richer life.

STATE GROWTH

What causes state growth is one of the most enduring questions in economics. Adam Smith (1937) in *The Wealth of Nations* argued that free markets, the protection of private property rights, and a minimal government presence in the economy leads to prosperity and growth. In other words, economic freedom leads to economic growth. Perhaps one of the greatest economic freedoms is the freedom to earn an income and then spend according to individual choices. Yankow (2014) found wages increase by 2.5% for each standard deviation improvement in state economic growth.

Figure 1: State Economic Freedom to Economic Growth Progression



As depicted in Figure 1, we conclude from the literature that economic and personal freedom results in positive net migration which, in turn, results in population growth. Population growth results in more available knowledge workers. When knowledge workers can work in a location with low unemployment, the workers gain a sense of freedom to move to other organizations. This freedom avails managers to create innovative workspaces to attract more knowledge workers. Available knowledge workers create competition, and competition creates innovation. Innovation leads to comparative and competitive advantage for companies, ultimately resulting in economic growth.

The Economic Freedom Index measures many of the quality's companies seek during their initial location or relocation decision process. We posit that organizations may use the Fraser Institute's *Economic Freedom of North America Index* (EFI) as an initial resource in site selection for company headquarters (Stansel, Torra & McMahon, 2019). Use of the EFI may allow managers to narrow site selections to specific states, allowing the company to narrow the scope of locations while designating time, money, and other resources on specific city

identification. This research focuses on the hypothesis that companies will locate or relocate corporate headquarters to states that rank higher on the Economic Freedom Index within the United States, thus further contributing to maximizing shareholder wealth by saving time and money.

RESEARCH DESIGN

Data Sets

To enhance the existing evidence and to examine the possible combined effects of economic freedom, migration, and state growth on the decision strategy of site selection of company headquarters, data was analyzed from 1997 through 2018. Data was gathered for each U.S. state, on economic growth, the degree of economic freedom in each state, net migration for each state, and the number of Fortune 500 companies per state.

In this research, the data set used for growth is from the Bureau of Economic Analysis (BEA), published by the U.S. Department of Commerce. This measure used to determine economic growth for each state is Per Capita Gross State Product (PCGSP). This variable measures growth from one period to the next.

Therefore, this raises an important question. What conditions cause economic growth to be concentrated in some areas, but not in others? One possible answer is that market institutions make the difference. Gwartney et al. (1999) and Lawson (2002) came to this conclusion and presented corollary evidence concluding that measures of economic freedom are what count, and that democratically derived political institutions may, in fact, even have a negative effect on economic growth.

For this study, the widely cited Fraser Institute's *Economic Freedom of North America Index* for each U.S. state was chosen and utilized as a general measure of the freedom of citizens to pursue economic activities. This index is a composite measure of many state policies that affect the economic freedom of individuals. More specifically, the index uses the size of government, discriminatory taxation, the degree of business regulation, and labor market flexibility. It assigns each state a score on a scale of 1 to 10, with a greater number implying a higher degree of economic freedom. Furthermore, the overall index is comprised of two sub-indexes. The first is the all-government index, which includes the impact of all levels of government - federal, state, and local. The second index, called the subnational index, measures the impact of state and local governments on economic freedom for each state. Through examining these indexes, it is evident that decentralized versus centralized decision-making is what economic freedom brings to the market. In turn, higher economically free states create more competitive markets in which resources are allocated through private decisions born of individuals and companies rather than government. Important components of economic freedom are parallel maxims defining what constitutes advantageous practices or behavior patterns – limits on coercive property and income taxes; the extent of government control over the private sector (regulations on entry to markets); the liberty to work at the occupation and remuneration of one's choosing (licensing requirements); and the ability to buy or sell goods at prices determined independent of government (Friedman, 1962).

Another important element of economic theory that is often overlooked is the freedom of movement. Acemoglu, Johnson and Robinson (2005) suggest that population change, as a result of migration, is both a signal of and a causal factor through the Tiebout (1956) migration hypothesis (i.e., “voting with their feet”) and the resulting compositional mix of local populations. Following Tiebout’s insight, a vast amount of research has reinforced how policy differences and changes alter both the number and characteristics of individuals and businesses in cities or states (Greenwood, 1997). Referencing this previous research as a guide (Faggian et al., 2012, Partridge, 2010, Ferguson et al., 2007), it has become evident that persistent positive net migration rates reflect which locations are more-or-less preferred as associated with varying levels of regional and state attractiveness. Thus, net migration may be a suitable predictor of location preferences for both individuals and companies. It may be assumed that the individual and business behavior is utility maximizing relative to pecuniary, as well as non-pecuniary, costs and benefits of various regional and state locations. Policymakers in states such as California, New York, and Pennsylvania are particularly concerned about “brain drain”, or the out-migration of highly skilled college graduates (Johnson & Reed, 2007). Subsequently, this research considers and defines these highly skilled college graduates as “knowledge workers.” Therefore, according to the Tiebout hypothesis and other key research on population migration, “knowledge workers” as well companies should, and will, move to where opportunities present themselves. The hypothesis is that there should be a flow of population away from states where economic freedom is relatively restricted and into states where economic freedom is relatively available. Hence, a positive statistical relationship should exist between state growth, economic freedom, net migration, and site selection strategy.

Finally, the Fortune 500 data is an annual publication by Fortune magazine that measures the largest corporations in the United States by total revenue within that fiscal year. The list includes both publicly and privately held companies. Making the Fortune 500 list is a prestigious achievement for each company. Over the past 15 to 20 years the trend of these companies achieving Fortune 500 status has shown significant change. This research uses data on the Fortune 500 companies, per state, each year to see the trends and changes in relation to economic growth, economic freedom, and net migration.

Model

To enhance the existing evidence and to examine the possible combined effects of economic freedom, migration, and state growth on the decision strategy of site selection of company headquarters, we analyzed data from 1997 through 2018. Data was gathered for U.S. states on economic growth, the degree of economic freedom in each state, net migration for each state, and the number of Fortune 500 companies per state.

As noted earlier, economic freedom is an essential determinant of the state’s ability to grow. Economic freedom also enhances the efficiency by which productive inputs are converted into output by increasing total factor productivity (vis-à-vis investments in human capital and technological change) and by enhancing capital accumulation. Although economic freedom has been a concept for many years, in the past 15-20 years its measurement has been facilitated by

the development of several indices which seek to roughly gauge the degree to which economic freedom exists. The Fraser Institute-developed economic freedom indices indicate the degree of economic freedom and broad respect for private property rights for the U.S. states, Canadian provinces, and countries around the world.

Economic freedom is clearly important for wealth creation. Current research has found that subnational units with greater degrees of economic freedom almost always experience higher rates of economic growth, *ceteris paribus* (Ashby & Sobel, 2008). This research uses the economic freedom index for the period 1997 through 2018. This economic freedom principle is illustrated in Table 3 where the top 5 U.S. states with the highest economic freedom index are as follows: Florida (7.87), New Hampshire (7.65), Texas (7.52), Tennessee (7.43) and South Dakota (7.37). Those compared to the 5 U.S. states with the lowest economic freedom index are Alaska (4.80), California (4.71), West Virginia (4.48), Kentucky (4.45) and New York (3.90). The top 5 states have an average percentage change in real GDP of 3.58 as compared to 1.88 for the bottom 5 states, or approximately 1.7 percent higher than the bottom 5 states.

Economic freedom also generates economic growth. For the same period, those states whose economic freedom is in the top 5 have an average annual growth rate of 4.06 compared to a rate of 1.20 for the bottom 5 states. The growth rate for the top 5 states is approximately 2.86 percent higher than the bottom 5 states.

To the extent that economic freedom affects state economic growth, there should be a relationship between net migration and the number of Fortune 500 company headquarters located in those top 5 and bottom 5 states. The 2016 net migration sum for the top 5 states is +378,089 whereas the bottom 5 states experienced a net migration loss of 332,671. Those same top 5 states witnessed an increase of 27 Fortune 500 companies where the bottom 5 states lost 14 Fortune 500 companies.

The formal estimated regression takes the following functional form to explain U.S. state growth.

$$Y_i = C + \sum_{j=1}^k X_j \beta_j + \varepsilon_i \quad (1)$$

e.g.,

$$Growth_t = C + \beta_1 EF_{t-1} + \beta_2 Net Migration_t + \beta_3 Fortune500_t + s_t \quad (2)$$

In dealing with panel data from 1997 through 2018, the regression is estimated using the Random effects model. The definition of the variables used in the empirical analysis are found in Table 1, the descriptive statistics for the variables are in Table 2, and the state data comparisons previously presented are found in Table 3.

Variable	Definition	Source
PCGSP	Per Capita Gross State Product	BEA
EFALL	Economic Freedom All-Government Index	Frasier Institute
EFSUB	Economic Freedom Subnational Index	Frasier Institute
Fortune 500	Fortune 500 companies per US State	Fortune 2018
Net Migration	Net Migration per US State	US Census Bureau

Variable	N	Mean	Std Dev	Minimum	Maximum
PCGSP	1100	4.4	2.71	-13.4	24.5
EFALL	1100	7.4	.342	6.07	8.10
EFSUB	1100	6.01	.874	4.20	7.68
Fortune 500	1100	9.804	13.48	0	58
Net Migration	1100	-23	58,064	-192,976	216,956

Table 3 Comparison Table (1997-2018)							
Top 5 Economic Free States with Fortune 500 Companies							
versus							
Bottom 5 Economic Free States with Fortune 500 Companies							
	Change in Fortune 500 Firms	Economic Freedom	Net Migration	% Change in Real GDP	State Growth	Unemployment	
1	Florida	+7	7.87	216,956	3.8	4.43	3.6
2	New Hampshire	-1	7.65	1,777	3.7	3.57	2.5
3	Texas	+12	7.52	125,800	3.7	4.65	3.9
4	Tennessee	+7	7.43	32,274	3.1	4.65	3.5
5	South Dakota	-1	7.37	1,282	3.6	3.01	3.0
		+24	7.57	378,089	3.58	4.062	3.3
41	Alaska	0	4.80	-5,122	1.0	-3.63	6.6
47	California	-8	4.71	-122,123	3.5	4.36	4.2
48	West Virginia	0	4.48	-9,001	0.0	-0.02	5.3
49	Kentucky	-3	4.45	-3,449	2.1	2.46	4.3
50	New York	-3	3.90	-192,976	2.8	2.87	4.1
		-14	4.47	-332,671	1.88	1.208	4.9
	Difference (Top - Bottom)	38	3.10	710,760	1.70	2.85	-1.60

Discussion of Findings

To test the hypothesis, the constructed regression model addresses what possible effect economic freedom, net migration and the site selection of company headquarters have on state growth. To gain insight into this question, the model estimated is state economic growth in terms of the economic freedom variables, net migration, and the number of Fortune 500 companies per state. These results are found in Table 4.

Table 4: Estimation for Equation (2) Variables		
Estimated Determinants of U.S. State Economic Growth, 1997-2018		
Dependent Variable: Per Capita GSP (Random Effects)		
	standard error	
	t-statistics	
	p-value	
	equation 1	equation 2
Estimation Method	All Government Random Effect	Subnational Government Random Effect
	EFALL	EFSUB
Measure of Economic Freedom	2.3393	0.3041
	1.2171	0.1117
	1.9200	2.7207
	0.0215	0.0033
Net Migration	7.52E-06	6.63E-06
	2.12E-06	2.22E-06
	3.3963	2.9858
	0.000364	0.001478
Fortune 500	0.016	0.0137
	0.007216	0.0071
	2.2304	1.9251
	0.0129	0.0273
Sample 1997 - 2018		
Included Observations	20	
Cross-sections Included	50	
Total Pool (balanced) Observations	1000	
	Weighted statistics	
R-squared	0.3957	0.3979
Adjusted R-squared	0.3821	0.3844

This is broken down into two parts: equation (1) regressing the all-government economic freedom index, net migration, and the Fortune 500 variables, on PCGSP state growth, and then equation (2) regressing the subnational government economic freedom, net migration, and the Fortune 500 variable, on PCGSP state growth. Results for the two estimations are reported in Table 4, which provides the estimated coefficients, the standard errors, and the *t*-statistics. The primary interest on the right side of the equation is the estimated coefficients for $EFALL_{t-1}$,

$EF\text{SUB}_{t-1}$, (the economic freedom all-government index lagged one year, the economic freedom sub-national index lagged one year), Net Migration_t and Fortune500_t .

Upon review, economic freedom, both at the all-government and subnational level, net migration and Fortune 500 has a statistically significant effect on GSP per capita or economic state growth. The regression results presented in Table 4 consistently show that economic freedom coupled with net migration and the number of Fortune 500 companies are consistent with the hypothesis that states with higher economically free states experience more growth that attracts more net migration and Fortune 500 companies. In other words, individuals and businesses are “voting with their feet” based on policy differences (economic freedom) among U.S. states. It is necessary to point out, that economic freedom measures a range of variables which determine how free people are to exchange among themselves, how much of their money they can keep, and the security of property rights, and how these properties work collectively not individually. This same proposition should hold for businesses and corporations in their decision process as to strategy of the location of the company headquarters. Therefore, state policy makers should pursue policies that ensure growth in economic freedom, net migration, and Fortune 500 companies in their respective states to promote long run state growth. This seems to illustrate Hayek’s (1944) very idea, that, state governments are more equipped and capable of governing themselves, and the Tiebout, “vote with your feet” hypothesis that individuals, and now “businesses” do relocate to where more economic opportunities exist as evidenced by the economic freedom index.

Limitations

The study does have limitations. First, the study focused only on the United States and organization headquarters relocations. A focus on knowledge workers which are most often located in an organization’s headquarters. The research did not include relocation of other facilities in a firm. If other facilities utilize knowledge workers, the use of the EFI in relocation decision making may be appropriate.

Another limitation is compilation of the data for company relocations. A single source was not available for headquarters relocation information, thus requiring us to limit the length of time for the study. Even with these limitations, the study can be replicated globally. Companies are increasingly using new terms to describe headquarters, such as, executive office, operations centers, and shared service centers. Therefore, more re-locations may have occurred than were reconsidered. Another limitation is the Economic Freedom Index has a two-year lag as the most recent year.

CONCLUSIONS

The strategy of site selection of company headquarters should be concerned with the economic freedom index as well as state growth before choosing a location. By creating a political, legal, and business environment consistent with economic freedom, states can significantly impact state growth, positive net migration, and the attraction of Fortune 500

companies. The findings presented here indicate that states that pursue and adopt more policies consistent with economic freedom are more likely to prosper and grow. For organizations seeking to create a competitive or comparative advantage, relocating their headquarters to a more economically free state may be the answer. People move to states with more economic freedom, and to attract skilled and knowledge workers, companies must follow.

Market feasibility studies can be expensive. However, based on the findings, managers could use the EFI as a first step in narrowing site selections to specific states. This allows an organization to maximize shareholder wealth to save time and money. By using the Economic Freedom Index to narrow to a specific state, then managers can turn their focus to additional key factors they believe will lead to development or maintenance of competitive advantage. Future research may focus on other organization locations such as manufacturing sites and warehouses.

Legislators may also be interested in this study. As a state pursues policies that ensure growth in economic freedom comes the issue of income inequality. At some point, governments may and will try to step in to try and correct the bad side of a perhaps “unfair” economic growth by transferring income and resources to low-income groups of the population that are not enjoying the benefits from this growth. This income redistribution can raise the unemployment rate and make access to workers harder for businesses. Thus, creating the possibility for organizations to move out of their state.

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