



**An examination of proposals for special tax zones in
regional Australia**

Discussion paper

Introduction

The past few years have seen interest in the potential of special tax zones (STZs), also known as enterprise zones, to lift economic performance in non-metropolitan Australia. The proposals for STZs differ from existing zonal taxation measures aimed at compensating individuals for living in remote locations, though the principles involved are similar. Under the proposals, areas identified as performing poorly against a number of criteria are designated for special assistance by government, usually, but not exclusively, through tax breaks or other incentives for companies to locate there.

Enterprise zones have generated a number of papers and reports as well as considerable lobbying of governments by its supporters. STZs have been used in the United States and Europe (mainly the United Kingdom) since the early 1980s, initially as a means of addressing the poverty of inner city areas. In the USA, their use has since expanded to encompass rural areas, and has grown to include both State and Federal programs. In the UK, they have evolved away from the initial focus on business development of the Thatcher period, towards the current UK Government's emphasis on sustainable communities and on addressing social exclusion. The European Union (EU) itself is responsible for highly interventional policies aimed at assisting depressed regions.

The case for STZs rests on a number of assumptions. For example, tax incentives are effective in attracting firms to regional areas, and that regional policy should be directed mainly at lifting poorer regions rather than assisting regions with greater growth potential. These assumptions raise issues about both the purposes of regional policy and the extent to which regionally targeted incentives can be effective.

There has been much debate over the efficacy of STZs. Some argue STZs merely draw investment away from adjacent regional areas in some cases, and in others reward firms that were going to expand or relocate in the region anyway? Others question if they are too costly to implement? Some question the whether the returns on such a taxpayer investment justify the outlay? And is there are better ways to encourage investment in regional areas?

The calls for STZs also raise a number of questions about current regional policy approaches, and about the complex factors that drive regional economies and industry location decisions. The current preference of governments in Australia is not to direct development to specified areas, particularly where this would go against market trends, but to work as a partner with local communities to grow the local economy and develop strategies "from the bottom up". Proposals for STZs argue for a return to regional policy approaches long rejected by governments of all colours.

Opinions on STZs as vehicles for regional development are sharply divided. The recent calls for STZs in Australia have come at a time when recent OECD research has found that governments of developed countries across the world

are generally dispensing with regional programs like STZs, because they have not worked. Nevertheless, these approaches have persisted in countries such as the United States, and have proven politically popular despite ongoing concerns about their effectiveness.

This paper addresses critically the arguments made on behalf of STZs, and suggests extreme caution in embracing their claims. The principal concerns are as follows:

- The case has not been made convincingly that regional Australia is sufficiently distressed economically to warrant special assistance for selected “zones”;
- Business location decisions are extremely complex, as are the processes driving regional growth and decline, and cannot simply be reduced to the provision of assistance to selected regions;
- The repeated claims that STZs have worked successfully overseas are, at best, highly exaggerated;
- There is no agreement as to the basis on which it would be decided which regions would qualify for special assistance;
- There is a risk that confining spatial targeting to a few particularly needy regions will be difficult under the weight of political pressures, thereby greatly increasing its cost to taxpayers;
- STZs are likely to encourage a mendicant mentality in regions targeted;
- Tax breaks seek to reduce business costs as an incentive to location in specified regions, and regions no longer simply compete on cost in a global world;
- Regionally focused tax breaks have been tried before in Australia, and were discarded because of their ineffectiveness; and
- Much of the current literature on regional policy rejects tax based incentives approaches as old fashioned and simplistic.

Of course, the issue of STZs for “depressed” regional areas raises much broader questions about the nature and purposes of regional policy. Chief among them are:

- Whether “place” based policies (moving jobs to people) are superior to policies directed at people (moving people to jobs);
- What really drives regional growth and decline, and what regions must do to grow their economies (Drabenstott 2005: 52);
- How effective government spatial policies can be in a globalised world; and
- Whether we want make assistance towards the “worst off” regions, however defined, a higher priority of regional policy than it is currently.

It all depends on what the real objectives of regional policy are taken to be. If the main objective of regional policy in Australia is to alter the imbalance between prosperous and populous cities and less well-off non-metropolitan regions, then perhaps the most effective policy response might be to grow our regional cities rather than to assist declining areas.

This need not mean that government interventions to assist regional Australian businesses and communities to become more competitive are out of the question. Rather it suggests that regional policies must be attuned to regional realities, to the latest thinking on economic development and to the recognised limitations on any government's capacity to direct development to particular regions.

What are STZs?

An STZ is a designated region which, having fallen below certain agreed economic and/or social indicators of disadvantage (such as high unemployment) is provided with government assistance for a certain specified period of time. Tax breaks for firms are usually a major part of the package of incentives provided. According to one definition of an "enterprise zone":

They would be geographic areas comprising a local government areas, or group of areas, which are performing below defined standards. These areas would nominate themselves on a co-operative basis and would not be 'chosen' by government, but would be assessed against objective criteria. Such areas may cross existing state boundaries. Once approved and designated, a zone would offer a range of attractive benefits to businesses. Any business locating in the zone, or an existing business expanding in the zone, would be eligible for a range of benefits subject to that business creating new net employment for Australia...(NSW Local Government and Shires Associations 2001).

Designation of a STZ can occur for a set amount of time. Companies locating or expanding into designated STZs may receive tax credits against defined government taxes and charges for a period of time. STZs are different from foreign trade zones, which allow freer trade access to specified areas.

The Australian Chamber of Commerce and Industry (ACCI) sums up some of the earlier proposals for enterprise zones as:

The centrepiece of the enterprise zones proposal is financial incentives, particularly taxation incentives. The argument for such an approach is essentially that taxation incentives provide a powerful stimulus to investment. By designating particular areas as enterprise zones and offering taxation relief to attract business, new industry and private sector jobs will be created, thus also satisfying certain social welfare objectives. It is advocated a form of strategic regional development policy (ACCI 2001).

STZs are said to provide a "win-win" situation for government and for the region. Those in favour of STZs argue the assistance is not a subsidy, since the assistance is simply a tax rebate on the extra tax paid by a company for employing additional people. The company benefits as its costs (perhaps

higher in a regional location) are reduced through the tax breaks available.

Recent Proposals for STZs in Australia

The report *Enterprise Zones: Creating Jobs and Prosperity in Regional Australia* was released by the NSW Local Government and Shires Associations (LGSA) and the Institute of Chartered Accountants in Australia (ICAA) in April 2001 (Manning 2001) set out the case for STZs.

There has also been interest in relation to personal taxation zone allowances. The National Farmers Federation (NFF) released a paper arguing for a restructuring and greater emphasis on taxation zone allowances. The emergence of these reports follows earlier work on enterprise zones. In 2000 the Central Regional Organisation of Councils (CENTROC) in New South Wales commissioned a study of enterprise zones by the Western Research Institute (WRI).

Over the years, a number of country based Independent Members of Parliament have also supported the concept. There have been a number of other adherents to the concept of STZs. Everaldo Compton, who has led the ongoing campaign for an inland rail link from Melbourne to Darwin, has argued that:

A strategy is needed to enable inland industries to absorb the heavy costs caused by the tyranny of distance – but there is none in existence. Taxation concessions or incentive grants based on employment and productivity are a major part of the answer and will encourage investment away from the cities. They should be implemented as a matter of urgency. The cost of those concessions will be less than the pointless handouts which government makes to the bush just to keep them quiet and get their votes (Dubbo Daily Liberal 2001).

Many supporters of STZs see the proposal as a potential solution to population drift from inland Australia, and as a counter to neo-liberal policies, which they see as a cause of this drift.

Criticisms of STZs Proposals in Australia

The National Farmers Federation (NFF) rejected the enterprise zones proposal in its 2001 discussion paper. According to the paper:

...for reasons of sound economic principles, transparency and good governance, use of the Commonwealth's tax powers should be confined to setting the broad parameters of business rather than seeking to determine what activities are worthwhile, or precise recipes of how they should be organised (NFF 2001:24).

The NFF also had a fear that:

... in their quest to host enterprise zones of the ad hoc type proposed, States might be drawn into any number of short-sighted inducements (NFF 2001: 24).

The Australian Chamber of Commerce and Industry (ACCI) also found fault with the proposal (ACCI 2001). The ACCI is concerned about some regions benefiting from a selective policy at the expense of other regions, and compares the STZs approach to investment bidding wars among States.

Gray and Lawrence also find fault with the proposal for enterprise zones, though from a very different perspective:

The creation of 'enterprise zones', based upon a US model, is heralded as a possible solution to Australia's regional problems ... It certainly represents one means by which fiscal equalisation can be attempted. But enterprise zones are almost exclusively focused on economic growth, not sustainable regional development. It is as if social benefits and environmental security will flow automatically from a host of taxation breaks and investment incentives – both linked to enhanced forms of local government cooperation ... We believe such an approach (a legacy of the 'old thinking' is naïve and would provide a partial solution, at best. Moreover, unless taxation law is attuned to the objectives of regional fiscal equalisation very little positive change will occur in regional Australia (Gray and Lawrence 2001: 206).

The proposals for STZs and enterprise zones have been firmly rejected by the Commonwealth Government. In the Commonwealth's *Stronger Regions, A Stronger Australia* statement it rejected STZs. Equally, there has been a rejection of "magic bullet" solutions to regional distress. For example, former Deputy Prime Minister John Anderson has stated:

For the past fifty years, state and federal governments have been searching for the single, perfect regional development policy. Their search has been marked by a succession of grand designs ... and a conviction that there is one magic solution that will repopulate the country (Anderson 2001: 2).

Later, the Commonwealth Government's Regional Business Development Analysis (RBDA) also explicitly rejected the notion of STZs. Hence any new embrace of STZs would clearly amount to an overturned of existing regional policies. However, it should be noted that the Commonwealth's Sustainable Regions Program (\$100 million over 4 years) bears loose similarity to the concept of STZs, for example its focus on declining regions and its targeting of assistance from other programs to selected regions.

The Regional Policy Context in Australia

The current approach to regional policy in most Australian jurisdictions can be summarised in a 1990 NSW Government policy statement, which saw the need for:

... a more sophisticated and refined approach. The resulting policy will not counteract economic, social and demographic trends. The policy will instead seek to steer the trends at the margin by recognizing and reinforcing the positive growth characteristics of regions and maintaining appropriate and viable indigenous economic activity...

... The policy is not restricted to incentives alone, but seeks to influence the economic environment in a manner which makes possible commercially viable location decisions that are beneficial to non-metropolitan N.S.W. (NSW Government 1990: 1-2).

On the face of it, this would not suggest that governments are likely to be amenable to a proposal targeting declining regions and reliant on incentives. However, recently (February 2006) the NSW Government introduced a policy of selectively targeting regions suffering high rates of unemployment with payroll tax breaks. These regions were to include metropolitan regions, hence the new measure cannot simply be seen as a "regional" policy in the traditional Australian sense of assistance to non-metropolitan areas.

The current regional policy approach includes the following elements:

- Recognition that the role of government is increasingly one of facilitation and partnership, not of central direction;
- The rejection of regional policy as a tool for helping only "depressed" regions, however defined;
- Focus on regional competitive advantage;
- A stronger role for communities in determining their economic futures;
- Emphasis on sustainable economic development;
- Focus on the community or region as the appropriate level for policy action rather than just the individual enterprise; and
- Preference for limited or "strategic" intervention rather than open-ended regional assistance.

Regional problems have increased in complexity, and hence the policy response has been to abandon blanket approaches. There has also been an increased focus on using a mix of policy instruments, and a move away from tax measures. This change recognises that companies make location decisions on the basis of far broader concerns than cost, and that reducing a business's cost structure (through tax breaks) won't necessarily make a company decide to locate in the preferred region.

While existing programs do seek to attract new outside investment to the regions concerned, there has been a substantial policy shift among most governments away from recruiting outside firms as a means of increasing regional investment. The emphasis is now much more on growing existing regional businesses. Here, incentives can still play a role. It is not simply a matter of letting the communities find their own solutions, but is rather a partnership approach. Nor have the policy changes over the last twenty years occurred in a vacuum. There has been a mixture of pragmatic incrementalism as well as reasoned reconsideration of past policies in the light of changing circumstances. Policy has also changed in response to structural changes in the domestic economy, the pressures of globalisation and trends in regional areas, as well as because of new regional policy ideas and new tools, competing government priorities and new ideologies.

The Case for STZs

The case for STZs are:

- There are widening regional disparities in Australia;
- This is primarily seen in increasing rates of unemployment in many regions;
- This will in the future impact negatively on national economic performance;
- Moving people to jobs is not feasible;
- We must move jobs to people;
- We should help the worst off regions through regional policies;
- Tax incentives are successful tools in other countries;
- Much of the cost of these programs could be offset against revenues.

The case for STZs rests on, a number of key assumptions and assertions contained in the various reports published earlier. These relate both to the diagnosis of the “regional problem” and to the likely effectiveness of the proposed solution:

- The market has not delivered regional development – governments should do something;
- Australia has low performing regional economies;
- Government actions can reduce regional disparities;
- STZs have worked overseas;
- STZs are cost effective;
- Recent Australian government regional programs are insufficient to solve regional development problems / are ineffective;
- Local community actions are insufficient of themselves to ensure positive regional development outcomes;
- Regional policy should attempt to address disparities in regional performance; and
- Tax incentives are likely to alter business location decisions.

Regional Disparities are Widening

A key element of the STZ argument is that regional disparities are widening among regions. This is reflected in greater unemployment and widening differences in incomes and wealth. Globalisation is exacerbating the trends. Out-migration is occurring from inland regions. Hence, there is a strong element in the argument for STZs that governments need to act urgently to reverse the growing divides. Evidence of widening regional disparities tends to support a divergence theory of regional economics, and to deny the neo-classical view that regional disparities narrow over time.

More Radical Government Intervention is Necessary

According to supporters of STZs, "... divergence of unemployment rates between Australia's regions is now too great to be countered by a policy of moving the people to the jobs. Jobs have to be moved to the people" (Sheppard 2001). This goes to the heart of the old debate in regional development theory between convergence and divergence. On the neo-classical view, regional welfare converges over time because of the free flow of resources among regions. Labour moves to high wage areas, while capital moves to low wage areas, thereby narrowing the divisions between richer and poorer regions. On this view, presented most clearly in recent times by the then Industry Commission (1993), the proper role of regional policy is to remove impediments to regional adjustment and the free movement of resources. In other words, governments should help people to move out of poorer regions, if anything, rather than moving investment to declining regions.

STZs and More Interventionist Regional Policies are Used by Other Countries Serious about Regional Development

STZs have been used in other countries (USA, United Kingdom) to encourage regional development, often through tax based relocation incentives. They are also used for other policy objectives, such as decreasing long-term unemployment or employment of disadvantaged groups.

The European Union (EU) is also held up by supporters of STZs as an exemplar of regional policy, with its focus on distressed regions and its use of massive funds to achieve its objectives. The EU, through its Structural Funds, assists lagging regions that tend to be whole countries rather than the neighbourhoods assisted through US STZs.

Are Regional Disparities Widening to the Point Where Further Intervention is Required?

There is an assumption that regional divergence generally, and the degree of regional divergence in Australia at the moment, is unacceptable.

Subsequently government intervention is required through the implementation of STZs.

On this view, it is not likely that mere government incentives will make a difference to the major economic trends and demographic shifts occurring, for example the long-standing but increasing preference of Australians to live on the coast, the ongoing farm rationalisation, and the opening of the Australian economy to the forces of globalisation.

The Current Regional Policy Context and STZs

Most observers of regional Australia now accept that regional outcomes are highly differentiated. Where proponents of STZs differ from supporters of current policies is over the extent of the economic divides, whether the divides are acceptable, and what governments can, and should, do about them.

Current regional policies are largely aligned to market processes. These policies rest, ultimately, on the conviction that uneven development, while it may be ameliorated, is to be expected and is not inherently a bad thing in itself. It is true that most contemporary governments accept the importance of markets in spatial development. For example, the Standing Committee on State Development (a bi-partisan Parliamentary Committee) in the early 1990s stated that:

... government action in regional development must be market-enhancing, not market distorting. The goal of creating sustainable development requires this (Legislative Council Standing Committee on State Development 1994: 89).

There is a conviction contained in this view, not that markets will necessarily deliver equality, or the kind of growth that will make all regions prosper, but rather that regional prosperity in the long term can only be based on market-driven growth.

Support for markets in the regional development context means that there must be a business case for firm location, and this has far reaching consequences for policy development. As Taylor and Garlick suggest, regional development is about more than merely “compensation” for less-well-off regions.

Accepting the key role of the market in regional development, and the belief that, ultimately, only markets can really deliver economically sustainable development, need not entail the conclusion that government actions are never warranted. But it does mean that government intervention should be of a particular kind, should be limited, and should be confined to actions that do not distort markets.

Part of the “government cannot solve all the problems” position is that there are now a number of players in regional development, with different roles and capacities. This is the “partnership” approach favoured by government, and often dismissed by many as evidence that governments have left it all to local communities to drive development.

An important philosophical question is whether government should have a role in selecting where economic development should occur. But for STZs to exist, government must have decided that certain types of region should be encouraged to have economic development, at the expense of encouraging others. Should governments have to make this kind of decision and this kind of distinction? Is there any basis on such a judgement could be made? One argument for helping less well-off regions relates to equity. Is equity a better motivating force for regional development than, say, economic efficiency?

As Stimson argues:

... our society is dividing on multiple dimensions – including shifts in industry and occupational structure, income distribution, the incidence of poverty. ... the differentiations across space in socio-economic phenomena also have complex multiple dimensions, which are explained inadequately by a ‘city/bush’ dichotomy popularly espoused by politicians and reported in the media (Stimson 2001: 198).

Hugonnier confirms that differentiation and the breakdown of the city-country divide has been an OECD country-wide phenomenon:

OECD’s investigations have shown that this division reflects less and less the traditional dichotomy between urban and rural areas. Performances are varying widely in all types of regions. As is the case with urban areas, wide differences in income and employment capacity are found between prosperous and lagging rural areas in Member countries.

... These new patterns of population settlement, relationships between urban and rural areas and rural diversification are leading public authorities to rethink their policies (Hugonnier 1999: 1).

Hence debates over the appropriateness or otherwise of STZs must be seen in the context of Australia’s regional development challenges and the thinking underlying current policy approaches - approaches that are broadly shared across jurisdictions and political parties.

Can Governments Deliver Regional Prosperity?

There are a large number of severe constraints upon governments’ capacity to shape the space economy. These include the following:

- History and geography;

- The existing settlement pattern;
- The market – the choices of investors as to where they invest, and the choices of businesses and households as to where they locate;
- The actions of other levels of government;
- Policy drivers in other areas of government administration;
- Fiscal constraints;
- Globalisation and industry restructuring; and
- The availability of local resources to drive development at the community level, eg leadership, local financial support for development initiatives, lack of cooperation among key stakeholders.

Sorensen (2000) has argued cogently that of the many regional processes that drive economic performance, governments (at any level) have relatively little power to control, or even in some cases, to influence them. Sorensen's list of regional development drivers includes the following:

- Biophysical resource endowment;
- Geographical accessibility;
- Human and social capital;
- Demography;
- Changing lifestyle preferences;
- Space transforming technologies;
- New production technologies;
- Expenditure on public infrastructure;
- Business management and development; and
- International events (Sorensen 2000: 19).

Sorensen finds, perhaps unsurprisingly, that governments exert little control, or even influence, over most of these regional drivers.

The Commonwealth's 2001 *Stronger Regions, Stronger Australia* statement by the Commonwealth reflects this view, regarding the challenges faced by regions as "... largely beyond the control of Australian governments" (Anderson 2001: 1). Hence it seems clear that governments have made realistic assessments of their own capacity to drive regional development outcomes.

The Likely Impact of Tax Based Incentives on Industry Location

Do tax incentives actually work in attracting businesses to the areas nominated for the incentives? Much of the available evidence suggests that government incentives are generally not significant in driving business location decisions. This has important implications for STZs, since support for them relies on the conviction that incentives can shape firms' location intentions. It means both that STZs are unlikely to provide sustained regional benefits, and that pursuing them would be a waste of considerable resources.

The Record of Area Based Tax Concessions in Australia

Tax concessions have actually been tried in Australia before at State level. In most States during the 1980s, governments offered complete payroll tax rebates to firms locating in regional areas.

All State Governments across Australia, however, abandoned open-ended tax breaks (payroll tax concessions) for regional areas, largely because they did not work. They were not successful in attracting new firms to regional areas in sufficient numbers to warrant the cost to taxpayers. They were simply rewarding firms already there. Only a handful of firms had actually relocated in the late 1980s, according to analysis by the then NSW Government.

Previous attempts to influence location and investment decisions through tax concessions, including in New South Wales, have not generally achieved their objectives. While it has been argued that tax concessions in the 1980s helped retain existing jobs in regional areas, analysis undertaken at the time strongly suggested that the old payroll tax concessions were not a sufficient incentive to create new employment. Current government thinking correctly stresses the need for a business case to be made, before regional development assistance is provided.

It may be argued that the payroll tax concessions were simply insufficient as incentives for industry relocation to regional areas. However, the concessions on offer were generous, and cost the NSW Government of the day as much as \$18 million per year in 1990 dollars (Legislative Council Standing Committee on State Development 1991: 6; the total amount of assistance provided under the Country Industries Payroll Tax Concessions Scheme from 1977 to 1990 was \$173.6 million). They were open-ended, and in the case of some large regional firms, amounted to a windfall gain of over \$1 million per year.

It may also be argued that STZs would offer greater incentives in that they would be better targeted to expanding firms. Yet it is difficult to see how a marginal decrease in a firm's tax burden would offer the kind of incentive that would make a difference to a firm's decision making.

Business Location Decisions

There are many factors involved in business decision-making. While industries such as mining, food processing and farm enterprises must operate in specific areas, there are many other industries which can locate where they choose. However, those industries are generally constrained by the desire to minimise their costs and maximise their profits.

Without the essential economic building blocks, no amount of incentives will help correct underlying regional problems. Proposals for STZs fly in the face of regional economics and location theory. They suggest, in effect, that the reasons why some regions grow while others decline, and why firms locate where they do, can be manipulated simply by offering firms inducements to

locate in certain regions. They suggest that the business climate can be evened out through government largesse, and the benefits of agglomeration economies nullified.

A study by Hodgkinson et al (2001) reinforces the relative unimportance of government assistance in location decisions. The firms surveyed included manufacturing and service industries, large and small firms, Australian and foreign owned firms, city and country firms, and businesses of various ages. Respondents to a business survey about factors affecting location and expansion decisions ranked government assistance at around 5 marks out of 10, ranking it 12th in a list of 28 location factors, or at the bottom of the 4th of 6 clusters of factors (Hodgkinson 2001: 45).

The study showed that while incentives clearly do count for something in location decision making, there are not anywhere near the top of the list. Factors such as the quality of the communications network, access to a developed road network, distance from customers, the image of the location, the cost of land and labour, and transport costs – in other words, traditional location factors (with the exception of communications networks) – are “top of mind” for businesses and investors.

Hence empirical studies of firms’ location decisions confirm both the importance of a range of location factors in decision making, and the relative lack of importance of government incentives. In other words, STZs based on tax based government incentives to relocate or expand in a designated region may not actually do what they set out to do. Offering incentives – even generous ones – does not guarantee that the businesses will relocate.

There is no Consensus that STZs have worked Overseas

One of the central supporting claims for STZs is that they have worked successfully overseas. There has been an assumption, repeated ad infinitum, that STZs work overseas, and that successive Australian governments have been remiss in not trying them here.. Yet, it is one thing to note that they have been tried but another to claim that they have been successful.

The US Experience

There has been considerable debate over tax based location incentives in the United States. The evidence is mixed. Some studies suggest that all the financial efforts have been worthwhile, while others are highly sceptical of STZs. Much of the writing on US enterprise zones must be seen in the context that US enterprise zones have often been applied to poor inner city areas. According to Lambert and Coomes:

The effectiveness of enterprise zone programs remains an open research question, although the evidence is increasingly negative (Lambert and Coomes 2001: 168).

An article by Dowall (1996) examined the effectiveness of California's Enterprise Zone program using shift-share analysis and a survey of businesses. He too concluded that the programs "have produced very modest economic benefits", and "in and of themselves, zone incentives and resources have apparently done little to boost job creation and business investment" (quoted in Lambert and Coomes 2001: 169).

Literature on enterprise zones has been surveyed by Wilder and Rubin (1996). They examined 21 studies variously covering all EZ programs in the United States. They find little evidence of STZ program success, though they do not conclude that the concept is a failure (Wilder and Rubin quoted in Lambert and Coomes 2001: 169).

Lambert and Coomes also conducted an in-depth study of the Louisville Kentucky Enterprise Zone Program. They make the following observations about the success of this program:

- Claims about the success of the Program by the agency responsible were "noisy and biased", with exaggerated claims, jobs counted even when the company later moved out of the Zone, and every job created within the Zone credited to the existence of the Zone;
- Checks with companies located in the Zone found at least a 20% overstatement of investment outcomes by the agency involved in administering the Zone;
- Obvious reasons for some companies to be located within the Zone other than due to the assistance were ignored – only a small proportion of private investment within the Zone was "possibly induced by the incentives";
- Neither the precise costs nor benefits of the zone can be precisely determined;
- The economic benefits have been "modest" while the cost has been "significant" (between \$US55 million and \$US150 million over the period 1982 to 1996);
- Few new employers have appeared in the zone;
- The truly distressed area of the zone did not generate new economic activity and continued to decline for the decade of the existence of the zone. The zone generally lost jobs to the rest of the county (Lambert and Coomes 2001).

The authors conclude negatively that:

Given the high program costs, the low economic benefits, the weak link between EZ incentives and private investments in the zones, it is difficult to document that this program has been effective (Lambert and Coomes 2001: 179).

If this is the kind of evaluation on which those in favour of STZ programs cite as successful one must regard their conclusions with extreme caution.

The difficulty of measuring the success or otherwise of STZs and tax based incentives has been noted by US observers of their own STZs. As Luke et al observe:

The actual effect of these tax incentives is hard to measure. Corporations threaten to leave if tax policies are not changed, and industrial recruiters often argue that several (unnamed) firms have declined to locate in the state because of the lack of incentives. Proving, however, that the tax policy was the major factor or even a major consideration in location decisions is almost impossible because corporate decision making is not open to public scrutiny. Businesses will try to maximise profits by reducing external costs associated with taxation. Whether their inability to get tax policies changed will cause them to locate someplace else is always difficult to assess. This being the case, states with few competitive advantages may change their tax code in an attempt to protect themselves against the possibility that locational decisions will be made on this basis (Luke et al 1988: 101-02).

Hence US STZs can be seen in the context of states' bidding wars (this is what the NFF actually argued in relation to the introduction of STZs in Australia), and this is a source of great contention in the US as in Australia. The other point raised by this analysis, of course, is the question of whether firms really move or expand in response to tax incentives. This, again, is highly questionable. And while states in the US persist with tax based strategies, there is no consensus that they have "worked".

Luke et al refer to the unwillingness of many US State and local leaders to see that the world has changed and that new tools and approaches are required to achieve regional prosperity.

... state and local leaders have a characteristic set of attitudes and perceptions about economic reality that inhibit the potential for economic growth and change. These attitudes are variously characterised as "learned helplessness" ... and "economic denial, withdrawal and blame" (Luke et al 1988: 22).

Luke et al conclude correctly that:

Economic development is more than a series of industrial attraction and business retention activities. It is a process of identifying strategic goals that will stimulate and generate new economic activity. ... Traditional policies have created a powerful barrier to local initiative and to community-based economic development strategies (Luke et al 1988: 26).

As Luke et al note:

In the 1970s, encouraged by billions of dollars in federal grants and loans, many state and local governments focused primarily on one

approach – industrial attraction. Now, federal dollars for local economic development are shrinking. Yet some states and communities have been slow to react to these changing circumstances. For example, economically distressed single-industry towns may be especially prone to cling to traditional industrial development policies, even though they are more vulnerable to shifting external forces (Luke et al 1988: 26).

Luke et al refer to the clinging to outdated development strategies as reinforcing “habits of the heart” (Luke et al 1988: 28). They draw up a list of the “outdated strategies” and the “new strategies”. The outdated approach they define as including:

- Industrial attraction and plant relocation;
- Reliance on federal policy guidance and financial assistance;
- Focusing on large manufacturing firms;
- Providing low cost labor;
- Providing low-cost land and tax subsidies;
- Expansion into regional and national markets;
- Increasing jobs and employment opportunities.

The new strategies identified by Luke et al involve:

- Local “home grown” business enterprise development;
- Reliance on state and local leadership;
- Focusing on smaller and younger firms;
- Providing skilled and flexible labor;
- Providing accessibility to advanced technology and financial capital;
- Expansion into international global markets
- Wealth creation and increasing the number of employers (Luke et al: 27).

Hence US economic development thinking has moved on from supporting measures such as STZs. US thinking now emphasises better regional governance, re-invention, the use of new technologies, entrepreneurship and the critical role of innovation as the key drivers of regional success, even though many US governments still persist with the ineffective business recruitment strategies of the past (Drabenstott 2005).

US thinking now recognises that the world has moved on from the days when the competitiveness of firms and regions could be measured according to cost structures. According to Drabenstott, one of the leading analysts of regional development in the US:

Maintaining the title of “lowest-cost producer is manageable when the only contenders are a few other regions in the nation. Maintaining that title when the contenders come from every corner of the globe is truly Herculean (Drabenstott 2005: 30).

As Drabenstott points out, regional development is now much more about “agility” and the capacity of regions to “... invent and build new economic engines” (Drabenstott 2005: 53). Merely lowering the costs of doing business in a region will not create a greater propensity to be innovative or entrepreneurial.

The European Experience

The European Union (EU) approach to regional development is often held up in Australia as an exemplar of “genuine” government commitment to regional development. EU programs often assist whole countries rather than regions or local government areas, and assistance is in the form of block grants. The focus is assistance for lagging regions through the Structural Fund.

While the EU certainly spends a lot on regional initiatives – of course in a vastly different economic development context to regional Australia – there have been different conclusions drawn about the effectiveness of all the effort. Armstrong has pointed out, for example, that as many as 45% of jobs created with the assistance of the Fund would have occurred without the assistance (Armstrong 2001: 250)

Bailey and De Propriis have pointed out that the much-admired EU Structural Fund has not necessarily had the impact often attributed to it. Their 2001 paper demonstrates, in relation to whether poorer regions have improved their positions, that:

- a) there has been no change in the composition of the bottom 50 regions;
- b) among these regions some have even experienced a fall in GDP per capita between 1986 and 1996; and c) the intra-country income gap has actually widened for most of the poor performing regions (Regional Studies Association 2001: 4).

The Organisation for Economic Cooperation and Development (OECD), in a recent report, certainly questioned the impact of big spending policies, and noted that many member governments had given up on these approaches. The ACCI has referred to the OECD report in the following terms:

... international studies ... have concluded that policies based on redistribution mechanisms involving direct assistance have done little to stimulate growth and employment in the regions concerned, and in the process cost governments billions of dollars (ACCI: 2001).

Hence, the international evidence is, at best, mixed. And were it to be established that the performance of European or US regions was superior to those in Australia, it might well be asked whether this was because of massive regional subsidies, or in spite of them.

The Likely Cost to Taxpayers of STZs

Simply spending large amounts of money on regional problems does not guarantee the effectiveness of the programs, particularly if they are poorly targeted. Expanding the size of regional policy interventions has been seriously questioned by the OECD. As Hugonnier has pointed out, one of the lessons of what he terms “government failure” experienced across most OECD countries in the last two decades of regional policy has been:

The uselessness of pouring massive amounts of assistance through bureaucratic channels into lagging regions (Hugonnier 1999: 6).

There is considerable conjecture over the likely cost of STZs to the taxpayer. On the one hand, supporters of STZs have been keen to play down their cost, pointing out that they would not “cost” anything at all, since they would only apply to “new” employment, which would generate its own taxation payments, save on social security, and contribute to local economies in other ways.

Possible Economic Distortions in STZs

Earlier arguments suggested that spatially selective tax incentives were unlikely to be successful in influencing firm behaviour. What would be the likely economic outcomes, however, if they were successful in encouraging firm relocation to, or expansion in, designated areas?

“Deadweight” Effects of Regional Policies

There have been concerns expressed about many regional policies and investment attraction efforts that the firms targeted “would have come anyway”. This has been termed the “deadweight effect” (see Armstrong 2001: 250). Armstrong has suggested that, for example, the European Union Structural Fund has had as much as a 45% deadweight effect.

Armstrong concludes that the so-called deadweight problem can be overcome (only to some extent) by selectivity in regional assistance:

High levels of deadweight are found in all types of regional policy and this remains the most potent of the arguments for selectivity (Armstrong 2001: 250).

The deadweight issue has been raised in relation to Australian decentralisation incentives. According to a Rural Development Centre study, describing earlier decentralisation programs:

Consistent with findings of other studies ...for most firms the decentralisation grants offered under various NSW schemes operating at the time represented a welcome addition to start-up capital rather than featuring as a major determinant in their decision to relocate.

It seems likely that most would have made the move anyway (RDC 1993: 66; emphasis added).

STZs would seem to be at least partially prone to the deadweight problem to the extent that open-ended tax incentives are used to attract firms to the zone.

STZs May Simply Move Economic Activity from One Region to Another

An enduring concern about tax zones has been the fear that, if successful in attracting new investment to regions, it may be that the investment would simply be drawn from neighbouring (or other) regions. This is the fear of the “zero-sum” outcome. As the ACCI argues:

Success in one region at the expense of another because of government policy would not only be bad policy but also politically very unpopular (ACCI 2001).

It is arguable that such political problems were close to the heart of the failure of 1970s growth centres, which were similarly spatially selective and could be seen as distorting location decisions.

The ACCI compared the 2001 enterprise zone proposal to the bidding wars that occur among States. There has been a long-term debate about the merits of the various States and Territories competing with one another to attract investment, and the practice is generally seen as highly problematic.

Businesses Locating for the Wrong Reasons

It has also been argued (ACCI 2001) that STZs would result in economic distortions. Communities just outside the zone might be disadvantaged, and businesses might locate just within the zone for the wrong reasons.

While the stated objective of STZs is to build regional competitive advantage, the mechanism chosen to do so – geographically specified tax breaks may, perversely, have the opposite outcome, by encouraging firms to relocate just to save tax payments. Some firms which formerly received payroll tax rebates have indicated that they only moved in order to comply with a decentralisation ethos, not for economic reasons. Such firms may be asking for trouble, by relocating for reasons other than sound business location principles.

Will Businesses Simply Move On Once the Enterprise Zone Period is Over?

The US has a strong tradition of bidding wars among States. There is certainly some evidence from the US that businesses attracted to lower cost States move on once the period of incentives runs out. While the costs of relocation are considerable, this concern is not without some justification.

Constitutional Issues

A number of observers have raised potential constitutional problems with STZ proposals. Section 99 of the Constitution states that:

The Commonwealth shall not, by any law or regulation of trade, commerce or revenue, give preference to any one State or part thereof, over another State or part thereof.

The Constitutional issues surrounding STZ type proposals have persisted despite attempts by their supporters to suggest that the dangers of legal challenges are overstated.

Policy Choices – In What Measure Should Governments Assist Declining and Growing Regions?

Governments face numerous choices as to how they assist regional development, and have a number of policy instruments at their disposal. The choices faced by practitioners at the local level are equally daunting, and there are no obvious answers. Assuming a government chooses to be spatially selective, it needs to determine which kinds of regions to support. How government should make this choice is not obviously apparent, unless the choice is related to objectives.

The answer may be that governments should help both growing and declining regions. Yet this argument ignores the reality that all policy actions have an opportunity cost, and that government resources are finite. The question therefore arises, where should governments direct taxpayer funds for regional development?

While equity is certainly a driving motivation in spatial policy, addressing the problems of poorer regions can only ever be part of a strategy to encourage regional development. It is also important to assist regions with strong growth potential.

This is particularly the case for those who argue for “balanced development” between city and country. This was at the heart of the growth centres debate in the 1960s and 1970s. A scatter-gun approach of spreading regional assistance thinly was rejected in favour of getting a better development “hit” by concentrating development around “growth poles”.

Hence, there may well be a paradox at the heart of STZ thinking. If the aim of the exercise is to diminish the apparently growing imbalances between city and country – and this does seem to be a primary motivation of supporters of STZs, a better way of achieving this may be to strengthen those areas most likely to attract new investment, not to focus on those least likely to attract investment.

Hugonnier has also expressed concern that pouring substantial amounts of assistance into lagging regions has "... favoured a culture of dependence on assistance and multiplied obstacles to development" (Hugonnier 1999: 6). Looking at the Mezzogiorno region in Italy as an example, Hugonnier noted that, despite much assistance, disparities in the region actually widened over a 15 year period (Hugonnier 1999: 6).

A related question concerning policy choices concerns the fact that the STZs approach, at least insofar as it provides business incentives, focuses very much on the firm, rather than the region's business climate generally. While it is firms that will create new regional jobs, providing the assistance to the firms themselves directly may not be the optimal use of taxpayer funds.

Alternately, assistance might be still directed to the firm, but used to address specific, identified problems experienced by regional enterprises, such as skilled labour shortages, training, infrastructure, management skills, business planning, export development, and general advice and support. These are already currently provided through a number of State schemes.

Difficulties in Measuring Regional Well-being

There is considerable debate about how to measure "regional well-being". Walmsley and Weinand have noted, for example, that "... there is no consensus on what comprises a definitive set of social indicators (Walmsley and Weinand 1997: 74).

Sorensen has claimed that:

... there are serious deficiencies in the variables used to measure regional well-being. Most studies are, in fact, only assessing selected regional conditions and omit many important considerations." (Sorensen 2000: 5).

For example, it may be that hidden income not normally considered as part of measured household income may cause significant variations in notions of distressed regions. How would any body assessing the claims of regions for assistance weigh a certain amount of unemployment against rural depopulation, for example? Which would signify the greater degree of "distress"?

Reliance on standard indicators may mask real decline. What about a region with extremely low unemployment but which has experienced substantial out-migration? What about a region with high unemployment but also high population growth? It may make little sense to compare these two kinds of regions. A third case may be a region which is steadily losing young people, but gaining retirees, who might be seen as contributing less to the local economy. Yet the population would show little if any decline.

Measuring income need not be an accurate indicator of wealth either. Equally, differences in income between regions may ignore the fact that the cost of living also varies from region to region. Also, different people, households and businesses value different indicators differently.

Some economic and social indicators are static, others dynamic (in other words, they measure changes in well-being over time). Do you measure well-being at a given time, or over time? If over time, what is the appropriate time period for measurement? Is two years of population decline sufficient? Or must it be five years? How long must a region have high unemployment to qualify, and how would the Government justify its choice? How high is high unemployment? Would a shortage of skilled labour in a region – in other words, too many jobs – be regarded as a regional problem deserving STZ status?

And how does one measure intangible positives and negatives about regions? For example, do unskilled jobs count for the same as skilled jobs? What about environmental values, amenity, quality of life? These issues are not matters of idle speculation. They are real issues that might determine which regions obtain funding and which do not. Hence, simply removing the decisions over who benefits from politicians may not solve the problems seen in traditional politically determined selection of targets for regional assistance. As Sorensen argues:

Well-being has inter-acting economic, social, cultural, environmental, medical, attitudinal, and geographical dimensions. The dimensions are internally multi-faceted, complexly interrelated and evolving dynamically. Except for the analysis of poverty, there is little agreement on the weights that one might assign to component variables, simply because lifestyle options and preferences diversify enormously with increasing wealth (Sorensen 2000: 5).

The complexity of measuring regional well-being reflects widely differing perceptions of the nature of the regional problem and the drivers of regional success, and poses significant practical problems for proponents of measures such as STZs, who optimistically assume that criteria for determining which regions are to receive assistance can be easily determined.

Conclusions

The case for STZs ultimately fails, on a number of grounds:

- It is by no means clear that regional Australia is generally “in decline”;
- The central assumption that greater government actions can and will effect better regional development outcomes than current approaches ignores the complexity of the processes driving regional development;
- The core argument that tax incentives will be effective in driving location decisions is shown to be hollow;
- Many studies confirm the suspicion that government programs do not, by and large, drive investment decisions;

- There is no way that an objective observer could possibly conclude that STZs have “worked” in the US, or that the EU approach of massive government subsidies has delivered unambiguously positive regional outcomes in proportion to the dollars or euros expended;
- Measures of regional well-being are fraught with problems, and in any case it is by no means obvious that the regions favoured by STZ supporters as candidates for assistance will be the ones that an analysis of distress will throw up.

Supporters of STZs favour looking to government for regional solutions. Their view of regional Australia contrasts with the view that regions should simply get on with the admittedly hard grind of making their local economies work better, albeit working in partnership with governments.

Simple solutions may help solve simple problems. But simple solutions will not generally be so effective if the problems are complex. Regional economic growth is driven by factors such as business costs, the size of the local economy, local industry structure, the competitiveness of local firms, critical mass, the amenity of the region, history, institutional support, infrastructure, the business cycle, national economic conditions, demand for the region’s products, external shocks, and industry diversity. Regional development is not simple.

Governments face difficult policy choices and have finite resources. There are serious questions about which regions to support, whether to focus on firms or communities or industries or whole regions, and how much to intervene. Governments have not always got regional policy right. There is always room to do better. There are many real “market failures” in regional areas, many real problems to be addressed, and addressed more systematically.

It is important to recognise that the regional world has changed, and governments seeking to influence regional outcomes in positive ways must tailor their interventions to the needs of the 21st century, rather than simply rely on policies that properly belong in the past, in times when competition was national rather than global and businesses based their investment and location decisions on cost.

Overall, the analysis contained in the case for STZs is not sufficient to suggest that is approach to regional policy warrants serious consideration by governments in Australia.