

Enterprise Zones: British Origins, American Adaptations

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The remit of this paper is impossible to achieve. It is first to distil the British experience in pioneering Enterprise Zones, and then to draw the lessons for American legislation. But the experience of the British Enterprise Zones is too recent and too incomplete; while the American legislation is still in a state of complete flux. So in a sense, for the purpose it is the worst of times; but, insofar as the article may appear in time to contribute to the American debate, it is also the best of times.

The Origins

My credentials for writing it are simple: when in March 1980 the British Chancellor of the Exchequer, Sir Geoffrey Howe, announced that his government would be creating Enterprise Zones, he graciously referred to me as author of the idea. This is perhaps open to debate. The fact was that in June 1977, at the annual conference of the Royal Town Planning Institute, I was asked to discuss some possible solutions to a problem that Britain shares with the United States: the decline of the larger, older inner city areas, which has now reached precipitous proportions. I looked at some standard answers: inject science-based industry, develop services, encourage tourism. But at the end of this review, I concluded pessimistically that none of the standard recipes could perform the miracle for the worst problem areas.

The most important problem here is one of mismatch: for the most part, the new growing activities require skills and educational capacities that the inner-city resident lacks. Britain, like America, has its growing problem of an urban underclass – though there, this class is not exclusively or even mainly composed of minority groups. The fact is that this group once could offer capacities – of brawn, of muscle – that have been displaced by capital equipment; in the age of the container and the fork lift, they are no longer needed. Yet, in just those industrializing countries to which both Britain and the United States are losing ground, the equivalent people can still find work.

The reason, it was argued, is that there they have not priced themselves out of a job. There would be a price at which the supply of labour, and the demand for it, would meet – but it is lower than the minimum legal price in the advanced industrial countries. An argument thus emerges: that we need to create, experimentally, a new kind of enterprise in our countries: a low-skill, low-wage, but highly innovative kind of economy that competes successfully with the newly industrializing countries on their own terms. It might be argued that this solution would create 'bad jobs'. But they are bad only in comparison to good jobs that are not – for these groups – a practical proposition. They are good jobs in comparison with the unemployment line – and that is the true comparison. Further,

as the evidence of the Asian nations clearly shows, they will rapidly get better, as the firms and the workers advance up the skill and learning curve.

Therefore, the answer might be to accept the fact. We should look to the model provided by the real economic success stories of the 1960s and 1970s – Taiwan and Korea, Hong Kong and Singapore. We would try to recreate, in selected areas of British cities, the same spirit of unbridled enterprise that has characterized those economies.

That would entail what I called a Freeport solution. Small, selected areas of cities would be thrown open to all kinds of initiative, with minimal governmental interference or control. The experiment would involve – so I argued – three main features. I want to stress these, because I feel that they are all essential to the success of the plan.

The first is the most obvious, and the one that everyone has noticed about the Enterprise Zone idea in its various forms: maximum freedom and minimum restriction. But I believe that if one accepts this, one should accept the logical consequences: such as area must be, for practical purposes, outside the limits of the parent country's legislation. Free zones, I argued in 1977, should be free of United Kingdom taxation, social services, industrial and other regulations. Bureaucracy would be kept to an absolute minimum; so would personal and corporate taxation. Trade Unions would be allowed, as in Hong Kong, but there would be no closed shops. Wages would find their own level.

It follows that in an important sense, such zones would be outside the effective economic territory of the parent country. Logically, they would be outside exchange and customs controls. All goods would be imported and sold free of duties and indirect taxes. In other words, such zones would be complete Free Trade Areas.

The further logical consequence of this would be free movement of labour and

capital. Completely free movement is of course not possible; even Hong Kong has had to move to stem the flow of people out of China. However, there is one essential feature of the scheme as I saw it, and that is the free movement of capital – and with it, entrepreneurship. One of the most important ingredients for the success of the whole plan, in my view, is that it encourages the rapid growth of an indigenous entrepreneurial class, so as to try to guarantee that growth will be self-sustaining. This is the most important lesson we can learn from the success stories of the Far East, and it is a point to which I shall return.

Finally, residence and work in the area could be based on choice. Since the special arrangements for the areas would effectively put them outside the United Kingdom, I suggested that they be administered as a British Crown Colony or Protectorate, on the Hong Kong model. Existing residents – who would be few, since the areas would be deliberately delimited in derelict and virtually depopulated places – would be free to stay or leave. But if they stayed, they would do so on the terms of the new territory: lower taxes, but fewer benefits.

I stressed that since such a model would present an extremely last-ditch solution to Britain's urban ills, it could be tried only on a very limited scale. It would be most appropriate for an area of a city that simultaneously faced extremely grave problems of economic decline, and of physical dereliction. But it should be tried as a unique economic experiment. The acid test would be whether such an area could emulate the Newly Industrializing Countries with their remarkable record of sustained and rapid growth through native entrepreneurship.

The British Zones in Practice

How do the British Enterprise Zones, as introduced by Mrs. Thatcher's government – and now eleven in number – accord with

this model? The obvious answer is: only in part. They have a tax holiday, in the form of a remission of local property taxes; the loss to local revenues will be made good by a grant from the central government. They have reduced capital gains taxes. They have a 100 per cent allowance against corporate income tax for commercial and industrial buildings. They also have a bonfire of controls – but not, notice, all controls. Zoning and planning regulations are reduced to the minimum – but they are not entirely abolished. But all kinds of national environmental and safety regulations remain in force. Further, the Enterprise Zones do not have Free Port status – though arguments are still taking place about the possibility of granting that status to certain zones. Most importantly and most emphatically, they do not have what was, in my view, perhaps the most important feature: the deliberate encouragement to outside entrepreneurs to come in and establish new businesses in the zone.

So, in many ways – despite the reputation of Mrs. Thatcher's government for conservative radicalism – there is nothing very radical about the Enterprise Zones. The worry is that in practice they will not achieve very much, and what they do achieve will be counter-productive. Unless they genuinely encourage new enterprise where no enterprise existed before, then it seems to me that they will be failures by definition. And what they may easily do is to attract footloose industry to locate just within the Enterprise Zone boundaries, taking it away from areas that are almost as deserving just on the other side of the line.

Economists will see a problem with this argument. If the result of the Enterprise Zones is to allow factors of production to be used more efficiently to produce higher returns, they will say, they are good in economic terms. The problem is that they may not have this effect. If they encourage industry to locate in places which are poor in other locational attractions – in places

with weak transportation links, or with high infrastructure costs, for instance – then the result could be economically counter-productive. At best, the advantages would be very marginal ones. The Enterprise Zones in their present form simply appear to avoid the issue of how to encourage new entrepreneurially-led growth.

The point about new entrepreneurial growth is vitally important, because the evidence is that it is this that disproportionately creates the new jobs. David Birch's remarkable research (Birch, 1980) indicates that in the United States, new jobs are created disproportionately by new, small firms. Indeed, were it not for these small firms, America's economic problems would be much worse than they are – for the larger firms tend to shed jobs, not to create them. More accurately, the job growth comes from firms that have reached a modest size threshold and are taking off to a new threshold – in other words, they are no longer small infant industries, many of which indeed die in infancy, but rather children growing into adulthood.

Birch concludes that the job generating firm tends to be young – though not brand-new. It tends to be small. And it tends to be dynamic – even volatile, for in the process of growth it may sometimes appear to contract. In other words, says Birch, it is the kind of firm that frightens bank managers and bureaucrats.

The Birch study has excited a great deal of attention in Britain – from politicians and from bureaucrats in the Department of Industry, in particular. For the small, dynamic firm is weakly developed in Britain compared with other nations – and in particular, compared with the United States. Birch argues for the United States that the different economic performance of regions and cities is closely related to their capacity to generate new small firms. Similarly, the notoriously poor economic performance of Great Britain could be related to the lack of this capacity.

The Relevance for America

As said, it is altogether too early to judge the success or otherwise of the Enterprise Zones in their homeland. But it is possible to speculate on their relevance for the United States, and then to discuss on some considerations that might lead to success or failure there.

First, as to relevance. America, evidently is now beginning to display many symptoms of what has been called the British Disease. Indeed, many facts that are now being attributed to the world recession – the high unemployment in some basic industries, the dismal profit record – should more properly be ascribed to a much more insidious *structural* change, whereby American industries progressively fail to compete successfully with their overseas counterparts.

There are however significant differences. Both the British and the American economies have areas of strength, and areas of weakness. But overall the strong part of the American economy is far bigger, as a proportion of the whole, than is that in Britain. America has the burgeoning industries of the Sunbelt: a wide range of consumer products in the Piedmont South, tourism and aerospace in Florida, aerospace again in Texas, energy-related developments in the Mountain West, aerospace and – above all – electronics in California, aircraft in the Pacific North West. The British economy has little to show in comparison. However, the geographical distribution of these strong areas is highly significant, and no one in the United States needs reminding of it. They are overwhelmingly in the Sunbelt – while the weaker sectors are concentrated in the Frostbelt of the Eastern Seaboard and the Mid-West.

This is no accident. Regional economists and geographers have written reams of analysis of the rise of the Sunbelt states. They do not yet agree on an explanation. Probably the answer is that there is no one

single factor. The search for cheap, less highly unionized labour may have been one – but it does not explain more than a small fraction of the growth. Far more important was the emergence in the Sunbelt of new, highly innovative, technologically sophisticated industries embodying a very high content of Research and Development investment. Some say that it was because of Federal contracts in aerospace and defence. That might explain Cape Kennedy, or Houston Space Center, or Silicon Valley. But it does not explain Holiday Inns or Kentucky Fried Chicken. Some argue that there was conscious planning by talented and far-seeing local individuals – as in the case of Frederick Terman, the Stanford professor who encouraged his electronics graduates to stay locally after graduation and thus to build Silicon Valley. But that explains only a few of the cases. To a large degree, it seems that there was simply a 'Climate of Innovation' in the Sunbelt. People felt freer here; existing industrial traditions, older ways of doing things, didn't cramp anyone's style. The British economic historian Sidney Checkland wrote a pamphlet about the rise and fall of the economy of the city of Glasgow; he called it *The Upas Tree*. This is a tree that spread out so far that in its shade, no other living thing would grow. Checkland argued that in Glasgow, the tradition of shipbuilding was a Upas Tree, that destroyed new and promising industrial traditions almost as soon as they were born (Checkland, 1975).

The Sunbelt, happily, has had no Upas Tree. Especially where the innovation is less in technology than in organization and management, the critical factor seems to have been that the more entrepreneurial individuals – for whatever reason – were more highly concentrated in the Sunbelt. Nothing else explains the rise of new industrial empires like Kentucky Fried Chicken or McDonald's Hamburgers, or Holiday Inns or Ramada Inns, or Coca Cola or Safeway, or Walt Disney World – just a

few of scores of major corporations that have originated in the Sunbelt. The innovative record of the Frostbelt, in contrast, is miserable.

This is clearly important in understanding what has been happening to the American economy in the last two decades. But what should really concern us now is what is going to happen to it in the remaining years of this century. Over fifty years ago a Russian economist, Kondratieff, produced a remarkable discovery: that ever since the Industrial Revolution, the economies of the western capitalist countries had moved in unison, in a series of long waves. To honor great discovery, Josef Stalin promptly put Kondratieff in jail, where he died. But in the 1930s the great American economist, Joseph Schumpeter, traced out the course of the Kondratieff waves down to that time. It emerged that the whole of modern economic history consisted of a series of Industrial Revolutions: the first, from the late eighteenth century, based on cotton textiles and iron smelting; the second, in the middle nineteenth century, based on steel and engineering; the third, in the early twentieth century, based on automobiles, chemicals and a wide range of consumer durables (Kondratieff, 1935; Schumpeter, 1939).

Since Schumpeter wrote, and exactly as he and Kondratieff predicted, the world has gone through a fourth long wave. It was the wave that was based on aerospace, electronics and related industries – though, like earlier waves, it was also marked by a further expansion of industries established in an earlier cycle. According to Kondratieff, this wave should have peaked in the 1960s and have taken the world into recession in the 1970s. I leave it to you to gauge Kondratieff's gift of prophecy.

In 1979, in the United States, there was published a most remarkable book – though it has not had the attention it deserves. It is a translation from the German of a work by Gerhard Mensch, called *Stalemate in Technology: Innovations Overcome the Depression*.

With a wealth of Teutonic scholarship, Mensch shows that the Kondratieff waves were based on accumulations of innovations. Not inventions, notice: innovations are commercially usable applications of inventions, a very different thing. Mensch shows how inventions seem to pile up in history, until quite suddenly a great bunch of them get turned into innovations within just a few years. And at that point, the economy turns from recession into new growth (Mensch, 1979).

Mensch even distinguishes what he calls 'radical years' in the economic history of the modern world: 1825, 1886 and 1935. The next radical year, Mensch concludes, is actually 1984, and he also concludes that at least half the basic innovations of the fifth Kondratieff wave had been completed by the end of the 1970s.

The critical question for all of us should be: where are these innovations being made? For the whole of past economic history suggests that in each of the previous Kondratieff waves, the balance of innovatory capacity has shifted. In the first, it was firmly monopolized by Great Britain. In the second, it was shared between Britain, Germany and the United States. In the third, the United States was absolutely preeminent. In the fourth, it began to share this position with Japan – and, to a limited degree, with some western European countries. I will leave it to you to guess where I believe the innovatory leadership of the fifth wave will locate. Yes, I fear it will pass to Japan – and with that, America could begin a long slide down the British slope.

In that context, I believe, the idea of the Enterprise Zone acquires a literally vital significance. For the only way in which our nations can turn the next great innovation wave to our advantage is to manage our affairs in such a way that innovators – or, in other words, entrepreneurs – are making their innovations here rather than elsewhere. It was for precisely that reason that I called for Enterprise Zones that would

replicate, as far as possible, the conditions of successful entrepreneurship in the innovative countries of the new industrial world.

These countries are sometimes represented as havens of unrestrained enterprise. I believe that this impression is wrong. Their entrepreneurs are indeed highly entrepreneurial – but they work within a framework of quite deliberate government encouragement, to develop the new technologies and the new frameworks of organization, that will allow them to occupy the next industrial frontier.

That has been the lesson of Japan – the nation that has pioneered this approach. American experts who have studied the Japanese success story, such as Herman Kahn and the Harvard sociologist Ezra Vogel, all stress the importance of the extremely close cooperation there between government bureaucrats and business leaders. The difference as compared with Great Britain and the United States is this: that in Japan the two sides work cooperatively, for the greater good of Japan Inc. Government supplies the basic research that identifies the next innovatory frontiers; it then pumps money into the early, more fundamental stages of research, that would be too costly and too risky for individual firms to undertake. Thereafter, it is up to the individual entrepreneurs to undertake their true function: to turn invention into commercial utilizable form.

That is the lesson now being copied from Japan by its newly industrializing neighbours: by the Republic of Korea, by Taiwan, by Hong Kong, by Singapore. These models are not identical. Some – Korea and Singapore – have a greater element of governmental planning, some – Hong Kong – less. All however tend to base their policies on a considerable degree of freedom to entrepreneurs to take decisions, coupled with a low degree of outside regulation and interference. Most tend to inject governmental spending in the form of economic infrastructure – especially through the

planning and development of industrial estates – and also social infrastructure, in the form of public housing, schools and hospitals. These, it should be stressed, are in no ways inimical to the success of the Enterprise Zone concept.

I suspect that within the next twenty years, we shall see an even more remarkable experiment of this kind. For there is emerging evidence that Mainland China, also, is rapidly developing its own version of the Enterprise Zone concept. In Canton, close to the Hong Kong border, it is laying out giant new industrial areas. You may be sure that the workers in these factories will be Chinese but that much of the management and virtually all the entrepreneurship – at least in early years – will be imported from outside. For the Chinese, with their traditional wisdom and willingness to learn, have already seen the success of the Japanese model in its homeland and outside – and they want to be the next in line. When they are, then the United States – and indeed the whole industrialized world – will face an economic challenge which will be mind-boggling.

We need to learn this lesson too – and rapidly, if Armageddon is not to overtake us. The task is to replicate the kind of business culture that thrives in the burgeoning new industrial zones of eastern Asia. Some may say that this involves a huge task of social remodelling – that we need painfully to reshape our values, to bring them closer to those of what Herman Kahn call the Confucian culture. Even if we determine that this is what we desire as a society, it is a job that looks like taking several hundred years – and we almost certainly do not have that long.

Let me stress again, also, that the problem has a strong geographical dimension. Put California or Texas on their own, and they almost certainly will count among the new industrial giants. The problem is our political responsibility for places like Pittsburgh and Detroit – or, in Britain,

places like Glasgow or Liverpool. They cannot lightly be abandoned – though I think that in both our countries, we may have to accept a much greater flow of people out of such cities and regions, into the places where entrepreneurship is providing new opportunities. It is in the older, the declining cities and regions where the Enterprise Zone concept must have its major relevance.

I need not say that such a prescription will not be popular. The very restrictive Enterprise Zone concept now developed in Britain has itself been attacked on the ground that it will introduce Asiatic sweatshops into that country, and will erode the hard-won rights of the workers. How that could be true, if the zones are to be introduced on a restrictive and experimental basis, I do not know.

Of one thing, however, I am certain. It is this: that we now need some radical experiment to bring our nations back into the front rank of innovative economic development. That effort must be concentrated in those regions and those cities where the entrepreneurial tradition is now weakest, and where therefore it is most in need of stimulation from outside. And that objective should be the first objective of any western government in the fraught circumstances of the 1980s.

The American Initiatives

It is difficult to sum up the American initiatives, because they are so many and varied. But it already seems clear that the various models of Enterprise Zone now being discussed in the United States differ in material respects from the British experiment.

First, as Dr Stuart Butler of the Heritage Foundation has pointed out, they are seen primarily as an instrument to revitalize decaying or decayed urban neighbourhoods. The Kemp-Garcia bill currently before congress even specifies that a mini-

mum of 4000 residents be located in any designated zone; and most of the incentives offered to businesses would go also to low-income housing.

Secondly, there is a specific concern to aid emergent small business. This arises in part from the important research findings of Dr. David Birch of MIT, which have indicated that two-thirds of all new jobs created in the United States originate from firms with twenty or less employees. But, he also found, the rate of job creation in depressed urban areas is much lower than elsewhere. To deal with this problem, the legislation proposes not only the removal of bureaucratic and regulatory obstacles to development, but also financial incentives that are particularly geared to small business creation – including accelerated depreciation and tax credits for both employer and employee that are refundable: that is, if the credit exceeds the firm's tax liability, then the Treasury will pay the difference to the firm. There are also more conventional incentives in the form of remission of capital gains tax and a 50 per cent allowance against tax for income or interest derived from an investment in the zones.

In important respects, therefore, the American Enterprise Zone concept is different from the British one. I personally believe that in most of these respects it is potentially superior. The critical test of the Enterprise Zone idea is whether it really generates new enterprises that in turn provide new jobs, and I believe that the American prescription is more likely to do so than the British one. Further, since there is likely to be state as well as federal legislation, there is every chance for interesting policy variations that can be evaluated in practice.

However, some words of caution may also be needed. First, the emphasis on minimum residential populations could mean a considerable amount of physical disruption in local neighbourhoods if the idea proves successful. I would personally

prefer a specification that the zone be close to, but not physically within, such a residential neighbourhood.

A second and related question is whether, if the zone does develop as expected, land and real estate values will not rise, thus displacing the very people the policy is intended to aid. Dr. Butler has suggested that this might be overcome if local residents themselves, through community organizations, could share in the increase in values. Since currently values in such areas tend to be very low, this need not involve a massive cost to the public purse. It certainly is an idea very well worth exploring.

A third question is whether the new enterprises, if they do take root, will really provide many job opportunities for deprived local residents or whether they will draw their labour force from outside, leaving the locals as unemployed and as deprived as before. It is difficult to answer this question in general terms because that will depend on the supply of and demand for specific industrial skills.

The answer is however clearly related to a fourth topic, that is one of the more potentially controversial aspects of enterprise zone legislation: the question of whether minimum wage laws should be suspended there. My own position is that provided the enterprise zones were reasonably limited in number and extent, so that for instance they formed only a relatively small part of a city or a metropolitan area, the suspension of minimum wage laws would create an interesting socio-economic experiment that should be tried. In these conditions, no one need suppose that workers were being forced *en masse* to take jobs at less than the minimum; they would do so only if they thought it worth their while. But probably, this experiment should apply only to young workers who are most prone to be unemployed, and who are also least likely to have family responsibilities.

Lastly, there is a question of whether the

Enterprise Zones will succeed on their own, or whether further measures will be needed. I myself believe that other complementary policies will need to be developed, particularly in the areas of training and financing. But they could be developed without excessive burden on the public purse, through a combination of tax remissions and arrangements with local finance institutions. This indeed may be the field in which most further thought will be required.

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