How Tax Arbitrage Ended GE’s Foray Into Silicon Valley

By Elizabeth Tandy Shermer
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The construction equipment manufacturer Caterpillar Inc. (CAT) recently joined a long line of businesses that have threatened to move their operations because of onerous state taxes. The historical record offers some sobering lessons for those contemplating such a move.

In the years after World War II, chief executives began a sustained flight from the Northeast, Midwest and Pacific Coast. Their eagerness to relocate was a response to the continued experimentation by local and state governments with the kind of progressive taxation that New Dealers had promoted during the 1930s.

Not surprisingly, mobile magnates and their site-selection scouts were well attuned to tax levels when they assessed whether communities had a favorable business climate. “Made intelligently,” one analyst pointed out, the choice of location “may cut production and distribution costs 10 percent or more.” Yet, he cautioned, “the penalties of bad judgment in this area are heavier than almost anywhere else.”

GE’s Lessons

General Electric Co. (GE) executives learned this the hard way. The company seemed poised to become a computer giant in the mid-1950s. Its small lab in Palo Alto, California, built one of the first machines able to meet the demands of modern consumer banking. Bank of America Corp., which contracted with GE, wanted the machines built outside of the progressively taxed Golden State to avoid $1.2 million in sales taxes, a large figure in the 1950s, but nonetheless small in relation to the bank’s profits.

The GE executive in charge of the project, Barney Oldfield, hesitated to leave the nascent Silicon Valley, where Hewlett-Packard Co. (HPQ) already thrived. Oldfield estimated that the added cost of fulfilling the contract “if the headquarters and manufacturing facility were remote from the development engineering group” was “several million dollars. I thought this would tip the scale.”

Nonetheless, GE’s president, Ralph Cordiner, desperately wanted to move operations to low-tax Nashville, Tennessee. “We were able to shoot that down on the issue of lack of attractiveness to high-grade professional people,” Oldfield remembered. Instead, GE chose Phoenix, then a well-spring of aerospace innovation, though not of computer technology.

The city was just eight hours by car from Los Angeles and a quick plane ride to San Francisco, a far shorter commute than the long trip between the Palo Alto lab and Tennessee. And the company was easily able to fulfill the first contract’s terms with a machine that set the standard
for banking technology for about 40 years. In the long run, however, the decision proved a disaster.

The division, isolated from the technology sector’s epicenter, was limited in scope and scale and it increasingly served only the company’s accounting needs. A transplanted senior project member blamed this lag on the local labor pool, which lacked “the faintest idea how to use a computer to design another computer, and were too busy doing it by hand to find out.”

Few Palo Alto technicians had wanted to leave California to pick up the slack. “The staff were not enamored with Phoenix either as a place to visit or work,” recalled a division head.

GE abandoned computing in the early 1970s. “I have tried to imagine what would have happened,” Oldfield said, if the company “had permitted us to locate astride what later became Silicon Valley, the home of Apple, Intel, Hewlett-Packard, Beckman Instruments, Sygenetics and the rest.”

Then, as now, California has very high state taxes. It is also the home of the nation’s digital economy, from which GE, for all its varied product lines, is largely excluded.