



## Are Enterprises Zones a Tool for Reducing Regional Disadvantage in Australia?

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### Introduction

There are two broad strategies that are used to promote national development in Australia. First, the commonwealth government is a careful manager of the macro economy and attempts to keep inflation and interest rates low by maintaining fiscal austerity. Second, commonwealth and state governments have been deregulating the economy in an attempt to promote efficiency and higher productivity. Together these two strategies have arguably been responsible for the strong performance of the Australian economy over the last decade or more.

A focus on the macro economy and increased reliance on the market mechanism seems to have done little to alleviate regional disadvantage and may have even exacerbated regional imbalances. In other words, while the nation appears to be developing there is significant variation across Australia, with some regions performing well while others continuing to experience high levels of disadvantage.

The Barwon Darling region of northwest New South Wales is an example of a disadvantaged region.<sup>1</sup> Due to the declining share of primary production, the migration of people to the coast and recent water reforms, the Barwon Darling region experiences high levels of economic and social

disadvantage, especially among its indigenous population. The economic disadvantage of the Barwon Darling region is shown by the loss of population and a general failure of the region's economy to generate employment opportunities. The social disadvantage is reflected in the comparatively low levels of post-school education, high crime levels and drug abuse.

Governments have a responsibility to address regional disadvantage so as to ensure that all regions of Australia have a greater opportunity to participate in the growth of the national economy. Indeed, Kenneth Button (1998) argues, 'if there is no, or, at the very least, very little regional convergence in economic performance then this can result in political difficulties'.

A more targeted and region specific policy response appears necessary to address regional disadvantage and to promote structural adjustment. In this respect commonwealth and state governments have adopted a program based approach to address regional problems. This involves the various departments of each level of government providing specific assistance to address individual problems. However, many people in disadvantaged areas believe that the program based approach is not effective. This means current regional development policies are not addressing the problems of disadvantaged regions like the Barwon Darling.

One policy tool that could possibly be used to promote regional development is enterprise zones. Enterprise zones have a long history in the United States and the United Kingdom.<sup>2</sup> Enterprise zones

<sup>1</sup> The Barwon Darling region covers the shire councils of Bourke, Brewarrina, Central Darling, Coonamble and Walgett and part of the Murdi Paaki Regional Council of ATSIC.

<sup>2</sup> This paper focuses on enterprise zones in the United Kingdom due to the limited amount of information available in English for European enterprise zones located outside the United Kingdom.

have also been recently introduced in France and Italy, while the general approach is also used in a number of other European countries such as Ireland, the Netherlands and Hungary. This paper reviews the international literature on enterprise zones to determine whether the zones are an effective tool for promoting regional development. The paper concludes with a discussion of a Barwon Darling enterprise zone model, which was developed on the basis of consultation with the local business community and incorporates the incentives that appeared to be the most successful in the international literature.

### Are Enterprise Zones Effective?

There is a large body of research that attempts to evaluate the success of enterprise zones as a tool for promoting development. To some extent the results of any specific evaluation are shaped by the methodology used in that study. Given the differences in the methods available and the fact that each one tends to have its own advantages and its disadvantages a decision had to be made regarding which methods were most valid. Accordingly, econometric studies and survey evidence were used to make an overall assessment of the effectiveness of enterprise zones. Survey and case study evidence were then used to provide an indication of the specific impact of different types of incentives. This combination of evidence from a range of different methods arguably provides a good picture of the effectiveness of enterprise zones.

#### *Are enterprise zones effective at generating employment growth?*

One of the key measures of the effectiveness of enterprise zones is employment growth. There are a number of multi-state studies of enterprise zones in the United States that have concluded enterprise zones tend to be effective in stimulating employment and job creation (Beck 2002, Erikson, Friedman & McCluskey 1989, US Department of Agriculture 1993). There is also evidence that enterprise zones in the United Kingdom are effective in stimulating employment growth (PA Cambridge Consultants in Potter and Moore 2000).

While enterprise zones do appear to be effective in stimulating employment this does not appear to be true in all cases. For example, Collits (2001, p. 54) cites evidence that shows enterprise zones were

not effective in the states of Kentucky, California and New Jersey. However, more recent research than that cited by Collits shows Californian enterprise zones have been effective (Hatamiya 1999, in Aphorpe 2002, O'Keefe & Dunstan 2001). In any case, it cannot be concluded from an examination of enterprise zones in three states that the concept has been ineffective in the United States. Firstly, there is evidence enterprise zones have worked effectively, to a greater or lesser degree, in a number of states, such as California, Colorado (Alm & Hart 1998), and Illinois (Community Research Services 1989). Secondly, as referred to above there are more comprehensive, multi-state studies that have shown enterprise zones tend to be effective in increasing employment in the United States.

The literature does not conclusively demonstrate the contribution of enterprise zones to employment growth. It appears that somewhere between 10 and 40 per cent of the employment growth that occurs in an enterprise zone can be attributed to zone incentives (Peters & Fisher 2002, US Department of Housing and Urban Development in American City and County 2002). Part of the problem in estimating the impact of enterprise zones on employment growth lies in the diverse nature of the zones in terms of their economic characteristics, the range of incentives offered and the administration of these incentives. However, the analysis of tax and spending incentives in enterprise zones by Fisher and Peters (1997 p. 129) concluded that it is likely enterprise zone incentives will produce measurable gains in employment or business investment in some cases.

The international evidence therefore indicates that enterprise zones can be effective in stimulating employment growth. However, enterprise zones do not appear to be universally effective, as there is some contradictory evidence. Similar conclusions were reached by the National Institute of Economic and Industry Research (2001), which stated, 'the balance of opinion is that there has indeed been net job creation'.

#### *Does an enterprise zone transfer economic activity from other regions?*

One argument that could be made against the effectiveness of enterprise zones in generating employment is that zones simply pirate jobs from other regions. In other words, enterprise zones

simply transfer economic activity from one region to another. However, the literature on enterprise zones, as reviewed by Peters and Fisher (2001 p. 123), consistently finds that enterprise zone incentives are less important than other factors such as availability of labour and access to markets. Enterprise zone incentives only make a difference at the margin,<sup>3</sup> when these other factors are equal. This finding supports the conclusion of Collits (2001 p. 35) that government incentives are generally not significant in driving business location decisions.

Given enterprise zone incentives only operate at the margin and are outweighed by other factors, it is likely that zone incentives are more likely to impact on location decisions between similar locations, where other factors like labour costs and access to markets are equal. For example, while a Barwon Darling enterprise zone might not be effective in attracting new businesses from city areas, zone incentives may attract new businesses considering a range of locations similar to the Barwon Darling. Survey evidence also suggests that the majority of new business establishments in enterprise zones come from the expansion of existing businesses and from new business formations (Klemens 2002, Peters & Fisher 1997 p. 127). Less than 20 per cent of new business investment consists of relocations of existing establishments or the establishment of a branch plant by a firm outside the zone. This suggests that the focus of an enterprise zone policy should be to support existing business growth and to promote new businesses.

Thus, while enterprise zones may not have an impact on the location decisions of non-local businesses the incentives may be effective in stimulating growth among businesses already located in the zone. Enterprise zones may also be effective in promoting 'home-grown' business formation by people (i.e. the unemployed) who are already living in the zone. In both these cases the expanded or new business is likely to have a greater attachment to the region, and according to research by Potter and Moore (2000), these businesses are more likely to remain in operation after enterprise zone incentives end.

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<sup>3</sup> It should be noted that the fact that enterprise zone incentives have an impact on the margin does not necessarily imply that enterprise zones have a marginal (i.e. small) impact on employment.

### *Do enterprise zones alleviate regional disadvantage?*

An important rationale for the implementation of an enterprise zone is to alleviate economic and social disadvantage. On this issue the available evidence is less clear. A survey of 51 enterprise zones conducted by Beck (2002), showed that nearly all measures of adverse socio-economic conditions increased between 1990 and 2000 in US enterprise zones. For example, the poverty and unemployment rates in the zones either grew at rates higher than the adjacent areas or declined less than the adjacent areas. In addition, enterprise zones continue to struggle with placing the long-term unemployed in jobs. From his analysis, Beck (2002) concluded, 'enterprise zones were not successful in their fight to offset or reverse the deleterious trends faced by inner-city or rural residents'. Interviews conducted by Klemens (2002), with community leaders, zone administrators and business persons located in enterprise zones also led to the conclusion that while zones are an effective method of promoting economic development, they are not highly effective in targeting distressed areas.

Survey evidence therefore suggests that enterprise zones may not be an effective way of addressing disadvantage. While there is little econometric work addressing the issue of disadvantage, Papke (1994 in Peters & Fisher 1997 p. 124) conducted an econometric study that found enterprise zones led to a 19 to 25 per cent reduction in the number of unemployment claims. While it is not possible to generalise from this result it is fair to assume that if enterprise zones tend to be effective in increasing employment, all else being equal, this would cause the rate of unemployment to fall. Therefore, while enterprise zones are likely to have difficulty addressing social disadvantage for the long-term unemployed and indigenous persons the policy should lead to a reduction in unemployment. In addition, there is evidence from Colorado that enterprise zone programs have a significant positive impact on per capita income in zone areas (Alm & Hart 1998).

Overall, the international evidence appears to suggest that the implementation of an enterprise zone policy is likely to lead to higher employment and businesses investment, although the zone may be less effective in addressing social disadvantage. However, this conclusion is largely based on evidence from enterprise zones in the United States, which are predominantly located in urban

neighbourhoods. Indeed, there is some evidence that the generation of regular work opportunities in the Barwon Darling could in itself be expected to cause a reduction in regional disadvantage. This conclusion is supported by B Lulham, the Wilcannia magistrate who wrote the following in a letter to express his support for Federal Government work programs (i.e. Newstart),

*I have noticed a very marked downturn in the number of matter coming before the court. Whereas in years gone by there were over 100 fresh charges each month before the court the figures lately have been approximately 10 or less each month. I am absolutely convinced that the fact that so many persons usually unemployed are now gainfully engaged in work is the main factor contributing to the marked decrease in crime.*

### ***Are enterprise zones relevant to regional and remote Australia?***

An important question to address is whether the international evidence is applicable to an enterprise zone established in a regional or remote area of Australia, like the Barwon Darling. However, Potter and Moore (2000) have examined the role of inward investment in urban, accessible and rural enterprise zones in the United Kingdom. The results for their sample of rural enterprise zones provide a useful indicator of the possible role of inward investment in a Barwon Darling enterprise zone. The main results that arise from an examination of remote enterprise zones in the United Kingdom are as follows:

- one-third of the businesses in a remote zone were influenced to invest there by enterprise zone incentives. In contrast, over half of the businesses in the United Kingdom enterprise zones were influenced by the incentives. The majority of these new businesses were short-distance transfers, which are businesses influenced by enterprise zone policy to invest in the zone instead of another location within the local area. A relatively high proportion of the businesses located in remote zones were new company start-ups relative to the average for UK enterprise zones (i.e. 33 per cent compared to 23 per cent). This suggests enterprise zones may have a greater impact on new business formation in remote areas;

- on average about half of inward investors establish businesses in the manufacturing industry. However, in remote zones nearly two-thirds of inward investors are in the manufacturing industry and no businesses invested in distribution (i.e. wholesale or transport). Inward investors in remote enterprise zones were more likely to recruit managers from the local population and to give jobs to people who were previously unemployed. For example, 55 per cent of the additional people employed in remote zones were previously unemployed, while the average for UK enterprise zones was 34 per cent;
- businesses that invest in remote areas are more likely to remain in that area once enterprise zone incentives end. This is shown by the fact that 75 to 85 per cent of inward investors in urban and accessible zones intend to move off zone upon de-designation, while only 55 per cent of inward investors in remote zones intend to move. This result also highlights the fact that attracting inward investment may not be a long-term solution as more than half of new businesses intend to leave enterprise zone areas when the incentives end. In other words, it is more important to support business expansion and 'home grown' business development.

The findings of the Potter and Moore (2000) study suggest that enterprise zones can be effective in both inner city and remote areas. Indeed, remote enterprise zones may be more effective in addressing social and economic disadvantage given the finding that remote zones are more likely to provide jobs for unemployed persons. Moreover, a remote enterprise zone may be more successful in the long-term given that new businesses established in remote zones are more likely to remain after the incentives end.

### ***What is the overall assessment of enterprise zones?***

On the whole enterprise zones appear to have had their successes and their failures, and there is continual debate regarding their general effectiveness as a model for promoting economic development. However, setting aside the academic debate regarding the general effectiveness of the model the fact remains that there is evidence that

enterprise zones are successful in some cases. This suggests if an enterprise zone was established in the Barwon Darling region the policy has a good chance of promoting employment growth if there is a sufficient uptake of the available incentives.

In addition, a Barwon Darling enterprise zone could stimulate business investment if the available incentives are targeted toward existing businesses and local people who would like to set up their own business. Therefore, a Barwon Darling enterprise zone is likely to be effective in promoting economic development in the region so long as the incentives are substantial enough to cause the desired effects on employment growth and business investment.

## The Barwon Darling Enterprise Zone Model

As discussed, the Barwon Darling community believes that the existing framework of development policies has not been effective in addressing the structural and long-term development policies of the region. Existing programs are perceived to be too fragmented and transitory. Likewise the free operation of the market has failed to generate economic development or helped to provide social opportunities such as a good quality education and employment for indigenous persons or the long-term unemployed. The Barwon Darling community would therefore like to form a stronger partnership with government to promote economic and social development in the region. The tool chosen to achieve this objective is the Barwon Darling enterprise zone model discussed in this section.

It is plausible to suggest that an enterprise zone could be more effective if the policy incentives match the needs of businesses in the region. Therefore, interviews were conducted with 22 businesses in the Barwon Darling region to identify the policy incentives they would prefer. A broad list of policy incentives that have been used in enterprise zones or could be used in a Barwon Darling enterprise zone policy was put together based on the results of the literature review. The businesses were asked to rank these incentives on a scale of 1 to 10, where 1 is no impact and 10 is a significant impact. The ratings for enterprise zone incentives were summarised in two ways:

1. Ratings were grouped into 'yes' and 'no' responses. A 'yes' response refers to an enterprise zone incentive that is expected to have a medium to significant impact on a businesses employment or investment decisions (i.e. a 5 to 10 rating). A 'no' response is one where an enterprise zone incentive has a minimal impact or no impact on employment and investment decisions or was not applicable to a specific business (i.e. a 1-4 or not applicable rating).
2. Ratings were ranked into first, second and third preferences. A first preference is the enterprise zone incentive that was expected to have the most significant impact on a respondent's employment and investment decisions. The second and third preferences were the next two most significant incentives. In some cases businesses ranked two or more enterprise zone incentives as equal. Thus, respondents may have two or more first, second or third preferences and the total number of preferences is greater than 66 (i.e. 22 respondents times 3 responses).

Table 1 shows the ratings for each enterprise zone incentive canvassed during interviews with businesses in the Barwon Darling region. The results show a mix of economic and social incentives was preferred by businesses in the Barwon Darling.

The interviews also suggest that it may be social problems like poor education, drugs and crime that are limiting economic development in the Barwon Darling rather than the inherent lack of profitability of the region's businesses. In these circumstances economic incentives such as wage credits and financial support for capital investment may be ineffective if used by themselves, as their impact may still be limited by social problems that make it hard to attract good employees. Addressing the problems of education, crime and drugs should improve the lifestyle of residents and make the Barwon Darling region a more attractive place to live for professionals and families. These social improvements could then be expected to flow to the bottom line of businesses in the region. Likewise, the generation of regular work opportunities in the Barwon Darling could also be expected to have social benefits.

Table 1: Ratings for enterprise zone incentives (number of respondents)

Enterprise Zone Incentives	Significant Impact?	First	Second	Third
Greater public support for education and training	18	7	3	3
Mentoring support for long-term unemployed and indigenous persons to help them make the transition to work	18	4	3	3
Exemption from various taxes (e.g. stamp duty, permit fees, business licence fees, and construction taxes)	18	4	2	5
Wage credit for additional employees	18	3	7	3
Increased crime and drug abuse prevention	17	5	2	2
Low cost finance for new investments	15	4	1	5
Accelerated depreciation allowances for new equipment	15	0	5	3
Increased government investment in local infrastructure	14	4	3	0
Grants to offset council rates for expanding businesses	12	1	1	3
Increased public provision for child care	12	0	1	3
Increased assistance with exports	11	4	0	4
Funding for professional services to assist with networking facilitation of industry networks and clustering	11	0	1	7
Payroll tax concessions for expanding businesses	7	1	2	1
Facilitation of industry networks and clustering	5	0	0	1
Property tax concessions for new property investments	2	0	0	2

Source: Interviews conducted with 22 businesses in the Barwon Darling region.

While social factors are important it should also be noted that a number of businesses highlighted the point that the specific incentives in an enterprise zone are not as important as whether or not they improve the viability of operating a business in the Barwon Darling region. In other words enterprise zone incentives will only have a significant impact on employment and investment decisions if they can bring about a net increase in the profitability of businesses and promote economic development in the Barwon Darling. In this respect economic incentives like tax credits, low cost finance and grants to offset various government costs and charges are important as they are highly visible incentives that directly impact on the profitability of a business.

The policy incentives preferred by Barwon Darling businesses are very similar to the range of existing government programs. In most cases existing commonwealth and state government programs provide the kind of incentives that businesses in the Barwon Darling would like as part of an enterprise zone. The one exception is accelerated depreciation, where there does not appear to be a program offering higher depreciation allowances to targeted groups. While existing programs may

address the issues raised by businesses in the Barwon Darling, anecdotal evidence suggests that these programs are not highly effective. The interviews also suggest there is a low take-up of existing programs due to the complicated application procedures required to obtain funding (i.e. excessive 'red tape') and a lack of awareness of the available programs due to the complexity of program-based assistance in Australia.

Given the broad similarity between the enterprise zone incentives preferred by Barwon Darling businesses and the type of programs provided by government it may be appropriate to use these existing programs as the base for a Barwon Darling enterprise zone. In other words, existing government programs could be restructured to meet the specific needs of businesses in the Barwon Darling region. This restructure to existing programs may include: modifications to eligibility criteria, improved delivery methods and funding for longer time periods. Greater promotion of available programs to ensure the Barwon Darling community is aware of the government programs that are available to assist the region would also be beneficial as there is a distinct lack of awareness of the forms of government assistance available.

The results of the interviews and the literature review were synthesised to develop an enterprise zone model tailored to the needs of the Barwon Darling region. This model includes three broad groups of incentives. Given their prominence during interviews social incentives are needed to improve the quality of life and could include: increased public support for education to improve basic reading and writing skills; mentoring for unemployed people, especially indigenous persons and the long-term unemployed, to help them make the transition to work; increased crime and drug prevention; an improvement in the quality of childcare; and more family-friendly work policies.

The economic incentives aim to promote employment growth and business investment. This could be achieved by: a 25 per cent wage credit for new employees; interest rate grants to reduce the cost of finance; accelerated depreciation grants to encourage capital investment; and grants to offset various government costs and charges that could assist new businesses.

Capacity building incentives are needed to strengthen the ability of the Barwon Darling community to drive development and to ensure that development continues after the funding of the enterprise zone ceases. The capacity building incentives could include: support for networking and clustering; the establishment of a research partnership with Charles Sturt University; advice from experienced exporters on how to penetrate foreign markets; and priority consideration for government infrastructure development.

Aside from the incentives, two of the other important elements of the Barwon Darling enterprise zone model are a decentralised administration and competition. A decentralised administration should be set up that is responsible for community planning, managing the budget, selection of eligible firms and allocation of funding for enterprise zone incentives. Local government should play a strong role in the administration of the Barwon Darling enterprise zone, as this will promote community empowerment.

There should be competition between eligible regions for designation as an enterprise zone and competition between eligible firms for the allocation of funding within a zone. This competition should enhance the effectiveness of enterprise zones as a development tool because public assistance is directed to local firms that are likely to produce the greatest net benefit.

## Conclusion

The benefits of national development over the last decade or more have not been evenly distributed across each region of Australia. Some regions are performing well, while others experience high levels of disadvantage. While effective at promoting national development the current regional policies do not appear to be effective in addressing the problems of disadvantaged regions like the Barwon Darling.

One tool that could possibly be used to promote regional development is enterprise zones. Enterprise zones can be effective in stimulating employment growth and business investment, although there is some evidence to the contrary. There is also evidence that even remote enterprise zones can support the expansion of existing businesses and the development of 'home grown' businesses managed by local people. In other words, enterprise zones are not only effective in inner city and urbanised areas and therefore the policy could be used more broadly to address disadvantage in Australia.

Interviews with members of the Barwon Darling business community suggest that an enterprise zone implemented in their region should include a mix of economic and social incentives. Economic incentives are needed to bring about a net increase in the profitability of businesses and promote economic development in the Barwon Darling. Social incentives are needed to improve the quality of life by addressing problems like poor education, drugs and crime that are also limiting economic development in the Barwon Darling. In combination with these two groups of incentives the literature indicates that capacity building incentives would also be necessary to support the long-term effectiveness of a Barwon Darling enterprise zone. These capacity building incentives should strengthen the ability of the local community to drive development, which will help to ensure that development continues after the funding of the enterprise zone ceases. In most respects all three groups of incentives can be provided through existing programs, but using the enterprise zone governance structure.

Given the evidence regarding the effectiveness of enterprise zones in some cases and the high levels of economic and social disadvantage in the Barwon Darling region it is logical to suggest that an enterprise zone be tested in the Barwon Darling.

This test would help to determine whether or not enterprise zones are an effective tool for promoting regional development in the Australian context.

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