WHY ENTERPRISE ZONES DON'T WORK

THE NOTION of the enterprise zone achieved considerable popularity under the aegis of Margaret Thatcher. The idea was to provide entrepreneurs with special incentives to locate in economically disadvantaged areas. The intention: encourage an inflow of investment and new jobs.

Nobody asked the obvious question: why couldn't everyone enjoy the incentives - to raise the level of prosperity across the board? Why assume that the urban "black" spots were exceptional victims of the tax system which required "incentives"?

The slide of the British economy into depression tarnished the concept of enterprise. But in what looks like an act of desperation, it has been polished up for a Scottish area where thousands of British Steel jobs are being wiped out by the closure later this year of the Ravenscraig works.

The British experiment - which also caught on in the USA - failed to produce the expected results. Why? The answer matters, for the Russians are now vesting faith in this notion, calling them "free trade" zones. If the Russian experiment fails, blame will be attributed to the free market - and that would set back the thrust towards reform. So an understanding of the economics of enterprise zones (EZs) has ideological consequences beyond the territorial boundaries of the UK. The USA, for example, now plans to create 50 EZs in the next four years, with "incentives" that include a zero capital gains rate for gains on investment in tangible property.

THE FAILURE of EZs could have been anticipated theoretically, if attention had been paid to the nature of the "incentives". These took the form of tax "breaks". They could not directly favour goods exported out of the zones, for practical and political reasons. In the shops, for sales tax purposes, how can you differentiate (without enormous bureaucratic implications) a TV set manufactured inside an EZ from a similar article manufactured just outside the zone? And how does a government explain to one manufacturer that his product ought to be more expensive (because of a higher tax burden) than his competitor's product?

So the fiscal incentives were directed at the capital and land markets, in the form of lower taxes on the profits of capital, and the cancellation (known in some quarters as a "holiday") of rates - the local property tax. Paradoxically, however, this tax regime militates against the infusion of capital. For under present tax-and-tenure arrangements, landowners can exact higher land prices or rents, to mop up the extra revenue that was supposed to go into the pockets of the capital-owning entrepreneurs! That's the theory. What actually happened?

In 1981, the Thatcher government designated the first of 25 zones that were to receive 100% capital allowances on industrial and commercial buildings; and the rates charge was abolished. Result: investment activity was not capital intensive: warehouses were the order of the day. This did not create either a substantial numbers of jobs or the conditions for longterm growth in output of wealth.

◆ Rents in EZs soared by up to 50%, compared with levels just outside the zones. The Department of the Environment conceded that this was because "the lack of rates enables the market to bear higher rents" - so firms locating in the EZs lost the "incentive" that was supposed to induce them into the area in the first place!

Equally damaging, however, was the negative effect on enterprise outside the zone. According to an oficial investigation by Roger Tym and Partners - a firm of London land economists - "development gains in the zones are most likely to be offset by reduced activity outside where the private sector was previously active in the area around the zone".*

◆ Jobs did not materialise in profusion. The zones attracted old-established firms rather than resulting in the creation of new ones. Warehousing (which requires few employees) accounted for nearly half the floorspace: these certainly did not add to the productive capacity of the economy. In 1987, the government admitted that the zones had proved expensive in "cost per job" terms.

The net result was disruptive. The general lesson for Thatcher's enterprise economy was that shrewd trading in land was the way to make the fast bucks - or, as the report by Tym and Partners put it; "The prior stage of assembling or dividing the land into marketable parcels and releasing it may be rather less attractive in an EZ unless the owner is able to develop and gain the benefits of the capital allownces and rates [property tax] relief or alternatively the land price rises sufficiently to make disposal attractive". This activity did not add much to the total sum of human happiness. The EZs added their fuel to the explosion of land prices, which created the conditions for the collapse from which Britain is now suffering.

**Monitoring Enterprise Zones*, London: DoE, 1983.

Published by the Centre for Incentive Taxation,
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