Submission No 21

ESTABLISHMENT OF SPECIAL ECONOMIC ZONES

Organisation: Central NSW Councils (Centroc)

Name: Cr Phyllis Miller

Position: Chair

Date Received: 23/03/2012

CENTRAL NSW COUNCILS

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Chairman: Cr Phyllis Miller, Mayor Forbes Shire Council

22 March 2012

Reference: pm:vp 031222
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The Chair,
Committee on Economic Development,
Parliament House, Macquarie Street,
Sydney NSW 2000

Inquiry into the establishment of special economic zones

Dear Mr Elliott,

Thank you for the opportunity to make a submission.

Centroc represents sixteen local government areas and one water authority in central NSW. This is an area the same size as Tasmania with about half the population and a bigger GDP. Centroc exists to advocate on behalf of the region's communities and deliver cost savings and other efficiencies to member councils. The Centroc Board is made up of the Mayors, elected representatives and General Managers of the region.

Centroc understands the terms of reference as,

"That the committee inquire into and report on the establishment of special economic zones providing state tax and financial incentives to promote economic growth, employment and investment in regional and rural New South Wales; and any other related matters."

Centroc is supportive of this region being better enabled to make a greater contribution to the national economy through the use of incentives for businesses to relocate beyond the Sydney basin. This will add benefit to both the livability of Sydney and the vibrancy of Central NSW.

Substantial work has been undertaken in the region regarding enterprise zones over the past decade. This began with efforts by the Local Government and Shires Association and the Institute of Chartered Accountants in 2001. Please find this attached.

More recently work has been undertaken in conjunction with the Western Research Institute and this is attached. There is a further supportive body of documents and this can be provided on request.

In the first instance, our Board suggests the following as the principles guiding the development of Enterprise Zones:

- responsible prosperity
- social equity
- improved skills
- increased employment

- increased household incomes
- equalisation of population growth
- equalisation of industry dispersion

Central NSW already has a strong and diverse economy with good transport links. Key stakeholders in the region are working collaboratively to build on this strength. For more documentation on the strength of the region please go see the Economic Development Profile on the Central West Regional Development Australia website.

While recognizing that considerable further work would need to be undertaken in looking for best of breed internationally and developing up the plethora of ideas for Enterprise Zones, the following high level opportunities are identified for the State to consider and further explore.

1. take action in providing concessions in the areas over which the State has control, for example pay roll tax, vehicle registrations, stamp duty and land tax.
2. provide other incentives for example special rebates against compliance costs and for training and skills development;
3. maximise opportunities for businesses in enterprise zones to successfully compete for State tenders for State work;
4. supported loan schemes;
5. targeted action in supporting businesses that build on a region's strengths and points of difference, for example in Central NSW in mining, food and beverage manufacturing;
6. implement spouse preference employment strategies for targeted workforce shortages;
7. work with the Federal Government on supernumerary programming for the unemployed through State agencies;
8. advocate to the Federal Government regarding broad ranging tax reform instituting enterprise zone and
9. deliver enhanced or priority delivery of State programs to support business innovation linked to industry action plans in enterprise zones.

As regional development is a priority for the Centroc Board, our members are keen to work with the State to ensure stronger regions in Central NSW.

Centroc members would be pleased to further discuss any aspect of this submission. Please contact the Centroc Executive Officer Jenny Bennett [redacted].

Yours sincerely,

Cr Phyllis Miller OAM
Chair

Central NSW Councils (Centroc)

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Local Government Shires Association of NSW and the Institute of Chartered Accountants April 2001, Enterprise Zones, Creating jobs and prosperity in Regional Australia

Enterprise Zones Status report by Graham Apthorpe and
Western Research Institute article, A review of Estimated Enterprise Zone Benefits for Government and Business

What's Right with Enterprise Zones and the Economy Servant or Master?: Response to Paul Collits article by Graham Apthorpe, Economic Development Manager Cowra Shire Council

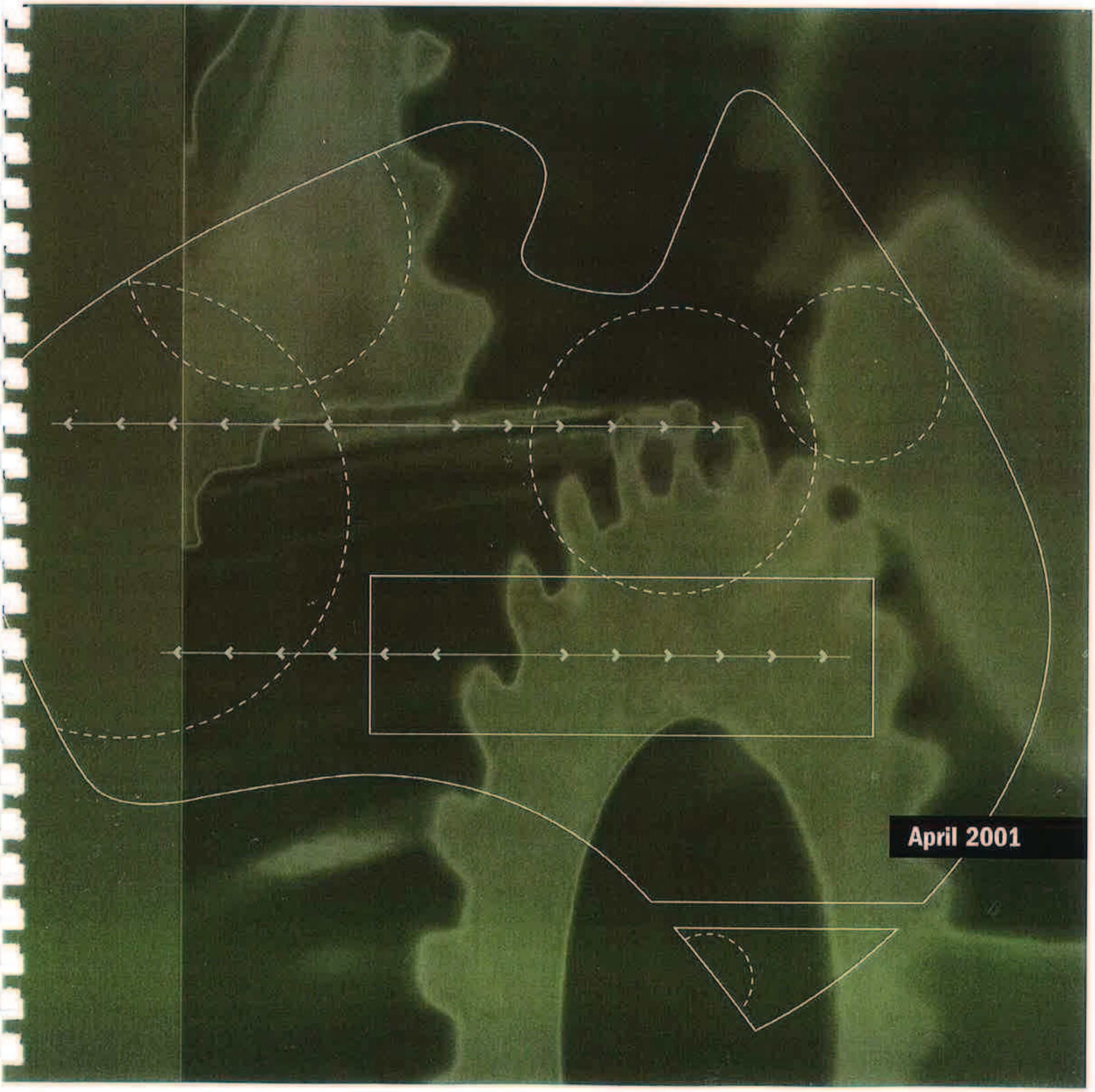
The Institute of
Chartered Accountants
in Australia

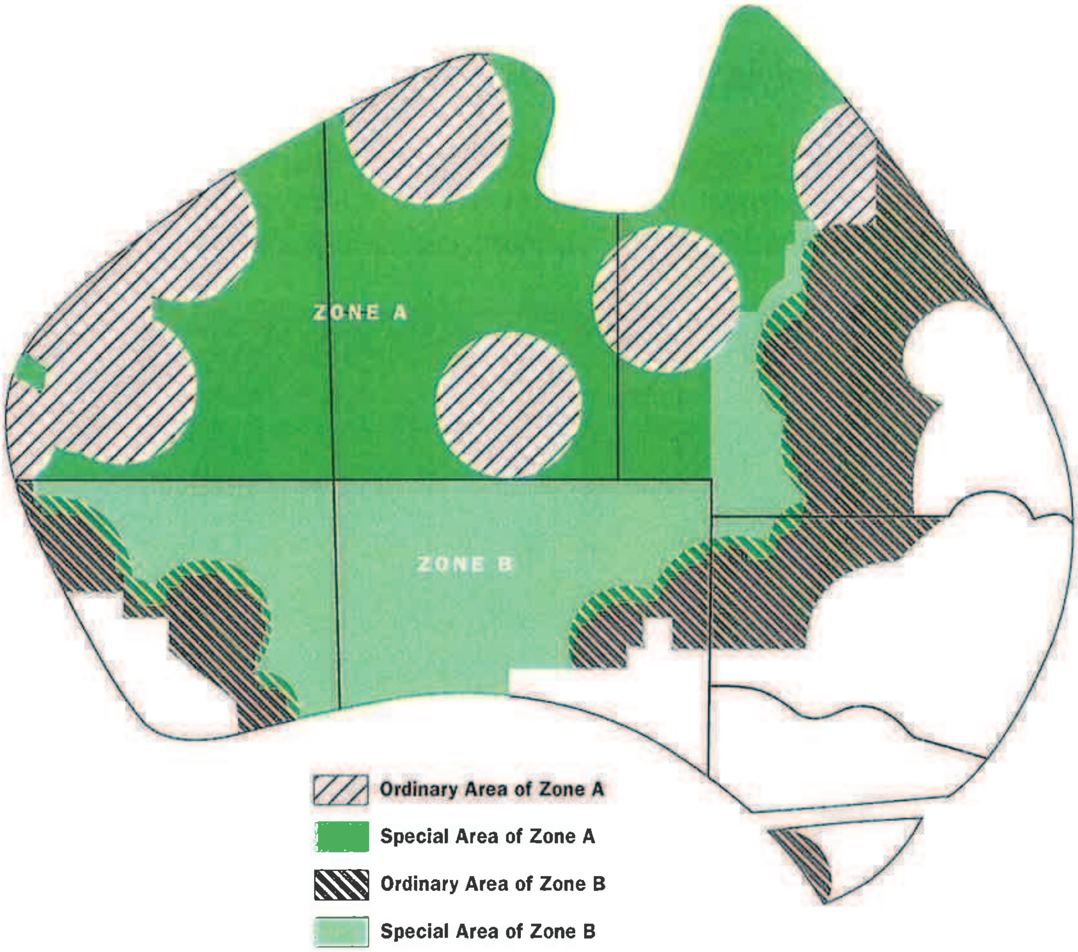
*Local Government and Shires
Associations of NSW*

ENTERPRISE ZONES

Creating jobs and prosperity in regional Australia

Australia's first major study into achieving regional equity through business-driven economic development undertaken by Dr Ian Manning from the National Institute of Economic & Industry Research (NIEIR)





enterprise zones

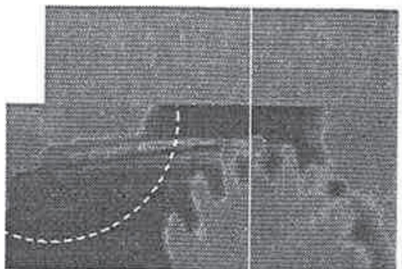
This research results from a joint initiative of The Institute of Chartered Accountants in Australia (ICAA) and the Local Government and Shires Associations of NSW (NSWLGSA). Both bodies include professional personnel with direct experience of the economic difficulties of regional Australia. The Institute's members practice in all parts of the country, and local government similarly covers all parts of Australia. Both bodies are concerned at the poor performance of many regions, and wish to contribute their members' expertise and grass-roots experience to develop a policy response.

The pursuit of solutions for regional Australia's problems has been hampered by a recognition lag: Australia is so accustomed to a pattern of economic growth which has benefited all regions more or less equally that it has been slow to recognise that there is now no guarantee that growth in GDP will be translated into income growth throughout the country. Now that the recognition lag has been overcome, we face a complex task of determining the causes of regional economic divergence. Why, in a time of rapid growth of national GDP, have incomes and employment been declining in many areas, particularly rural and country areas? Community disquiet and a growing understanding of the long-term social consequences for the nation have altered Australia for ever.

There is also no doubt that no other Western democracy, except perhaps New Zealand, has shown less interest in the regional spread of economic opportunity.

Suggested explanations of regional Australia's low level of economic performance differ in the extent to which they regard the regions as master of their own fate. At the one extreme, regional business is blamed for failure to embrace change, particularly the new economy. At the other extreme, the less-successful regions are seen as hapless casualties of globalisation, exacerbated by Australia's dogmatic implementation of economic rationalist policies. These are extreme views, but there is no doubt that the problems have their origins in Australia's place in the international economy and hence in unfavourable trends in world trade. There is also no doubt that no other Western democracy, except perhaps New Zealand, has shown less interest in the regional spread of economic opportunity.

This study was commissioned in the conviction that policy development needs to take a fundamental shift towards establishing sound economic principles to make regional areas attractive for private enterprise. This will require correction of the over-arching problems of regional areas as perceived by private investors. Present programs in this area are no more than a sprinkling of short-term competitive grants; they must be replaced by long-term serious commitments. This study finds that private-sector job-generation is the priority for regional Australia, and whether it is encouraged by budgetary expenditures or tax expenditures (tax revenues foregone) the commitment must be made. If it is not, the divergence of critical economic outcomes will continue at the present alarming rate.



An important aspect of Australian economic history has been the lack, until recently, of major divergence in growth rates and levels of prosperity between regions. Indeed, it has been taken for granted that all regions will advance, even if some grow faster than others, and Australia has therefore been slow to recognise the recent emergence of major divergence in levels of regional prosperity. These are now, however, of established policy interest.

Judged by the rate of growth of GDP, Australia's performance was highly satisfactory for most of the 1990s. However, from a regional point of view, the pattern of growth left much to be desired. The most drastic trend was the regional divergence in unemployment rates.

Australians have tended to regard unemployment as cyclical, to be absorbed by speeding-up economic growth in general, which implies that unemployment should be countered by temporary assistance at most. The evidence in this report indicates that regional divergence in job generation rates will not be corrected by purely macroeconomic policy at the national level, whether monetarist, neoclassical or any other kind, or by microeconomic reform.

It is much easier to identify the regions which grew, and those which lost out, than it is to be specific as to the precise reasons why. However, identification of winners and losers is an essential first step towards answering two questions:

- why was there such a divergence in regional prosperity? And
- should anything be done about it, or should divergence simply be accepted as part of the price of growth?

In this report, regional divergence is seen as a sign of weaknesses in the Australian economy which, while it did not hinder growth during the 1990s, is likely to do so in future. The most serious weakness is the tardy adoption, in many industries and regions, of the knowledge-industry model of industry organisation. Given that adoption and adaptation of this model is a requirement for continuing growth, Australia has the opportunity to address a national economic weakness at the same time as it moves to equalise regional growth rates. Divergence in regional growth rates should not be accepted as part of the price of growth, and indeed continued acceptance implies deteriorating growth performance.

In addition to the argument that active regional policy is required to sustain national economic growth, the costs of the regional divergence in unemployment rates have reached the point where governments face a choice between intervention and national disintegration. Given this choice, there is a serious danger that they will respond by reverting to past interventions without pausing to consider the differences required in an age dominated by the knowledge economy.

Overall, Australia is still short of jobs, and reductions in unemployment will require either net job generation or net labour force withdrawal. However, any purely macroeconomic solution risks generating over-full employment in favoured regions while depression remains in the unfavoured regions.

Moving people to the jobs is not feasible beyond the rate at which destinations can absorb new workers, and even then may be inefficient due to congestion costs. Policies are therefore required to generate jobs in the areas which are at present short of jobs. If successful, such policies preserve the social and physical capital of existing communities, and once this is taken into account promise lower costs than policies which continue to enhance the attractions of the presently attractive areas. The divergence of employment 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 generated where the people are.

Over the past two decades the Commonwealth government has had little in the way of regional policy. Its policies on road, health and education funding and on telecommunications and other utility regulation have not been co-ordinated at the regional level. In some regions the policies have been mutually supportive, but there have also been regions where Commonwealth policies have been at cross-purposes.

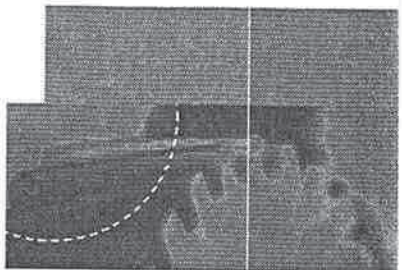
Programs for regional Australia need to be simple and transparent, with eligibility measured objectively. Among the US programs, enterprise zone programs show considerable promise as a precedent for Australia.

By the way of comparison with the USA, Australia lacks programs which:

- encourage and resource regional governments to prepare regional development strategies, and to gain community ownership of the strategies, and which
- provide resources to underpin job creation through the private sector.

This report includes a lengthy list of the programs by which the US federal government assists local communities with their economic development strategies, particularly private-sector job creation. (A further list could be appended for each state.) The list refutes those naïve Australians who think that the USA is a haven of laissez faire with respect to regional policy. It is not: the considerable economic achievements of the USA, including the recent invention and spread of the knowledge-industry model of industry organisation, have been accomplished in the context of high levels of government economic intervention. The current Australian hands-off approach to regional economic development policy cannot be supported by appeal to American practice.

Programs for regional Australia need to be simple and transparent, with eligibility measured objectively. Among the US programs, enterprise zone programs show considerable promise as a precedent for Australia. American enterprise zone programs are restricted to areas which are disadvantaged according to objective criteria, and which have developed coherent local economic development strategies. They emphasise the generation of private-sector jobs based on long-term investment strategies which include adoption of knowledge-industry best practice in order to ensure continuing competitiveness. There are equivalent programs in the European Union and elsewhere in the OECD.



US enterprise zone programs recognise that, in regions of high unemployment, the number of unemployed people far exceeds the number of job vacancies, and accordingly no amount of training, job search assistance or threat can transfer all social security recipients with employment potential into jobs. The programs accordingly emphasise job creation, and investment to undergird job creation. An important benefit under US enterprise zone programs is the provision of tax incentives both to the employment of disadvantaged people and to investment. Though these provisions involve foregoing revenue as compared with across-the-board application of tax rates, their success as incentives provides considerable revenue offsets to their revenue cost.

It is noticeable that, in Australia, the Commonwealth directly matches only two of nearly fifty US programs relevant to regional business development: the export development program and the indigenous land purchase program. Should the Commonwealth initiate enterprise-zone programs for disadvantaged and economically distressed regions, the following gaps in its program coverage are likely to become acute:

- the lack of programs to provide loan guarantees and venture capital for small to medium business and for local government,
- the lack of grants for local economic development planning, investment attraction, business development and community development and
- the lack of assistance with business development (including management and technical advice to bring small to medium businesses into the knowledge economy) and assistance with government procurement.

There is a strong case that these programs, which exist separately in the US, should be incorporated into any adaptation of the enterprise zone program for Australian purposes.

Given the lack of regional governments in Australia, there is no alternative but to divide primary responsibility for regional development between state and local governments. This should present no serious barriers to implementation, since local government is provided under state legislation and councils are accustomed to working with state agencies. There need be no objection to the division of responsibility varying between and indeed within states, to suit local circumstances. In addition to administering programs, an important task for state and local governments will be to contribute their expertise as to how job generation may be sustained in each region.

Unless governments have the courage to intervene with preferential policies for the regions, with the principal focus of encouraging private investment and growing jobs, these areas are likely to continue their decline and hence their cost to the rest of the country. Overseas comparisons of the strength and multiplicity of programs to counter trends to regional divergence show quite clearly that a significant level of government activity is needed to rejuvenate the regions which are currently falling behind. The study finds that investment of the order of $2-$3 billion a year in enterprise zone and supporting programs can be justified on the basis of international comparisons and responsible macroeconomic policy.

Recommendations

1. The Commonwealth government, the Australian Local Government Association, the Institute of Chartered Accountants in Australia, the State governments and other relevant business and industry groups should join in a Federal Parliamentary Task Force to develop targeted incentives for regional Australia. This work should be completed by 30 September 2001.

2. The Commonwealth government should recognise the need for policies specifically designed to improve the economic performance of under-performing regional areas.

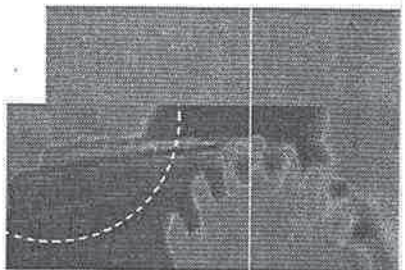
3. The Commonwealth government should recognise the role of business and private industry in supplying job growth in under-performing regions, and implement policies to assist such industry to develop and prosper.

4. The incentive program should include the creation of Enterprise Zones to encourage the introduction of new industry and the expansion of existing industry in under-performing regional areas.

5. For the purpose of identifying Enterprise Zones, regions should be defined as Local Government Areas, with provision that:
   - regional groupings of LGAs should be encouraged, particularly where LGAs are small in relation to economic regions and
   - possibly, that where a large non-eligible LGA adjoins an eligible LGA, and identifiable parts of the large LGA share the disadvantaged status of the eligible LGA, those parts may be considered for inclusion in the enterprise zone.

6. Declaration as an Enterprise Zone should be available to regions which are experiencing economic distress, particularly high unemployment. Eligibility for enterprise zone assistance should be based on objective criteria of disadvantage which should include:
   - high unemployment rates, calculated by a broader measure than the standard ABS labour force survey definition, and including allowance for persons working noticeably shorter hours than they would wish and persons not actively looking for work, but who are anxious to join the workforce, including early retirees;
   - either as part of the unemployment measure, or separately, allowance should be made for the number of social security claimants likely to be affected by the government's 'mutual obligation' requirements, including persons in work-for-the-dole schemes; while
   - consideration may be given to low rural land values per farm property as a supplementary indicator in rural areas (defined as those with a high proportion of rural production in GRP) and
   - consideration may also be given to favouring areas with significant production in export industries organised on small-business lines (on the grounds that returns to an Enterprise Zone program are likely to be unusually high in such areas).

It is noticeable that, in Australia, the Commonwealth directly matches only two of nearly fifty US programs relevant to regional business development: the export development program and the indigenous land purchase program.



7 Regional commitment to an economic development strategy plan should be mandatory for selection as an Enterprise Zone. These strategies and/or plans may require further development following declaration, and should be updated regularly. Provided that it is consonant with the general aims of the enterprise zone program, the development plan may identify particular industries and particular types of investment for support. All incentives offered in the Enterprise Zone should support the development strategy, with particular attention to reducing investment risk.

8 Enterprise Zones should be financed by the Commonwealth but implemented by state and local governments, subject to Commonwealth guidelines.

9 Each Enterprise Zone should provide strong incentives to job generation and to investment which is expected to result in job generation, but there should be flexibility for regions to select from a range of acceptable measures and within a broad financial envelope. The merits of providing incentives as tax incentives available only in Enterprise Zones should be considered as an alternative to budgetary expenditures.

10 Investment incentives in Enterprise Zones should be guaranteed to remain in place for sufficient time to have a full incentive effect, ie for at least ten years and preferably 15.

11 Financial intermediaries should be required to report their investments by region, and should receive incentives (and perhaps regulation) to invest in Enterprise Zones, subject to these investments meeting commercial requirements.

12 Wage subsidies should be a permissible form of expenditure in Enterprise Zones. However, they should only be a compulsory component if adopted by the Commonwealth as an adjunct to its social security policies, and then only if the Commonwealth elects to provide them through the enterprise zone program rather than as an independent program. Job generation should, however, be a major aim of regional development strategies, and should be included as a criterion in the assessment of plans and hence the selection of regions to become Enterprise Zones.

13 There should be provision for increased priority for infrastructure projects in enterprise zones, at least as regards infrastructure identified as essential for plan success.

14 The development of community colleges and similar educational, research and technology diffusion institutions should form a part of the development plan and of the program in each enterprise zone.

15 Each enterprise zone should be monitored under Commonwealth guidelines. The Zone administration should report on assistance granted and compliance with the conditions under which assistance was granted.

16 When the enterprise zone program is implemented, Zone Rebates should continue to be provided in the income tax system, but the boundaries of the regions of eligibility should be reviewed.

Most importantly, concerns raised by some Government representatives in earlier discussions that the Australian Constitution presents a potential barrier to taxation based incentives are ill founded. Advice from Special Counsel finds that there is no constitutional impediment to Commonwealth participation in the setting up of such Zones or providing for tax incentives in these designated areas.

The reservations that have been expressed are not soundly based and are not justified by the totality of existing High Court decisions. Those decisions provide support from a number of perspectives, and we would expect that the present High Court would follow the clear precedents available on this matter.

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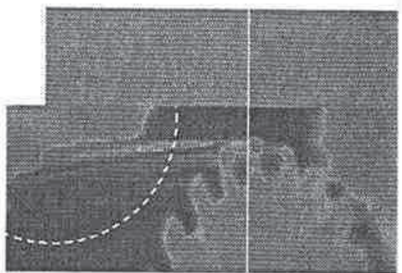

Structure of the Report

This report comprises ten chapters, with the following themes.

Chapter 1
Describes the historic approach to regional economic policy in Australia, and documents the recent breakdown in this approach, with its dire result in regional divergence in unemployment rates.

Chapter 2
Situates the developments of the 1990s in the international context of globalisation and the rise of the knowledge-industry model of industrial organisation. It concludes that Australian regions can only regain prosperity if they hasten to adopt the knowledge-industry model, adapting it to their particular circumstances.

Chapter 3
Returns to regional policy as it may be exercised at the national and state levels. It considers the types of regional policies which Australia has used in the past, and notes the danger that the recent realisation of the extent of regional divergence will lead to knee-jerk reversion to past policies which are no longer appropriate. It concludes that Australia should look overseas for examples of up-to-date and successful regional policies.

Chapter 4
The regional policies adopted in the European Union are briefly described, and the policies adopted in the USA are considered in more detail.
The emphasis on updating industrial organisation to the knowledge-industry model is underlined.

Chapter 5
Considers the issues likely to be encountered in adapting European and (particularly) American precedents to Australia. It nevertheless concludes that adaptation of the US enterprise zone model would be possible and desirable.

Chapter 6
Asks how Enterprise Zones would be introduced in Australia, and concludes that they would have to be financed by the Commonwealth but implemented by state and local governments jointly.

A feature of the US enterprise zone program is that it is confined to economically-distressed areas, assessed by objective criteria. Chapter 7 concludes that, in Australia, eligibility should be on an LGA basis (or groups of LGAs where the areas are small) and the primary criterion should be unemployment rates, particularly as they may be estimated from social security uptake. Following US precedent, Enterprise Zones should only be declared if there is evidence of local planning for economic development, and commitment to a coherent local strategy.

Chapter 7
Explores the eligibility for enterprise zone support.

Chapter 8

Considers the content of enterprise zone programs, and argues for flexibility within a financial envelope.

Chapter 9

Provides very rough estimates of the possible budgetary cost, underlining that much of the cost will be offset against revenues, and much of it should be treated as investment rather than current expenditure. It argues that reasonable coverage of Australia's disadvantaged areas can be had for a budget of between $2 and $3 billion a year. This level of expenditure would be responsible from a macroeconomic point of view, and would be of the same order of magnitude (adjusted for population) as regional development expenditure in the European Union.

Chapter 10

Finds that there is no constitutional impediment to Commonwealth participation in the setting up of such Zones or providing for tax incentives in these designated areas

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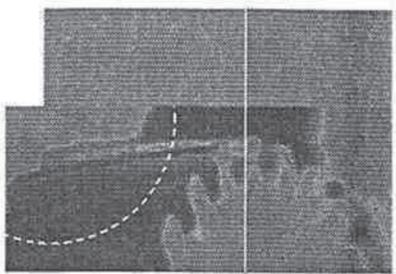

Patterns of regional economic growth in Australia

An important aspect of Australian economic history has been the lack, until recently, of major divergence in growth rates and levels of prosperity between regions. Indeed, it has been taken for granted that all regions will advance, even if some grow faster than others, and the country has therefore been slow to recognise the emergence of major divergences in levels of regional prosperity. These are now, however, of established policy interest. Recent interest in regional policy represents a revival rather than the kindling of a totally new policy area. We therefore begin by reviewing earlier regional policies.

Australian regional development policies to the 1970s

So long as they retain responsibility for the law of real property, even in the most market-oriented of countries governments have an irreducible minimum role in regional development: they provide the legal framework for land use, and must register and at least passively approve the changes in land ownership which are frequently associated with changes in land use. At a minimum, governments also provide local roads, and administer access to property for utilities and network services. They are increasingly involved in the control of environmental costs and the allocation of environmental resources, such as water. In that they administer property ownership, control environmental costs and provide at least minimum services, governments are inevitably involved in policy for regional economic development. In this sense, Australia has always had, and continues to have, regional policy, particularly at state and local government level.

In the nineteenth and most of the twentieth century Australian governments went much further than this. They sought to develop the land, and so invested in transport facilities (ports, railways and roads) and in water and electricity supply; they subsidised immigration, provided free education and sponsored scientific research into agricultural problems. They also invested in complementary urban development. Observing that prosperous countries overseas invested in manufacturing as well as in agriculture, they introduced measures to encourage investment in manufacturing, chiefly by reducing levels of risk.

From Federation, the broad scope of developmental policy was set by the Commonwealth. Though the Commonwealth was aware that policies with respect to different industries had different locational effects (manufacturing was urban and concentrated in NSW and Victoria, sugar was produced in Queensland, and so on) it left regional development to the states. Its most location-specific policy made nationwide standards of public service provision possible (though not required) by grants which assisted the smaller states. It also administered loan funds with an eye to developmental prospects.

Allocations of loan funds, coupled with their own limited tax bases, encouraged the states to build developmental policy around public works expenditures, with very little resort to tax concessions or other business assistance. This involved them in regional policy, since public works are inevitably location-specific. The Commonwealth provided incentives to invest, but these applied without respect to region. The states added a very minor regional component to these incentives under the banner of decentralisation policy. The main incentives were concessional rail freight rates to regional manufacturers, which, as it turned out, did not even compensate for the costs imposed by the monopoly elements in rail operations and pricing. It should not therefore be surprising that decentralisation policies were ineffective. On the other hand, there were numerous instances of regional development following from infrastructure construction.

An interesting exception to the general lack of regional differentiation in the Commonwealth tax system is the Income Tax Zone allowances, which were introduced in 1945 so that post-war development would not be hindered by high rates of taxation on incomes earned in remote areas. These provisions remain, having been last reviewed in 1981, though the geographical definition of remote areas is now outdated.

Whatever its successes in the nineteenth century, in the 1900s and 1920s and in the post-war boom, the Australian developmental state ran into trouble in the 1970s. The causes of the stagflation which beset the country in those years have been variously diagnosed, but an influential element in most accounts is that government controls and government involvement in business operations resulted in general inefficiency. In other words, the very means by which the states had promoted development had turned counter-productive. Policy emphasis turned to cost control, on the argument that if costs were reduced, development would burgeon under market leadership. Again, it was argued that the finance sector had grown in sophistication and could provide this leadership. It could allocate investment much better than governments, which would be better occupied by promoting competition and withdrawing from all forms of development planning. The implications for regional development were that governments should:

- divest themselves of all bar minimum involvement in utilities, roads and legal infrastructure, and
- administer their remaining involvements passively, according to market leadership.

Australia being a federal country, this agenda was implemented with varying degrees of enthusiasm in different states. Even at Commonwealth level traces remain of the former more direct developmental approach, particularly in road finance. However, the underlying judgement remains that whatever patterns of growth result from free competition are to be welcomed as the most efficient possible.

On the basis of conventional measures-particularly growth in GDP-these policies were widely acclaimed as successful during the 1990s. However, performance was not wholly satisfactory. It was widely agreed that the balance of payments deficit was too high to be sustainable, and the national savings rate too low. Regional disparities in performance also increased to a point where there is a danger of ill-judged reaction.

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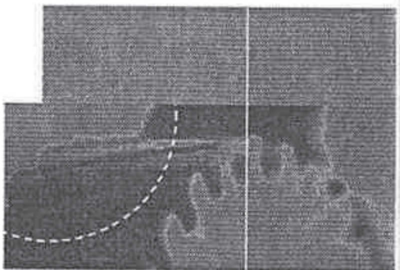


Table 1 - Productivity and unemployment rate by region

Region	GRP including dwelling 1991-98 (% p.a.)	GRP per employed person 1991 (1998 $m)	GRP per employed person 1998 (1998 $m)	Growth in GRP per capita 1991-98 (% p.a.)	Difference in output per employed person 1998 from average for all regions(a) (1998 $m)	Employment growth 1991-2000 (% p.a.)
ACT	3	57522	76760	2.4	11270.9	1.18
Brisbane City	4.6	48267	59989	2.9	-5500.8	2.28
Central Adelaide	2.7	52743	65089	2.5	-400.1	0.89
Central Coast NSW	4.2	51294	57103	2	-8386.7	3.34
Central QLD	5.1	60853	75754	4.4	10264.5	2.09
Central Western NSW	4.5	43215	58385	4.3	-7104	0.04
Darling Downs and South West QLD	3.7	41296	48631	3.7	-16858.7	2.93
Darwin Top End	4	62675	66871	1.5	1381.7	2.39
East Melbourne	2.9	59532	65573	2.4	83.9	1.15
Eyre and Yorke SA	2.4	49341	66789	2.8	1299.6	-6.58
Far and North Western NSW	3.6	45356	60097	4	-5392.3	-0.64
Far North QLD	6.2	41974	50167	3.4	-15322.6	3.74
Gippsland VIC	-2.8	93007	85376	-2.7	19886.2	-2.03
Global Sydney	4.3	71732	93545	2.8	28056.1	1.19
Gold Coast and Hinterlands	6.1	41102	45695	2.6	-19794.6	2.88
Golden Region VIC	2	46068	52195	1.6	-13293.9	2.04
Goulburn VIC	2.2	39236	49640	1.7	-15849.2	1.64
Hobart & Southern TAS	2.5	49639	55523	2.3	-9966.1	0.25
Hunter NSW	3.9	54658	67669	2.9	2179.3	1.6
Illawarra NSW	3.8	58318	65232	2.7	-257.3	2.13
Inner Melbourne VIC	3.3	65834	83273	1.5	17783.4	1.54
Inner West Sydney	3	63485	80545	2.3	15055.4	1.88
Ipswich QLD	4.7	37934	49239	3.4	-16250.3	2.62
Loddon VIC	2.5	40835	48439	1.9	-17050.2	0.25
Mackay QLD	7.2	65957	85710	5.3	20220.9	3.05
Mallee - Wimmera VIC	4.1	37277	50510	4.4	-14979.2	1.29
Mersey-Lyell TAS	2.1	48856	58419	2.6	-7070.7	-0.5
Midlands and Central WA	7.7	51675	79684	7	14194.8	1.31
Murraylands SA	6.9	31648	54906	6.8	-10583.8	5.25
Murray-Murrumbidgee NSW	4.3	41321	54314	4.1	-11175.8	1.86
North Brisbane	6	38059	44346	2.2	-21143.6	4.91
North Coastal NSW	2.9	37234	42485	1.3	-23004.2	1.07
North Melbourne	3.7	50602	59403	2.8	-6085.9	1.35
North North West Sydney	3.5	72751	85923	2.7	20433.2	1.7
North West QLD	2.5	75703	86585	3.4	21095.4	0.21
Northern Adelaide	3.2	44253	54474	2.5	-11015.6	1.15
Northern and Central Perth	5.6	52136	59089	3.7	-6400.6	3.07
Northern NSW	2.4	45320	58197	3.4	-7292.3	-0.9
Northern Tasmania	1.6	44312	50145	1.5	-15344.3	1.1
Nth QLD	6.3	44806	58429	5.4	-7060.1	0.68
Outer South West Sydney	4.3	49617	57408	2.7	-8081.6	3.17
Outer West Sydney	4.4	49307	57938	3.2	-7551.6	3.6
Ovens - Hume VIC	3.9	40095	48654	3.5	-16835.5	2.18
Pilbara - Kimberley WA	5.8	181517	258849	5	193359.3	0.43
South East NSW	3.1	42191	52136	2.4	-13353.2	2.17
South East SA	5.6	34917	52311	5.7	-13178.9	5.24
South Eastern WA	6	89571	112865	4	47375.5	2.41
Southern Adelaide	3.2	46594	55095	2.6	-10394.1	0.46
Southern Melbourne	4.5	54174	66610	3.6	1120.7	1.89
Southern NT	-1	67577	63558	-2.1	-1931.6	1.34
Southern Perth	3.1	52476	58490	1.2	-6999.6	2.57
Southern Sydney	3	63972	74424	2.1	8934.9	0.77
Southern WA	5.3	51690	63624	3.1	-1865.8	1.85
Sydney Production Region	3.5	50204	60831	2	-4658.4	1.79
West Melbourne	2.9	50210	59168	1.5	-6321.6	2.41
Western Victoria	3.2	37902	49734	3.6	-15755.8	-0.44
Westernport VIC	2.7	50155	53052	1.2	-12437.2	1.83
Wide-Bay Burnett QLD	5	36419	43441	2.7	-22048.1	0.85

Note: (a) The GRP estimates employ a common national deflator. This productivity growth in resource regions in Australian dollars will be less than the quantity shipped because of declines in Australia's terms of trade. Some rural regions have high growth rates because of the effects of the 1991.
Source: YourPlace LGA database.

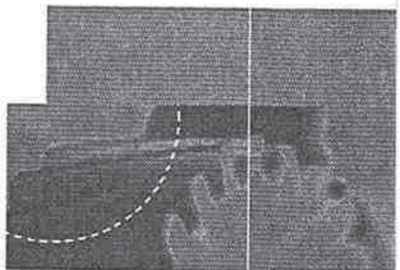
Recent economic growth in Australia's regions

Judged by the rate of growth of GDP, Australia's performance was highly satisfactory for most of the 1990s. Judged by conventional indicators (gross regional product or GRP, the regional equivalent of GDP) growth was also reasonably widespread. It has become fashionable to speak of a rural/urban divide, but the patterns are rather more complex, and merit closer examination.

Starting with patterns of growth in GRP, it is convenient to divide Australia into fairly large regions, for which GRP can be calculated with a fair degree of confidence. National Economics has divided Australia into 58 regions, of which 23 lie in the million-plus metropolitan areas and 35 comprise other cities and rural areas. Each region comprises an area within which businesses are likely to interact and hence to share common fortunes. Both rural and metropolitan areas are divided into regions: thus Victoria has six metropolitan regions and six country regions. It is not claimed that the regional boundaries are ideal, and the boundaries certainly do not prevent interaction between regions. The decision to divide the metropolitan areas into regions reflects research on the business networks of those areas, but the considerable level of commuting between metropolitan regions renders them less self-contained than the country regions.

It has become fashionable to speak of a rural/urban divide, but the patterns are rather more complex, and merit closer examination.

The 58 regions were assessed for overall economic growth performance and prospects as indicated by GRP. It was found that one-third of the regions had accelerated away from the rest. Of these 20 regions, 13 were metropolitan, and the rest were mostly remote areas with significant involvement of the mining industry supplemented in some cases by tourism and defence. No traditional agricultural region appeared among the top twenty: of the top twenty, the closest approach to a traditional rural region was Mackay, Qld, but here agriculture is considerably supplemented by mining and tourism (Table 1).



The two-thirds of also-rans included 14 metropolitan regions, mainly traditional manufacturing areas such as Northern Adelaide, SA, Ipswich Qld, Westernport Vic and the Western suburbs of Sydney. They included only two remote areas: the pastoral inland of NSW and Queensland, which have not been able to compensate for declining pastoral profitability with a switch to mining. All 21 of Australia's traditional rural regions were included among the regions afflicted by low rates of growth of GRP.

Despite the divergence of rates of growth of GRP, it remains that only Gippsland, Vic, recorded negative growth. The reason was the decline in offshore oil production. In all other regions GRP grew by at least 1.5 per cent a year. Though 1.5 per cent is significantly below the national average rate of 3.1 per cent a year from 1991 to 1998, it has not been unusual in Australian history for some regions to grow at around half the national rate. Indeed, as the economy accommodates to changing patterns of geographic opportunity, it is to be expected that some regions will lag the national average, and the fact that some have done so is not in itself sufficient reason to argue that regional policy should be activated to bring them into line. However, the case for regional policy strengthens when we turn from GRP to trends in employment.

Recent developments in employment

From a local point of view, what matters about regional economic development is not so much growth in GRP as growth in incomes received within the region. There is also an interest in the spread of those incomes, concentrating on employment. Growth in GRP and regional employment are increasingly divorced, particularly in areas where local industries are experiencing rapid growth in labour productivity, with consequent declines in employment. A case in point is Pilbara-Kimberley, WA, where GRP increased by 5.8 per cent a year from 1991-1998 but generated employment growth of only 0.43 per cent a year. With a less favourable industry mix, Eyre and Yorke, which includes the South Australian Iron Triangle, generated GRP growth of 2.4 per cent a year despite employment declining at 6.6 per cent a year.

It was not only in mining and manufacturing regions that growth could not be guaranteed to generate jobs. Several rural areas also experienced output growth without employment growth, notably most of NSW away from the coast. Some of the output growth reflected recovery from drought, but there is also a long-term trend for the productivity of labour to increase in agriculture, and hence for job losses if not made up by growth in other sectors.

The converse can also happen, and decline in GRP fail to generate commensurate declines in employment. The most common example arises where there is a decline in regional mining output. Because mining employs few local people in relation to the value of production, falls in the contribution of mining to GRP are not usually accompanied by equal percentage falls in employment. During the 1990s GRP in Gippsland (Vic) declined by 2.8 per cent a year mainly due to the decline in Bass Strait oil and gas production. The accompanying decline in employment was less rapid than the decline in output, at 2 per cent a year, reflecting the lack of linkage between employment and oil and gas output.

Most of the decline in employment was due, not to the decline in oil and gas output, but to a decline in construction activity associated with electricity production, and to a major increase in the productivity of labour employed in the electricity supply industry.

In two other types of region the increase in labour productivity was relatively slow, and hence job growth was not far behind GRP growth. These were:

- outer metropolitan areas with a high level of labour-intensive construction (Central Coast, NSW, Outer West Sydney, West Melbourne and Westernport, Vic), and
- rural areas, generally with modest growth (Darling Downs, Qld, Goulburn, Vic, Northern Tasmania, SE NSW and SE SA).

Job loss in remote Queensland feeds unemployment on the coast.

As a result of the failure of growth in some regions to generate jobs, from 1991 to 1998 there was a considerable range of rates of employment growth in Australia's regions. Ignoring the two outliers already discussed (Eyre and Yorke SA, and Gippsland) rates of employment growth ranged between decline of 1 per cent a year and growth of 5 per cent. With employment declining in 7 of the 58 regions, the prima facie case for corrective intervention is stronger than any case which might be based on regional divergence of GRP growth rates. The case for intervention strengthens when we consider the link to divergent trends in unemployment rates.

Recent developments in unemployment

Unemployment results when the growth rate of the regional workforce exceeds the growth rate in jobs accessible from the region. In country regions most of the accessible jobs are within the region itself, and direct comparison of growth rates is possible, but in metropolitan regions there is considerable cross-regional commuting. Unemployment is also inherited, and in regions which start with high unemployment rates the rate of job growth has to outpace the rate of workforce growth if unemployment levels are to fall.

Workforce and employment trends can interact. At one extreme, job decline can result in labour exodus, so that unemployment rates do not rise even if employment is falling. This most often happens in remote regions, where a decline in employment empties the construction camps. Even if the workers become unemployed, they are not unemployed in the job-losing region. The counterpart of this movement is that unemployment rates tend to be high in regions which combine attractive living conditions with low housing costs. Job loss in remote Queensland feeds unemployment on the coast.

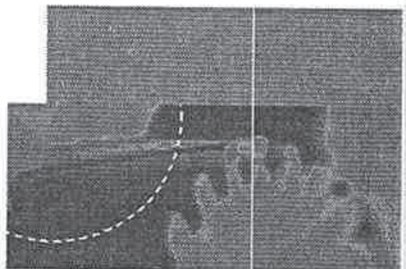


Table 2 - Corrected unemployment rates

Region	1991	1996	1998	2000	Official June 2000
ACT	4.0	8.0	8.2	7.3	5.3
Brisbane City	6.4	8.5	8.3	7.8	6.0
Central Adelaide	7.7	15.4	16.5	14.1	6.4
Central Coast NSW	8.5	10.6	11.2	10.4	7.0
Central QLD	6.9	14.3	10.7	9.7	8.0
Central Western NSW	7.0	9.8	10.1	11.2	5.2
Darling Downs and South West QLD	6.7	8.0	9.2	8.7	5.7
Darwin Top End	12.3	12.1	11.4	13.0	3.8
East Melbourne	4.3	5.9	6.0	5.2	4.5
Eyre and Yorke SA	7.1	13.4	14.9	16.6	10.4
Far and North Western NSW	9.4	12.0	13.3	13.7	7.0
Far North QLD	11.1	11.7	11.4	12.8	8.1
Gippsland VIC	7.2	13.3	12.7	16.2	10.5
Global Sydney	5.1	6.5	5.4	3.4	3.2
Gold Coast and Hinterlands	8.6	12.6	12.7	12.1	8.0
Golden Region VIC	8.9	10.9	12.8	11.6	8.0
Goulburn VIC	7.1	10.1	11.0	10.4	7.1
Hobart and Southern Tasmania	10	17.6	20.2	16.5	9.4
Hunter NSW	8.1	13.2	12.7	12.4	7.9
Illawarra NSW	9.8	11.4	13.7	11.7	7.0
Inner Melbourne VIC	10.2	15.4	12.3	11.0	5.6
Inner West Sydney	5.3	6.3	5.4	3.3	3.1
Ipswich QLD	7.9	9.7	11.7	11.7	8.0
Loddon VIC	9.2	13.8	12.5	13.5	8.0
Mackay QLD	7.9	13.9	9.8	9.0	7.8
Mallee - Wimmera VIC	8.4	10.0	10.3	10.1	5.2
Mersey-Lyell TAS	11.5	14.0	16.3	21.1	10.6
Midlands and Central WA	8.9	8.1	7.3	8.8	6.3
Murray - Murrumbidgee NSW	7.2	7.8	8.9	9.0	6.3
Murraylands SA	15	11.6	11.3	10.7	8.9
N.N. West Sydney	2.0	3.0	2.9	2.1	2.3
North Brisbane	10.2	14.9	15.9	12.2	9.6
North Coastal NSW	13.9	19.1	19.7	20.2	11.1
North Melbourne	8.0	10.7	11.1	10.2	8.5
North West QLD	5.4*	1.8*	2.1*	5.6*	7.4
Northern Adelaide	9.6	12.6	14.4	14.1	9.6
Northern and Central Perth	8.6	8.9	7.2	7.1	5.6
Northern NSW	7.8	10.7	12.2	12.9	6.6
Northern Tasmania	10	13.1	14.7	14.9	7.2
Nth QLD	7.2	11.6	10.4	11.5	8.3
Outer South West Sydney	6.8	8.4	9.1	7.0	7.3
Outer West Sydney	4.5	8.5	8.0	6.7	4.8
Ovens - Hume VIC	5.7	9.1	9.1	8.9	6.4
Pilbara - Kimberley WA	7.3	8.2	7.0	11.2	8.6
South East NSW	7.8	8.0	8.6	11.6	6.9
South East SA	9.8	7.6	7.8	7.8	6.4
South Eastern WA	11.3	6.7	5.0	7.7	5.7
Southern Adelaide	6.3	5.5	4.7	8.5	7.7
Southern Melbourne	6.2	7.8	7.2	5.9	3.8
Southern NT	13.6	12.3	13.1	16.8	5.0
Southern Perth	8.6	8.2	7.8	8.0	6.8
Southern Sydney	3.6	4.9	5.2	3.9	3.4
Southern WA	7.1	7.4	7.5	8.2	6.2
Sydney Production Region	9	11.8	10.9	8.8	6.1
West Melbourne	9.2	12.4	10.9	9.3	8.1
Western Victoria	6.7	8.1	9.6	9.1	6.7
Westernport VIC	7.1	9.1	7.8	6.8	6.7
Wide-Bay Burnett QLD	10.2	13.2	13.8	13.9	10.7
Australia	7.55	10.14	10.06	9.41	6.59
Official U.R.	9.4	8.4	7.9	6.6	

*Note: * Remote area figures may be unreliable*
Source: NIEIR's LGSA YourPlace database.

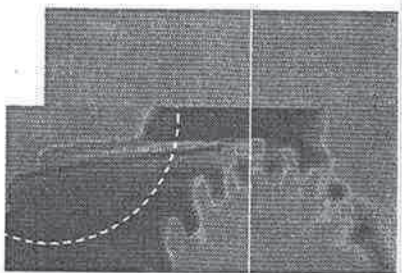
enterprise zones

Over the country as a whole, the official ABS unemployment rate declined from 9.4 per cent in 1991 to 6.6 per cent in 2000. The definition of unemployment used by the ABS has been essentially constant over the period. However, the purpose of the unemployment rate is to provide a measure of wasted resources and difficulty in finding work. Unfortunately the constant definition has been compromised by several Commonwealth policies, particularly the transfer of recipients of unemployment allowances to disability pensions (which takes them out of the workforce) and the effect of work-for-the-dole schemes in increasing the number of people who worked at least one hour a week and hence were not statistically unemployed.

The evidence in this report indicates that regional divergence in job generation rates will not be corrected by purely macroeconomic policy at the national level, whether monetarist, neoclassical or any other kind, or by microeconomic reform.

Various attempts have been made to adjust unemployment rates to obtain a better measure of wasted resources. Using Centrelink data, National Economics has recently calculated a measure which emphasises the impact of unemployment on social security outgoings, and also its impact on primary income earners (as distinct from secondary earners within a household). The essence of the method is to estimate the uptake of social security benefits due to unemployment, as distinct from other causes. For this purpose, it is assumed that uptake of the age pension is not due to unemployment, but that portion of the uptake of both disability allowances and single parents' payments, and the whole of work-for-the-dole allowances, is due to unemployment. For this purpose, the age-specific uptake of disability allowances was assumed constant at 1991 levels, and the excess assumed to be due to unemployment, with an analogous calculation for single parents.

Recalculating unemployment rates by this definition reverses the national trend, which is now upwards, from 7.6 per cent of the workforce unemployed and dependent on social security in 1991 to 9.4 per cent in 2000. We will term this the adjusted unemployment rate (see Table 2 opposite)



During the 1990s, adjusted unemployment rates fell in three of the seven Sydney regions (and in three more the increases were marginal), in two of the six Melbourne regions (and in three more the increases were marginal), and in both regions in Perth. There were also falls in the WA goldfields and in the SA wheat/wine regions. At the other extreme, increases in the adjusted unemployment rate of 9 or more percentage points were recorded in NW Tasmania, Eyre and Yorke (SA), and Gippsland (Vic). These were all regions adversely affected by industrial restructuring. The rest of Tasmania, Central and North Adelaide, Loddon in Victoria, North Queensland and the greater part of country NSW experienced increases of 4 but less than 9 percentage points.

Many of these changes accentuated the differences which had already opened up during the 1980s between high and low unemployment areas. By 2000 Global, Southern and Northern Sydney (ie the Sydney metropolitan area east of Olympic Park) were experiencing full employment even by 1960s definitions, and East and Southern Melbourne and Westernport were not far short. At the other extreme, adjusted unemployment rates in excess of 14 per cent (and up to 21 per cent) applied in the whole of Tasmania, much of SA, Gippsland in Victoria and the North Coast of NSW.

The co-existence of full employment in select parts of the country with severe depression in others is already the cause of a major but generally unrecognised policy intervention: by way of taxation and government expenditure on social security and service provision a major redistribution occurs between the full-employment and depressed regions. Across Australia as a whole social security and similar payments contribute 14 per cent of gross household income, but in the depressed regions the contribution is closer to a quarter of all income received. Taxpayer complaint concerning the costs of the social security system have led to continuous attempts to target payments more carefully. Most recently the McClure report has advocated the imposition of 'mutual obligation' requirements on social security claimants of working age, the 'mutual obligation' consisting, essentially, of stricter administration of the 'work test' which has been part of the social security system since the introduction of unemployment benefit. (The work test provides that claimants who refuse jobs considered suitable by the social security administration can be denied benefit.)
A grave inadequacy of the McClure report is its failure to take into account regional divergence in adjusted unemployment rates: 'mutual obligation' requirements which make perfectly good sense in Sydney are likely to be unworkable in NW Tasmania.

A positive feature of the McClure report is that it recognises that many social security claimants are people who lack the skills which are now in demand, and it advocates training to help to fit people for the available jobs. This again makes very good sense in regions where there are vacancies for skilled workers; it makes less sense in regions where the demand for labour is slack at all skill levels. In these regions the case is far stronger for interventions which generate jobs. The case for job-generating intervention becomes stronger again if we consider the costs of regional unemployment.

Costs of regional unemployment

The divergence of regional unemployment rates is a serious failure of the economic system, whether considered from an equity and from an efficiency point of view. The regional divergences in unemployment rates are in turn associated with differences in incomes and wealth. Regions blessed with high employment growth also tend to generate capital gains in housing, which provide undeserved rewards to those who sell out and leave the region, and undeserved barriers to those who wish to access the region's jobs starting from a high unemployment region.

So long as the differential unemployment rates persist, the following costs must be borne:

- People in the full-employment areas have to pay higher taxes than otherwise to provide social security incomes for unemployed people in the high-unemployment areas.
- Macroeconomic policy has to be run so as to prevent the occurrence of excess demand in the full-employment areas. This inevitably leaves high unemployment in other areas, and so a waste of growth opportunities due to unutilised resources.
- A joint effect of these two costs is a further cost in social cohesion, with residents of the full-employment areas resenting the social security payments made to residents of the low-employment areas, and residents of the low-employment areas resenting their denial of employment opportunities.
- A further potential cost may arise from resistance to technological change, once people learn that whole regions do not necessarily benefit from their participation in productivity improvements.

What can be done to avoid these costs? In the next chapter we will assess the predicament of Australia's regions in the context of global trends in economic organisation and competitiveness.

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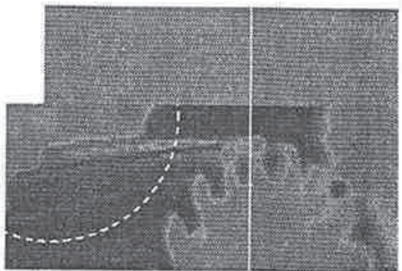

Conclusion

During the nineteenth and most of the twentieth centuries, Australian governments followed developmental policies with strong regional elements centring on the provision of infrastructure. However, by the end of the 1970s these policies were losing support, for several reasons:

- As the example of the overbuilding of electric power generation capacity showed, it was possible to over-invest in infrastructure.
- It was argued that market decisions would provide a more efficient pattern of industry structure and also of regional growth.

Heeding these arguments, governments tried to withdraw from regional policy. In practice complete withdrawal is impossible so long as governments remain responsible for property law, roads, the location of major educational institutions and other location-specific services; withdrawal therefore took the form of leaving decisions to the market where possible, and refraining from co-ordinating the remaining government decisions.

The partial withdrawal of government from regional policy coincided with an alarming divergence between regions, not so much as to rates of economic growth as measured by GRP, but in rates of unemployment and social security dependence. By the peak of the boom in 2000 full employment had been achieved in Sydney east of Olympic Park, but at the opposite extreme the rates of unemployment in several other regions were comparable with those experienced in the 1930s.

The costs of regional divergence in unemployment rates have reached the point where there is a choice between intervention and national disintegration. The danger is that governments will respond by reverting to past interventions without pausing to consider the differences required by the current international context. Whatever its merits, the recent decision to enhance regional road funding is a reversion to traditional infrastructure-based regional policy. The need is for something more.

Globalisation and regional economies: the rise of the knowledge-industry model

During the 1980s it was common to consider the USA as a rapidly declining force in the world economy, and to look forward to the day when the East Asian Tigers, led by Japan, would achieve dominance. However, during that decade the Americans developed what is now known as the knowledge-industry model of industrial organisation, and during the 1990s they used this model to re-establish their pre-eminence as the world's most efficient producers in a wide range of industries. This is not to claim that the USA has addressed all its areas of economic weakness: its low savings ratio, balance of payments deficit, high level of household indebtedness and considerable inequalities can all be considered weaknesses, but with enhanced productivity and international competitiveness based on the knowledge-industry model, it has the opportunity to address these issues and remain dominant in the world economy. In passing, one may note that, apart from the level of inequality, Australia shares the American weaknesses, but not its strength in adopting the knowledge-industry model.

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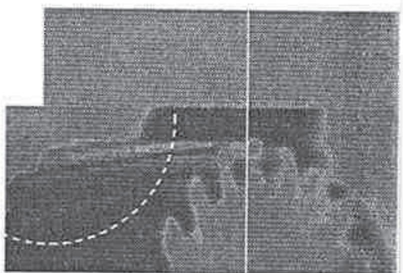
What is the knowledge-industry model?

The knowledge-industry model of industrial organisation is fundamentally a response to the increase in the importance of knowledge as a determinant of success or failure in the production of goods and services. Though knowledge can be codified and recorded in various ways, it ultimately resides in human heads. No single head can hold the knowledge relevant to any line of production, so success depends on two factors; first, specialisation by individuals who master the knowledge in particular areas (including the art of putting together specialised knowledge) and second, building networks of knowledgeable individuals, including those who understand the scientific and cultural fundamentals underlying any line of production; those who understand the translation of these fundamentals into products and services, those who understand the art of production, and those who understand selling and marketing. Ultimately these networks depend on consent, since effective human interaction is voluntary. It cannot be commanded by bosses and administrators; nor can it take place if the benefits are not apparent to the individuals concerned; in other words, if there is no social milieu in which interaction can take place.



The essence of the knowledge-industry model is to cluster production of particular goods and related services within particular regions, and develop strong networks between enterprises in each region. The model concentrates on the development of supply chains for each final product, with the supply chain consisting of independent but co-ordinated enterprises, thus mixing competition and collaboration. Products are developed using teams put together for the occasion; different product developments require different teams, and the most successful regions are those which can readily put together teams to identify opportunities, and to develop products competitive in world markets. Similarly, production is by alliances of enterprises, with the possibility that an inefficient link in the supply chain will be replaced by a competitor, thus ensuring efficiency along the chain.

The model is supported by recent developments in information technology, but has not done away with the need for personal contact between network participants, hence its regional basis.

The knowledge-industry model modifies the two previous American, and Australian, models of industry organisation. In manufacturing, vertical integration was previously dominant. It relied heavily on command and control; its fundamental weakness given the importance of knowledge in production was that it concentrated decisions at the top, and did not provide scope for knowledge inputs at all levels of production. It was characterised by production in-house, rather than by outsourcing to trusted contractors in long-term relationship. The knowledge-industry model as applied to manufacturing involves outsourcing of such items as materials supply and maintenance, and the concentration of the manufacturer on product development and marketing-in both of which areas thee may be considerable employment, under contract, of specialist design and market research firms.

A particularly striking example of the re-organisation of an industry where all things were previously done in-house is the railways. In the first half of the twentieth century each state had a railway department which not only ran trains but built locomotives and ran railway refreshment rooms, and even in some states ran poultry farms to supply the refreshment rooms. By contrast, the railway industry now comprises a network of specialist businesses: businesses which build, maintain and hire-out locomotives and rolling stock; businesses which build and maintain track, and businesses which run various sorts of trains, which in turn market their services largely to the specialist logistics businesses which have taken over from the in-house transport clerks of shippers.

The knowledge-industry model likewise differs from previous American, and Australian, industry organisation in small-business industries such as agriculture, in that it emphasises networks rather than producer independence. It provides the milieu in which knowledge can be shared, rather than expecting each producer to acquire and defend his own particular knowledge base.

In the model as practised in the USA, large businesses remain important, but compared with the 1970s their position is less frequently based on the economies of vertically-integrated large-scale production, and more often on economies of large-scale marketing, not to speak of the profits which can sometimes be generated through market control and control of technology.

An important advantage of the knowledge-industry model over vertical integration is that businesses do not have to maintain the full panoply of specialist expertise relevant to their industry in-house, and can take advantage of knowledge inputs from a wide variety of sources. Since the specialist expertise that will be required in such areas as marketing and product development is unpredictable, it reduces costs to contract it in as required from specialist businesses. As compared with the competing-small-business model, the knowledge-industry model saves costs by maintaining links between businesses, so that they can identify projects which would be beyond the resources of any one taken singly, and so that when they join together on a project they do not have to spend time learning about each other before they can go ahead.

The model manages risk not by central planning but by dispersing it between the contracting firms. Lead producers off-load many of their risks onto subcontractors, who can manage the off-loaded risks through association with multiple buyers for their services. Risk is also managed by informal co-ordination across the network, which helps to maintain workloads for the collaborating firms. In turn, this control of risk underwrites investment in both capacity and product development. As the system becomes better understood, it is likely that the financial sector will become more involved in risk management, but the basic principles were developed in high-technology manufacturing industries and not in the finance sector.

In its use of subcontracting between firms specialising in marketing and those specialising in aspects of production and product development, the knowledge-industry model echoes industry organisation in Japan. However, there is a major difference: firms which specialise in marketing do not attempt to control product development, and do not hinder contact between product developers and consumers. The Japanese emphasis on central planning can not match the rate of new product development of knowledge-industry groups of firms.

Even in the USA, not all industries yet operate according to the knowledge-industry model, but with the rapid dissemination of information technology, and with the decline of large bureaucratically-managed producers, many industries have changed model, or are in process of changing.

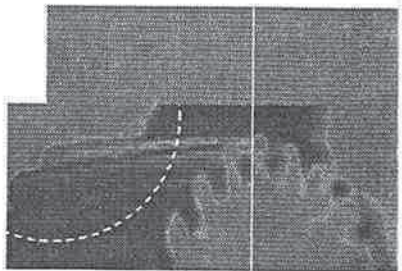
An important advantage of the knowledge-industry model over vertical integration is that businesses do not have to maintain the full panoply of specialist expertise relevant to their industry in-house, and can take advantage of knowledge inputs from a wide variety of sources.

The knowledge-industry model and international trade

A very important feature of the knowledge-industry model is its relationship to success in international trade: both to success in overseas markets, and success in meeting import competition. This arises from three sources:

- cost reductions stemming ultimately from specialisation in the application of knowledge to production;
- investment in equipment made possible by the control of risk through dispersion and, most important
- its encouragement of a high level of product and service innovation.

The knowledge-industry model leads to high levels of innovation because of its mixture of competition and collaboration between specialists in different kinds of knowledge. A high level of innovation is in turn crucial to export success, in that it is in general easier to sell an innovative product or service on global markets than to sell a standard product. A new product, or a version of an existing product which is sufficiently differentiated from others, does not meet domestic competition in importing countries, which is not only a marketing advantage in itself, but also means that it is less likely to encounter protective barriers.



From this point of view, Australia has backed the wrong horse. Instead of assisting and cajoling its industries into adopting the knowledge-industry model, and with it high levels of product innovation and differentiation, it emphasised cutting costs in the production of standard commodities, and went on a diplomatic campaign to persuade other governments to adopt free trade for these commodities. The campaign failed to prevent falls in commodity price levels, which followed costs. Given this failure, and the concomitant failure to shift rapidly to the knowledge-industry model particularly as regards levels of innovation, and it is not surprising that Australia should have a chronic balance of payments deficit and a declining currency. The regional effects are also noticeable: many of the regions which are in most trouble are those which are most engaged in export, or import-competing, production.

Adoption of the knowledge-industry model by Australian business

Though the knowledge-industry model was not invented in Australia, it is well suited to Australian business culture; in fact, probably better suited than the competition-without-collaboration which is current government industry policy. Many Australian industries have changed to the knowledge-industry model or are in process of changing. Awareness of the advantages of the knowledge-industry model is generally high in formerly vertically-integrated industries, and some have advanced considerably towards adoption of the model. The mining industry provides an example. In other Australian vertically-integrated industries, however, high levels of overseas ownership are hindering formation of regional knowledge-industry clusters, particularly when they insist that product development and marketing functions be directed from the overseas head office. By contrast, many small-business industries are experiencing difficulty in learning and applying the new methods. In all industries adoption of the model can be hindered by Australia's thin industry structure: the absence, in most regions, of critical components for the formation of knowledge-industry clusters of firms.

An important result of adoption of the knowledge-industry model should be diversification of production, particularly export production, and an increase in the emphasis on innovation as a characteristic of exports. Unfortunately, the ease with which adoption of the model translates into international competitiveness through product differentiation varies by industry. It is very difficult for the mining industry to differentiate its products, and even though it is rapidly adopting the knowledge-industry model it remains a commodity producer. The scope for product differentiation in agriculture is much greater (frequently referred to as niche marketing), but there have been formidable barriers to converting a small-business industry into a knowledge-industry, with the result that much Australian rural industry remains in commodity production. Only in selected agricultural industries (wine, perhaps dairy) has knowledge-industry clustering of farming with manufacturing resulted in marketing success.

The switchover to the knowledge-industry model is one factor which helps to explain the different fortunes of Australian regions over the 1990s.

Can failure to adopt the knowledge-industry model explain divergence between Australia's regions?

The emergence of the knowledge-industry model as the most competitive mode of industry organisation may be related to the divergent fortunes of Australia's regions in several ways. Three of these are direct consequences of adoption of the model.

- The model depends on informal networks of contacts between specialist firms. Despite the possibilities inherent in developments in telecommunications, these networks are most easily formed in urban areas.
- The model tends to concentrate value in the more specialised parts of supply chains; in product design rather than routine production. Income tends to flow to regions which gain technological leadership. These regions need not be urban, but require a significant concentration of specialised supply.
- Involvement in knowledge-industry relationships which extend across countries is easier for firms which are located close to major international airports than for more distant firms. High levels of overseas ownership accentuate this effect in Australia.

The extent to which adoption of the knowledge-industry model accelerates urbanisation varies across industries. The mining industry provides an example of strong urbanisation. Employment at mine sites is diminishing rapidly, while employment in mining services is rising. Mining service firms need to locate close to major airports in order to take assignments anywhere in the world. By contrast, in the wine industry regional clustering has been of greater importance, and much of the research and development capacity of the industry is located in the regions of production. Tourism can also adopt knowledge-industry techniques for marketing and service development, but much of its employment is necessarily located where accommodation and tour services are required. Regional fortunes may thus reflect industry mix, with relatively high employment generation in regions where the adoption of the knowledge-industry model does not urbanise employment.

In addition, the rate of diffusion of the model has been quite different between industries, with regional effects. Those primary-production industries which have not developed close links with their buyers on a producer-to-processor basis are far from adopting the model, and are suffering from the consequences of not doing so. Geographically, the diffusion of networks away from metropolitan areas is hindered by distance, but can be assisted by telecommunications.

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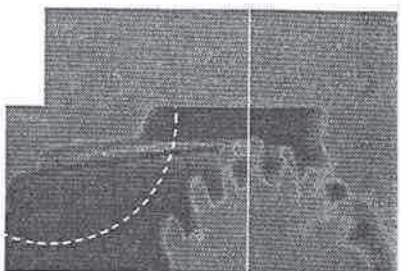

Patterns of adoption of the knowledge-industry model provide part of the explanation for the pattern we have already noted: the most prosperous regions tend to be either metropolitan or remote, with depression common in the closer-settled rural areas. It is arguable that the knowledge-industry model has been adopted most rapidly at both ends of the regional spectrum: in metropolitan centres, with their concentration of design, research and financing talent and their proximity to international airports, and in remote areas, which have been early to appreciate the benefits of telecommunications-based development even though they have not always had the quality of connections needed to take advantage of the potential benefits. This applies particularly to remote areas reliant on mining, which has adopted the model, and much less so to the pastoral interior.

Though the switch to the knowledge-industry model helps to explain recent regional divergence in Australia, a number of other factors are also important. They include the following:

- Industry growth rates have diverged, with regional effects. In general, manufacturing industry has done poorly, while finance, marketing and media have prospered. Employment growth in sophisticated financial services goes some way to explaining the prosperity of Global Sydney, and provides another example of an industry where application of knowledge-industry techniques has centralised employment.
- As always, major infrastructure projects can affect regional prosperity for years at a time. It is probable that construction for the Olympic games contributed significantly to the attainment of full employment in Sydney in the late 1990s.
- It has been claimed that financial reform in Australia has reduced the availability of finance for regional investment. For example, national superannuation contributions take finance out of regions which may previously have remained in the region as business or household savings. With exceptions, the trend has been to invest this flow of funds overseas or in the major cities. Despite the growth in financial sophistication, it is also arguable that the financial sector has yet to provide desirable flows of funds to support small-business investment and regional infrastructure.
- Despite continuous reforms to the educational system and to the funding of non-commercial research, there are arguments that optimal levels for support of regional development have yet to be reached.
- As already noted, unemployed people will tend to gravitate away from regions of high housing costs and towards areas where low housing costs accompany pleasant living conditions.

Despite the several factors which have made for regional divergence, adjustment to the knowledge-industry model of production will be important for all regions, and in reducing the waste of resources currently taking place in the high-unemployment regions.

Conclusion

The knowledge-industry model has rendered previous modes of industry organisation uncompetitive. At the industry level these include both large-scale firms which try to do everything in-house, and small-scale firms which aim to compete without forging collaborative relationships with related firms. At the economy level, countries which adopt the knowledge-industry model, at least in their tradable sectors, are likely to perform well in international trade, and hence in economic growth. This is because knowledge-industries tend to score well in innovation. The world market rewards innovation, not, as Australia has found out, efficient production of standard commodities.

So long as world trade continues to reward innovation, countries have a simple choice: adopt policies which support innovation, or submit to relentless decline in standards of living. This may not always be the case: it is possible that war or natural disaster may re-create a trading climate which rewards commodity production. However, that climate is not yet. So long as innovation is important, and so long as the knowledge-industry model is the proven way to encourage it, Australia would be well advised to address its backlog in industry conversion.

This is not to say that an Australian knowledge-industry model will or should be an exact copy of the American original. Many other countries are ahead of Australia in this, and are already producing variants on the American original which are more suited to their cultural circumstances, and which may also avoid some of the weaknesses of the American version. It is up to Australia to take advantage of its own social and cultural circumstances to produce a version which outperforms the original.

All of this is of fundamental concern for regional policy, since there is a strong regional element in the creation of world-competitive knowledge industries. Indeed, the knowledge-industry model can only be implemented at an industry/regional level. Australia's lack of policies to hasten the adoption of knowledge-industry organisation reflects its lack of regional policies; and adoption of an active regional policy implies encouragement for industry reorganisation on a knowledge-industry basis.

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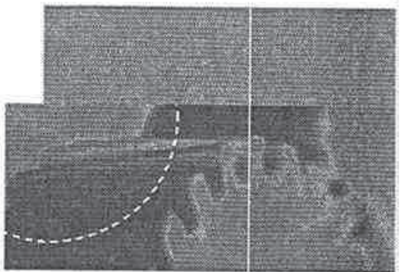

Responses to regional unemployment divergence

Attention was first drawn to the regional divergence of Australian unemployment rates in 1995, with Gregory and Hunter's analysis of trends between the 1971 and 1991 Censuses. Gregory and Hunter emphasised the decline of manufacturing as the primary cause. A first reaction was to argue that the costs were transitional: the government's emphasis on cost-minimisation was inevitably unfavourable to manufacturing, but a new economy would emerge based on commodities and services, and regional relativities would be restored. Later work demonstrated that high unemployment was not confined to rust-belts, and that the full-employment enjoyed in Eastern Sydney was indeed the exception rather than the rule.

Since the end of full employment in the 1970s the debate on unemployment has been conducted very largely in national, macroeconomic terms. The differential impact of unemployment by skill level has been observed, and policies put forward to assist people to improve their skills. Labour market deregulation has also been promoted as a way to reduce unemployment, and many previous labour-market rigidities have been abolished. The realisation that full employment in Sydney can co-exist with depression-era unemployment rates in other regions renders much of this debate irrelevant. A new debate is required, concentrating on regional unemployment.

This is not to argue that the Commonwealth response should not have any macroeconomic elements. Overall, Australia is still short of jobs, and reductions in unemployment will require either net job generation or net labour force withdrawal. However, any purely macroeconomic solution risks generating over-full employment in favoured regions while depression remains in the unfavoured regions.

One possible response to the divergence in regional unemployment rates is to concentrate on bringing the people to the jobs.

Move the people to the jobs?

If the divergence in rates of job-generation between regions is regarded as inevitable and permanent, the obvious solution is to move the people to the jobs. There are, however, several problems with this solution.

- Except where it is undertaken slowly, the solution involves writing down both physical assets such as housing and social assets such as the sense of local community in the unsuccessful areas.
- The migration solution may also involve writing down of physical assets in the destination areas: congestion increases, and the areas have to be redeveloped at higher density to accommodate the expanded population.
- The question arises as to who is to bear the costs. An obvious but politically impractical solution would be a capital gains tax on owner-occupied housing, which will be paid mainly by residents of the successful areas, with the proceeds used to finance the internal migration. A market-oriented alternative approach which ignores the inequitable incidence of capital gains would simply be to require people from the unsuccessful regions to move to the successful, bearing their own costs of doing so. This approach may, however, be beyond the means of many of the intended migrants, resulting in a stalemate.

Moving people to jobs is a feasible long-run strategy, as Australia found with its post-war migration program. However, it is not feasible beyond the rate at which the destination areas can absorb additional workers, and it is still costly if wide regions are condemned to population decline. It cannot be implemented quickly enough to provide the answer to Australia's present regional disparities.

Generate jobs for the people where they are?

We have emphasised the urbanising effects of the knowledge-industry model, at least in the first phase of its adoption. However, abstracting from changes in industry organisation, the trends should be the other way. Reductions in transport and communications costs have the theoretical effect of increasing the range of footloose industries; that is, of economic activities for which there is no compelling cost-minimising location. Given this trend, the puzzle is why there should be such a divergence in regional unemployment rates: employers should recognise that labour is available in the unsuccessful regions, and be anxious to move there to take advantage of a workforce which is happy to be employed. It is possible, though, that these benefits are not enough to persuade employers to enter the unsuccessful regions, and indeed there may be psychological factors to do with the atmosphere of depression which keeps them away. Yet if production really is footloose, it should be possible to shift at least some of it into the unsuccessful areas at no great investment cost. The investment cost is further reduced if it is offset against the capital losses which may arise if the people have to move to the jobs.

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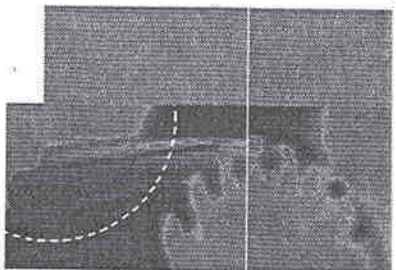
A variant of moving the jobs to the people arises from the diagnosis that high unemployment may be due to a developmental lag. Two reasons have been given as to why recent reductions in transport and communication costs have been accompanied by the concentration of jobs in the major cities.

- The reduction has been accompanied by an increase in average skill requirements (due to technological developments which abolish low-skilled work, or shift it to low-wage countries). This has disadvantaged regions with less skilled, or de-skilled populations, which happen to be the non-metropolitan areas.
- The adoption of the knowledge-industry model has increased the premium on face-to-face contact between specialists, and hence the premium on location in regions where such meetings can easily be arranged.



In both cases, it is arguable that the advantage presently accruing to the major cities need not be permanent, and the presently unsuccessful regions can catch up. In the case of skill lags, it is a matter of upgrading skills, but also of generating jobs to match the upgraded skills, including production venues where the skills can be learnt. In the case of face-to-face contact, it is a matter of improving communication techniques further, to the point where they neutralise the competitive advantage of nodality.

In summary, the persistence of significant regional differentials in unemployment rates within the one country is costly to governments because of the support required for the unsuccessful regions and the growth opportunities foregone. Rather than bear these costs, it is desirable to reduce the unemployment differential. Given that the differential appeared under free-market policies, and that the differential has not proved self-rectifying through market equilibriation, it is time to explore the scope for intervention to generate jobs where the people are, and/or hasten the spread of prosperity from the currently prosperous regions to those which are currently missing out. These interventions may prove less costly than the alternatives of putting up with differential unemployment rates until eventually the market sorts them out, or of encouraging the people to move to the jobs. However, what precise policies may be appropriate?

This returns us to the question posed at the beginning of this chapter; that of regional policy.

Current interventions

Over the past two decades the Commonwealth government has had little in the way of regional policy. Its policies on road, health and educational funding and on telecommunications and other utility regulation have favoured some regions over others, often unwittingly due to lack of co-ordination at the regional level. In 1996 the present government opted to cancel its predecessor's tentative steps towards an active regional development program, and it also opted to reduce government commitment to the provision of development finance. Apart from the distribution of states' grants, current Commonwealth policy with differential regional impacts includes:

- a limited range of tax concessions, for example income tax concessions for residents of remote areas; and, more important,
- allocation of road investments, policies which influence but do not determine the allocation of telecommunications and other infrastructure investment, and policies affecting the distribution of education services. (By privatisation and National Competition Policy the Commonwealth has deliberately circumscribed its powers in these areas, and in any case its powers are limited by the Constitution.)

The emphasis in Commonwealth economic policy over the past two decades has been on cost control, both through macroeconomic and microeconomic policy. It has pursued the benefits of competition, but unlike the US government has not encouraged the collaboration also required to implement the knowledge-industry model. In pursuit of cost reductions, it has greatly reduced tariffs, but it has failed to implement any substitute policies to address the original purpose of the tariff: control of risk levels to encourage investment. The impact of its emphasis on cost control has been favourable for the mining industry, which had the resources and the skilled personnel to access and apply information technology, but has left the more traditional rural industries exposed to international competition. These industries have limited capacity to take advantage of developments in information technology, and limited access to knowledge-industry techniques. Manufacturing has also declined, the major factor being the lack of risk control which has discouraged the investment required to build up full-scale knowledge-industry production clusters.

The states have the primary responsibility for regional policy. They:

- provide limited tax concessions (but their total taxation revenue is so small compared with the Commonwealth that these concessions are minor) and
- invest in both infrastructure and education, but subject to Commonwealth guidelines in important respects, and again with reduced scope for regional emphases following privatisation and National Competition Policy.

State governments have often been led into courting particular overseas investors, rather than developing existing regional producers into coherent knowledge-networks. Their hope is that the overseas investors will bring technology for local transfer. Sometimes this hope is realised, though realisation generally requires considerable negotiation skills. Overseas the trend is away from investor courtship, and indeed the EU has regulations to prevent its member governments from competing with each other, on the grounds that this only results in races to the bottom.

Over the past two decades the Commonwealth government has had little in the way of regional policy.

Local governments sometimes also court large investors, though at this level there is a growing appreciation of the weakening links between headline investments and local incomes.

As remarked in the previous chapter, the lack of coherent regional policy is closely related to the lack of policies to encourage adoption of the knowledge-industry model.

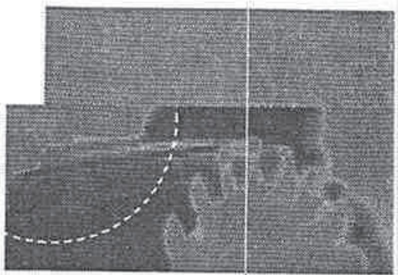
Australian precedents for enhanced regional intervention

If current regional policies are not sufficient to stem the divergence of unemployment rates, one possibility is a reversion to previous policies.

Infrastructure?

For most of their histories, the Australian states have pursued infrastructure construction policies as an instrument of regional development. These policies fell into disrepute in the 1980s, with the following providing examples:

- Investment in power generation so as to attract electricity-intensive business reached the point where power was being sold considerably under cost to some purchasers, paid for by others in an elaborate process of cross-subsidisation.
- Investment in water supply for irrigation had indeed increased agricultural production, but much of the value of production was offset by environmental costs, and in any case was not sufficient to earn a commercial rate of return on the headworks.



Reflecting these problems, funding has been curtailed for public infrastructure investment, and as far as possible responsibility for infrastructure has been shifted to the private sector, sometimes through complicated government/private financial deals. Except for roads, direct government investment in infrastructure now has to run the gauntlet of full financial assessment, and if it is not justified on a strict financial analysis has to go through the cost/benefit process before any non-commercial funds can be applied.

These reforms have increased the efficiency of infrastructure investment, but how do they relate to job generation in high-unemployment regions? Using existing methodology, it is open to governments to include job generation among the arguments in the cost/benefit analysis, and hence identify infrastructure projects which are beneficial once job generation has been taken into account even if they do not yield satisfactory financial returns. Two questions then arise.

- How many projects are there which would be justified on job-generation grounds? Would there be enough to return the high-unemployment regions to full employment?
- If there are so many worthy projects, why are they not being financed?

It is suggested that the emergence of high-unemployment regions does not require any change in infrastructure investment assessment methodology, though it may be desirable to conduct a review of projects to ensure that job-creation effects in the job-deficient regions have been properly included among the benefits, and that projects have not been denied resources for fear of causing excess demand in these regions (as distinct from the full-employment regions). There may also be scope to increase the budgetary priority of projects in the job-deficient regions. However, infrastructure is no panacea, and may divert attention from the primary task of re-inventing Australian industries on a knowledge-industry basis. Indeed, there is a serious threat that governments, anxious to be seen to be responding to high regional unemployment, may reach for the nearest available big-ticket infrastructure investments, and pursue these rather than tackling the riskier but more rewarding task of developing world-competitive rural and manufacturing industries.

Growth centres

For a while in the 1970s and 1980s the Commonwealth government experimented, half-heartedly, with growth centres. These were integrated urban and industrial developments on the 'new town' model intended to absorb population increase without adding to congestion in the metropolitan areas. They were promoted partly because of dissatisfaction with the results of preceding decentralisation policies, and were intended to reach a critical urban mass after which they would continue growing of their own accord. The growth centre policies certainly did the recipient cities no harm, though whether they were a cost-effective investment is another matter. The important point is that they are not particularly relevant to the present case, where the problem is widespread unemployment in whole regions.

Locating government footloose production

In the nineteenth century the government of the colony of Victoria was faced with a number of substantial towns which were losing their economic base as a result of the inevitable decline in gold mining. The government responded by locating orphanages, asylums and prisons in these towns. These services were selected because, by then-current practice, there was no requirement to locate them in any particular place: they were the nineteenth century equivalent of today's footloose industries. The government accordingly located them in places which were short of jobs, and they provided an important element in the economic base of those towns for a century.

Though orphanages are no longer needed, and it is no longer accepted practice to segregate sufferers from mental illness from the rest of society, the importance of government footloose services as potential contributors to the economic base of regions is illustrated by the lively competition between regions for new prisons and defence facilities. Though governments have distanced themselves from direct production of many services, they still wield considerable purchasing power. Where government-financed production can equally efficiently be carried out at a variety of locations, it makes sense to choose the location where production is likely to make the greatest possible contribution to reducing unemployment.

In practice, locational decisions for government production are likely to be hard to distinguish from deliberate public sector job-creation.

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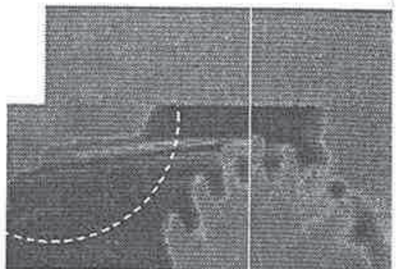
Tax-financed job creation?

A further possibility hearkens back to the depression of the 1930s. If the unemployment rate in some regions is really as bad as it was during that depression (though disguised by the social security system) there may be a case for revisiting relief work.

The Commonwealth's 'mutual obligation' approach to social security implies that jobs are readily available as an alternative to social security payments in all parts of the country. While this may be true even for unskilled people in Sydney and for most skill levels in Melbourne, it is manifestly untrue in many other parts of the country: one may instance almost the whole of Tasmania, in which productivity increases have reduced rather than increased employment. Why not, therefore, add some additional tax money to the social security money already being spent and generate jobs in these areas? Examples could be increasing the finance available for education, welfare services and environmental care, all of which are fairly labour-intensive and hence generate plenty of work per dollar spent.

The prospect of tax increases to finance job generation may be horrifying to taxpayers, yet the required tax increases may not be large, since there are offsets in the form of reductions in social security outgoings and increased tax revenue from the increases in activity generated by the new jobs. In due course the additional jobs may even become self-financing: for example, an increase in environmental and welfare services in Tasmania could lead to its being the next retirement 'sunbelt', and returning to self-sustaining growth in population if not in average income much on the current model of coastal Queensland.



Increases in education, welfare and environmental services create public-sector employment, though the actual work can readily be contracted out to private firms and non-profit agencies. Jobs can also be created through wage subsidies to private sector activity. This may be regarded as preferable, since there is a greater chance that the skills gained, and the jobs themselves, will become sustainable on the private market and not depend on continuing tax finance. On the other hand, there is a greater danger that the wage subsidies will substitute for wages which would have been paid in any case. These benefits and dangers depend very much on local circumstances, and whether to spend on wage subsidies or public sector job creation should be left to local decision.

Generalising, if relief work is to contribute to regional development it should:

- provide services which meet recognised needs, and justify any required tax increases, and
- generate maximum spin-off in private sector development.

The contribution will be all the greater is relief work is not seen as a means of fostering the full achievement of the region's potential.

Regional tax concessions

For the most part, in Australia tax concessions which aim to influence the location of employment have been provided by state and local governments aiming to attract investments and hence jobs. The range of tax concessions which can be provided by these governments is limited (payroll tax, land tax and rate holidays are the main possibilities), and concessions are frequently supplemented by grants and by services in kind. Over the past decade or two there has been a tendency for state governments to increase their resort to this type of concession, for two main reasons.

- The state governments (though not, apparently, the Commonwealth) are painfully aware that investment levels are not sufficient to maintain employment, let alone generate target levels. They argue that many investments, particularly those involving technology transfer, yield benefits to people of the state which cannot be captured by the individual investor, hence the justification for subsidies.
- Conversely, multi-national firms, particularly in the footloose industries, are increasingly skilled in playing government off against government in the search for subsidies. An important strategy of these firms is to ensure that negotiations are 'commercial in confidence'. This maximises their bargaining power, and also minimises the extent to which they can be required to deliver on the promises they have made to the state which gains the investment.

These types of concession incur several risks:

- competing jurisdictions may engage in a 'race to the bottom'
- investors may fail to deliver on the promises they have made, particularly if agreements are 'commercial in confidence' and
- the loss of revenue from tax concessions may be made up by cuts to services and increases in other taxes which have a net debilitating effect on regional development. (On the other hand, a successful investment may generate considerable extra revenue, even after allowance for concessions.)

The Commonwealth has so far denied any need for action to increase investment, and has tried to curb state industry assistance programs. For example, the states' use of their electricity utilities for industry assistance provides one reason why the Commonwealth set out to reform the industry. An alternative approach would concede the need for active investment attraction, though with the emphasis changed away from the attraction of footloose multinational firms to investment by local business. It would move away from the present ad hoc negotiations, with their wide range of discretion for politicians, officials and consultants, towards a more systematic approach. This paper, indeed, recommends such an approach.

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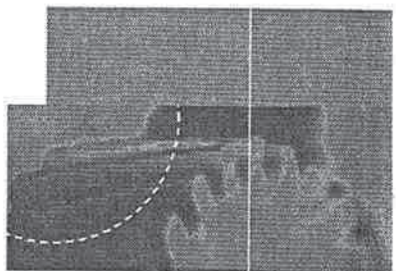
Tax concessions and industry-specific assistance at the Commonwealth level are also subject to the danger of competition between jurisdictions, but on a larger scale, for here the competition is international, and there are so far few international agreements to combat it. However, competition between jurisdictions need not be a concern should the Commonwealth decide to use tax concessions to influence location within Australia.

The remote-area income tax concessions are unusual in that they are not designed to encourage investment directly, but rather to offset some of the costs of living in remote areas, and hence encourage people to live there. The extent to which additional costs of living are offset is a moot point: so much depends on individual consumption patterns, and there is some doubt as to the relevance of prices where urban services are simply not available in the remote areas, and vice versa. However, the cost-of-living argument has been accepted by the social security system, which also pays remote-area allowances. From this point of view, remote area allowances are an equity provision rather than developmental; the argument is that tax should be imposed on real income adjusted for prices, rather than on nominal dollar income. However, in so far as they allow employers to pay lower wages than would otherwise be required to attract personnel of given quality to remote areas they may have developmental effects. It is recommended that they remain, but that the geographic areas of availability should be updated to reflect present-day cost patterns.

Industry development policies

The Australian states, and to a lesser extent the Commonwealth, have also developed a wide variety of policies to assist industries in various ways. The Commonwealth emphasised the tariff: it is accepted that the days of protection are numbered, but the Commonwealth has yet to produce a substitute for the tariff by way of risk-containment policies which encourage and validate investment in export industries and those exposed to international competition (which is increasingly the same thing).



Australia also has experience, and indeed past successes, in many of the types of policy listed in the next chapter, which covers regional policies in several other OECD countries. The states also have experience, with past success, of policies designed to update the technology and organisation of industries. In both cases past experience can be adapted to hasten the improvement of competitiveness on knowledge-industry principles.

Conclusion

The divergence of adjusted 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.

Current regional policies are inadequate for the task, so there may be a case for reverting to past policies. Past Australian experience with location-specific development policies has included infrastructure investment, the old state decentralisation policies, the newer growth centre policies, experience with relief work and experience with industry development policies. It is concluded here as follows:

- Australia's basic policies with regard to infrastructure investment are appropriate, though they may require fine-tuning to deal with the reality of regional divergence. However, infrastructure development does not guarantee a convergence of regional unemployment rates. The success of infrastructure investments is primarily judged by their contribution to increases in GRP, but as noted above, increases in GRP can no longer be relied upon to translate into increases in regional employment and incomes.
- Decentralisation and growth centre policies are not appropriate responses to the present predicament.
- Job creation is more directly an answer to the present predicament of vastly divergent regional unemployment rates.
- Tax concessions, provided they are well-designed, can provide cost-effective incentives to investment and job creation.
- In the light of international precedents, industry policies are worth re-examination, since they are the most directly related to promoting the transition to knowledge-industry organisation.

These conclusions from past Australian experience are necessarily tentative. It is important to recognise that the programs were de-emphasised for two reasons:

- primarily, because both major political parties elected to believe that tax cuts were more popular with the electorate than expenditure on economic development and
- secondarily, because problems of detailed design and administration were identified which could be used to discredit the programs, particular in relation to the perceived virtues of the private sector in regional development.

In other words, active regional policy was abandoned due to the tightness of government budgets following the end of full employment, and not because of fundamental flaws or failures. Economic development expenditures were sacrificed to reconcile tax cuts with the pre-committed increases in social security expenditure which resulted from increased unemployment. This was truly a case of short-run expediency, since, as it turns out, the expenditures sacrificed were those necessary to minimise unemployment in the long run.

The present task is therefore to re-invent regional policy against the background of the shift to the knowledge-industry model, and the compelling foreground of unacceptable divergence in regional unemployment rates.

Fortunately, there is a wide body of overseas experience to draw upon.

International precedents

The major OECD economies, including the USA, the EU and Japan, all pursue well-established and active regional development policies at the national/super-national level; none of them have left regional development to the market. Even New Zealand, which for two decades had no regional development policies, has recently returned to the ranks of countries with pro-active regional policies.

In the USA, growing regional inequalities have resulted in a significant involvement of governments in the development and implementation of policies to enable regions to restructure and attain their economic potential. The American programs and implemented by federal or state governments in conjunction with local government. The most prominent group of programs goes under the generic title of Enterprise Zones. Though small in scale compared to EU programs, Enterprise Zones, along with many other government programs, mean that American governments are far from content to leave patterns of regional growth to market determination.

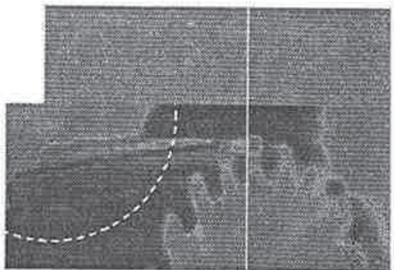
The divergence of adjusted unemployment rates between Australia's regions is now too great to be countered by a policy of moving the people to the jobs. Jobs have to be moved to the people.

American Enterprise Zones form an important precedent for Australia. Their relatively small scale suits them to policy experiment, and their provenance in the country which invented the knowledge-industry model argues that they are likely to be useful in hastening adoption of knowledge-industry techniques. However, before describing the American precedents in detail, we will briefly consider the European programs.

Location-specific economic development programs in Europe

In Europe, both national governments and the EU mount regional economic development programs. Differences between the programs are:

- the national programs target relatively small areas, whereas the EU programs target large regions and indeed entire member countries (this contrasts with the USA, where both federal and state programs target small geographic areas)
- the EU programs are basically project-based grant programs, accounting in total for a third of the EU budget; the national programs are varied in content.



EU programs

The EU directs around 30% of its expenditure through its Structural Fund. For the 2000-06 sextennium expenditure is being directed towards three objectives:

- development and structural adjustment of regions in which development is lagging, accounting for 70% of the funds (the identified regions account for 22% of the population of the EU)
- economic and social modernisation in areas facing structural difficulties, especially agricultural adjustment and high unemployment (12% of the funds; these regions have 18% of the population of the EU, though they are generally more compact than the lagging regions)

- adaptation and modernisation of education, training and employment practices, accounting for the remaining 18% of the funds, which are not geographically targeted.

Funds are supplemented by member states. In addition, the EU operates a cohesion fund, which is available for spending on projects in member states where GNP per capita is less than 90% of the union average, namely Spain, Greece, Portugal and (till recently) Eire. Cohesion funds are distributed between eligible states using a formula based on population, GDP per capita and area. (This equates to a crude version of the Commonwealth Grants Commission process in Australia.)

The Structural Fund budget is significant: if in Australia the Commonwealth government spent a similar amount, per capita, on regional development it would find itself spending AUD 2.3b a year. During the 1990s, structural fund transfers are estimated to have raised GDP by 10% in Greece, Eire and Portugal. Structural funds are allocated to areas and projects proposed by member states. Criteria of project selection include estimated effectiveness in job creation, the quality and durability of the jobs created, and probable demonstration effects. The projects are implemented by local government.

In the EU, protocols have been negotiated to prevent member states and their local governments from engaging in bidding wars to attract footloose industry. These are regarded as merely a race to the bottom.

Ireland

When it joined the EU Ireland was relatively poor, and was still dependent on rural production; it had not industrialised, but had rather been a source of industrial workers by emigration, and its population was well below its nineteenth century peak. Industrialisation began in the 1970s. Ireland decided not to promote itself as a low labour-cost location, but rather as a location which offered skill for money.

The industrialisation of Ireland was partly financed from EU transfers, but largely from foreign investment. Prior to the UK joining the EU, Ireland attracted North American investment because it provided an English-speaking location within the EU; this was important in its early moves into information technology. These moves paid off in the 1990s, by which time information technology production directly traceable to the original US investments was supplemented by indigenous developments; eg in adapting interactive software to the requirements of non-English languages, a development which took advantage of the peculiar relationship which the Irish have with English.

Following four decades of regional policy, Ireland is now a virtual opposite for Australia: national income is growing rapidly, there is a high investment rate and an even higher savings rate, with a balance of payments surplus which is being used to repay past loans. Here at least is one case of economic success in which regional policies have played a pivotal role, though as always other factors were also involved and it is difficult to estimate the strength of the causal relationship between regional policy and economic growth.

Location-specific economic development programs in the USA

Both the US federal and state governments have an abundance of programs to encourage economic development, many of which overlap and complement each other. These include:

- programs which are available throughout the country (or state), but which are of special relevance to poor areas and
- programs targeted on poor or distressed areas, including objective definition of the geographic area of eligibility.

In the remainder of this chapter we will consider the geographically targeted programs, and in Chapter 5 we will turn to the context of the programs.

Both the US federal and state governments have an abundance of programs to encourage economic development, many of which overlap and complement each other.

Enterprise zone programs in the states of the USA

A majority of US states have enterprise zone programs, and collectively these programs outweigh the federal program. There are significant differences between state programs, but the programs bear a family likeness.

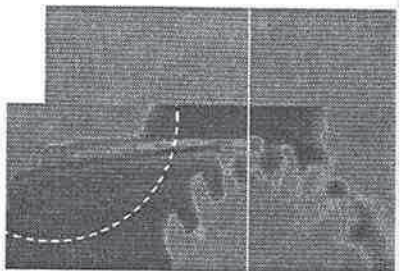
Boundaries of EZs

Many of the US programs grew out of urban redevelopment, and the designated areas are accordingly quite small. In the Iowa state program a county must first be selected, and then the EZs, which may not comprise more than 1% of the land area within the county. In Texas EZs must be at least 2.6 km2 but not more 52 km2. There may also be minimum population requirements. In some rural areas it is not possible to declare EZs since densities are too low to attain the minimum population within the maximum area requirement. In other areas EZ declaration is not possible because the local council is too weak administratively to apply. However, California has a special program for value-added agricultural land use economic zones, in which agriculture must form 60% or more of the local economy, plus other typical EZ conditions. Even in this instance the zones are sub-county in scale.

Over the country average EZ population has been given as 5,000 nonmetro and 20,000 metropolitan.

California allows boundary expansion by 15% into related but unqualified areas.

Zones are designated for at least 10 years, and up to 20 or in some programs.



Planning requirements

In most states EZ status is achieved by competition between eligible applicants. The competition is basically in terms of planning competence. Plans may be required to cover marketing, job development, provision of local incentives and financing. Development potential as assessed from the plan, workability of the plan, commitment to the plan and compatibility with state/federal policy may be taken into account. However, in some states the programs are hardly competitive and membership of the program is virtually as of right.

Zone eligibility

It is a common feature of EZ programs that they are targeted on relatively poor areas; that is, in order to apply for program membership and undertake the planning requirements an area must qualify as economically distressed. Typical criteria include the following:

- unemployment rates, eg 150% of the state average or more
- property tax rate at 125% of the state average or more; significant property tax arrears
- low property values; declaration of blighted status
- evidence that private investment is not being attracted
- population and/or job decline (eg 12% decline over the last 9 years or 4% over the last 3)
- low household incomes (eg at least 70% of households receiving less than 80% of state average household income, or by comparison with an absolute level); presence of high poverty levels
- ageing populations
- high housing vacancy rates.

Conditions may be absolute or may be by ranking within the state. Once declaration is achieved, it lasts for at least a decade, whatever happens to the qualifying conditions.

There may be a differentiation between rural/agricultural and urban/industrial zones. Various special circumstances may be considered in declaration, eg some states have provisions for declaration of areas affected by defence industry restructuring.

Benefits

Benefits are available for private businesses located in the zone, or which set up in the zone. In many programs benefits are restricted to businesses which increase employment within the zone. Benefits may also be restricted to businesses operating within particular industries, and may not be available to businesses which transfer employment from elsewhere in the same state.

Regulatory benefits

Local government generally endeavours to reduce the burden of regulation in Enterprise Zones, for example by:

- suspension and/or relaxation of building codes
- building fee concessions and/or
- streamlining of permits.

Tax incentives

Enterprise zones generally make use of tax incentives which may, however, be restricted to businesses operating in certain industries, eg manufacturing, processing, shipping or storage. In some zones target industries are tightly defined. There may also be other criteria eg a minimum sustained level of job generation. Incentives relate to taxes imposed by the jurisdiction declaring the zone, which in the case of US states generally involves a fairly wide range of taxes. Local government often relies on rates (property taxes) alone, and hence cannot offer as wide a range of incentives except in conjunction with the state and/or federal governments. Incentives commonly offered at state level include:

- remission of minor taxes such as business licence fees
- state and local sales tax credits for purchase of qualified equipment, basically equipment for use within the zone, maybe to a maximum value eg $1m. There may be limits as to type of equipment (eg for use in manufacturing)
- property tax exemption for investment in qualified property (or pegged values)
- state corporate income tax concessions for business income estimated to be earned within the zone including accelerated depreciation and sometimes a R&D credit. (In the case of businesses operating in more than one part of the state, profits attributable to the EZ are pro-rated from the state level by a formula involving payroll and property values.)
- wage subsidy by credit against state payroll or state corporate income tax. The credits commonly taper from 50% in the first year of employment down to 10% over 5 years, and are available only for qualified employees, being new jobs filled with employees hired from a target group variously defined but with a core element of long-term unemployed. For equity there has to be provision for seasonal operations. Programs may have maximum wage limits, or maximum wages deductions below the limit wage; but there may also be minimum wages specified. There may also be credits for training.
- deductions from interest earned by lenders to businesses within the zone from the corporate income tax liabilities of the lender.

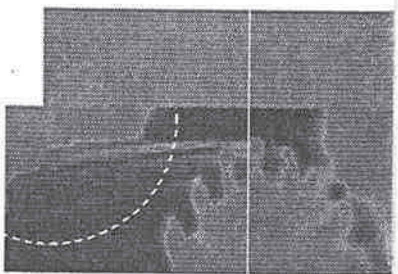
Tax concessions can generally be carried forward.

It is a common feature of EZ programs that they are targeted on relatively poor areas; that is, in order to apply for program membership and undertake the planning requirements an area must qualify as economically distressed.

Cash benefits

Some EZ programs also include cash assistance for business, such as:

- grants eg for shopfront upgrades
- loans at concessional interest rates; often via a revolving fund.



Benefits in kind

Other benefits can include:

- construction of infrastructure directly relevant to particular firms
- preference in government contracts.

In summary, the US state programs concentrate on:

- wage subsidies directly targeted on creation of employment for disadvantaged individuals
- incentives to invest in businesses in Enterprise Zones, particularly for equipment purchase and for the supply of finance and
- grants to finance complementary infrastructure investments.

The US Federal Program

The US federal empowerment zone/enterprise community (EZ/EC) program is minor compared with the sum of the state programs. In 1993 Congress authorised creation of 9 Empowerment Zones (of which 3 were to be rural) and 95 Enterprise Communities (of which 30 were to be rural). In 1997 a further 20 EZs were added, of which 5 were to be rural, and in 1999 a further 20 rural ECs. EZ/ECs were declared for 10 years.

This created a hierarchy of federal geographically-targeted assistance for distressed areas, as follows:

- many federal programs discriminate in favour of distressed areas and/or disadvantaged individuals
- areas which applied for EZ/EC status but were not selected have received ad-hoc federal grants
- ECs receive a moderate level of assistance and
- EZs receive a high level of assistance.

The federal government also supports industry parks with the aim of setting up clusters of mutually-supporting businesses. Unlike EC/EZs, no distressed area requirements are imposed, and federal funding comes from generally-available developmental programs. This funding is supplemented by private and local government money, and the planning element comes from local government. The eligibility conditions for general federal industry assistance programs favour areas which are putting development plans into action.

The federal enterprise zone program is similar to most state programs, as follows.

Geographic definitions

EZ/ECs must be based on contiguous census tracts and have populations less than 30,000 and areas less than 2,600 km2 (note that the maximum area is much larger than for most state programs, and is designed to allow inclusion of rural areas).

Eligibility conditions for federal EC/EZs

In 1993 eligibility conditions concentrated on poverty, with at least 20% poor in all included Census tracts, at least 25% in at least 90% of included tracts, and at least 35% in at least 50% of tracts, in addition to general unemployment and distress. In 1998 these conditions were eased somewhat, and outmigration was added as a criterion.

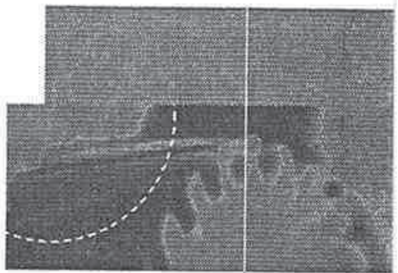
The program requires competitive application by the local governments of eligible regions. Application is via preparation of a long-term strategic plan. The federal authorities have graded these plans into EZ, EC, consolation prize and fail categories. Following selection, EZ/ECs have two years to develop comprehensive plans including measurable objectives, which are benchmarked.

The program requires competitive application by the local governments of eligible regions. Application is via preparation of a long-term strategic plan.

Benefits from federal EC/EZs

Businesses in the ECs and EZs are eligible for the following benefits, subject to meeting eligibility conditions.

- The Treasury portion of the Federal program includes corporate income tax deductions of up to USD 20,000 p a for approved investments in EC/EZ.
- The Treasury portion of the Federal program includes tax credits for qualified employees in EZs only (20% wage credit for the first USD 15,000 wage paid to each qualified employee; with provision of 40% credit for the first USD 6,000 wage paid during the first year of employment of 'high risk' youth)
- The Treasury portion of the Federal program includes tax exemption of interest for loans at least 75% of the proceeds of which go to finance purchase of 'qualified zone property' within an EZ.
- The Department of Energy portion of the Federal program includes grants of not more than USD 50,000 to assist with development of comprehensive sustainable development plans in EC/EZs. The grant can be applied to capacity building and other activities such as industrial ecology and land-use planning.
- The Treasury portion of the Federal program includes grants to establish EZs and to stimulate job creation for disadvantaged workers and the long-term unemployed.
- The HUD portion of the Federal program includes preference to EZ/ECs for allocation of grants to local government for housing estate development.
- Grants are also available from the Department of Agriculture portion of the Federal program for EZs in rural areas.
- The Department of Energy portion of the Federal program includes provision of sustainable development workshops in EZ/ECs.



In addition, EZ/ECs received assistance and preference in accessing other federal distressed area/disadvantaged person programs, and generally there are also state and local government contributions. Assistance in these categories includes public housing construction, infrastructure investment and education and public health service improvements. Financial provisions include revolving loans to finance equipment investment and microloans for job training. In sum, the federal program is very similar to the typical state program in its range of benefits.

Program expenditure

It has been estimated that the first round US federal EC/EZ program included expenditure of around USD 500m in government funds. Over half of the funds were drawn from federal programs other than the EC/EZ program, and there were also state funds involved. It is not clear whether the expenditure estimates include tax expenditures. Even if tax expenditures are additional to those costed, the program is quite small compared to the EU structural fund. Converted to AUD and pro-rated by population, the federal EC/EZ program equates to expenditure of around $25m a year, roughly one per cent of the European program. However, the US federal program is supplemented by the state programs, and total expenditure on enterprise zone programs in the US would be several times that on the purely federal program.

Assessment of US enterprise zone programs

US enterprise zone programs are smaller than the EU programs and operate in the context of a large number of other government programs which assist local economic development. Though a number of economists have endeavoured to assess the programs, these characteristics have hindered identification of success. The programs themselves cover a range of business assistance, and it is no simple matter to summarise their effect, which also hinders econometric investigation. Given these problems, academic assessment of the programs has necessarily been somewhat tentative.

A survey of studies of state enterprise zone programs completed during the decade after the first program was commenced (ie before the federal program had come into effect) concluded that there had indeed been job creation, and after allowance for the substitution by some employers of subsidised for non-subsidised labour the cost per job created was in the range between USD 1,000 to USD 13,000; in other words, in the same range as less geographically-specific job creation programs. These conclusions were reasonably well established even though the studies exhibited a range of statistical virtues and vices almost as great as the range of enterprise zone programs and provisions. These conclusions underlay the decision by the US federal government to begin its own enterprise zone program.

There has been some discussion as to whether the created jobs were simply shifted from other locations, or whether there has been net job creation at the national level. The balance of opinion is that there has indeed been net job creation, if only because the program assists in reducing economic costs through shifting jobs out of congested areas. A prime example is shifting jobs from the congestion of New York City across the Hudson into redevelopment areas in New Jersey. This development would probably have occurred anyway, but it is argued that it was accelerated by the enterprise zone program, which at the very least helped to overcome the anti-redevelopment effects of the US property tax system.

Not every region is blessed with developmental opportunities as obvious as those in New Jersey. However, independent assessment has reported success in job generation in less favoured rural areas. As improvements to education and as investment incentives take effect, this has extended into generation of high-wage jobs in addition to the low-wage jobs originally targeted. Another approach to the assessment of enterprise zone programs has been to gauge the level of business knowledge of the programs and the extent to which businesses claim to be influenced by the programs. This methodology is subject to the obvious criticism that businesses will tend to support the programs, but even so the surveys adduced that businesses were aware of the enterprise zone incentives, and took them into account in location decisions, though the incentives themselves were of marginal significance. This points out that US enterprise zone programs are but a small part of the total US business assistance program.

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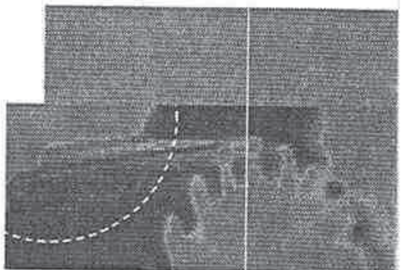


Conclusion: international precedents

In Europe the objectives of regional development policy are to enable regions to attain their economic potential. Most successful regions have a number of core competencies, and hence innovative regional policies have sought to strengthen the core competencies of poorly-performing regions. These core competencies include competitive firms that operate in collaborative clusters and networks; knowledge-based workers who continually upgrade their skills, and collaboration between business, government and community. The European states also recognise that major investments are often required in regional education, research and development, technology transfer, telecommunications and physical infrastructure.

New instruments of regional policy have emerged as the knowledge-industry model has gained pre-eminence. The broad features of the policies in these countries are as follows:

- The focus has shifted away from business attraction towards enhancing the competencies of firms, households and organisations within the region. Investment attraction follows successful implementation of this process.
- The generation and exchange of knowledge has become central to the innovation and investment process.
- The development of business and community networks is emphasised, along with the development of trust between network participants.
- Government intervention has shifted from a top-down approach to a bottom-up approach, with initiative and direction from within the region and government responding with financial and human resource support.

In the USA, enterprise zone programs share many of these characteristics, but are oriented more towards job creation in particularly disadvantaged areas. These are sometimes too small to be considered a 'region' in Australian terms.

All this is a far cry from the remote area allowances and road grants which are the major components of Commonwealth regional policy. Some of the Australian states and many local governments and regional organisations of councils are considerably ahead of the national government in matters of regional policy, but are hindered in pursuing their vision due to financial constraints. The lack of Commonwealth support for regional economic initiatives is particularly serious given the Commonwealth's dominance of taxation, and the consequent limited capacity for state and local government to finance investment and grant tax incentives.

Adapting overseas programs to Australian conditions

Though it is arguable that Australian regional disparities have reached the point which requires response on the large, European, scale, we will first consider the American precedent for possible adaptation to Australia. In considering such adaptation, it is first necessary to place American Enterprise Zones in the context of US economic policy as a whole.

The context of US Enterprise Zones

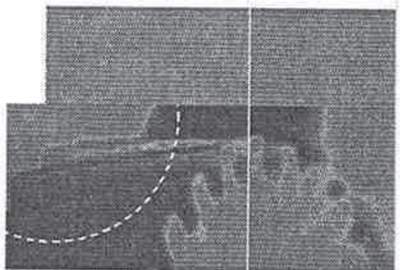
The US government publishes a guide to the federal programs which may be accessed by local governments developing strategic economic development plans. Even allowing that not all the listed programs are significant, the guide makes it plain that the US federal government is very active in regional development, by contrast with the hands-off attitude of the Australian Commonwealth government. The following summary list is included in this study for the benefit of those Australians who mistakenly believe that the American federal government pursues a laissez-faire approach to industry and regional development policy.

The lack of Commonwealth support for regional economic initiatives is particularly serious given the Commonwealth's dominance of taxation, and the consequent limited capacity for state and local government to finance investment and grant tax incentives.

The plethora of US federal programs

The numerous programs listed in the guide include many programs which are complementary, and some which are near-substitutes though delivered through different departments. Indeed, a cynic (or a public choice theorist) would observe that the list reflects the tendency of US politicians to maximise photo opportunities and press releases by multiplying the number of programs. The list certainly does not look administratively efficient; yet it provides enterprising local governments and other community development agencies with numerous opportunities to obtain assistance in cash and in kind. An important element in the EC/EZ program encourages local governments to access these opportunities systematically. This implies that transfer of the EC/EZ program to Australia without the wide range of other US federal industry supports may result in a greatly weakened impact.

The following lists US federal programs with the Australian Commonwealth equivalent, if any. In both countries federal programs are supplemented by state programs. Enumeration of state programs would greatly lengthen the list, but since the American states are also highly pro-active in industry attraction and assistance the impression would remain that governments have a much higher level of practical concern for industry development in the USA than in Australia.



Access to capital

- government guarantee of loans to small business (no equivalent)
- loans to certified development companies (no current equivalent)
- community adjustment and investment programs for areas disadvantaged by tariff cuts (no current equivalent)
- community development financial institutions, providing grants and loans for setting up financial intermediaries to serve distressed communities and low income individuals (no current equivalent)
- microloans, financing non-profit financial intermediaries to make loans of maximum $25,000 each for the finance of small business (no equivalent)
- historic preservation fund (national heritage program)
- small business investment companies, providing top-up funding to venture capital companies (no equivalent)
- the Community Reinvestment Act requires financial intermediaries to provide minimum levels of service in communities from which they source deposits, including provision of loans, especially for affordable housing. Institutions are not required to make non-commercial loans, but are required to report on the geographic distribution of their investments (no equivalent).

Business assistance

- limited business and industry loans to rural areas (no equivalent, but the US program is more in name only)
- intermediary re-lending program for business development, especially for aboriginal people (some ATSIC programs have come close, but are currently curtailed)
- an Office of Business Initiatives provides training for small business (there may be an indirect equivalent through TAFE)
- an Office of Government Contracting assist small business, disadvantaged people and women to obtain government contracts (no formal Commonwealth equivalent)
- an Office of Minority Enterprise Development assists business people of disadvantaged background (ATSIC has provided equivalent services, though these services are currently curtailed)
- One-stop Capital Shops assist small business by blending loans (no equivalent)
- a Procurement Technical Centre Program assists small business especially in contracting for defence requirements (there may be an informal equivalent in the Commonwealth Department of Defence; but it is less relevant, since a high proportion of defence equipment is imported)
- a Service Corps of Retired Executives provide business angels (no Commonwealth equivalent, and not much at state level either)

- Small Business Development Centres provide management assistance (no Commonwealth equivalent)
- Assistance to small, minority and women-owned business is also provided through the US Department of Energy (no equivalent).

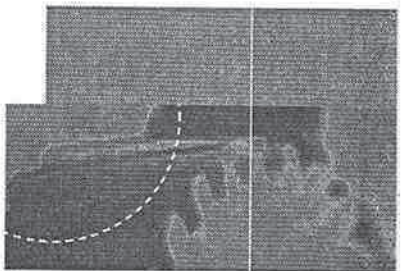
Community building

- Americorps, a volunteer youth service plan (no equivalent)
- a Good Neighbour Program aims to ensure that federal work location decisions fit in with local development (no formal equivalent; these matters are left to individual departments)
- the National Senior Service Corps is a volunteer plan for older people (no equivalent)
- Competitive grants are available for urban community development (no equivalent).

All this is a far cry from the remote area allowances and road grants which are the major components of Commonwealth regional policy.

Economic development

- a Brownfields Economic Development Initiative provides grants and loan guarantees to local governments engaged in redevelopment (no Commonwealth equivalent)
- a Brownfields Tax Incentive widens tax deductibility for expenses incurred in redevelopment (no equivalent)
- a large program of Community Development Block Grants finances public facilities, community services, crime reduction, housing and assistance to non-profit business (no current Commonwealth equivalent, except marginally under the Commonwealth-State Housing Agreement)
- Community Economic Adjustment Planning Assistance is available to finance redevelopment following closure of defence installations (there may be equivalent programs on an ad hoc basis)
- an Economic Adjustment Program provides assistance to state and local government to develop strategies to address deteriorations in the economic base of localities, not confined to distressed areas, and additional to the EZ/EC program (no Commonwealth equivalent)
- an Economic Development Initiative provides grants and guaranteed loans to areas undergoing economic revitalisation (no equivalent)
- Indian tribes and tribal co-operatives receive loans for land purchase (in Australia the Indigenous Land Corporation runs an equivalent program)
- an International Trade Administration provides export assistance (in Australia the Department of Foreign Affairs and Trade has an equivalent program)
- a Planning Program for States and Urban Areas distributes grants for economic development planning (no current Commonwealth equivalent)



- a Public Works and Development Facilities Program distributes grants to distressed communities to assist them in attracting investment, diversifying and generating jobs (no current Commonwealth equivalent)
- a program knows as Rebuild America provides grants to improve the energy efficiency of communal buildings and flats (there are some equivalent grants under Greenhouse response)
- Rural Co-operative Development grants are provided to assist with upgrading technology (in Australia this is left to the state level)
- Rural Development Grants are provided for small business development in rural areas, some of which are distributed through local government and non-profit agencies (no equivalent Commonwealth program)
- support is provided for business development and market development by small companies owned by disadvantaged persons (no equivalent)
- loan guarantees are provided for local governments borrowing for economic development, public housing or infrastructure (no current equivalent)
- various programs are provided to assist business in selling to the military (possibly an informal equivalent)
- Transportation for Agricultural Marketing is a grant program to assist with planning transport for agriculture (no equivalent)
- Work opportunity tax credits are provided for employers who hire individuals from targeted groups (no equivalent).

Education, Environment and Health

The document lists numerous individual programs. They are not listed here since most of them have some form of equivalent through existing Commonwealth/State arrangements.

Housing and homelessness

- Affordable Housing Partnerships provide technical assistance to low-cost housing providers (no current federal equivalent)
- Farm Labour Housing Grants and Loans (no equivalent except perhaps through the Commonwealth-State Housing Agreement)
- a Home Investment Program provides grants to the states and local government for local housing strategies (the CSHA is a partial equivalent, but allows less local flexibility)
- a Multifamily Housing and Health Care Facilities Mortgage Insurance Program assists private construction of welfare-related housing (no equivalent)
- rehabilitation of single room occupancy for homeless individuals and also for boarding houses (there has been a homeless component in the CSHA)
- supportive housing program of accommodation and services for the homeless (some equivalent programs).

Human services, farm support, infrastructure, public safety

Again the US government has numerous programs. The Commonwealth matches or surpasses many US programs in human services, but has been less concerned than the US federal government with farm support, infrastructure or public safety.

Technical assistance

- management and technical assistance to help small business and disadvantaged people in accounting and business development (no equivalent)
- grants to assist local governments engage in development planning (no equivalent)
- plus various programs to provide technical and planning assistance in energy, water and transport.

This is merely the federal program list, and even this list includes only the programs which may be accessed by local government: it therefore omits the very significant assistance the US federal government grants to various industries through defence contracts. Each of the fifty American states adds a further array of programs, big and small, effective and ineffective.

In Australia, the Commonwealth is wont to argue that most of these matters are state responsibilities, and its lack of programs is therefore appropriate. However, the contrast with the USA remains, since the Australian states mount industry assistance programs which are no more extensive than those of the typical American state, without taking the federal programs into account. The limited fiscal resources of the Australian states (due to award of most tax bases to the Commonwealth) prevent them from mounting regional economic development programs on anything like the same scale as the combined federal/state programs available in the USA.

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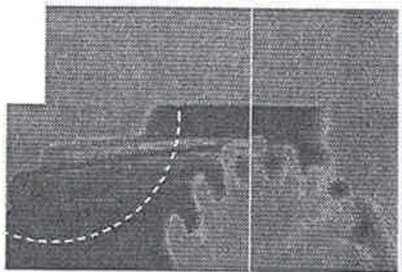
Common themes

Reading the list, it is easy to see why American economists have consistently argued for simplification of the list of programs. An influential school of American economists favours the minimal state, and argues that the list should be simplified by program abolition. Indeed, the economic theories propounded by this school assume that the minimal state has already been achieved. One reason for including the list in full is to refute those naïve Australians who believe the American economists, and think that the USA is a haven of laissez-faire. It is not. The considerable economic achievements of the USA, including the recent invention and spread of the knowledge-industry model, have been accomplished in the context of high levels of government economic intervention.



Given that the knowledge-industry model was developed in the context of active government intervention, there is a prima facie case that the American pattern of economic intervention is highly successful, despite its ramshackle appearance. In considering the list, a number of themes may be identified.

- Many programs involve government intervention in the finance sector so as to direct funds to various forms of local economic development. This may include government assumption of risk (especially through loan guarantees) and/or institutional support (eg the one-stop capital shops and assistance for development of community-based financial institutions). Financial intermediaries are required to report loans and deposits by geographic area. Since bank de-regulation Australia has had no generally equivalent programs, though governments may negotiate with financial intermediaries to assume some of the risk when the intermediary is financing an infrastructure project the government wants carried out. Prior to bank de-regulation the purpose of the US programs was partly carried out by directives on credit allocation and by the policies of government-owned financial intermediaries.
- Many programs involve direct federal grants. Not only are the grant programs numerous; grants for regional economic initiatives are generally available to local government, while grants for business development are available direct to businesses. Many of the grants programs are rather specific, but the Community Development Block grants are significant, flexible and as-of-right. Though the Commonwealth government currently has next to no grant programs to encourage economic development, there have been programs in the past. For constitutional and political reasons eligibility for most Australian grant programs distributed funds via the states.
- A number of programs are essentially advisory, including important programs advising on how to contract for government, especially how to gain defence contracts. The latter are very important, given heavy US spending on technological development from the defence budget.
- Apart from the EC/EZ program, only two programs offer tax incentives: the brownfields tax incentive and the general provision of tax benefits for businesses providing work opportunities for disadvantaged people. Some of the effectiveness of the EC/EZ tax benefits may derive from the general absence of such benefits in the federal tax system.

It is noticeable that the Australian Commonwealth directly matches only two of the US programs: the export development program and the indigenous land purchase program. Should the Commonwealth initiate EZ-type programs for disadvantaged or distressed regions, the following gaps in its program coverage are likely to become acute:

- lack of programs to provide loan guarantees and venture capital for small to medium business and for local government
- lack of grants for local economic development planning, investment attraction, business development and community development

- lack of assistance with business development (including management and technical advice to bring small to medium businesses into the knowledge economy) and
- lack of assistance with government procurement.

There is a strong case that these programs, which exist separately in the US, should be incorporated into any adaptation of the EZ program for Australian purposes.

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Differences between Australian and US circumstances

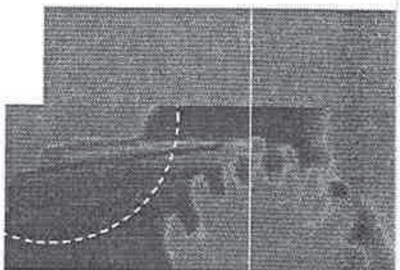
US enterprise zone programs provide a precedent for Australia. However, it should be remembered that some aspects of the US programs may not be applicable in Australia.

Background programs

As already pointed out, the US program operate against a background of a far richer set of programs of industry and community development assistance than is available in Australia. Compared with Australia, the US has a much longer history of tackling major regional divergences, dating back at least to the underdevelopment of the South following the American civil war. By contrast, Australia has let regional development slide, partly because it is the province of state and local governments (which are under-financed compared with the Commonwealth) and partly because, up to the 1970s, industry development was relatively even across regions. This in turn reflected a wide spread of economic opportunities, but was also due to good management through infrastructure development and trade policies. With the recent divergence of regional unemployment rates in Australia, and the increase in concern over regional divergence, the whole range of US regional development policies should be considered as possible precedents. At the very least, if Enterprise Zones are to be adapted as the basis for Australian regional development policy, consideration should be given to including items from the wider US menu in the concept.

The role of property taxes

The US programs include reference to high property taxes as a reason for declaration of Enterprise Zones. This reflects the different role of property taxes in the US, where property taxes are commonly used to finance services such as education, health, police and even welfare services; services which in Australia are mainly financed on a state-wide basis by the states from their own revenue and Commonwealth grant funds. This has led to a much greater range of property tax rates in the US than in Australia, where the range of services financed from rates is more restricted than in the US. In addition, Australian local governments receive grants, ultimately from the Commonwealth, which are distributed on a horizontal equalisation basis. There is no need to include in any Australian program those elements of US programs which reflect the limits to financing education, health, police etc services from property taxes, nor to include elements which reflect the lack of a local government horizontal equalisation program.



Ghettos

The US programs include provisions which reflect the need for redevelopment of the 'ghettos' within US cities. The hallmarks of such tracts include run-down to derelict housing and high crime rates, and the emphasis is on housing renewal and associated community development. American ghettos have been blamed ultimately on the US history of racial segregation, but institutional factors have also been important, including high dependence on property taxes to finance redistributive services and heavy investment in freeways which have blighted inner suburbs at the same time as they improve accessibility in outer areas. By contrast, Australia has a much better record on piecemeal urban redevelopment, including prevention of neighbourhood deterioration.

In adapting the enterprise zone concept for Australia, there is no need to include aspects deriving from American urban redevelopment requirements. Put another way, the Australian social security, education, health and policing systems already provide minimum incomes and services in poor areas, and so long as these minima are maintained there is no need to adopt those aspects of American regional policy which attempt to make up for the failings of US welfare policy.

The US or the European precedent?

These differences from the US precedent have been considered at length because it has become customary for Australian policy-makers look across the Pacific; a tendency which has been accelerated by the relative decline of the UK as an economic and military power. However, EU precedents are also worthy of consideration. It is true that these precedents come largely from an intellectual and political mileau which is not Anglo-Saxon, but the examples of Ireland and Scotland show that the ideas are accessible to English-speaking people, and indeed may be more useful to the people of small, peripheral English-speaking countries than mainstream US/UK ideas.

Compared to the US, the European precedents involve significantly larger expenditures. The difference is even greater when it noted that European social security, education and health systems provide higher levels of floor income in depressed regions within the Union than the US social security/welfare arrangements do in that country. The European precedents also have a much stronger economic development perspective, as against the job creation emphasis in US Enterprise Zones, though one must hasten to add that the US attends to business development through a whole range of complementary programs. The third major difference is that the EU system runs on a project basis, and relies on expenditure rather than tax incentives; the US systems feature tax incentives. All three differences reflect the American predilection for low taxes, and the Europeans' relative tolerance of high tax rates. However, policies on both sides of the Atlantic recognise regional disadvantage and try to overcome it by sustained intervention.

The knowledge-industry model of industrial organisation originated in the USA, and the trend towards its adoption tends to be taken for granted in that country. American accounts of enterprise zone programs are written mainly for domestic consumption, and accordingly do not expand on the role of Enterprise Zones in updating regional industry to best practice from a knowledge-industry point of view. In any case, this is not the major purpose of the zones, which are primarily concerned with job creation in limited areas of serious disadvantage. Updating to the knowledge-industry model is encouraged by other US federal and state programs, which are not so strictly targeted geographically. By contrast, the Europeans are conscious that they lag the USA in adoption of the knowledge-industry model. In part the lag reflects Europe's status as a technological follower in a number of industries, and in part it arises because the model requires adaptation to European culture. The EU authorities are also acutely conscious of the existence of a number of culturally-distinctive lagging regions within the EU. Accordingly their regional programs emphasise institutional adaptation and development.

The EU programs also have the recommendation of one stunning success-Ireland-and variety of more moderate successes and successes-in-waiting. With so many small Enterprise Zones pursuing development policies with such varying degrees of enthusiasm and against such diverse backgrounds of disadvantage, success rates are far harder to summarise for the US programs, though they have had their share of deemed success.

Though the adoption of the knowledge-industry model is not such a big leap for Australian business as it is for businesses located in some regions of Europe, Australia's thin and patchy industry structure hinders adoption of the model compared to most parts of the US. Accordingly regional programs should have a much more 'European' emphasis on adoption of the knowledge-industry model, and hence on its adaptation to local circumstances, than the US programs. Again, the Australian division of powers between the Commonwealth, the states and local government requires adaptations for which there will be no overseas precedents. On the other hand, the US precedents include much useful experience in how to select target areas, including shielding the process from political patronage; how to develop local development plans in a knowledge-based economy and how to relate business incentives to those plans. A most useful precedent is the role of the federal government in regional development planning: it sets standards and publicises precedents, but does not itself draft the plans, which must be locally prepared and locally owned.

For these reasons, we will continue to base the discussion on US precedents, even though it is arguable that, in general purpose, the European precedents are more relevant for Australia.

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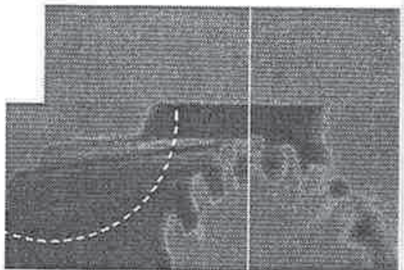

An enterprise zone program for Australia?

In Chapter 1 we made the case that the divergence of unemployment rates between Australian regions has reached a point which requires policy response. In Chapter 2 we argued that the divergence has occurred against the background, in high-income countries and to some extent in Australia, of the switch to the knowledge-industry model of industry organisation. The divergence in part reflects the impact of Australia's partial adoption of the knowledge-industry model on regional employment. In Chapter 3 we argued that response to the divergence requires the generation of additional jobs in the high-unemployment regions. Though past Australian experience with regional policy instruments provides a few significant precedents, the transition to the knowledge-industry model means that policies which were effective in the past cannot be guaranteed to produce the desired results in the future.

In Chapter 4 we described the well-resourced regional development programs operated by the European Union, and then considered the American enterprise zone programs in rather more detail. Both sets of programs provide precedents for regional intervention, and both emphasise the importance of strategy formation jointly by administrative agencies, business and the people of each region. Central government assesses the plans and provides the finance, but it neither develops the plans nor administers their implementation. In Chapter 5 we revisited the US programs, and noted that many detailed aspects of the US enterprise zone program will have to be revised if the program is to be taken as a precedent for Australian implementation.

The argument thus far provides two main rationales for regional policy:

- developing in each region a sound basis for adoption of the knowledge-industry model and
- addressing regional divergence in unemployment rates.

In Australia with its present level of regional divergence, a set of preferential policies is required for economically distressed regions, not to provide a windfall for regional businesses but to maintain the equality of opportunity which was formerly guaranteed through the relative equality of rates of economic growth. These policies should be based on the overseas precedents for effective government intervention to correct the under-utilisation of resources in depressed regions.

The need to upgrade to knowledge-industry best practice re-formulates the regional economic development policies of the nineteenth and early twentieth centuries with less emphasis on physical infrastructure and more on knowledge infrastructure. The need to generate jobs requires a direct response to uneven development. Both rationales are urgent: regions will become uncompetitive if they do not adopt the knowledge-industry model, but such adoption by itself cannot be guaranteed to counter the divergence in unemployment rates which is the main symptom of regional distress. Accordingly, regional policy will be ineffective unless it addresses both rationales.

Following European precedent, the two can be incorporated into a single mission statement, such as 'ensuring that each region develops its social and economic potential to the full', it being understood that a region has not achieved its potential unless it has both achieved full employment and adopted the knowledge-industry model, or some culturally appropriate variant of the model which allows it to live in peace and prosperity in a world where the knowledge-industry model provides best practice for industry organisation.

Though regional policy may work under a unified mission statement, a great deal of attention must be given to its two main components.

Regional development in the context of the knowledge-industry model

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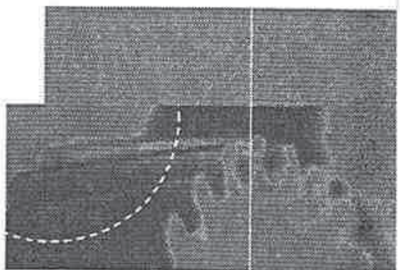
Adoption of the knowledge-industry model is likely to increase the importance of regions as units of economic organisation, because the interpersonal networks involved in product development and actual production tend to be most intense on a regional basis. Despite the importance of the region in their formation, these production networks are far from isolationist; they occur in the context of the intense awareness of what is going on in other regions and countries that is made possible by current telecommunications. However, it remains that intra-regional relationships are vital to development, which means that the focus of government developmental policy is likely to move from the national to the regional level, and hence from the Commonwealth to state and local governments. On the American precedent, the Commonwealth is best occupied as a funding agency and an assessor and adviser in the development and implementation of regional plans.

Though adoption of the knowledge-industry model gives industries and regions a sporting chance of prosperity, there are no guarantees.

- Some industries in some regions may not be able to make the conversion. Too many essential elements may be lacking.
- Strategies which accelerate the conversion in some areas are likely to be inapplicable in others. Much depends on the starting point.
- Even successful conversion at the industry level does not necessarily bring prosperity to all regions involved. The mining industry provides an important example where the application of knowledge-industry techniques has contributed to the prosperity of cities such as Perth, but has reduced mine-site employment opportunities.



In other words:

- there can be no one strategy for adoption of the knowledge-industry model and
- even successful strategies do not directly address the divergence of unemployment rates.

This means that regional policies may need to include job-generation policies in addition to policies to speed the adoption of the knowledge-industry model. Indeed, in extreme cases these may be two separate ends of policy, though there will also be cases where both ends cab be pursued jointly. It all depends on regional circumstances.

Implications of the knowledge-industry model for governments

The knowledge-industry model is primarily a model for the organisation of private industry. However, as US programs attest, in all industries and regions government participation is required, particularly in the following areas:

- education and training will be under-provided unless governments finance those aspects where the benefits cannot be appropriated by employers and where individuals, left to themselves, will under-provide;
- product development requires discerning consumers in the local market. Governments through the education system assist in generating consumer participation in product development;
- research and development will also be under-provided unless governments finance those aspects where the benefits cannot be appropriated by private finance;
- physical infrastructure will be under-provided, and under natural monopoly is likely to be over-priced, unless governments intervene. Telecommunications infrastructure is particularly important, as is infrastructure which assists network formation, particularly through an active regional social life; and
- governments also have numerous opportunities to assist more directly in the development of the regional networks which are the sine qua non of the knowledge-industry model.

There are no surprises in this list: it has been generated more by trial and error in an increasing number of jurisdictions. Compared to past models of economic development, the knowledge-industry model increases the relative emphasis on research, education and social networks. The latter tend to have been overlooked in the drive to efficiency, though the recent emphasis on social capital has returned them to public discussion.

Though the list includes services which are the subject of national policies and administration, it points to the importance of local knowledge. Network-building and putting people into contact requires local, personal knowledge, as does the identification of market opportunities in an increasingly niche-market world. Adoption of the knowledge-industry model increases the potential returns from local government leadership.

Apportionment of responsibility between governments

It is implicit in the discussion so far that primary responsibility for regional development lies with regional government. However, a major responsibility for financing lies with the central government.

The Commonwealth

In Australia, the identification of an essentially financial role for the Commonwealth accords well with the division of powers in the Constitution. The Commonwealth has the major taxing powers in the country, and is accustomed to administering grant programs. Accordingly its primary role should be:

- provision of direct finance for regional development
- provision of tax concessions, if, following the US example, these are to be part of the program
- provision of financial support through its regulation of the finance sector and
- setting the rules for relationships between regional development and the social security system.

Finance never comes without strings attached. The strings in this case should be:

- setting and administering the rules for defining and identifying eligible regions;
- setting the rules for development of regional programs (following the US example, where regions do not in general qualify for assistance unless they both draft and guarantee local support for regional development strategies);
- providing information on precedents and examples, but not so as to limit the scope of regional development plans and
- assessment of regional development plans as a condition of funding, particularly initial funding. (The Commonwealth would require that regional government is committed to the plan, and this in turn would require commitment by local business, labour and other stakeholders. The Commonwealth would also require that the plan minimises investment risk, both through careful identification of regional strengths in relation to market opportunities and through the promotion of mutually-supportive investments. These tasks could well be carried out by a specialised quasi-financial agency, on the lines of AusAID.)

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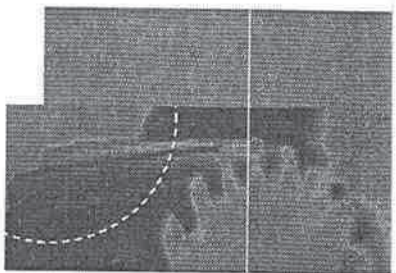

Regional government

Placing responsibility for strategy development and implementation with regional government raises the obvious question that Australia has local governments and state governments but no regional governments. Only two of National Economics' 58 regions comprise single local government areas, the ACT and Brisbane City, and in both cases the boundaries reflect political decisions taken in the early part of the twentieth century and not present-day economic networks.

Given the lack of pre-ordained regional governments, there is little alternative but to divide primary responsibility for regional development between state and local governments. However, this should not be a major impediment to implementation: local government is provided under state legislation, and councils are accustomed to working jointly with their state governments. Responsibility should be allocated locally as far as possible, given that the need for economic development is continuously being brought home to elected members and council staff in potential Enterprise Zones, and given also that local co-ordination is required between the thematic offerings of state departments.

There is no particular reason why the precise division of responsibility between state and local government should be the same in each state. For example, it may be adjusted according to the relative administrative strength. Provided local governments take responsibility and co-operate with one another, the lack of pre-ordained regions may even be an advantage, since programs can be prepared on the basis of economic regions defined as groups of local governments. In a number of states such regional groupings already exist, and some of the regional organisations have an enviable record in promotion of economic development within their regions. Though ultimate responsibility lies with local and state governments, elements of administration may be delegated from both these to regional development authorities, with considerable scope for experiment in different states and indeed in different regions within the one state.

The macroeconomics of regional policy

Given the Commonwealth's emphasis on macroeconomic policy, it is important to show that regional policy can contribute to the achievement of its overall economic goals.

During the post-war period, and especially during the last two decades, the Australian economy has been characterised by several persistent imbalances, most notably a chronic balance of payments deficit and its counterpart, a low savings rate. The policy response has emphasised cost-cutting, especially through the efficiencies of competition, and one gratifying result has been a rapid increase in the quantity of exports. However, the increase in quantity has been broadly negated by a reduction in unit value. The balance of payments deficit remains. Worse, during the 1990s Australia generated a fairly modest flow of investment in new productive capacity, and the level of aggregate demand necessary for economic growth was only maintained by encouraging consumers to spend, which inevitably ate into their savings and further reduced the savings rate.

The centrepiece of policy in the 1990s was microeconomic reform and its close relation, competition policy. In vertically-integrated industries these policies were broadly consistent with conversion to the knowledge-industry model, though we may suspect that the accompanying infusion of overseas ownership has hindered its full adoption. The policy did not touch previously competitive industries, which were expected to flourish as a result of cost reductions. The most frequent result was that cost reductions in these industries enabled bare survival in the face of price reductions. In both types of industry there was a failure to generate high value-added products and services. Australia is now a net importer of most goods and services which are rapidly growing in international trade, and most of its exports are of goods and services which are diminishing in relation to total international trade. If this imbalance persists, standards of living will have to be wound down even in the wealthy parts of the country.

This is not the place to argue about macroeconomic policy, but rather to point out that regional policy has potential to help address the fundamental macroeconomic predicament in a number of ways:

- At a minimum, extension of knowledge-industry techniques on a regional basis may assist the survival of industries which are currently hard put to meet international competition. A significant proportion of Australia's rural exports is under threat from the combination of low prices and the need to invest to overcome environmental costs. If these industries succumb the balance of payments deficit is likely to reach levels which will require significant reduction in Australian standards of living.
- In some cases, conversion to the knowledge-industry model will permit product development and upgrading, so that prices improve and a greater proportion of total sales value is captured in Australia. This in turn will generate investment opportunities, which can replace the promotion of consumption as a source of aggregate demand, and permit the rebuilding of national savings without falling into depression due to lack of demand.
- Regional investment opportunities are in turn a major inducement to regional savings, so assisting with national savings goals.
- The employment-creation aspects of regional policy also provide opportunities to address deficiencies in environmental, educational and welfare services at low aggregate cost.

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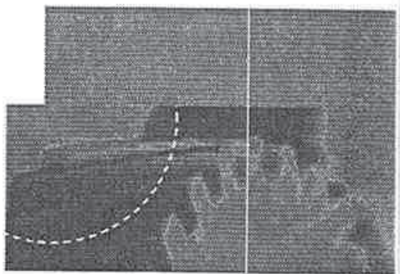


Conclusion

The knowledge-industry model requires forbearance on the part of national governments. They do not have the local knowledge or contacts to prepare or implement plans for regional economic development; and as industry decentralises through application of the model the contacts between the central government and the central administrations of large firms and its contacts with peak industry bodies will tend to be less and less useful. The model requires industry-government contact to be increasingly local.

The Australian constitution is remarkably well attuned to the division of labour which the knowledge-industry model requires between central and regional governments. Regional policy, including Enterprise Zones, should be developed and implemented locally. However, Enterprise Zones, which have an important redistributive aspect in addition to their developmental function, require central finance. The task of the Commonwealth will be to provide this finance under conditions which encourage regional creativity in response to regional problems.

Though the task for the Commonwealth is clear enough, the division of responsibility between the states and local government is less clear-cut. The knowledge-industry model does not require any particular division of labour between these two, save that administration must be sufficiently local to be able to foster local networks. There is scope for alternative arrangements which differ between states.

Regional policy can make a major contribution to the central Commonwealth task of macroeconomic management, with potential to contribute to the acknowledged national weaknesses in savings and the balance of payments.

Having considered the division of responsibility between the levels of government, two major tasks remain:

- how should regions eligible for enterprise zone programs be defined and identified? And
- what should be the content of the programs?

Eligibility for enterprise zone support

The essence of an enterprise zone program is that it is reserved for assisting regions which are falling short of realising their economic potential. On US precedent, before a region can be identified as an enterprise zone it must:

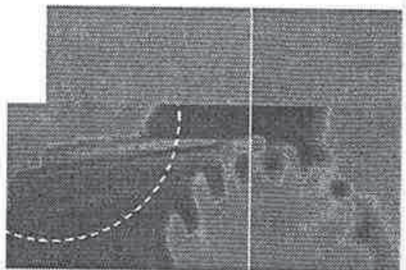
- be geographically defined
- meet objective eligibility criteria and
- complete a strategic plan and demonstrate commitment to the plan, to the satisfaction of the authorities financing the zone.

The Australian constitution is remarkably well attuned to the division of labour which the knowledge-industry model requires between central and regional governments.

Geographic definitions

The small areas targeted in many US enterprise zone programs partly reflect the urban redevelopment heritage of the program, but also reflect the advantages of tight targeting: resources can be concentrated on getting measurable results in confined areas. However, the tightly-defined target areas are far from self-contained, and it is probable that program benefits spill over into adjacent areas, particularly those which supply workers to the EC/EZs. (This may not be of concern to US program administrators, since the wage subsidy element in the programs is tightly targeted at the individual level.) A more serious problem is that the small size of the EC/EZs means that boundaries sometimes bisect places which perceive themselves as single communities, and where there is no obvious difference in disadvantage between one side of the boundary and the other.

By contrast with the US programs, the EU programs are targeted at broad geographic regions. The EU regions are large enough to encompass whole labour markets (people who live in them are likely to work in them, whereas US EC/EZs are likely to have numerous commuters both in and out) and are also large enough to include significant industry clusters (groups of firms which inter-relate as suppliers of inputs and users of outputs). The larger size of the EU regions matches the greater availability of funds and the concentration on industry development, as against the significant component of assistance targeted to poor individuals in the US programs.



Realistically, Australian programs, at least at first, are not likely to be financed with European generosity. It may therefore be necessary to target them tightly, and to select relatively small areas. However, given that the purpose of the program is regional development rather than property redevelopment, the areas should be large enough for economic planning purposes; they should preferably be reasonably self-contained labour markets, and should contain sufficient economic activity for industries to be inter-related. Taking these factors into account it has been proposed that Australian Enterprise Zones should be LGAs or groups of adjacent LGAs (the regional approach).

The obvious advantages of using LGAs are:

- LGAs cover nearly all the country, with very little dispute as to which council is responsible for which area (the excepted areas are the unincorporated outback in SA, NSW and the NT; the possible disputed jurisdictions arise where Aboriginal and Torres Strait Islander councils have responsibility for communities within local government areas),
- LGAs are legal entities, complete with administrations, revenue sources and mechanisms of democratic responsibility, and
- where individual LGAs are not the appropriate unit, there is often a history of regional co-operation, and a program which is based on LGAs can be broadened to the regional level where the constituent LGAs believe that this would be more effective.

These are major advantages. However, Australia is a large and diverse country, and LGAs may not be universally appropriate. Arguments in favour of larger, regional units distinguish urban and rural areas.

In urban areas, and with the possible exception of Brisbane, local governments do not cover whole labour markets or industry-cluster areas. It can be argued that these can only be covered by taking metropolitan areas as a whole, in which case very large regions would be recognised. Because they are large, they regress towards the mean and are unlikely to be found disadvantaged. An alternative argument is to recognise partially separate labour markets in metropolitan areas. In cities like Sydney and Melbourne the CBD and inner suburbs draw workers from all parts of the metropolitan area and beyond, but the middle and outer suburbs are more segmented, with labour movement tending to form a radial pattern. The corresponding regions are already described by such terms as western suburbs, northern suburbs and so on. In Sydney, Melbourne, Adelaide and Perth it is possible to group the suburban LGAs (and indeed their adjacent ex-urban LGAs) into segments, but in Brisbane this is not possible without subdividing the City of Brisbane.

In non-metropolitan areas similar groupings may also be appropriate (eg provincial cities may be grouped with surrounding LGAs with which they are linked by commuting and by industry supply and demand). Away from the provincial cities each LGA may have a greater degree of self-containment both in labour and in supply of such services as contracting and maintenance, but not all councils have the administrative capacity required to benefit from an enterprise zone program. This is likely to be less of a problem than it was a decade or so ago, since several states have reformed their patterns of local government, but small and administratively weak councils remain in some states.

In both the metropolitan and non-metropolitan cases there are thus arguments, valid in at least some parts of the country, for eligibility to be based on groups of LGAs rather than single LGAs. The rules might be:

- any LGA may apply for participation in the program in its own right
- any LGA may apply for participation jointly with one or more neighbours, provided the combined entity satisfies eligibility criteria and assists with improved development planning and/or administration

- the Commonwealth and/or state may suggest to adjacent eligible LGAs that they should form a grouping, but should not withdraw eligibility should they fail to do so.

The opposite question also arises: should it be possible for parts of very large LGAs to join adjacent LGAs which are eligible as Enterprise Zones? For example, if Ipswich qualifies, what about the adjacent areas of Wacol and Inala, within Brisbane city? In any other metropolitan area it is likely that they would have their own LGA, so why penalise them for the actions of the Queensland government eighty years ago in incorporating them into Brisbane? It may be desirable to allow discretion to cover such cases.

The question may also arise as to whether parts of large LGAs, which satisfy eligibility criteria, should be eligible for enterprise zone status even though the whole LGA is not, and in the absence of eligible neighbours. Such areas would be eligible under most US programs, with their tight targeting. However, this reflects the emphasis on urban redevelopment in US programs, rather than the economic development focus suggested for Australia. It is suggested that such areas should not be eligible, at least in the first round of assistance.

Criteria for eligibility

Both the US and EU examples have a double-barrelled set of eligibility criteria:

- objective criteria of distress, deprivation and the like and
- preparation of development plans and in the EU case component projects.

The process involves identifying areas by objective criteria, and inviting them to prepare development plans as a basis for possible assistance. Plan preparation itself may attract assistance, but in the last analysis there comes a time when the funding government either accepts the plan as a basis of assistance or rejects it.

Strategy development and plan preparation are so intimately related to the actual content of assistance that we will defer consideration of them till the next chapter.

The objective criteria of distress should reflect the purpose of the program. The more the purpose is to generate jobs, the more the criteria should reflect people in need of jobs; the more the purpose is to increase the national economic growth rate by taking advantage of overlooked economic opportunities, the more the criteria will emphasise the capacity to take advantage of strategic investment. The latter emphasis is close to traditional Australian state development programs.

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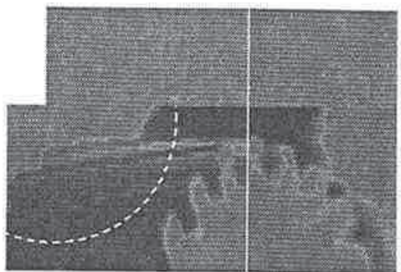


One of the purposes of the objective criteria is to limit assistance to areas which are genuinely distressed, and so limit opportunities for pork-barrelling. The Americans, in particular, are depressingly familiar with regional competition for central government largesse, and accordingly insist on this aspect of Enterprise Zones. To this end, it would be an advantage if:

- the criteria for eligibility are reasonably simple, so that any failures to implement them may be readily identified and
- the technical work of identification of eligible areas should be performed by an independent agency which publishes both the criteria and the values against which they are assessed.

Under Australian circumstances it would be valuable for eligible areas to be identified by a Commonwealth agency which is separate from the Commonwealth and state agencies which assess development plans and allocate funds.

Unemployment

Given that one of the two primary motives for an enterprise zone program in Australia is the regional divergence in unemployment rates, and following US precedent, a high unemployment rate must be considered as a candidate criterion.

A first question must be: is the criterion available at the local level? The answer is a qualified yes. ABS official unemployment rate estimates are derived from the labour force survey, which is not statistically significant at the LGA level; at best estimates are available at regional level, where they are liable to standard errors which are large enough to have potential to make the difference between eligibility for enterprise zone status or not. However, it is possible to derive estimates of local unemployment from Centrelink data, benchmarked to ABS totals. Regional estimates can also be benchmarked to the Census every five years, though the definition of unemployment in the Census is not the complete and complicated definition implemented in the labour force surveys.

A link between Centrelink returns and estimated unemployment rates is possible because there is at present a strong correlation between persons supported as unemployed through the social security system and the ABS definition of unemployment. However, the correlation is not complete.

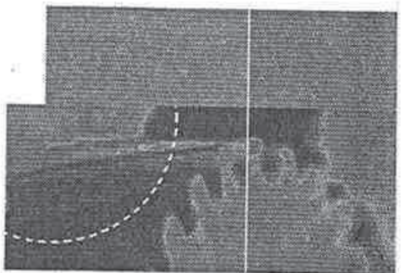
- Job search requirements have been relaxed for some classes of unemployment beneficiary (eg unskilled middle-aged men in areas of low job opportunity) and therefore some beneficiaries may not meet the ABS' definition of unemployment, which requires job search.
- Conversely, not everybody who meets the ABS definition of unemployment is receiving unemployment assistance. This applies particularly to short-term unemployed people who are in the waiting period for benefits. In future, if the government applies 'mutual obligation' principles severely, it may also apply to unemployed people who have been denied benefits.

The preceding paragraphs have assumed that the ABS definition of unemployment provides a relevant indicator for enterprise zone declaration. However, it is arguable that the ABS definition has serious deficiencies for this purpose.

- The definition does not take into account the number of people who are working shorter hours than they would wish.
- It pays no regard to earnings, and the relationship between earnings and the number of people to be supported from those earnings.
- It excludes people who are receiving social security support in the form of disability support payments or single parents payments, even though many of these people would rather earn their own living, and even though they are to be subjected to 'mutual obligation' policies.
- It excludes people who are working in work-for-the-dole schemes (more technically, job-creation programs which provide part-time jobs in which people earn wages tied to social security rates, such as the Aboriginal Community Development Employment Projects).
- It also excludes people who are not receiving social security payments, and who would take a job were one available, but who are not actively seeking work (the 'hidden unemployed').

One of the purposes of the objective criteria is to limit assistance to areas which are genuinely distressed, and so limit opportunities for pork-barrelling.

These exclusions would not matter if unemployment according to the ABS definition was strongly correlated with the broader definition which includes the above groups. Unfortunately this is not the case. For example, as described in Chapter 1, National Economics recently adjusted unemployment rates to add back people on disability support payments who could reasonably be expected to become employed should suitable work become available, and also to add back people on young people's work support schemes (but not CDEP). Though the revised unemployment estimates were correlated with the ABS estimates, the correlation was such that the higher the ABS estimate, the bigger the adjustment, as would be expected if Centrelink is more inclined to put people onto disability support payments in regions where job search is hopeless than in full-employment regions. (Unemployment rates in Sydney barely move as a result of the adjustment, but the rates in North West Tasmania and North Coastal NSW jump from 11 per cent to over 20 per cent.) More serious is the diversity of experience. In particular, adjusted unemployment rates in the Northern Territory are much higher than the ABS rate would indicate, whereas the adjustment is relatively small in high-unemployment suburbs of metropolitan areas such as Campbelltown (Sydney) and Northern Adelaide.



This National Economics calculation suggests that it would be possible to identify potential Enterprise Zones from Centrelink data related to unemployment, supplemented by data from other agencies such as ATSIC which run work-for-the-dole schemes. This identification would be particularly appropriate if the primary purpose of the zones is seen as job generation, and would also accord strongly with commitment to 'mutual obligation'. Problems may arise, however, if the application of 'mutual obligation' principles renders the social security system more selective than it is now, with resulting increases in the regional incidence of unemployed people who receive no social security support.

An alternative, broader measure of un- and under-employment can be derived by calculating age/sex adjusted jobholding rates. This measure can be defined as the proportion of individuals holding jobs, standardised by age and sex. An important refinement would be to recalculate the ratio in terms of hours worked, by age and sex, to get over the problem of the numerous individuals who wish to work longer hours. A limit could be imposed on hours per person, so that the measure is not affected by individuals who work in excess of standard hours. The proportion in each group in each region could then be compared with the proportions in a standard region, say the full-employment region of Sydney. The shortfall could then be reported for a standardised national age/sex profile.

All the information necessary to produce this indicator (save for the hours worked adjustment) is available at the regional level from the Census every five years, and between Censuses reasonably accurate estimates can be made using ABS population estimates and business register job data.

A comparison with the adjusted unemployment rates considered above shows the expected negative correlation: the higher the adjusted unemployment rate, the lower the level of labour utilisation. Once more, Sydney east of Olympic park provides the full employment standard, with labour utilisation rates at around 67 per cent. However, the relationship is not complete. In particular, remote mining regions such as the Northern Territory, the WA goldfields and the Pilbara have high labour utilisation compared to their adjusted unemployment rate, indicating the co-existence of a fully-employed population group with another population group (presumably mainly Aboriginal) which remains unemployed.

It can be argued that the labour utilisation rate provides a better broad definition of the gap between actual and full employment than the adjusted or social-security unemployment rate. However, the remote area example is instructive. In National Economics' judgement, the unemployment rate calculated from Centrelink returns provides the best current indicator of the need for job creation.

Poverty rates, low household incomes

Though unemployment rates feature prominently among the eligibility criteria for Enterprise Zones in the US state programs, they are not part of the federal program, which focuses on regions with high proportions of poor households. This presumably reflects a view that low incomes are important, not unemployment per se.

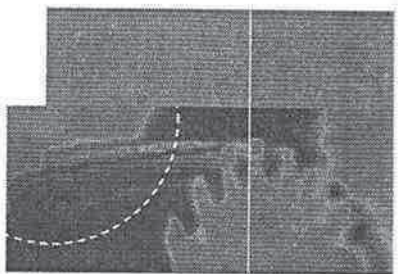
This criterion is simpler to apply in the US than in Australia, and probably more relevant, too, for two reasons:

- The US has very low minimum wages in relation to the average wage, and the US enterprise zone programs therefore target the working poor as much as the unemployed. Though it is Australian government policy to reduce the minimum wage in relation to the average, the difference has yet to reach US levels, and in Australia unemployment is still a relatively good predictor of poverty.
- The US has an official poverty line. Australia hasn't, and no federal government has shown any inclination to endorse one even indirectly. (The 'Henderson' line has always been unofficial.) Federal governments of both political persuasions have justified their unwillingness to endorse an official poverty line by the controversial nature of such lines.

In National Economics' judgement, the unemployment rate calculated from Centrelink returns provides the best current indicator of the need for job creation.

The second of these reasons means that Australia is unlikely to recognise poverty counts as a criterion of eligibility for Enterprise Zones. This leaves us with the proportion of low-income households as a possible candidate.

For the purpose of identifying enterprise zones, it may not matter much that it is notoriously difficult to estimate the incomes of wealthy people. Of more concern is the difficulty of estimating the incomes of some low-income people, particularly those who operate small businesses or farms. Here accounting questions, particularly the question of depreciation, may interact with poor record-keeping and the effects of tax avoidance to produce rather artificial estimates of income; and this without addressing the further question of whether asset-rich but income-poor households should be included in the tally. Farm incomes are also notoriously liable to fluctuation with the seasons and with commodity prices. Unfortunately, farms are concentrated in particular regions. If a low-income methodology is adopted which treats farmers' reports of low income generously, these areas will easily qualify as Enterprise Zones, but it will be very difficult for them to qualify if evidence of low farm incomes is excluded on the grounds that farmers generally have a substantial asset base even if it fails to generate income.



Household income can only be adjudged 'high' or 'low' in relation to household size; therefore to implement this measure information is required which cross-classifies households by size. Such information is available for each region from the Census, though the income definition for each household is broad-brush to say the least. However the Census information can be refined from survey data, and reasonable estimates derived for the household income distribution by region, questions of farm and small-business income apart. Another hoary question which arises at this point is the equivalence scale: how much should income be adjusted for household size? Though this question can cause endless academic debate, the OECD recommends rough-and-ready adjustments which would be adequate for purpose of selecting Enterprise Zones.

Despite the need to ride roughshod over the problems of estimation of farm and small-business incomes, the need to combine surveys and the Census, and to provide an equivalence scale, estimates of low-income households can be calculated by region. This allows a comparison between low incomes and unemployment rates. Though high-unemployment regions tend to have high proportions of low-income households, the relationship is far from close, mainly due to the location of retired households. Some regions have high proportions of such households, and hence of low-income households, even though their unemployment rates are low. If incomes are to be used as a criterion for the selection of Enterprise Zones, it would be desirable to exclude households of age pension age from the calculation. Even then, the difficulty of calculating self-employment and farm incomes accurately will inevitably affect the estimates. These difficulties argue against including household income as a criterion. On the other hand, rural regions may claim that many farmers stay on the job despite low incomes, and that such regions will miss out if unemployment and social security receipt are emphasised.

A suggestion which has US precedent is that a distinction should be made between rural and urban Enterprise Zones, with rural zones defined as those with a high level of farm output in GRP. Unemployment rates can then be used as a criterion of eligibility for non-rural zones (which will be the vast majority), but in the rural zones can be replaced by more complex criteria including chronic low farm income.

Out-migration, ageing, job loss

A number of US programs include evidence of out-migration among the criteria, presumably on the ground that this leaves housing and other facilities under-utilised. The measure is presumably net out-migration, ie population loss due to migration. For small areas this can often be approximated by population decline. If the reason for inclusion is under-utilisation of facilities, more direct measures may be available; however we find, below, that direct measures of housing under-utilisation are not very satisfactory. The other argument against using out-migration as a criterion for Enterprise Zones is that it may sometimes form an acceptable solution to economic problems, as for example when mineral deposits are exhausted or rural production has to be radically changed due to environmental costs.

Population ageing is related to out-migration, in that young people tend to leave first. As such, it is a useful indicator of areas which are in economic decline. However, it is necessary to distinguish regions where population ageing is due to selective out-migration, and those where it is due to in-migration of retirees. Difficulty in making this distinction means that population ageing is probably not a very useful indicator in Australian circumstances.

Job loss has often been put forward as a criterion for regional assistance, particularly where it is argued that jobs have been lost as a consequence of government policy. Governments frequently adopt policies which are expected to yield national benefits, but where at least some groups will bear costs. Where the policies involve taking over real property, it is a constitutional principle that compensation should be paid. It has been argued, by extension, that compensation should also be paid where policies reduce people's real wealth in other ways, for example, by rendering their personal skills obsolete, or by withdrawing job opportunities. Following this extended principle, the Whitlam government attempted to compensate workers who lost their jobs as a result of tariff cuts; similarly the US government has attempted to compensate areas adversely affected by the North American Free Trade Agreement. In the Australian case, it was found difficult to distinguish workers who had suffered from tariff cuts from those who were losing their jobs due to other factors. It was also argued that the needs of the two groups were similar. A concentration on needs accordingly draws attention to unemployment rates and low incomes rather than to recent job loss.

The rate of growth of total employment in a region can be used to measure aggregate job gains and losses. A comparison with adjusted unemployment rates shows a very loose relationship. In particular, retirement and lifestyle areas tend to have high adjusted unemployment rates, given their rates of job growth, while metropolitan areas tend to have low rates. A possible explanation is that unemployed people tend to avoid the metropolitan areas, with their high housing costs, and gravitate to the lifestyle areas, which combine pleasant surroundings with low housing costs.

This suggests a dilemma for regional policy. The obvious advantage of concentrating job creation in lifestyle regions is that the unemployed are already there. However, it may cost less to create jobs in metropolitan areas, and expect the unemployed to move back: once employed, they are more likely to be able to afford urban housing costs. As against this, an important reason for regional policy is to reduce urban congestion costs. The returns to job creation may therefore be higher outside the metropolitan areas, though not necessarily in the lifestyle regions, since these are on their way to becoming congested and have been accused of imposing high environmental costs.

Despite the attractions of job loss as a criterion for creation of Enterprise Zones, it is suggested that unemployment rates (particularly the social-security based version) provide a more direct measure.

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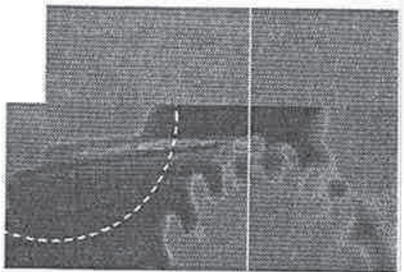
Housing vacancy rates

Housing vacancy rates, which are collected nationally at the Census, may be interpreted as an indicator of under-utilised infrastructure. However, it is difficult to collect them on a comparable basis, including adjustment for vacancy rates in resort areas. Another problem is that housing vacancy rates require a judgement as to whether the vacant housing is habitable or not. For example, where farm amalgamations have occurred, the houses which are no longer used as farmsteads may be shown as vacant even when they have been used for years as haysheds. For these reasons, housing vacancy rates are not a strong candidate for use in Australia.



Property values

In some US states, property values and rate revenues are among the criteria for declaration of an enterprise zone. The inclusion of rate revenues reflects the different role of rates in the US, and would not be appropriate in Australia. However, the inclusion of property values has its attractions, since such values reflect the demand for land and are hence an indicator of the level of economic activity in the region. High land values are also a major component of the high levels of household wealth in Sydney and other metropolitan areas.

Across Australia, land is valued for local government rating purposes. However, not all councils use the same value base. The most commonly adopted is unimproved value, which is less satisfactory than the more inclusive definitions as an indicator of the level of wealth, though it has its merits as an indicator of location rents generated by economic activity. Unfortunately, there is considerable suspicion that valuation methods vary from state to state, though the Commonwealth Grants Commission has proposed methods of adjusting for this.

Property values per hectare are high in urban areas and low in rural areas. Expressed per household or per capita, however, rural values can be quite high. In rural areas, farm value per farm household can sometimes provide a more accurate estimate of farmer prosperity than estimates of farm income, though it can be argued that the rural land market is slow to catch up with the earning capacity of farm businesses, and also that urban demand for hobby farms and rural retreats can raise farm values in the favoured districts well above the agricultural potential of the farm. The contrary argument is that rural reconstruction is far easier in such areas, since farmers can sell out. Despite these problems, there is an argument for using property values as one of the criteria for enterprise zone status, at least in rural areas.

Gross regional product (GRP) per capita, and growth of GRP

GRP has been put forward as a supplement to household incomes as a measure of the affluence of a region, the implication being that regions with low GRP a head should receive assistance. However, as discussed in Chapter 1, the relationship between GRP a head and incomes is increasingly tenuous, and there is no equity argument for assisting regions with low GRP a head as distinct from those with low household incomes.

A related proposal is that areas with low growth rates of GRP a head should, as a matter of equity, be assisted. The equity argument is that regions with low growth in GRP are less likely than others to generate jobs and incomes for their residents. Once again, this argument fails because more direct indicators are available, and GRP growth is not closely related to income and job growth.

As with income estimates, GRP estimates in rural areas fluctuate with the seasons and with commodity prices.

Estimating GRP at the regional level involves a fair amount of interpolation, but it is probable that estimates could be made which would be sufficiently accurate were it desired to use it as a criterion.

Regions with growth prospects

It is important to distinguish the argument that regions with low GRP a head should be assisted from the argument that there should be investment in areas with high GRP growth prospects. This latter is the traditional developmental argument, and still carries weight in regional developmental policy as a whole. Further, in so far as an aim of regional policy is to encourage growth, including by such means as increasing the uptake of the knowledge-industry model, there is much to be said for identifying regions where investment is likely to produce growth.

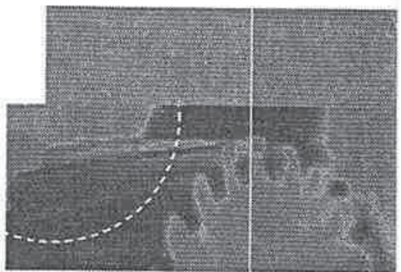
At this point there can be a conflict between the two components of regional policy: assistance to areas with high unemployment, and assistance to areas which have been slow to take advantage of the knowledge-industry model. Delays in the adoption of the knowledge-industry model do not necessarily result in high unemployment rates. A problem here is that, whereas there are many measures of unemployment and related distress, few measures have been developed of the extent to which the knowledge-industry model has been adopted, or indeed of the potential for its adoption.

Further, in so far as an aim of regional policy is to encourage growth, including by such means as increasing the uptake of the knowledge-industry model, there is much to be said for identifying regions where investment is likely to produce growth.

One argument used in the US in favour of high unemployment rates as a criterion of eligibility for enterprise zone status is that high unemployment tends to be a mark of an region undergoing transition difficulties. In the American experience, regions with poor economic prospects tend to return low unemployment rates coupled with low incomes. In these regions poor prospects keep unemployment rates down through emigration and through withdrawal from the workforce. It has certainly been the Australian experience that regions with high unemployment rates tend to generate low workforce participation rates, but it is a moot point whether these are a mark of poor prospects, or merely another aspect of transition difficulties.

Meanwhile, the argument that prospects are relevant to the identification of Enterprise Zones cannot be easily dismissed. One reply is that the second phase of the European/US eligibility procedure-the planning requirement-serves to concentrate assistance in zones where rates of return are likely to be high. Another is that supplementary indicators could be used to bias selection in favour of regions where rates of return are likely to be high. Criteria may include:

- a high level of export production (or, which increasingly amounts to the same thing, a high level of output of internationally tradable goods and services),
- presence of industries considered to require assistance to adopt the knowledge-industry model, particularly small-business industries, and
- presence of factors considered to inhibit adoption of the knowledge-industry model, but which are likely to be overcome with assistance. Once again, a high proportion of small business may indicate a region which has above-average potential for benefit.



These criteria could be combined. For example, mining industry output could be excluded from the calculation of export production, since the industry is already well on the way to adoption of the knowledge-industry model, but pastoral and agricultural export production included, since these small-business industries have not had the same opportunities to adopt the model even though they are well suited to it.

Educational qualifications

One of the reasons for poor economic results in a region may be a lack of qualifications on the part of its residents. It has been suggested that this can be used as a criterion for assistance.

Though Census measures of qualifications are available, they do not relate directly to the skills required in a region. Regions differ in employment opportunity and hence in the pattern of skills required to take advantage of opportunity. It is important for regional planners to be informed on the skills available in their region, and on skill and training shortcomings; but difficult to translate this awareness into a criterion for assistance.

Compound indices

If a variety of criteria are candidates as indicators of eligibility for enterprise zone status, why not create a compound index? This approach has been followed in the UK, where the Department of Transport and the Regions calculates an Index of Local Deprivation from the following components:

- lack of amenities and local services
- household overcrowding
- the proportion of 17-year-old persons not in full-time education
- the proportion of land considered derelict
- the proportion of income security recipients in the population
- the proportion of children in households dependent on income security
- the proportion of children failing or gaining low marks at the school leaving exam
- the proportion of long-term unemployed
- the unemployment rate
- high property insurance premiums (an indicator of property crime) and
- the regional standardised mortality rate.

The index was first calculated because it was felt that eligibility for regional assistance should be based on a broader indicator than simple unemployment rates. As might be expected in the UK, with its overhang of urban slums, the index has an urban feel, and is more directly relevant to welfare service provision than to the distribution of economic development funds. Even so, were such an index to be developed for Australia it could prove useful in the distribution of development assistance.

In the USA, an alternative, simpler approach is commonly used: candidate areas are required to meet eligibility criteria on each of a series of indicators, such as having high unemployment, low incomes and low property values. This avoids the mysterious processes which go into the creation of overall indices, while allowing multiple criteria to be used.

Conclusion

An Australian enterprise zone program should be based on LGAs, with provisions that:

- regional groupings of LGAs should be encouraged, particularly where LGAs are small in relation to economic regions and
- possibly, that where a large non-eligible LGA adjoins an eligible LGA, and identifiable parts of the large LGA share the disadvantaged status of the eligible LGA, those parts may be considered for inclusion in the enterprise zone.

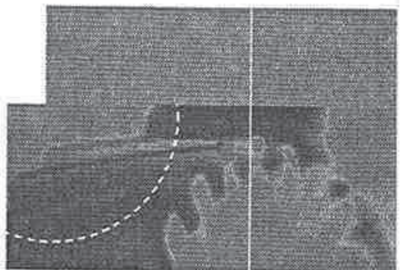
Eligibility for enterprise zone assistance should be based on objective criteria of disadvantage and on the production of a development strategy which ensures that assistance is put to the best use. The objective criteria should include:

- high unemployment rates, calculated by a broader measure than the standard ABS labour force survey definition, and including allowance for persons working noticeably shorter hours than they would wish and persons not actively looking for work, but who are anxious to join the workforce, including early retirees;
- either as part of the unemployment measure, or separately, allowance should be made for the number of social security claimants likely to be affected by the government's 'mutual obligation' requirements, including persons in work-for-the-dole schemes; while
- consideration may be given to low rural land values per farm property as a supplementary indicator in rural areas (defined as those with a high proportion of rural production in GRP) and
- consideration may also be given to favouring areas with significant production in export industries organised on small-business lines (on the grounds that returns to an Enterprise Zone program are likely to be unusually high in such areas).

Eligibility for enterprise zone assistance should be based on objective criteria of disadvantage and on the production of a development strategy which ensures that assistance is put to the best use.

In Australian circumstances, there are likely to be difficulties and unfairness in the use of the following criteria:

- incomes
- out-migration, ageing or job loss
- housing vacancy rates and
- GRP.



These are not recommended as criteria for Enterprise Zones. Unemployment rates, calculated by a broader measure than the current ABS definition, should be the primary identifier.

Content of the program

To make an effective contribution to regional development, an enterprise zone program must offer significant assistance. This assistance should result in job generation and economic development. It should not result in windfall gains for recipient businesses; that is, in payments beyond those levels which are required as incentives for program participation and which cover the costs of participation. The US precedents provide many examples of program conditions which chart the fine line between incentives and windfall gains.

However, before considering the assistance which might be made available, we must first discuss the planning requirements required to maximise the likelihood that assistance will contribute to the fulfilment of regional potential.

Local strategy

An essential feature of Enterprise Zones is that they involve an infusion of resources into the zones by higher levels of government. A condition of the infusion should be that the area is active in making its own efforts to develop. This does not necessarily mean that the area is already spending heavily on development from its own funds, since the essence of the objective criteria for selection discussed in Chapter 7 is that such funds are not readily available in the selected regions. The expected local input should rather be in terms of vision, planning and commitment to implementation.

We concluded in Chapter 6 that the Australian program should be Commonwealth financed but conceived and delivered within the benefiting regions. The main opportunity for the Commonwealth to exercise control over the program should therefore lie in the acceptance or rejection of regional program plans. The arguments for strict Commonwealth guidelines in this respect are:

- the Commonwealth provides the cash and should strictly audit expenditures as a responsibility to its taxpayers
- in so far as Enterprise Zones are complementary to 'mutual obligation' and other social security policies, they are an area of Commonwealth interest, and
- in so far as Enterprise Zones involve financial sector regulation, the responsibility lies with the Commonwealth.

However, there are other considerations.

- In so far as the powers required to implement Enterprise Zones do not lie with the Commonwealth, they lie with the states, though they may have been delegated to local government. It would greatly strengthen the program if it were implemented in conjunction with the states: the history of Commonwealth attempts at regional development programs which bypass the states is not encouraging. It may be that this will lead to program differences between states, but, given that the states have different economic opportunities and administrative traditions, this may be no bad thing.
- Enterprise Zones, particularly on the US model, benefit enormously from detailed local knowledge and commitment. Strict Commonwealth guidelines run the risk of stifling local initiative and prohibiting innovative local development strategies.

The EU model is project-based; local government comes up with projects which merit funding, and the EU forms an essentially development-banking role or a related aid-grant role. Within Australia AusAID has developed sophisticated cost-benefit methodologies for assessing development grants, including assessment of their distributional effects, and a similar methodology could be applied to regional development within the country.

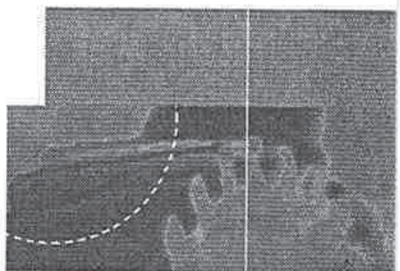
By contrast, the US model emphasises open-ended incentives to the private sector rather than project-based investment initiatives. The important point is that these incentives are offered only in areas where they can be administered by local government which has demonstrated a capacity to work with the private sector for job generation and local economic development. A major part of the demonstration is the preparation of a development strategy which includes the enterprise zone incentives.

It should not result in windfall gains for recipient businesses; that is, in payments beyond those levels which are required as incentives for program participation and which cover the costs of participation.

A notable feature of the US precedents is the availability of grants from various sources (federal and state, and not wholly within the enterprise zone programs) to assist with local economic development planning. The grants encourage 'bottom-up' planning with a high degree of community consultation and participation. The funding governments insist on an inclusive consultation process, but do not pre-empt the product of the process. Investment projects in turn must support the development plan. In this way the granting governments incorporate local knowledge into the regional investments which they finance. There is also scope for regions to experiment with strategies which are not in fashion in the state and federal capitals, and hence to add to the total of experience. At the same time, the granting governments make available expertise in plan development, and draw attention to precedents elsewhere.

The precise approach adopted in each state should be negotiated with the state government, and include:

- provision by the Commonwealth of finance for plan preparation,
- provision by the Commonwealth and the state of expertise in plan preparation,
- commitment by the state to plan implementation, including contributions in kind where its own services are involved,
- provision for the assessment of plans as a condition of Commonwealth finance, with the emphasis on local relevance and not on ideas emanating from the Commonwealth (this should even apply to the knowledge-industry model, about which information should be provided but which should not be enforced) and
- Commonwealth finance should also be conditional on local commitment, including a minimum commitment of planning resources.



These conditions raise several questions.

- The conditions imply that some high-unemployment regions will not become eligible as Enterprise Zones, due perhaps to their state failing to participate in the program, or to their own failure to apply, or to their application being seen as deficient by the Commonwealth. The obvious strategy is to wait and try again.
- A more difficult case arises if budgetary limitations cause the Commonwealth to deny funds to regions which are eligible and submit a high-standard application. In the US, the federal government was caught in this position and assisted regions in this position to seek substitute funding sources. Australia does not have such a large range of substitute funding sources as the US, but it may still be possible for the Commonwealth to contribute to plan financing to some extent, either directly or in co-operation with the finance sector.

Time horizon

In both the US and the EU, Enterprise Zones are declared for at least ten years, with some declared for up to twenty years. The reason is that the programs aim to influence the investment decisions of private business, not merely operating decisions. Structural unemployment cannot be addressed by simply creating jobs without complementary investment, since this limits job creation to what can be done with existing equipment.

Commitment of this order has not been readily forthcoming from Australian governments except for major infrastructure projects such as the Snowy Mountains Scheme. Regional development is more often a matter of small grants, available from year to year as the budget has room and the Minister is in need of press releases. Such grant schemes can have very high administrative costs, both on the part of the applicants and the recipients of grants, and yet cannot be the basis of any ongoing program. It is imperative that Australia should follow overseas precedent and institute Enterprise Zones timed to last long enough to influence investment decisions.

There might seem to be a contradiction between this long-run time horizon and the importance of job creation to reduce unemployment and complement the government's 'mutual obligation' philosophy. Australians have tended to regard unemployment as cyclical, to be absorbed by a speeding-up of economic growth in general, and that accordingly unemployment should be countered by temporary assistance at the most. However, we have considered the evidence and concluded that the regional divergence in unemployment rates indicates a regional divergence in job generation which will not be corrected by purely macroeconomic policy at the national level (whether monetarist, neoclassical or any other kind) or by microeconomic reform.

The requirement to go beyond simple make-work policies, essentially enhancements of work-for-the-dole, does not mean that regional policy should be wholly investment-oriented. Investment per se can no longer be guaranteed to yield jobs; indeed much investment is calculated to improve labour productivity and abolish jobs. A balance has to be struck, therefore, between employment generation and investment to back up the employment generation, so that jobs are indeed created but are firmly based as well. As remarked above, the project assessment methodologies already developed for overseas aid assessment can be applied in this context, and recommended to regions as they prepare their plans.

Set menu or flexible package?

Most US enterprise zone programs provide a fixed list of incentives, with many of them involving governments in open-ended expenditure commitments. These incentives may be closely related to the strategy of development, but the standard list is not always suited to implementation of the plans developed in particular regions-even though there is some scope for regional variation in implementation. A development in some US state programs (but not the federal program) has been to set an envelope of estimated cost, plus a list of approved incentives, and allow each region to select among the approved incentives to the limit of the expenditure envelope. In this way the US programs can approach the European, which are run on a block grant basis, with expenditures closely related to the project plan.

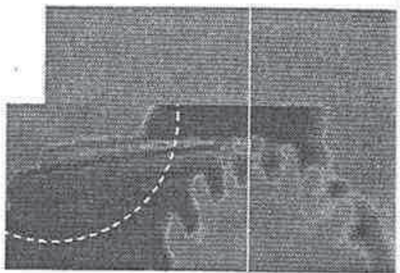
The set menu aspect of US programs is related to their use of tax incentives, which have to be inserted into tax acts and are therefore difficult to vary from zone to zone. If tax incentives are not used, there is much to be said for a project finance approach to Enterprise Zones; however, if tax incentives are used, at least the tax component is likely to be standard across zones.

A balance has to be struck, therefore, between employment generation and investment to back up the employment generation, so that jobs are indeed created but are firmly based as well.

Budgetary or tax expenditures?

Industry assistance can be achieved by direct expenditures from budget or by tax expenditures (ie deductions from tax liabilities). If grants are tax-free the two forms of expenditure can be made closely equivalent, both from the point of view of budgetary impact and from the point of view of the receiving business. The US enterprise zone programs rely strongly on tax expenditures, for the following reasons.

- In a business climate which concentrates on tax cuts rather than on the benefits of government expenditures, it may be politically easier to provide tax expenditures (which can be dressed up as a tax cut) rather than budgetary expenditures (which require tax increases to finance them). This argument is more apparent than real, since tax expenditures, like budgetary expenditures, can only be financed from increases in general tax rates.
- US business is sensitive to tax incentives, and as a matter of routine more likely to take advantage of such incentives than of equivalent grant programs; hence for a given expenditure the tax incentive route yields higher returns.
- The incentive effect applies even in cases where investors fail to make profits and accordingly there is no tax expenditure. This again raises the rate of return on actual expenditure.



- There is a feeling among US business that tax incentives are more reliable in the long run than budgetary incentives, which are more readily subject to annual revision (this is the mirror image of the Treasury preference for budgetary expenditures, which are kept under closer annual scrutiny and hence more readily changed as budget priorities change). This greater long-run reliability reinforces their investment incentive effects.
- Open-ended incentives (ie incentives with an unknown budgetary impact) are more readily incorporated into tax concessions than into budgetary expenditures, which tend to be capped. Once again, the uncapped nature of the expenditures (though they may be rigorously controlled in other ways) heightens their incentive effects, since any taxpayer who qualifies for the concession receives it.

Disadvantages of the tax expenditure route include the following:

- As noted above, Treasuries oppose such expenditures on the grounds that they are less readily controlled, and less readily varied, than budgetary expenditures.
- Tax expenditures complicate the tax system (though no more than budgetary expenditures complicate the expenditure side of public administration).
- Tax expenditures are available only to assist taxpayers. In the case of payroll tax concessions, only large business receives the concession, since small businesses are exempt from payroll tax. In the case of corporate income tax concessions, only profitable businesses receive the concession, though in US enterprise zone schemes there are generous loss carry-forward provisions which provide postponed benefits. However, as noted above, it is not necessary to receive the tax expenditure in order to be influenced by the incentive.
- In Australia corporate income taxes are a Commonwealth tax, and therefore subject to constitutional restrictions. There is some constitutional uncertainty as to whether tax concessions can be provided on a geographic basis, even where the area of availability is defined objectively in terms completely unrelated to state boundaries. However, there are also constitutional constraints on Commonwealth expenditure programs.
  These constraints point in the direction of joint Commonwealth/state programs. Just as state participation is desirable to ensure co-ordination of expenditure, so it may also be desirable to assist with the tax expenditure side.

One reason for favouring tax incentives in Australia is the precedent set by zone rebates in the income tax. These were originally granted with regional development in mind, and the original layout of regions specified areas where it was considered that development assistance was required. By all criteria the specified areas are now out-dated: they include areas where considerable development has taken place, as well as areas which would be eligible for assistance under the objective criteria suggested above. As income tax deductions, they have been of most benefit to highly paid personnel in the designated regions, which means that they have favoured the mining industry and its employees-even employees who only nominally live at the mine, flying in from their real homes elsewhere. By the same token, the allowances are of minimal benefit to low-paid workers in the eligible regions. There is a strong case for re-orienting these allowances to favour job generation, and to re-draw the boundaries to emphasise regions suffering from high unemployment.

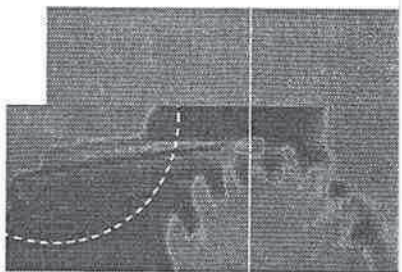
The arguments for and against the use of tax incentives are fairly evenly balanced, though the US precedent carries considerable weight since the US Treasury is just as anxious as the Australian to avoid tax expenditures. A major advantage of tax incentives is economy of expenditure for a given strength of incentive, arising because expenditures are not necessarily incurred. It may be possible to include this feature in budgetary incentive programs, by designing the incentive as a reward for successful performance rather than as an aid to performance: eg payments are not made until a certain number of jobs have been created and sustained for a year or so. The problem with such incentives-in-arrears is that they do not assist investors at the point when their cash flows are lowest. They are therefore likely to be most effective for firms which are not facing financial constraints, and may be completely ineffective for small and other businesses which are having difficulty financing investment.

There is a strong case for re-orienting these allowances to favour job generation, and to re-draw the boundaries to emphasise regions suffering from high unemployment.

Wage subsidies

Most US enterprise zone programs incorporate wage subsidies targeted to the employment of disadvantaged workers. However, not all programs include wage subsidies: for example, the Iowa program relies on investment concessions tied to the creation, by a firm, of at least ten new jobs expected to last at least ten years each and which pay at least 90 per cent of the average wage.

The wage subsidies which are part of most US enterprise zone programs, including the federal program, are paid in the form of corporate income tax credits, which may be carried forward if no tax liability arises in the year in which the wages are paid. (Note that in the US the states impose corporate income tax as well as the federal government.) California may be taken as an example. Tax credits are available for the employment, within Enterprise Zones and after declaration of the zone, of workers who meet various tests of disadvantage such as long-term unemployment or social security receipt. The credit is 50% of wages paid (up to a limit of 150% of the minimum wage) in the first year of employment, reducing by 10% a year till in the sixth year of employment no credit is available. There are various provisions for credit recapture in circumstances such as employment termination, and special provisions apply for industries with predictable seasonal rhythms. Wage subsidies are restricted to genuinely new positions; employers gain no benefit by replacing existing employees with subsidy-eligible workers. Local administration of the scheme ensures that this condition is met. According to the local development plan, the subsidies may be limited to businesses in particular codes of the industry classification.



By Australian standards, the California minimum wage is low, at USD5.75 an hour; accordingly the maximum wage subsidy over the five years of diminishing eligibility is around USD27,000 per worker, with a maximum subsidy of USD4.32 per hour in the first year.

Australia has past experience of job-creation schemes based on wage subsidies. The differences from the US enterprise zone schemes include:

- payment in Australia as a grant rather than as a tax credit,
- the US schemes are geographically limited to Enterprise Zones and
- the Australian schemes were targeted at short-term job creation rather than long-term, and accordingly were not nested into local economic development plans.

It would be possible for wage subsidies in Enterprise Zones to be granted by state governments by deductions from payroll tax liability, though these subsidies would only apply above the payroll tax threshold. The Commonwealth could grant such subsidies either by budgetary expenditure or by deduction against corporate income tax. In view of the close relationship between the payments and the Commonwealth's existing social security responsibilities it is suggested that the finance of the payments should be a Commonwealth responsibility, but with local administration. This would include local certification of eligibility for tax deductions.

The relationship between Enterprise Zones and social security

Because the US lacks a national social security program for unemployed people, its Enterprise Zones do not emphasise the interaction between social security and social security payments. In Australia there will be opportunities to align social security and enterprise zone programs.

Though the exact content of the government's intended 'mutual obligation' reforms of the social security system is not known, it may be assumed that the reforms will include a mixture of the following:

- assessment of social security recipients with a view to their re-entry to paid employment
- assistance to gain such employment, including training and work experience schemes such as work-for-the-dole and
- threats of withdrawal of benefit in the event of non-compliance with required training or job acceptance (the former 'work test', perhaps increased in severity).

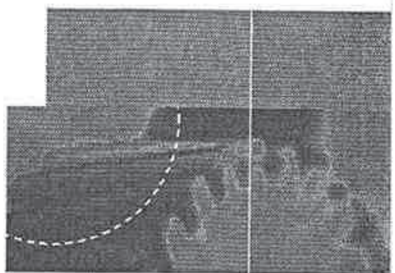
It is intended to extend the approach, which is already applied to unemployed people, to single parents and to persons with degrees of disability which do not prevent jobholding. The approach is predicated on the belief that at least some social security recipients have entered a culture of dependence on social security, while others remain recipients due to individual characteristics, particularly lack of skills, which can be remedied by appropriate services. Threats are required to shock recipients out of the culture of dependence, and assistance is required to make them more attractive to employers.

As remarked in Chapter 1, in regions of full employment this approach may succeed in transferring from social security to employment a high proportion of recipients with employment potential (it being conceded that there are recipients whose disabilities preclude employment, and also that age pensioners are excused from 'mutual obligation' requirements). In these regions the numbers transferred may not be great, since the social security system already incorporates work incentives and assistance to find work. In regions of high unemployment, however, the number of unemployed people greatly exceeds the number of work vacancies. In these regions, no amount of training, job search assistance and threat can transfer all social security recipients with employment potential into jobs. In Chapter 6 we also discussed the possibility of moving the people to the jobs, and concluded that the scope is limited, chiefly by the availability of housing and by the capacity to generate additional jobs in full-employment areas.

In that one of the proposed purposes of Enterprise Zones is to create additional employment in regions of high unemployment, the program is obviously complementary to 'mutual obligation' provisions. What should be the relationship between the two? In the USA, where many states have adopted a 'mutual obligation' philosophy for their welfare systems, the division is clear: the welfare authorities provide individualised job preparation, while wage subsidies are provided to encourage employers in Enterprise Zones to employ former welfare beneficiaries. In Australia, there is no need to follow this precise precedent. If wage subsidies are assessed as helpful in returning social security beneficiaries to work, they could be incorporated in the 'mutual obligation' program, and made available to employers throughout the country, or possibly to employers in high-unemployment regions whether or not the regions have been declared Enterprise Zones. This would have the advantage of clearly distinguishing job-creation incentives related to the social security system from economic development programs in disadvantaged regions under the enterprise zone program-even though the enterprise zone program would emphasise job creation.

Another area of relationship between 'mutual obligation' and Enterprise Zones involves education and training. There will be a need for co-operation between the Commonwealth authorities and their agents administering 'mutual obligation' and local government administering the enterprise zone, and in particular the education and training aspects of the local strategy. There will be little point in having Commonwealth agencies prepare social security recipients for jobs which the local council knows will not be generated.

There will be a need for co-operation between the Commonwealth authorities and their agents administering 'mutual obligation' and local government administering the enterprise zone, and in particular the education and training aspects of the local strategy.



Investment incentives

Firms which develop businesses in US Enterprise Zones are eligible for various tax incentives, including the following, with variation from program to program. Once again the incentives may be restricted to particular industries identified in the development plan.

- remission of various minor taxes (permit fees, business licence taxes, construction taxes)
- sales tax exemption for equipment installed
- property tax concessions
- payroll tax concessions
- accelerated depreciation for equipment newly installed in Enterprise Zones. The precise conditions may include minimum and maximum values for the equipment; that the equipment should stay in the zone; and/or that the equipment is associated with job generation.
- R&D concessions similarly.

These enterprise zone provisions complement a wide range of other investment incentives at federal, state and local levels.

Economic assessments of the US programs report that the investment incentives tend to dominate the wage subsidies, and that it is possible for the combined package to result in job losses as firms invest in labour-saving equipment. The assessments have little to say on the relationship between the investment incentives and adoption of the knowledge-industry model.

Australia has experience with most of these forms of concession. The differences between current and recent Australian examples and US Enterprise Zones are:

- sales tax exemption is irrelevant, being already provided under the GST package,
- state and local programs are confined to minor taxes and land and payroll taxes, local government programs to property taxes and minor charges,
- state and local tax concession packages are generally put together as part of the process of bargaining to attract particular investments, and are often not part of a coherent local development strategy;
- though the Commonwealth has from time to time included accelerated depreciation in its corporate income tax, the purpose has more often been counter-cyclical than developmental, and there has never been a location-specific element;
- there is also a R&D concession in the Commonwealth corporate income tax, again without any geographic component;
- the incentive effect of corporate income tax provisions in Australia is possibly blunted, vis a vis the US, by dividend imputation: firms may forgo concessions in order to provide franked dividends, and
- Australian concessions operate in a context in which there are fewer alternative investment incentives.

In considering the role for investment incentives in an Australian program, it is desirable to remember that an important purpose of an Australian program would be to improve industry competitiveness, particularly by accelerating adoption of the knowledge-industry model. Rather than provide open-ended incentives, it may be possible to reward, or even fully finance, particular steps which contribute towards the creation of a knowledge-industry. Investment could then be financed by own savings, loans and equity, as at present but with interventions to increase the flow of funds to Enterprise Zones. This raises the question of the role of the finance sector.

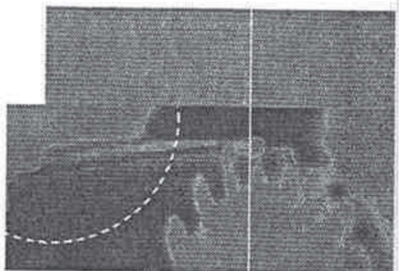
In considering the role for investment incentives in an Australian program, it is desirable to remember that an important purpose of an Australian program would be to improve industry competitiveness, particularly by accelerating adoption of the knowledge-industry model.

Financial provisions

Financial intermediaries which finance approved investment in US Enterprise Zones may be able to deduct part of the interest received in calculating their corporate income tax liabilities. This incentive is in addition to the large range of generally-available measures aimed at providing finance for small and developing businesses, including loan guarantees and a lively series of venture capital provisions. It should also be remembered that the structure of banking in the USA is far more regionalised than in Australia, and that banks are required to prepare regional statements of sources and uses of funds, both of which direct management attention to regional financing opportunities.

Against this background, it may not be desirable for Australia to copy the exact form of US incentives to financial sector investment in Enterprise Zones. Other measures may be more urgent, such as:

- imposition of regional accounting requirements on financial intermediaries as part of the quid quo pro for government licensing (the banks are licensed deposit-taking institutions, and the superannuation funds are licensed to provide financial services under the National Superannuation Scheme) and
- re-invention of development banking and the strengthening of venture capital institutions. This may involve innovation in risk-sharing processes. A link also needs to be forged between regional development planning and the financing of development, since such development planning can reduce the overall risk levels of complementary investments.



Such developments are required for all regions: even within the full-employment metropolitan areas representatives of the emerging new-technology industries argue that their investment needs are not being met. This is even more so in non-metropolitan areas where investment in traditional industries is depressed but the financial sector does not seem to be fully aware of the opportunities which might be created by local endeavour, nor of the risk-reducing potential of local economic development planning. The Commonwealth could use Enterprise Zones as test cases, and could assist in providing innovative investment finance in these regions, for example by way of loan guarantees.

A further US precedent is the revolving loan fund, administered by local government and originally financed by federal or state grant, though sometimes enlarged by local depositors who receive state or federal guarantee. Such funds can considerably assist the accomplishment of local development plans, and can be a very efficient way of taking advantage of local knowledge in the allocation of investment finance.

Financial provisions are among the areas where Australia conspicuously lacks equivalents to the all-of-country programs made available by the US government. Accordingly, it will be necessary to examine these areas carefully in adapting the US programs to Australian circumstances, and will probably be desirable to emphasise these areas in the Australian program.

Infrastructure

Unlike nineteenth and twentieth century Australian regional development programs, US Enterprise Zones do not emphasise infrastructure. However, development planning inevitably reveals infrastructure deficiencies. In the US programs, response to these deficiencies is not generally the responsibility of the enterprise zone program as such, but location within an enterprise zone, and endorsement by the zone administration, raises the priority rating of infrastructure projects. It is suggested that this approach be adopted in Australia, in preference to the current infrastructure-first (effectively roads-first) policy.

Education and training

The American approach to education and training is similar to the approach to infrastructure. Both are key elements in regional success, but both are a general responsibility of governments, and the role of the enterprise zone administration is to ensure that the authorities deliver.

With the greater emphasis on adoption of the knowledge-industry model in Australian Enterprise Zones, education and training provisions, and related research support provisions, are likely to form a more central element in Australian programs. The OECD suggests that community colleges are likely to provide a useful component of adoption of the knowledge-industry model in most regions, whereas more sophisticated measures such as industry parks are likely to succeed only in the more favoured and organisationally advanced regions. Since the need is widespread, there is an argument for inclusion of a community college strand in all enterprise zone plans. Implementation will involve co-operation between the states and local government, and should form an important part of the intergovernmental negotiations to develop enterprise zone programs.

Deregulation

US Enterprise Zones often include provisions for streamlining of administrative processes. They occasionally go further, and include provision for reduced standards in building regulations and occupational health and safety and the like, on the argument that these are required if US sites are to compete, under the NAFTA free-trade agreement, with places in Mexico. On the whole, however, attempts to gain cost advantages through reductions in regulatory standards have been resisted, if only because the cuts required to reduce US costs to Mexican levels are fairly drastic. It is also argued that they are unnecessary: US regions can compete with Mexico on the basis of superior resources and productivity rather than by cutting standards.

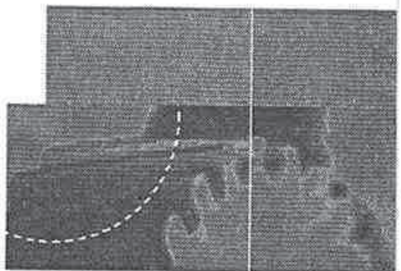
In Australia, the arguments are similar. Regions may gain cost advantages by cutting standards below those in the rest of the country, but they have a long way to go if their intention is to compete with third world sites in direct wage costs. The advantage may also prove illusory if it feeds back in any way to reduced productivity: cutting the corners on building and health and safety standards can be counter-productive.

With the greater emphasis on adoption of the knowledge-industry model in Australian Enterprise Zones, education and training provisions, and related research support provisions, are likely to form a more central element in Australian programs.

Monitoring

As already argued, a condition of declaration as an Enterprise Zone should be preparation of, and commitment to, a regional development strategy. It follows that a further condition should be monitoring progress in achievement of the plan, and documenting any changes which become necessary. This will include an annual report, addressed to the people of the region, which will include comparisons of performance to date with targets set in the plan. The Commonwealth will develop a core data set which all Enterprise Zones will be required to collect, to assist in national cross-comparisons.

By contrast with current state practice in negotiating ad hoc agreements with investors, the report should also specify the incentives available in the enterprise zone, and should report on the take-up of incentives, and on the compliance of the beneficiaries with the conditions attached to those incentives.



Conclusion

The conclusions to this chapter comprise a number of recommendations.

An Australian enterprise zone program should follow both US and EU precedents and require preparation of regional development plans or strategies as a condition of declaration as an enterprise zone. These strategies may require further development following declaration, and should be updated regularly.

Investment incentives in Enterprise Zones should be guaranteed to remain in place for sufficient time to have a full incentive effect, ie for at least ten years and preferably 15.

There should be incentives to business investment and employment generation in Enterprise Zones, particularly to the generation of employment for disadvantaged workers. The merits of providing these incentives as tax incentives available only in Enterprise Zones should be considered as an alternative to budgetary expenditures.

Financial intermediaries should be required to report their investments by region, and should receive incentives (and perhaps regulation) to direct investment towards the support of Enterprise Zones, subject to these investments meeting commercial requirements.

Scope should be allowed for local variation in incentive packages, though it may be desirable to specify minimum percentages of expected expenditure to be devoted to business incentives and to education and training.

Provided that it is consonant with the general aims of the program, the development plan may identify particular industries and particular types of investment for support.

Wage subsidies should be a permissible form of expenditure in Enterprise Zones. However, they should only be a compulsory component if adopted by the Commonwealth as an adjunct to its social security policies, and then only if the Commonwealth elects to provide them through the enterprise zone program rather than as an independent program. Job generation should, however, be a major aim of regional development strategies, and should be included as a criterion in the assessment of plans and hence the selection of regions to become Enterprise Zones.

There should be provision for increased priority for infrastructure projects in Enterprise Zones, at least as regards infrastructure identified as essential for plan success.

The development of community colleges and similar educational, research and technology diffusion institutions should form a part of the development plan and of the program in each enterprise zone.

Each enterprise zone should be monitored under Commonwealth guidelines, and should report on assistance granted and compliance with the conditions under which assistance was granted.

Program budget

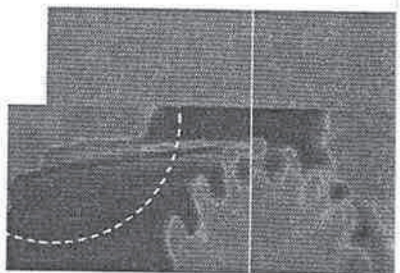
In this preliminary study it has not been possible to place a dollar value on the benefits of enterprise zone programs. Suffice to say that the benefits are expected to outweigh the costs by a considerable margin. One purpose of insisting on the preparation of strategy plans as a precondition of declaration as an enterprise zone is to assist in identifying projects which will yield significant benefits. Again, the purpose of the various incentive and investment programs which are to be implemented in each enterprise zone is to yield net benefits. This is expected to be true even if the benefits are identified narrowly: increased utilisation of resources in currently distressed areas; self-respect and increased incomes for people who currently have very low chances of finding a job. In addition, benefits are expected in terms of national unity, and avoidance of the police actions which residents of the favoured areas might otherwise have to implement in order to prevent the people of the distressed areas from expressing their disaffection in practical ways.

Investment incentives in Enterprise Zones should be guaranteed to remain in place for sufficient time to have a full incentive effect, ie for at least ten years and preferably 15.

Though Enterprise Zones are to be structured so that benefits outweigh costs, there is no denying that they will require the investment of Commonwealth funds. There are several ways to calculate the amount which could sensibly be invested. In this chapter we briefly consider four calculations:

- What would be the cost of equalising regional unemployment rates through a traditional job-creation scheme?
- On US precedents, what would be the cost of a minimal pilot program of Enterprise Zones?
- Again on US precedents, what would be the cost of an enterprise zone program which was available in all regions where the unemployment rate is more than 150% of the national average?
- Finally, from a macroeconomic point of view, what would be a responsible level of expenditure?

The first of these calculations is not an indicator of how much should be budgeted for Enterprise Zones; it is, rather, an indicator of the seriousness of the problem addressed. The second calculation gives minimum sensible expenditure; the third the level of expenditure which could be justified for a major program to address regional disparity. The fourth calculation supports the third.



The public-sector job-creation alternative

Enterprise Zones are not a traditional employment-creation policy, since they combine elements of job-creation with capital accumulation and the updating of industry organisation to produce sustainable economic growth on a local basis. However, as a broad indicator of the seriousness of the problem which they address, we will first consider the alternative of responding to regional inequality through traditional public-sector job-creation schemes, involving tax increases to finance increases in the output of labour-intensive services.

It has long been open to the Australian government to regain full employment through job creation schemes. However, the government has consistently ignored this option, for example it did not take seriously the policy program for a return to full employment put forward by Langmore and Quiggin in 1994. The reasons for the disdain included the priority for tax cuts, the conviction that the deregulated private sector can always do better, and the fear that a return to full employment would worsen the inflation rate.

Langmore and Quiggin's program was put forward before the extent of the divergence between regional unemployment rates was realised. An important aspect of this experience has been the achievement of full employment in Sydney without significant inflationary result. In 2,000 the unemployment rate over the Sydney metropolitan area was between 4 and 5 per cent of the workforce, whether measured at official rates or from social security uptake using National Economics' methodology. Across much of the metropolitan area the rate averaged 3 per cent. Whatever may have been the case in the days of wage-push inflation, it would appear that labour market reforms have done away with any need to maintain high unemployment rates as an insurance against inflation. From this point of view, it therefore makes sense to set a target of 4.5 per cent unemployment nationally. A job-creation program could then be specified which achieves this rate by equalisation of regional unemployment rates.

The number of jobs required to meet the target can be calculated as follows. It is assumed that jobs are provided by publicly-financed job creation, either through wage subsidies to the private sector or through direct public finance of job creation (whether or not the jobs are provided in the public sector or by contractors).

1. Define the national target unemployment rate as the adjusted unemployment level currently applying in Sydney.
2. In all other regions, provide sufficient jobs to reduce the unemployment rate to the Sydney benchmark. This may be roughly calculated as equal to the number of unemployed plus the number of other social security recipients expected to seek jobs under the 'mutual obligation' principle. (Note that the total number of jobs to attain Sydney-standard full employment will be greater than this, due to latent demand from the 'hidden unemployed' and also due to the need to replace any net reduction in private sector jobs resulting from the taxes required to finance the program.) Somewhat over 500,000 jobs are required.
3. Cost the jobs at a conservative net $9,500 p a each (ie pay plus administrative and investment costs of say $20,000 per job per annum less recoupment from social security, additional tax revenue and the like; but for conservatism excluding multiplier effects since these will probably have to be dampened for balance of payments reasons).
4. Multiply required jobs by the cost per job.

The result is approximately $5billion a year. This cost is roughly double the equivalent cost, for Australia, of EU regional policy. However the EU cost estimate excludes non-regional employment creation programs. It would increase the expenditure of governments in Australia by 3.5 per cent and would increase taxes as a proportion of national income by less than 1 per cent. In other words, the cost of direct intervention to generalise the good

enterprise zones

fortunes of Sydney to the country as a whole would be large, but not completely unthinkable. Given latent demand for labour-intensive publicly-financed environmental, welfare, educational and health services, it is even possible that support might be mustered for the tax increases required by this approach.

The estimate of $5billion gives an indication of the seriousness of the divergence of regional unemployment rates. It also presents a challenge to those who place their faith in the private sector and in tax cuts: can they produce alternative policies for the achievement of regional equality in unemployment rates?

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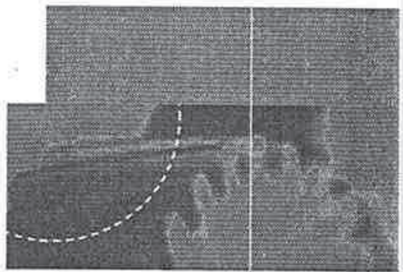
The Enterprise Zones proposed in the current study may be assessed as part of such an alternative program. As compared with direct public-sector job-creation, they emphasise private sector opportunities by galvanising latent private-sector activity in the high-unemployment regions. Admittedly they initially involve tax increases, but the major role of the tax increases is to finance investment, and after the initial increases tax-rate reductions can be expected as the investments come to fruition. Another difference is that Enterprise Zones are nor envisaged as a blanket program. There is a requirement that assistance be limited to disadvantaged regions which can prepare, and commit to, satisfactory development plans, which implies that some regions will miss out. Again, the emphasis in enterprise zone programs is on business development for long-term competitiveness, and this does not guarantee immediate employment generation.

The US precedent: a pilot program

A more useful approach to the size of an initial program would be via an estimate of the expenditures per enterprise zone required to mount an effective enterprise zone. Expenditures in the first year or two, before declaration of the zone, involve assistance with planning, and can be quite modest: of the order of $50,000 to $100,000 per applicant zone. However, once the zone is declared, expenditure is required to provide meaningful business incentives. The US federal government budgets around USD 1-2 million a year for each fully-fledged enterprise (empowerment) zone, or of the order of USD 200 per zone resident. At the current rate of exchange this is AUD 2-4 million a year per zone; say $400 per resident. Australian Enterprise Zones may require rather larger funds, for the following reasons:



- Allowance should be made for the off-budget tax concession component of US enterprise zone programs.
- As pointed out in Chapter 6, Australia lacks many of the complementary programs which can be accessed by local governments administering enterprise zones in the USA. If Australian Enterprise Zones are to be effective, they will have to be enhanced to make up for this lack. It is true that there may be partial offsets in that some elements of the US enterprise zone programs can

be omitted in Australia since they are already covered by Commonwealth or state provisions, but the judgement is that the additions required for effectiveness are likely to outweigh the subtractions.

- Australian minimum wage rates are higher than American, which may increase the outgoings involved in the job generation side of Enterprise Zones.

At an expenditure rate of (say) $5 million a year per zone, and expecting declaration of three or four zones in each large state with smaller numbers in the smaller states and territories (though it is doubtful if any region within the ACT would meet the eligibility criteria), the total number of zones in an initial pilot program would be around 20 and expenditure around $100 million. This is not out of kilter with US expenditure, totalling federal and state programs and allowing for accessing funds from programs which are not confined to Enterprise Zones. However, as in the US, a limited program of this nature would inevitably omit a very large number of areas which met all reasonable eligibility criteria.

The US precedent: a program to cover all economically distressed regions

The potential for the enterprise zone program is ultimately limited by the number of disadvantaged areas. Disadvantage is a matter of degree, and expenditure can be limited by making the selection criteria very stringent. For example, if Enterprise Zones are declared only where adjusted unemployment rates exceed 20 per cent the number of eligible regions will be quite small. It will exclude many areas which, by common consent, are in economic distress. However, if the criteria are set at approximately American standards of stringency, the program would be available to LGAs with adjusted unemployment rates of 14 per cent and over (in 2000 14 per cent was 150% of the national average). Approximately 20 per cent of all Australians live in LGAs with adjusted unemployment rates above this level. If Enterprise Zones were declared in all these LGAs, and expenditure of $750 per capita per annum was authorised, the total budget would be approximately $2.6 billion: very close to the EU equivalent level of expenditure on regional development. It could be financed by an increase in the average rate of income tax of the order of 3 per cent, or approximately $7 per week per income tax payer. (There is little point in calculating the equivalent increase in the GST rate, since the 10 per cent rate has been locked in by Commonwealth/state agreements.)

At all times in assessing this expenditure it should be remembered that, though it is recorded as expenditure in the public accounts,

- much of it is clawed back through reduced social security outgoings, increased taxation and the like and
- much of it is a long-term investment. Indeed, the purpose of founding the investment program on long-term plans is to return dividends in the form of permanent increases in regional employment and incomes.

A macroeconomic approach

Another approach to the calculating the desirable size of program starts from the proposition that significant investment is required to hasten the adoption of the knowledge-industry model of industry organisation in regional Australia and to exploit the opportunities which this adoption will make available. Much of the investment will not be recorded as such in the national accounts: investment in education and in changes to industrial organisation are not recognised as such in statistical returns. The change will accordingly require expenditures which are classified as investment, and expenditures which are classified as current. In its initial stages it will also require investments which do not meet current commercial hurdle rates of return, for two reasons:

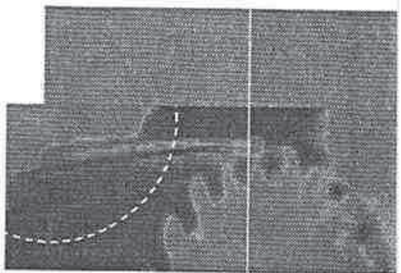
- there are arguments that financial markets are currently generating unsustainably high commercial hurdle rates, and
- investments in such areas as education and industry reorganisation, and even in infrastructure, yield rewards which cannot be captured by commercial investors.

Accordingly there will have to be a high level of investment either:

- written off as current expenditure or
- government-financed without respect to immediate rate of return.

In Australia, private sector investment is currently (1999-2000) running at the respectable rate of 19.4 per cent of GDP, with government investment at 5 per cent, a total of 24.4 per cent. However, private investment is expected to fall away over the next few years, due if nothing else to slack in the demand for housing, so that the national investment rate falls to around 22 per cent of GDP for government and private investment combined. To maintain investment at 25 per cent of GDP would then require an addition of approximately $20 billion to investment demand in 2001-02. Not all of this should be expended in lagging regions: for example, if Sydney's airport capacity is not increased, Australia will lose business to better-organised global cities such as Singapore. However, a substantial portion should occur in such regions. In this context, a program of public investment, education and funding for business re-organisation in Enterprise Zones (broadly defined) of the order of $3billion a year would be of the right order of magnitude. Not all this expenditure need be in the enterprise zone program so defined, but total public developmental expenditure of this order is required in the high-unemployment regions, in addition to all-Australia programs.

The public investments recommended as part of the Enterprise Zone program are complementary to private investment, and the total return from the program is maximised when public investment concentrates on projects which yield returns which cannot be captured by private investors.



Net costs

The costs calculated above have been the costs which will appear in government budgets. Once again it is emphasised that, while these expenditures appear in the budget as costs, and hence imply that tax revenue must be raised to cover them, the net budgetary effect is much more positive. This is for two main reasons:

- Some of the expenditures substitute for other government expenditures, particularly in job-creation.
- Most of the expenditures contribute to investment one way or another, and may therefore be expected to yield future returns. This applies obviously and directly in the case of investment incentives; it applies a little less directly in the case of education and training, and can even apply in the case of wage subsidies (if a wage subsidy enables a worker to gain permanent and eventually unsubsidised employment, there is a considerable saving in social security expenditure from the public budget).

The public investments recommended as part of the Enterprise Zone program are complementary to private investment, and the total return from the program is maximised when public investment concentrates on projects which yield returns which cannot be captured by private investors. One purpose of the planning process recommended as essential to each enterprise zone is to identify such projects. The more public investment concentrates on such projects, the greater the likely rate of return.

In Chapter 8 the issue of the Commonwealth's ability to provide taxation incentive based programs for regional economic development was discussed briefly. Due to concern expressed in various quarters that Enterprise Zones and their taxation incentives would be excluded per se, because of the Australian Constitution, advice was sought and commissioned by the ICAA/NSWLGSA and is now provided by P. Brazil, Special Counsel (Phillips Fox) and is attached as Appendix A. It finds as follows:

"We have examined the proposal for Enterprise Zones for Australia contained in the Report entitled "Enterprise Zones for Australia - Achieving Regional Equity through Business Driven Economic Development" prepared by the Institute of Chartered Accountants in Australia (the Report) and find that there would be no constitutional impediment to Commonwealth participation in the setting up of such Zones, as proposed, and in particular that there would be no impediment to the Commonwealth providing for tax incentives in such zones.

Any reservations that have been expressed in that regard are not soundly based, and are not justified by the totality of existing High Court decisions or by the likely attitude of the present High Court on this matter."

The advice discusses the Commonwealth's Constitutional Powers in light of a number of precedent cases brought against the Commonwealth from immediate post Federation until recently. Those decisions, together with the determination of the intent of the constitution, especially the oft quoted Section 51(ii), finds that the Commonwealth can have a high level of confidence in instituting tax based incentives as proposed with the Enterprise Zone model.

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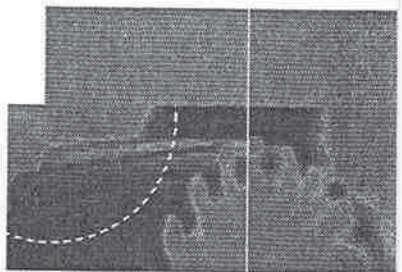

Conclusion

The seriousness of regional divergence in unemployment rates may be demonstrated by costing a public-sector employment-creation scheme designed to equalise unemployment rates across the country. This scheme has been conservatively estimated to require a Commonwealth appropriation of $5billion a year.

The enterprise zone proposal, while targeted on disadvantaged regions and despite its emphasis on jobs, is not a job-creation scheme of the traditional type, since it emphasises investment to create long-run regional competitiveness. Judging by the US precedents, a budget of $5 million in the first year (to cover planning and set-up costs) followed by $100 million a year (indexed for ten to fifteen years) would be sufficient to set up a pilot program with around 20 zones spread across the country. However, such a pilot program would omit the great majority of regions likely to be judged as in need, and complete coverage of regions suffering unemployment rates more than 50 per cent above the national average would require investment of the order of $2.6 billion a year.

If current expectations of a recession are realised, this level of increased government investment expenditure would make very good sense from a macroeconomic point of view, as well as from the point of view of regional policy. However, even if a recession does not occur, the divergence of regional experience alone justifies the policy.

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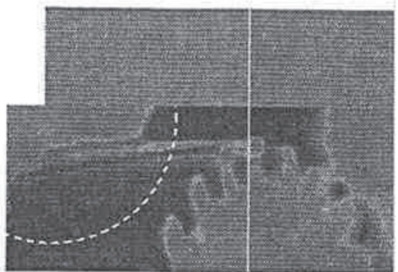

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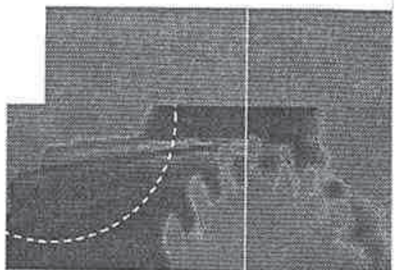
CONSTITUTIONALITY OF PROPOSED ENTERPRISE ZONES TO

ENCOURAGE THE INTRODUCTION OF NEW INDUSTRY AND

THE EXPANSION OF EXISTING INDUSTRY IN

UNDERPERFORMING REGIONAL AREAS

ADVICE



PAT BRAZIL

21 MARCH 2001

CONSTITUTIONALITY OF PROPOSED ENTERPRISE ZONES TO ENCOURAGE THE INTRODUCTION OF NEW INDUSTRY AND THE EXPANSION OF EXISTING INDUSTRY IN UNDERPERFORMING REGIONAL AREAS.

1. Summary of Advice

1.1 We have examined the proposal for Enterprise Zones for Australia contained in the Report entitled "Enterprise Zones for Australia – Achieving Regional Equity through Business Driven Economic Development" prepared by the Institute of Chartered Accountants in Australia (the **Report**) and find that there would be no constitutional impediment to Commonwealth participation in the setting up of such Zones, as proposed, and in particular that there would be no impediment to the Commonwealth providing for tax incentives in such zones.

1.2 Any reservations that have been expressed in that regard are not soundly based, and are not justified by the totality of existing High Court decisions or by the likely attitude of the present High Court on this matter.

2. The Proposal

2.1 The proposal would involve not only the Commonwealth Government but also State Governments and Local Government. As set out in the Recommendations in the **Proposal**, it would contain the following elements

The incentive program should include the creation of Enterprise Zones to encourage the introduction of new industry and the expansion of existing industry in under-performing regional areas.

For the purpose of identifying Enterprise Zones, regions should be defined as Local Government Areas, with provision that

- **regional groupings of LGA's should be encouraged, particularly where LGA's are small in relation to economic regions and**
- **possibly, that where a large non-eligible LGA adjoins an eligible LGA, and identifiable parts of the large LGA share the disadvantaged status of the eligible LGA, those parts may be considered for inclusion in the enterprise zone.**

Declaration as an Enterprise Zone should be available to regions which are experiencing economic distress, particularly high unemployment. Eligibility for enterprise zone assistance should be based on objective criteria of disadvantage which should include

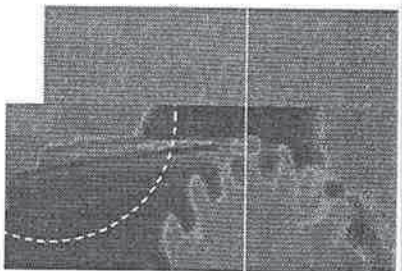
- high unemployment rates, calculated by a broader measure than the standard ABS labour force survey definition, and including allowance for persons working noticeably shorter hours that they would wish and persons not actively looking for work, but who are anxious to join the workforce, including early retirees;

- either as part of the unemployment measure, or separately, allowance should be made for the number of social security claimants likely to be affected by the government's 'mutual obligation' requirements, including persons in work-for-the-dole schemes;

- consideration may be given to low rural land values per farm property as a supplementary indicator in rural areas (defined as those with a high proportion of rural production in GRP) and

- consideration may also be given to favouring areas with significant production in export industries organised on small-business lines (on the grounds that returns to an Enterprise Zone program are likely to be unusually high in such areas).

Regional commitment to an economic development strategy plan should be mandatory for selection as an Enterprise Zone. These strategies and/or plans may require further development following declaration, and should be updated regularly. Provided that it is consonant with the general aims of the enterprise zone program, the development plan may identify particular industries and particular types of investment for support. All incentives offered in the Enterprise Zone should support the development strategy, with particular attention to reducing investment risk.



Enterprise Zones should be financed by the Commonwealth but implemented by state and local governments, subject to Commonwealth guidelines.

Each Enterprise Zone should provide strong incentives to job generation and to investment which is expected to result in job generation, but there should be flexibility for regions to select from a range of acceptable measures and within a broad financial envelope. The merits of providing incentives as tax incentives available only in Enterprise Zones should be considered as an alternative to budgetary expenditures.

Investment incentives in Enterprise Zones should be guaranteed to remain in place for sufficient time to have a full incentive effect, it for at least ten years and preferably 15.

Financial intermediaries should be required to report their investments by region, and should receive incentives (and perhaps regulation) to invest in Enterprise Zones, subject to these investments meeting commercial requirements.

Wage subsidiaries should be a permissible form of expenditure in Enterprise Zones. However, they should only be compulsory component if adopted by the Commonwealth as an adjunct to its social security policies, and then only if the Commonwealth elects to provide them through the enterprise zone program rather than as an independent program. Job generation should, however, be a major aim of regional development strategies, and should be included as a criterion in the assessment of plans and hence the selection of regions to become Enterprise Zones.

There should be provision for increased priority for infrastructure projects in Enterprise Zones, at least as regards infrastructure identified as essential for plan success.

The development of community colleges and similar educational, research and technology diffusion institutions should form a part of the development plan and of the program in each enterprise zone.

Each enterprise zone should be monitored under Commonwealth guidelines. The Zone administration should report on assistance granted and compliance with the conditions under which assistance was granted.

When the enterprise zone program is implemented, Zone Rebates should continue to be provided in the income tax, but the boundaries of the regions of eligibility should be reviewed.

3. The Commonwealth's Constitutional Powers

3.1 The leading constitutional case to date for schemes of this kind is the *Australian Assistance Plan Case (1975)* 7 ALR 277 (the "***AAP Case***") which was brought by Victoria against the Commonwealth challenging a not dissimilar proposal. The AAP was not the subject of separate legislation but existed only as an administrative scheme, the features of which were set out in two Discussion Papers and a document entitled "Australian Assistance Plan – Guidelines for Pilot Programme" prepared by a committee of the Social Welfare Commission (established by the *Social Welfare Commission Act 1973*). The AAP provided for the establishment and financing of Regional Councils for Social Development "to assist in the development, within a nationally coordinated framework, of integrated patterns of welfare services". The Councils were to inquire and report, and also to plan, stimulate and actually provide social welfare services; they employed staff, received grants and had a wide discretion in deciding how to spend the money granted. Councils were set up and were operating in various States, including Victoria.

3.2 The Victorian challenge to the AAP failed on various grounds but four of the seven judges (McTiernan, Stephen, Mason and Murphy JJ) gave judgments that stand as authority for the proposition that the validity of appropriations for such regional schemes is not ordinarily susceptible to effective legal challenge. Assistance could also be obtained, in defending the present **Proposal**, by relying on what is called the "Nationhood" power to be implied from the Constitution as appertaining to the Commonwealth as a national government, particularly in relation to the expenditure of moneys appropriated by the Commonwealth. Jacobs J in the *AAP Case* said (7 ALR, at 340)):

> "The growth of national identity results in a corresponding growth in the area of activities which have an Australian rather than a local flavour. Thus, the complexity and values of a modern national society result in a need for coordination and integration of ways and means of planning for that complexity and reflecting those values. Inquiries on a national scale are necessary and likewise planning on a national scale must be carried out. Moreover,

the complexity of society, with its various interrelated needs, requires coordination of services designed to meet those needs".

3.3 Also there has been a significant development in that "regional development" has now been specified in the current Administrative Arrangements Order made by the Governor-General as a matter to be dealt with by a Federal Department of State, namely the Department of Transport and Regional Services. This means that it has been made a subject for the exercise of the executive power of the Commonwealth referred to in Section 61 of the Constitution, a provision that was much discussed in the *AAP Case*, and this provides an additional basis for constitutional support for the **Proposal**.

3.4 Another important factor in the positive view we take of the constitutionality of the proposal in the Report is that the States are proposed to be involved in setting up the Enterprise Zones. This could make it less likely that a State or States would attempt to challenge the proposal if implemented. State participation could also provide a safe alternative means of delivering parts of the **Proposal** constitutionally, and that would be as part of a State grant's scheme under Section 96 of the Constitution. Expenditure of Commonwealth moneys under the **Proposal** by way of such grants would be clearly constitutional. In particular, State grants under Section 96 are not caught by the limited prohibitions in the Constitution against discrimination or preference as between States or parts of States.

4. Constitutional Prohibitions Against Discrimination and Preference as Between States and Parts of States.

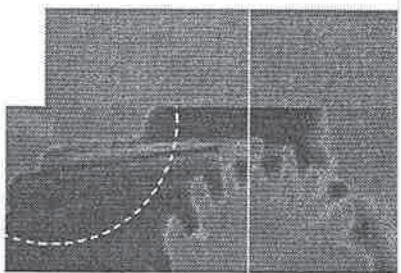
4.1 The prohibitions are contained in Sections 51(ii) and 99 of the Constitution. They read:

> 51. The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:-
>
> (ii) Taxation; but so as not to discriminate between States or parts of States:
>
> 99. The Commonwealth shall not, by any law or regulation of trade, commerce, or revenue, give preference to one State or any part thereof over another State or any part thereof.

4.2 The first thing to note is that these prohibitions only apply to laws and regulations of a limited kind – namely those made under the inter-State and overseas trade and commerce power in Section 51(i) of the Constitution and tax laws made under Section 51(ii). As already noted, they do not apply to State grants under Section 96 of the Constitution, if they do not discriminate between States: *Moran's Case* (1939) 61 CLR 735 at 763 (High Court) and (1940) 63 CLR 338 at 348-9 (Privy Council).

4.3 This still leaves the possibility that tax incentives and other incentives that deal with overseas or interstate commerce in the proposed Enterprise Zones might conflict with Sections 51(ii) and 96. As to what is meant in this regard by a **preference** or **discrimination** against a State or part thereof, in *Elliott v Commonwealth* (1936) 54 CLR 657 the majority of the High Court thought a preference was invalidated by section 99 only if given to localities which are taken as States or parts of States as such (at 675) or are selected by virtue of their character as parts of a State. This had been the view of Isaacs J speaking of the prohibition of discrimination in section 51(ii) in *The King v Barger* (1908) 6 CLR 41 and by the majority of the Court in *Cameron v Deputy Federal Commissioner of Taxation* (1923) 32 CLR 68. Isaacs J said (at 107):

> "The pervading idea is the preference of locality merely because it is locality, and because it is a particular part of a particular State. It does not include a differentiation based on other considerations, which are dependent on natural or business circumstances, and may operate with more or less force in different localities; and there is nothing, in my opinion, to prevent the Australian Parliament, charged with the welfare of the people as a whole, from doing what every State in the Commonwealth has power to do for its own citizens, that is to say, from basing its taxation measures on considerations of fairness and justice, always observing the constitutional injunction not to prefer States or parts of States".



4.4 Subsequently in *Clyne's Case (1958)* 100 CLR 246 which involved a specific challenge to federal income tax zonal concessions, Dixon CJ, Williams, Kitto and Taylor JJ begged to differ from *Elliott* and Isaacs J, saying they were unable to appreciate the distinction between the selection of an area and the selection of the same area for the same purpose 'as part of a State' (at 266). However, the challenge failed on other grounds, and income tax zonal concessions to residents of defined areas in the States have continued to apply ever since. The view expressed in *Elliott* was questioned but not overruled.

4.5 This being the state of play in the High Court, there has been a relevant development that helps significantly in resolving the difference of judicial views in a way that supports the constitutionality of the **Proposal**. This is the decision of the United States Supreme Court in *United States v Ptasynaski* (1983) 62 US 74. It dealt with the provision in the United States Constitution requiring "taxes be uniform throughout the United States", on which Sections 51(ii) and 96 of our Constitution was based. The decision concerned the US *Crude Oil Windfall Profit Tax Act* of 1980 which exempted from the tax imposed by the Act domestic crude oil defined as oil produced from wells located north of the Arctic Circle or on the northerly side of the divide of the Alaska-Aleutian Range and at least 75 miles from the nearest point on the Trans-Alaska Pipeline system. The US Supreme Court unanimously held that this exemption did not violate the Uniformity Clause's requirement that taxes be "uniform throughout the United States":

- The Uniformity Clause did not require Congress to devise a tax that falls equally or proportionately on each State nor did the Clause prevent Congress from defining the subject of a tax by drawing distinctions between similar cases (at 80-82).

- Identifying "exempt Alaskan oil" in terms of its geographic boundaries did not render the exemption invalid. Neither the language of the Uniformity Clause nor previous decisions prohibited all geographically defined classifications. That Clause gave Congress wide latitude in deciding what to tax and did not prohibit it from considering geographically isolated problems. Congress could not be faulted for determining, based on neutral factors, that "exempt Alaskan oil" required separate favourable treatment. Such determination reflected Congress' considered judgment that unique climatic and geographic conditions required that oil produced from the defined region be exempted from the windfall profit tax which was devised to tax "windfalls" that some oil producers would receive as the result of the deregulation of domestic oil prices that was part of the Government's program to encourage the exploration for and production of oil (at 84-86).

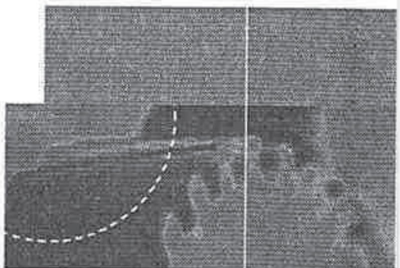
5. Conclusion

5.1 We conclude therefore that the present High Court would accept that there would be no constitutional impediment to the Commonwealth's participation in setting up the Regional Enterprise Zones proposed in the **Proposal**.

5.2 The recent trend of the Court towards looking at the purpose and effect of government initiatives in determining constitutional validity extends to taking notice of social facts, as shown in *Castlemaine Tooheys Ltd v South Australia (1990)* 90 ALR 371. In that case weight was a given to United States decisions and doctrines, and this seems to us to be a similar situation in that regard. Even more pertinently, reference is made in the judgment of Gaudron and McHugh JJ to the meaning of discrimination for constitutional purposes in the following terms (at 387-388):

> "...a law is discriminatory if, although it operates by reference to a relevant distinction, the different treatment thereby assigned is not appropriate and adapted to difference or differences which support the distinction. A law is also discriminatory if, although there is a relevant difference, it proceeds as though there were no such difference, or in other words if it treats equally things that are unequal – unless perhaps there is no practical basis for the differentiation."

5.3 The present **Proposal** is firmly based on the relevant social facts, and these would be taken into account if there were a challenge. The attachment following demonstrates that the Federal Government has made regional development a main item in its programs and budgets. Material of this kind could be taken into account in any challenge.



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'Regional Development as an Established feature of Federal Programs and Budgets '

1. Introduction

1.1 The recent trend towards looking at the purpose and effect of legislation to determine its constitutional validity, makes an examination of surrounding facts even more pertinent (Zines, *The High Court and the Constitution*, 4 ed at 481). This was done in *Castlemaine Tooheys Ltd v South Australia* (1990) 90 ALR 371, and a similar approach is appropriate in relation to the present **Proposal** which addresses the national concern for regional development.

1.2 This Appendix gives pertinent examples of the development of Australian policy and practice in this area as a type of 'Brandeis Brief', in support of the constitutional argument in the Advice. It does not purport to be exhaustive and in particular it does not supercede or alter what is contained in the **Proposal** itself.

1.3 It provides an overview of current Australian policy and practice regarding regionalism, with some specific and pertinent examples.

2. Regionalism in Australia

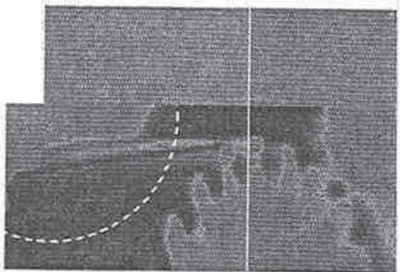
2.1 Regionalism has existed in Australia since at least the 1930s, with tax reforms that provided concessions for those living in rural and remote zones (these concessions continue to the present day, and are elaborated on below). Regionalism was given a further boost by the Whitlam Government in the 1970's, particularly through the AAP, and by subsequent governments.

2.2 The House of Representatives Standing Committee on Primary Industries and Regional Services produced a report in February 2000 entitled "Time Running Out : Shaping Regional Australia's Future" ("Time Running Out"). This report concluded that there is an urgent need to "firstly acknowledge the deficiencies in infrastructure that exist throughout regional Australia and secondly, the need to remedy that lack of infrastructure.". The Report examined the basis for its conclusion that investment in Australia needed to focus on regions:

> *"Regional economies throughout the world are facing global pressures that, combined with rapid technological advances, increasing productivity growth from commodity sectors and the need to ensure environmentally sustainable development, bring the prospect of spiralling decline for those regions suffering skills loss, reduced investment and, notably, lack of infrastructure…A new regional policy framework is urgently needed in Australia to address the cycle of increasing prosperity for high-performing regions and decline for other regions caught in low income, low employment growth patterns."*

2.3 Inherent in the above description of economic conditions is the effect of globalisation. The Federal Government has recognised the need to incorporate regionalism into its overall economic, fiscal and developmental policies and initiatives, noting that 'Regional infrastructure is vitally important to ensuring the continuation or, in many cases, the rejuvenation, of economic development not only in the regions, but for the nation as a whole.' ("Time Running Out").

2.4 This awareness is reflected in the announcement, reported in "The Australian Financial Review" on 14 March 2001, that the Federal Government was planning a "far reaching review of policies for regional Australia, including new 'zonal' tax concessions…The Deputy Prime Minister (and Minister for Transport and Regional Services), Mr John Anderson, is leading the push to find better ways to target and coordinate existing rural assistance programs which cost the Government about $2b annually".



2.5 In addition, a media release from Senator Richard Alston (20/6/99) announced the Government's "Accessing the Future" initiatives to "meet the Government's commitment to revitalise regional Australia by improving and restoring services. The initiatives, funded from the proposal next 16.66% Telstra sale, would expand regional opportunities for employment, business, research and development, education and information services." The initiatives include:

- Rural Transaction Centres

- Television Fund to extend SBS-TV to Australians in regional areas

- Building IT strengths, to address current market failures and policy gaps that are preventing optimal growth of new and developing innovative Australia IT&T businesses.
- Building Additional Rural Networks (BARN) to expand and promote improvement in the services, quality and price of regional telecommunications services

2.6 A joint statement on 9 May 2000 by the Deputy Prime Minister and Senator the Hon Ian MacDonald (Minister for Regional Services, Territory and Local Government), entitled "Regional Australia: Making a Difference", further emphasised the Federal Government's support for regional communities. In particular the statement noted that "The Federal Government acknowledges that there is a clear role for the Commonwealth in encouraging regional development and coordination beyond ensuring the national economic fundamentals are sound."

2.7 Issues associated with regionalism recur in the work of the House of Representatives Standing Committee on Primary Industries and Regional Services, and also in the functions of the Department of Transport and Regional Services (DOTRS). This includes encouraging government departments to take account of regional activities and needs.

2.8 DOTRS also funds a range of initiatives focused specifically on the needs of regional Australia. These include :

Countrylink Australia : an information access service for country people relating to their entitlements and obligations.

Flood Recovery Fund : extra support is provided to rural and regional communities in flood affected areas

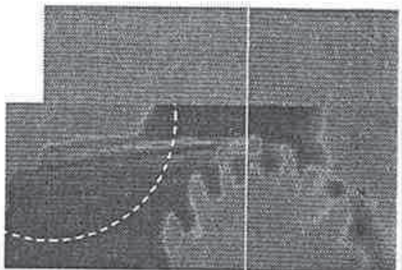
Regional and Rural Women's Unit : aims to increase the participation of women in the community in leadership roles and government decision making Regional Communities Programmes : initiatives to strengthen regional and rural Australia Research and Development Programs for rural and regional Australia: The programmes' objectives are to improve the availability and application of research and data on rural social and economic issues to foster community development activities.

Reference : www.dotrs.gov.au/regional (DOTRS Website)

2.9 Importantly, all relevant Federal government policy submissions must now include a Regional Impact Statement (RIS) and the Government is developing memoranda of understanding to ensure that programs across Government have maximum benefits for regional and rural Australia.

2.10 Regionalism is clearly becoming an important consideration in other areas of government policy. A compelling example of this is the strong theme of regionalism in the 2000-2001 Commonwealth Budget, which contained a number of initiatives focused specifically on regional Australia. A Wine Equalisation Tax Rebate Scheme was introduced to assist small wine makers in regional Australia, and the Fuel Sales Grant Scheme was introduced, whereby grants are provided to fuel retailers for sales to consumers in non-metropolitan areas with a higher rate of grant provided for sales in remote areas. Also, the Remote Air Service Subsidy Scheme, which provides regular services to remote ports through Australia, had its funding doubled. In addition, the Budget strongly supported continued investment in regional infrastructure, regional industry development, and regional tourism programmes.

2.11 The Australian tax system contains two further tax rebates which are based on regional considerations. The long standing tax rebate under s79A of the *Income Tax Assessment Act* 1936 provides for a rebate of tax for individual taxpayers who reside or stay in certain areas of Australia. The rebate is in recognition of uncongenial climatic conditions, isolation and the high cost of living encountered by residents of these areas in comparison to the rest of Australia : Tax Ruling 94/28. That Ruling provides a list of all points that fall within Zone A and B, which are deemed 'special areas' attracting the rebate. Tax Ruling 94/27 provides guidelines to assist in determining an individual taxpayer's eligibility for a zone rebate under s79A. Another tax rebate is available to telephone subscribers in remote areas who do not enjoy the 'benefits of untimed local calls' ($169pa).



2.12 Telstra also features investment on regional basis. Over four years to 30 June 2000, Telstra has invested $5.5b in telephone network in regional Australia. Telstra has also invested $1.5b in 1999/2000 to support regional customers. This has included the Remote Australia Telecommunications Enhancement (RATE) Program to upgrade radio telephone systems, and Telstra's commitment, announced in April 2000, to spend and additional $350m over 3 years to upgrade rural access networks : Media Release, DOTRS, June 1999.

Enterprise Zones Status report.

I provide this report in light of the NSW Legislative Assembly's investigation into Special economic Zones. It is a précis of the events which took place from 2001 onwards. This report provides a number of caveats which will have to be overcome if the rural regions(and I use that term deliberately) are to achieve any traction with tis review.

Economic Zones is the generic term for identified areas that offer a range of concessions to increase economic activity. Alternative names are Enterprise Zones, Industrial Zones etc. Following a visit to the USA in 1995 and again in 2000 I developed a proposal at Cowra Shire Council level which was then submitted to Centroc which had the economic counsellor from the USA Embassy in Canberra, Michael Delaney speak at a Centroc meeting on the benefits of EZ in the USA. Michael was the USA's chief negotiator for the USA/Australia Free trade Agreement. Centroc adopted the concept and referred it to the LGSA which together with the Institute of Chartered Accountants in Australia joined forces and developed a detailed submission prepared by National Institute of Economic & Industry Research (NIEIR). This submission was launched at Parliament House Canberra in 2001 and was followed by a series of meetings with Federal politicians and Ministers. The report was picked up by the national media and a series of radio interviews were conducted. The LGSA and ALGA adopted Enterprise Zones as policy and promoted the idea for a number of years.

Initial acceptance of the idea in principle at government level soon changed to opposition. Amongst various issues raised that it would not work was a supposed problem with Section 51 of the Australian Constitution, citing issues relating to variable taxation between the states. The LGSA/ICAA report had already included a detailed opinion by a Constitutional Special Counsel which found no impediment to EZ mechanisms in that regard.

The EZ ideas polarised politicians. Some in disadvantaged communities desired it and supported the idea whilst others dismissed it as unworkable. Those in city electorates appeared to adopt a "dog-in-the-manager" attitude. Because their electorate had no discernible disadvantage when objective measures were applied (a key component of the EZ mechanism to identify where benefits were needed) they actively opposed the idea. Independents such as Tony Windsor and the late Peter Andren and were strong supporters. The Deputy Prime Minister was a strong opponent, much to the consternation of many regional members. A statement made by one politician summed up the overwhelming political imperative and why EZ were in trouble at that point in time and it was as follows: *that a neighbouring electorate may receive some advantage over my electorate.* In addition Treasury supported by the Treasurer Peter Costello actively opposed the idea.

In an attempt to bolster support the LGSA/ICAA made submissions to the Commonwealth Regional Business Development Analysis Panel. Inspite of some 68% of all submissions having suggested a change to taxation policies for regions, the Panel made no recommendations in respect of taxation. An off the record comment by a panel member was that if we wanted change in that area then "change the bloody government."

The whole flavour of Government involvement in regional areas was based on pork barrelling government electorates in trouble.

There was a consensus in the regions that the Regional Business Development Analysis Panel was a deliberate distraction which was confirmed by no results or actions. A western Council (Coonamble) instituted a Tent Summit moderated by Mr Kerry O'Brien (ABC 7.30 report). The recommendations from this summit were positive and supportive of EZ but again no politicians were present.

Around this time a very active group based at Bourke were pursing their proposal for an EZ and developed a strong support base however after two years of inaction by the Commonwealth they gave up.

The LGSA/ICAA worked to modify the EZ concept to move it away from what was being seen and promoted by those opposing it as a backing losers. The concept was refined to promote the understanding that EZ incentives would apply to an statistical area recognised by the ABS however would only apply to individual businesses which engaged additional employees to expand their businesses. They would engage them under a guarantee that certain funding/taxation benefits would apply. In order to pursue this particular and specific approach I developed a taxation model based on a system I had seen operate in California and this was tested and further developed by the Western Research Institute and then published. See attached.

My general concern with the NSW enquiry is as follows:

- That the general problems outlined above will be mirrored at state level
- That States do not have the taxation powers required to give real strength to such zones

A Review of Estimated Enterprise Zone Benefits for Government and Business

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The term 'enterprise zone' refers to a range of policy instruments applied to a geographic area to encourage economic activity. Enterprise zones have been used in the United Kingdom, the United States and the European Union to address social and economic disadvantage, and to promote employment growth and business investment. For some years, the Western Research Institute has been involved in the study of enterprise zone models applicable to regional New South Wales communities, particularly in the north-western region. A model developed earlier this year for the Cowra Shire provides a simple example of how an enterprise zone can benefit business, the Commonwealth Government and the community. Compared to the base case, a business can improve profitability by up to 38% in the first six years of accessing the enterprise zone benefits. Likewise, the Commonwealth Government can improve their fiscal balance by up to 31% in the first six years. In addition, the benefits of an enterprise zone can extend to the community through the intangible social benefits and flow-on economic benefits that are associated with a person moving from welfare to work.

An enterprise zone is a geographic area where economic activity is encouraged with a set of policy instruments that are not generally applicable outside the zone. Enterprise zones are generally used in areas of particular social and economic disadvantage such as rural and remote areas. A range of incentives may be used, although the most common are tax credits for new employees, tax deductions for new capital investment and property tax reductions.

Disadvantaged regions can be identified by high unemployment, low employment growth, widespread poverty and low incomes. This type of imbalance is caused by market failure whereby the relatively small volume of output from a region causes labour mobility and a decrease in capital liquidity. The evidence suggests that the free operation of the market will not automatically correct regional imbalance. As the more prosperous regions continue to develop as a result of in-migration, out-migration from disadvantaged regions results in depressed demand; lower output; increased unemployment; and accelerated decline in regional services. Without government intervention the disadvantage experienced in regional areas will continue.

The concept of enterprise zones originated in the United Kingdom in the early 1980s, with the aim of promoting physical and economic regeneration in areas with problems that could not be overcome through market forces or existing urban and regional policy instruments. The idea was later seized upon by the United States in the mid-1980s.

The primary rationale for most enterprise zones is to create jobs. If an enterprise zone is successful in generating employment growth, the levels of disadvantage in economically distressed areas should decline, all else being equal. Enterprise zones are also used to stimulate business investment. This can occur if businesses move into the zone or if existing businesses expand their operations within the zone. Increased business investment may also create jobs for the local unemployed people.

While the term 'zone' refers to a designated area in which a government wishes to achieve its regional development goals, enterprise zone benefits are only available to individual businesses within the zone that meet strict criteria laid down by government. Legal opinion by Senior Counsel obtained by the Local Government and Shires Associations of New South Wales and the Institute of Chartered Accountants in Australia concluded that there would be no constitutional impediment to the Commonwealth Government's participation in setting up regional development mechanisms such as enterprise zones.

An Enterprise Zone Model

Since 2003 the Western Research Institute has examined the role of enterprise zones in Australia, particularly in the north-western region of New South Wales. This research suggests that an enterprise zone model could address economic and social disadvantage through social, economic and capacity building incentives. The Institute has also recently been asked to examine the benefits to business and government of establishing an enterprise zone in the Cowra Shire of New South Wales.

The objective of the Cowra model was to move people from welfare to work and to ease the burden and risk of business expansion in the short- to medium-term. The model presented a simplified example of how tax credits could assist both businesses and the Commonwealth Government to encourage regional development by stimulating distressed communities and reducing welfare outgoings. The creation of jobs, both within the communities and throughout the region, provides the foundation on which residents can become economically self-sufficient and communities can revitalise themselves (Delaney 2000).

The Cowra model only considered the effect of an economic incentive (tax credit) on aspects of the business and Commonwealth Government receipts and payments including:

- Centrelink payments
- income tax
- company tax
- Goods and Services Tax (GST)
- job network training (long-term unemployed placement payment).

The model proposed that the enterprise zone be administered through local government and therefore also considers the effect of a local government administration fee.

Assumptions of the Model

The Cowra model proposed a tax credit to businesses that employ individuals previously on welfare payments. The incentive to the business was assumed to be a tax credit for 75% of new employee's wages in the first year (decreasing by 20% of the original amount for each subsequent year of employment, so that in the sixth year no wage credit is given). In addition, an administration fee of $10,000 would be paid by the Commonwealth Government to local government in the first year.

The model was based on the case of one hypothetical business in the Cowra Shire. The figures used to represent the business situation were developed by Cowra Shire Council in consultation with local manufacturing firms. The business was assumed to have an initial staff of 20 employees, turnover of $2.6 million per annum and costs of $2,358,600.

As a result of the enterprise zone scheme, the firm employs three additional people, all of whom were receiving Centrelink payments (Newstart Allowance). Two of the new employees were assumed to be long-term unemployed and part of a couple. The other was unemployed and single. Upon recruitment by the firm, the new employees are paid a wage of $31,000 per annum, net of 9% superannuation.

As a result of employing the three additional employees, the firm is assumed to become more productive, with a sales increase of 10% of initial sales revenue in the first year of employment and a further 5% in the second year of employment to a total increase in sales of 15%. Variable costs (which include inputs, freight, advertising, bank charges, computer operations, electricity, insurance, interest, packaging and repairs) were assumed to have increased at the same rate as sales – by 10% of initial costs in the first year of employment and a further 5% in the second year to a total increase of 15%.

Workers compensation insurance was assumed to be 10% of the total wage bill for the firm and hence increased in the first year of employment by $9,300. Payroll tax was calculated as 6.2% of the total wage bill for the firm (for each dollar over $600,000). The total increase in payroll tax in the first year of employment was therefore $5,766.

If not employed with the hypothetical firm, it was assumed that within three years, all three of the unemployed individuals would have found alternative employment. For calculation purposes, it was also assumed that one of the long-term unemployed would have found work in year one, the other in year two and the single person in year three.

When on unemployment benefits, the income of the three individuals ranges from $10,000 to $19,000, depending on their situation. When employed, the individual's income increases and as a result household expenditure was also assumed to increase.

Testing the Model

Centrelink payments

Newstart Allowance is a payment made by the Commonwealth Government to people aged over 21 who are unemployed. Table 1 outlines Newstart Allowance payments by Centrelink based on simple demographic information (note that these payments are subject to an income and asset tests that have not been considered in this model).

Table 1: Commonwealth Government Newstart Allowance payments.

	Newstart Allowance	
	Fortnightly ($)	Annually ($)
Single, no children	410.60	10,675.60
Single, with children	444.20	11,549.20
Single, 60+ after 9 months	450.00	11,700.00
Partnered	741.00 (370.50 each)	19,266.00 (9,633 each)

Source: Centrelink 2006

Total annual unemployment payments to these three people are $49,207.60, that is:

one employee who is single with no children ($10,675.60)
+ 2 employees who are partnered (2 × $19,266.00).

It is assumed that as a result of employment of the two partnered individuals, Centrelink payments to the couple cease.

When these three people are employed, the total savings to the Commonwealth Government is $49,207.60 per annum.

As the savings to the Government cannot be accrued perpetually, it was assumed that all of the individuals would find employment within three years. Therefore, savings to the Government were considered to be reduced to $29,941.60 in the second year (total minus one of the partnered individuals); $10,675.60 in the third year (minus the other partnered individual); and zero each subsequent year.

Income tax

In addition to savings to the Commonwealth Government on unemployment benefits, the model demonstrated that where unemployed people start working income tax revenue would also increase. Table 2 outlines individual income tax rates for the 2006–07 financial year as defined by the Australian Taxation Office (ATO).

Table 2: Individual income tax rates for the 2006–07 financial year.

Taxable income	Tax on this income
$0–$6,000	Nil
$6,001–$25,000	15c for each $1 over $6,000
$25,00–$75,000	$2,850 plus 30c for each $1 over $25,000
$75,001–$150,000	$17,850 plus 40c for each $1 over $75,000
Over $150,000	$47,850 plus 45c for each $1 over $150,000

Source: ATO 2006

As a result of the employment of these three individuals, the Government receives an additional $9,268.86 of tax revenue per annum compared to that which would have been received when these people were receiving Centrelink payments. The net increase in income tax revenue can be calculated as tax paid by the three employed individuals minus tax paid by the three unemployed individuals, as shown below:

[($2,850 + (($31,000 - $25,000) x 0.3)) x three employees]
– [(($19,266 - $6,000) x 0.15) x two employees)
+ (($10,675.60 - $6,000) x 0.15)]

Tax credits

As an incentive for taking up new employees, it was assumed in this model that the business receives tax credit from the Commonwealth Government of 75% of the total wage bill for the three new employees in the first year, decreasing each year until there is zero credit in the sixth year of employment. The tax credit for each of the first five years of employment is provided in Table 3.

Table 3: Tax credit per year of employment.

Year	Tax Credit
1	$31,000 x 3 x 75% = $69,750
2	$31,000 x 3 x 60% = $55,800
3	$31,000 x 3 x 45% = $41,850
4	$31,000 x 3 x 30% = $27,900
5	$31,000 x 3 x 15% = $13,950

The tax credit is not paid to the business but is deducted from gross profit and therefore reduces company tax paid. Specifically, gross profit is reduced by the value of the new employees' wages (as would usually occur) plus the tax credit (which is the enterprise zone incentive). The value of the tax credit each year is shown in Table 4, where the tax credit deduction is equal to *tax credit x company tax rate (0.3)*.

Table 4: Net value of the tax credit to the business.

Year	Non-Enterprise Zone Company Tax ($)	Tax Credit Deduction ($)	Adjusted Company Tax ($)
1	78,649	20,925	57,724
2	99,229	16,740	82,489
3	99,229	12,555	86,674
4	99,229	8,370	90,859
5	99,229	4,185	95,044

Company tax

The addition of three new employees was expected to increase profit to the business, therefore company tax revenue to the Commonwealth Government can also be expected to increase. However, as referred to above, the increase in company tax is offset by the tax credit and is therefore calculated as: *30% of (gross profit minus tax credit)*, as shown in Table 5.

Table 5: Calculation of company tax (with tax credit).

Year	Gross Profit ($)	Tax Credit ($)	Adjusted Gross Profit ($)	Company Tax ($)
1	262,164	69,750	192,414	57,724
2	330,764	55,800	274,964	82,489
3	330,764	41,850	288,914	86,674
4	330,764	27,900	302,864	90,859
5	330,764	13,950	316,814	95,044

Compared to company tax revenue prior to the employment of the three additional individuals, the Government could be expected to lose around $14,696 (due to the tax credit given) in the first year and then gain $10,096 in the second year, with further increases in subsequent years as a result of increased profit.

GST

The model assumed two types of increased expenditure that would result in increased GST revenue to the Commonwealth Government. These are increased household expenditure as a result of increased earnings and increased sales by the firm.

Annual household expenditure was estimated using the Australian Bureau of Statistics (ABS) 1998–99 Household Expenditure Survey (ABS 2000), inflated to the September quarter 2005 using the Consumer Price Index (ABS 2005). Table 6 outlines estimated GST revenue based on household expenditure from the Newstart Allowance and earned income.

Table 6: Household expenditure and GST revenue.

Expenditure[a]	Newstart Allowance ($)	Earned Income ($)
Annual Goods and Services Expenditure	22,509	44,260
Fresh Food and Medical Expenses[b]	2,589	4,525
Total Expenditure (including GST)	19,920	39,735
GST	1,811	3,612

[a] Expenditure by individuals on Newstart Allowance based on New South Wales average household expenditure for the lowest income quintile. Expenditure by employed persons based on the New South Wales average household expenditure for the third income quintile.

[b] These household expenditure items are GST exempt. Fresh food is assumed to be one-third of total food expenditure.

Assuming equal expenditure for each of the employees, the Government could expect an increase in GST revenue of $5,403 as a result of increased household expenditure.

Sales by the firm were assumed to increase by 10% of initial sales revenue in the first year of employment and a further 5% in the second year of employment, to a total increase in sales of 15%. Table 7 outlines sales for the first five years of employment and the GST collected by the business to be paid to the Government.

The Government could expect an increase of $26,000 in GST revenue in the first year and a further $13,000 in the second year due to increased GST revenue from sales.

Table 7: Sales revenue and GST collected.

Year	Sales[a] ($)	GST ($)
1	2,860,000	286,000
2	2,990,000	299,000
3	2,990,000	299,000
4	2,990,000	299,000
5	2,990,000	299,000

[a] Sales are net of GST.

Job network training

The Commonwealth Government pays $2,000 per registered client to Job Network providers to provide training and services to the long-term unemployed. Upon finding employment for the long-term unemployed, the Government also pays the Job Network provider between $240 and $8,000 depending on the individuals classification and time spent out of work. For the purpose of this model, it was assumed that the placement payment to the Job Network provider would be $1,000. In total, the Government was expected to save $4,000 (training fee for two long-term unemployed), but to pay the $2,000 placement fee (for the two people) to the Job Network provider.

Local government administration fee

It was proposed that the enterprise zone model would be administered under local government, hence a once-off payment of $10,000 in the first year be paid to local government for their role in the scheme.

The Effect of Enterprise Zones

The effect of the enterprise zone on the hypothetical firm and on the Commonwealth Government, is shown in Tables 8 and 9 respectively.

Conclusion

The general rationale for enterprise zones is to promote employment growth and to increase business investment. Specifically, enterprise zones can:

- promote long-term sustainability
- alleviate economic and social disadvantage
- address the structural and long-term development problems of a region
- provide social opportunities such as a good quality education and employment for disadvantaged individuals
- generate a stronger partnership with government to promote economic development.

The Cowra model illustrated the benefits for business and the Commonwealth Government that can arise from the implementation of an enterprise zone. Where unemployed people are able to gain employment, the business benefits from improved productivity and the Government is able to both reduce expenditure and increase revenues.

The benefits of an enterprise zone to business result from increased output and tax credits, which essentially increase the profitability of the business. The enterprise zone reduces the risk to the business of employing additional workers and can ensure that profitability is not threatened in the first critical years of employment where the productivity of workers may not be at its peak. The model has shown that, compared to the base case, the business can improve profitability by up to 21% in the first year and up to 38% in the first six years of employment.

The Government is also able to benefit from the enterprise zone. The benefits of an enterprise zone to the Government result from a reduction in unemployment benefits paid and increased revenue generated (income tax, GST and company tax). The model illustrated that, despite giving a tax credit to business, increased revenue more than outweighs this cost. Compared to the base case, the Government can improve their balance by up to 19% in the first year and up to 31% in the first six years.

Aside from the economic impact of an enterprise zone, the largest impact would undoubtedly be felt by the community through the intangible social benefits and flow-on economic benefits that are associated with a person moving from welfare to work. Particularly, a reduction in economic and social disadvantage within a community could also reduce policing, justice, health, medical, public housing and other welfare costs. In addition an enterprise zone model has the capacity to help those who are unemployed become more fulfilled, productive and successful Australians.

Table 8: Enterprise zone (EZ) impact: business perspective. [a]

	Base Case ($)	Employ 3 Additional People without EZ ($)	Employ 3 Additional People with EZ Year 1 ($)	Year 2 ($)	Year 3 ($)	Year 4 ($)	Year 5 ($)	Year 6 ($)
Sales	2,600,000	2,860,000	2,860,000	2,990,000	2,990,000	2,990,000	2,990,000	2,990,000
Costs:								
Wages	900,000	993,000	993,000	993,000	993,000	993,000	993,000	993,000
Superannuation	72,000	80,370	80,370	80,370	80,370	80.370	80,370	80,370
Payroll tax	18,600	24,366	24,366	24,366	24,366	24,366	24,366	24,366
Workers Compensation Insurance	90,000	99,300	99,300	99,300	99,300	99,300	99,300	99,300
Other Variable Costs [b]	1,228,000	1,350,800	1,350,800	1,412,200	1,412,200	1,412,200	1,412,200	1,412,200
Fixed Costs [c]	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Gross Profit	241,400	262,164	262,164	330,764	330,764	330,764	330,764	330,764
Tax Credit			69,750	55,800	41,850	27,900	13,950	
Adjusted Gross Profit			192,414	274,964	288,914	302,864	316,814	330,764
Company Tax	72,420	78,649	57,724	82,489	86,674	90,859	95,044	99,229
Net Profit	168,980	183,515	204,440	248,275	244,090	239,905	235,720	231,535
Difference (compared to base case)		**14,535**	**35,460**	**79,295**	**75,110**	**70,925**	**66,740**	**62,555**

[a] Employing three additional workers without the enterprise zone will improve net profit each year and in Year 6 will be identical to the enterprise zone case as shown in the far right hand column of the table. However, the tax credit has reduced the risk to the business in the first few critical years of the employment expansion and thereby increases the chance that the business will actually employ the additional workers.

[b] 'Other variable costs' include inputs, freight, advertising, bank charges, computer operations, electricity, insurance, interest, packaging and repairs.

[c] 'Fixed costs' include accountancy fees, rent and telephone services.

Table 9: Enterprise zone (EZ) impact: Commonwealth Government perspective.

	Base Case ($)	Employ 3 Additional People without EZ ($)	Employ 3 Additional People with EZ Year 1 ($)	Year 2 ($)	Year 3 ($)	Year 4 ($)	Year 5 ($)	Year 6 ($)
Payments:								
Centrelink	49,208							
Job Network	4,000							
Provider benefit		2,000	2,000					
Local government admin fee			10,000					
Total	**53,208**	**2,000**	**12,000**					
Receipts:								
Income tax	30,681.14	44,631	44,631	44,631	44,631	44,631	44,631	44,631
Company tax	72,420	78,649	57,724	82,489	86,674	90,859	95,044	99,229
GST (household expenditure)	77,679	83,083	83,083	83,083	83,083	83,083	83,083	83,083
GST (sales)	260,000	286,000	286,000	299,000	299,000	299,000	299,000	299,000
Total	**440,780**	**492,363**	**471,438**	**509,203**	**513,388**	**517,573**	**521,758**	**525,943**
Balance	387,572	490,363	459,438	509,203	513,388	517,573	521,758	525,943
Difference (compared to base case)		**102,791**	**71,866**	**121,631**	**125,816**	**130,001**	**134,186**	**138,371**

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What's Right with Enterprise Zones and the Economy Servant or Master?: Response to Paul Collits' article

Graham Apthorpe, Economic Development Manager

Graham Apthorpe MBA is the Economic Development Manager at Cowra Shire Council. He leads the Enterprise Zone Working Group for the NSW Local Government and Shires Association and is the Australian Local Government Association's representative for the current Commonwealth Government inquiry into regional business impediments. He has visited a number of Enterprise Zones in the USA and continues to research the applicability of the concept for Australia. Here he provides a personal perspective into the issues raised by Paul Collits' article 'What's Wrong With Enterprise Zones' from *Sustaining Regions* Volume 2, Number 1.

Paul Collits' article certainly contributes to the debate on Enterprise Zones but I challenge his assertion that the case for them 'ultimately fails'. Not only have overseas Enterprise Zones been a successful mechanism for twenty years both at community and political levels but they are popular in terms of regional and rural inclusiveness, providing an opportunity for distressed areas to share in the overall benefits of economic success. Interest in Enterprise Zones for Australia arises from a concern that existing policy is not helping us to move towards similar inclusiveness and achieve the economic and social indicators we desire.

My first experience of economic development work was in Narrabri in North Western NSW around twenty years ago. The local Flour Mill was closing and taking with it a dozen or so jobs. I joined a team of earnest locals attempting to influence the company to reverse the decision and we sought advice from some old hands who had been involved in decentralisation issues in the 1960s and 70s. With wisdom and experience one respected elder of the town took us aside and counselled us, advising that we were unlikely to succeed, (he was right) and that we would be travelling down a very long, hard and difficult road. For anyone involved in economic development issues in country Australia, his words were and remain prophetic. Some years later the Chairman of our Regional Development Board said on his retirement that he had hoped to be responsible for creating just one real job, but sadly in spite of his and the board's best endeavours, he had no confidence he had been able to achieve that goal. Why is it, that so many in regional and rural Australia perceive the economic development job to be so difficult and if that is a reality, can it be changed? My belief is that economic development is difficult in regional Australia, because our needs as communities run counter to the economic forces in Australia at present and in attempting to combat those forces, we have few effective tools.

Regional and Rural economic development is mainly concerned with jobs and population growth. Australia's economic structure delivers fewer commercial opportunities for regional areas than city areas because our rural and town economies lack depth. Certainly there are some successes in regional Australia where market forces have delivered some strong results, however many communities are only just surviving. The job of the economic developer is to attempt to alter the economic result within their area of responsibility, to change the natural forces of decline and to stimulate private sector job growth.

Many would paint the Government's approach to economic issues particularly those concerning regional and rural areas as laissez-faire and driven by market forces but clearly this is not the case. Governments apply certain values to their decision making and these are apparent in economic policy. Governments want sick people to get better and so they subsidise pharmaceuticals, they desire balanced media coverage and regulate media outlets. They see market benefits in regulating the numbers of taxis. Public safety and regulatory issues are best served by the independence of government. Safety nets are provided through a strong welfare system. The principal of Horizontal Fiscal Equalisation is well entrenched in Australia to ensure the equitable delivery of government services across the land. Governments make these decisions because the market will not always deliver the results society wants.

Regulatory positions and the demands of society result in government having the ability to significantly affect 'the market' but there has been a reluctance for Federal governments over a number of administrations to extend a general philosophy of intervention into the development of regional economic development policy.

It is in such a climate that local government has explored the potential of new economic development tools to change this situation. While recognising a variety of skill levels and commitment by individual councils, local government has increasingly faced the burden of job retention and population loss. In spite of some very solid relationships and some very user friendly policies from State Governments they have often lacked the power to change the overwhelming forces of centralisation and movement of business to metropolitan areas. The lack of any substantive and transparent economic development tools at Federal level which target individual businesses to encourage their expansion and to stimulate job growth (in comparison with similar regions overseas) has required many individual and ad hoc local government efforts across the nation. This is simply a waste of resources when an overlaying mechanism such as enterprise zones could be in place to greatly assist local efforts. It is a major concern to local government that Australia's value-centred approach in many areas of public and commercial life does not extend to regional Australia.

So Why Enterprise Zones?

Local Governments' interest in enterprise zones extends beyond the 'shiny new toy' syndrome. It has been a deliberate process. The concept was initiated by the Central West Regional Organisation of Councils (NSW) and then continued by a partnership between the Local Government and Shires Association of NSW and the Institute of Chartered Accountants in Australia. It has been canvassed at a number of State and National local government and accounting conferences, and included in the Australian Local Government Association's submission for the Federal Budget. Interest in this mechanism resulted from the belief that the current economic structure is unlikely to deliver the results needed in country Australia and allow these areas to capitalise on its resource base. Few believed that this could be achieved by just a positive attitude, by hype, talking the areas up, promotions, glossy brochures and promotional CDs and web sites. It was more likely to be achieved by making regional areas an attractive investment proposition with some levelling of the playing field, recognising that the market generally delivers lower profitability from regional areas. The private sector must be convinced that it can make a profit in a regional area, equal to a city location.

Value-centred economics can change that situation and can install a regime which recognises the differences between city and country and put in place a range of incentives (many tax based) which reduce risk and reward success. By foregoing tax, and transferring part of those payments already made to employment agencies and welfare recipients, to businesses when they create jobs, we could substantially increase jobs, reduce the welfare bill and increase taxation revenues via GST, PAYG and Company taxation. It is a very low risk policy option for government as no jobs means no incentives and there is no massive injection of funds required.

Paul Collits identifies that development is typically lumpy and inequalities are accepted as normal. This may be an acceptable notion between economists but the argument is difficult to sustain in a country hall when addressing real people who may have lost their jobs. The choice for governments in the many situations found in regional areas lies somewhere between the extremes of evacuation and abandonment or massive subsidies to keep them alive! New ways of stimulating economies which have potential to expand should be found. The States have some excellent programs for regional development but still have payroll tax. The Federal Government does not have similar regional policies equivalent to those (non-subsidy) policies found in the USA, Ireland, UK and Europe.

Many working in economic development contend that Australia needs to expand its options for regional areas not limit them and the present situation of each local government authority and regional group trying to find its own solutions is wasteful. The USA's rural areas face similar difficulties to those in regional Australia but they have the tools to stimulate private sector job growth at local level. In the USA, action can be taken by rural communities in the knowledge that they have something substantial to offer the private sector on a reward for success basis. In its simplest form a business in an Enterprise Zone funds itself. It assumes the risk of expansion, of new investment and of job creation on the basis that the business will be expanding. It does so on the basis that if it achieves what it sets out to do it will be rewarded by paying less tax on the growth component than it would if it was not in a zone. The tax credits are used to offset tax liability as and when needed and cannot be 'cashed in'. To claim then that Enterprise Zones require massive government expenditure is incorrect. The issue of upgrading infrastructure in rural areas is another matter complementary to the regional economic development debate but independent of the way in which Enterprise Zone mechanisms work.

Local Government does not believe Governments should do it all but neither does it believe that the market will deliver equity to rural areas...in fact it is unlikely to ever do so. We need an integrated approach with the three levels of government and communities working within a system which is transparent, simple and substantial. For too long economic development has been a conversation within public and academic circles about trying to place order over the private sector. As public authorities our best results for private sector job growth will come from creating a climate which reduces risk but encourages risk taking.

Paul Collits raises concern in respect of Constitutional issues. Advice by Special Counsel obtained for the Local Government and Shires Association of NSW/ICAA report sees no impediment to Enterprise Zones being created in Australia and that the High Court would be unlikely to recognise a challenge to them. Informal advice by the Federal Attorney General has confirmed this understanding.

Enterprise Zones, Empowerment Zones, Renaissance Zones, Business Migration Zones are various names for a range of interventionist programs designed to recognise disadvantage and attempt to correct it by assisting those areas to participate in the economy as a whole. Both the USA Embassy in Canberra and other agencies in the USA have over a number of years, assisted local government's interest in Enterprise Zones. The European Union Embassy also has been generous with its time and resources. We have been advised that severe economic differences can lead to embitterment in the USA's rural areas and Enterprise Zones have that fact as a consideration. Likewise the EU bears in mind that regional disparity does not bode well for Europe as a whole. Most western democracies have mechanisms similar to Enterprise Zones; Canada, Australia and New Zealand being the exceptions.

Numerous studies have been undertaken over the years to investigate the success of Enterprise Zones. In 1995 UK's Enterprise Zones program was reviewed (PA Cambridge Economic Consultants 1995) and among other matters, it was found that 58,000 jobs had resulted directly from the zones with considerable additional economic activity having been generated. Standard and Poor's (1997) reported that the creation of empowerment zones in the USA, along with other economic development tools, can assist areas to move towards their economic goals. The Californian Trade and Commerce Agency (Hatamiya 1999) reports that its program is a success and since the designation of the first Enterprise Zones and Economic Incentive

Areas over 12 years ago, they have contributed to the creation of over 88,000 jobs. A study of Colorado's experience (Alm and Hart 1998) shows that Enterprise Zone programs have had a positive and significant impact on both employment growth in target areas and the level of per capita income. A study undertaken by the USA Department of Agriculture (Reeder 1993), while recognising that some areas may not benefit from interventionist methods, nevertheless concludes that Enterprise Zones have been effective at stimulating economic development. Beck (n.d.) points out that State Enterprise Zones have experienced growth and that zones had more businesses operating than prior to designation, taking into account natural growth factors. Dr. Karen Mossberger (2000) notes the emerging consensus over the positive effects of tax incentives via Enterprise Zone programs on business location decisions and Timothy Bartik (1991) concludes that state and local policies can significantly affect the long-run level of business in a local economy.

That Australia has not used the successful methods utilised overseas for a number of decades in most western democracies is a concern. Enterprise Zone type mechanisms are conspicuously absent from Australia's economic development tool box. We have held on to outdated notions of communities 'visioning their futures' and tinkering at the edges and reacting when major regional employers close down. There has been little passion for new directions, little political momentum and little new thinking. Much of what is held up as regional policy consists of a changing regime of grants which pits community against community for limited funds. Where is the integration between Local and State regional economic develop policies and where are the Federal policies? Where is the National plan for Regional Australia? How much more motivated would our regional and rural areas be if they had a Federal Government committed in the same way as the US State of Oregon with its preamble to its Enterprise Zones legislation:

> The health safety and welfare of the people of this state are dependent upon the continued encouragement, development, growth and expansion of employment, business, industry and commerce throughout all regions of the state, but especially in those communities at the centre of or outside of major metropolitan areas for which geography may act as an economic hindrance. There are areas in the state that need particular attention of government to help attract private business investment into those areas and to help resident businesses to reinvest and grow and that many local governments wish to have tax incentives and other assistance available to stimulate sound business investments that support and improve the quality of life.
> Oregon State 285B.665 (2001)

With such a philosophical approach appropriate economic tools would necessarily follow!

Enterprise Zones may not be a perfect solution for regional Australia but there is significant interest in them as an effective adjunct to existing regional economic development policy. Communities, which have identified opportunities, will be able to present themselves for designation as an Enterprise Zone and if successful will then have a mechanism available for the private sector to take those regional opportunities forward. It seems a reasonable response by government to provide the Enterprise Zones mechanism as and where it is desired especially if government is genuinely committed to communities being responsible for their own futures.

Historically local government has been hamstrung in its ability to interface with and influence the private sectors' investment decisions. Local government is at the coalface of economic development issues and while Australia does not yet have Enterprise Zones many in regional Australia are working toward that goal. Perhaps Roy Green's observations from 1991 as editor for *Enterprise Zones – new directions in Economic development* are of interest to us now 'From the outset, many promoters of the enterprise zone concept offered that it was but one experimental approach to tackling the seemingly entrenched and complex problems posed by local and economic distress' (Green 1991, p. 2). A decade later Enterprise Zones have moved past the experimental stage to become an entrenched and recognised tool for regional areas. Perhaps by accepting that our problems in regional Australia are also entrenched and then considering the evidence for Enterprise Zones, Australia might find a valuable tool that will change that fundamental flaw. What we have now, as far as policy, seems certain to perpetuate regional and rural Australia's existing divergence from acceptable social and economic benchmarks.

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