ENTERPRISE ZONES: NEW DEAL, OLD DEAL, OR NO DEAL?

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I. Introduction

The purpose of this paper is to examine some of the salient features of the concept of enterprise zones, especially those aspects included in the administration's plan, in an effort to predict the actual outcome of this policy proposal if it is enacted and implemented. Even though the concept of enterprise zones is advertised as a new approach, a central part of our argument is that in terms of its incentives the proposed legislation basically is similar to previous programs. In fact, we argue that the present legislative proposal may be viewed best as a combination of selected features from previous programs rather than as a logical extension of the original ideas for enterprise zones. In making this observation, we distinguish between the rhetoric surrounding the legislative proposals and the actual initiatives. The current rhetoric has the appealing ring of free-market ideals. The actual legislative proposal backs away from the original ideals and retains the features of previous programs. Accordingly, the lessons learned from those previous efforts at the federal, state, and local levels provide important insights as to the expected impacts of the Enterprise Zone Proposal.

A central idea of the Enterprise Zone Proposal is that depressed areas can be rejuvenated by creating a climate which encourages economic activity. According to Stuart Butler, author of the major scholarly book in America endorsing the concept, Sir Geoffrey Howe,

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who attributes the basic idea to Peter Hall, was the major architect of enterprise zones in Britain.[1] The zones are supposed to be areas in which economic freedom is maximal and the forces of the market are to be unleashed. The basic notion is that economic activity is to be stimulated through the provision of incentives.

There have been differences in the various conceptions of enterprise zones. Peter Hall seems to emphasize entrepreneurship and especially young businesses. Sir Geoffrey Howe and the British legislature appear more willing to accept extensions of existing businesses. The administration's proposal, as opposed to the rhetoric associated with it, does not make a distinction between newly created and existing businesses. The major incentives included in the Reagan proposal are: relief from regulation and relief from taxation. However, to our knowledge, none of the various versions of the Enterprise Zone Proposal, British or American, involves total relief on either score.

Although basic underlying philosophical premises may be quite different, many previous domestic programs have operated by providing incentives. Some have provided tax incentives while others have provided direct subsidies. There is a clear relationship between tax incentives and direct subsidies in terms of the monetary impact on firms. The point is that previous and existing programs which operate with incentives provide experiences and evidence from which it is possible to draw inferences about the operation of enterprise zones. Major parts of this paper are devoted to summarizing some of the experiences of salient aspects of previous programs and attempting to apply some of the lessons from those programs to the current proposal for enterprise zones.

II. The Administration's Proposal

The administration's Enterprise Zone Program has two basic objectives. The first is to create jobs, with an emphasis upon disadvantaged and chronically unemployed workers, in the nation's depressed areas. The second objective is to redevelop and revitalize the designated

[1]See Stuart M. Butler, *Enterprise Zones: Greenlining the Inner Cities* (New York: Universe Books, 1981). The introductory statement prior to the first chapter outlines Sir Geoffrey Howe's basic conception. This book is a major exposition of the associated ideas. See also Peter Hall, "Enterprise Zones: British Origins, American Adaptations," *Built Environment* 7 (1981): 5–12. See also Susan S. Jacobs and Michael Wasylenko, "Government Policy to Stimulate Economic Development: Enterprise Zones," in Norman Walzer and David L. Chicoine, eds., *Financing State and Local Governments in the 1980's: Issue and Trends* (Cambridge: Oelgeschlager, Gurin and Hain, 1981), pp. 175–201.

areas. While these are both popular and worthy objectives, they are not necessarily consistent if recent history is taken as a guide. Experience suggests that *successful* revitalization efforts often result in displacement of low-income households without creating great numbers of primarily low-skilled jobs. The program aims at stimulating private sector economic activity within the zones with a special emphasis on low-skilled jobs, which although laudable in its aims, probably works against the current of successful revitalization experiences.

Although there may have been a philosophical preference for entirely new and entrepreneurial economic activity, the program recognizes and welcomes any private sector economic activity that might be attracted to the designated areas. The reason for this concession may be a recognition of the administrative difficulties that may be encountered in any attempt to distinguish between entirely new and relocated economic activity.

At the federal level, the program does not require any new appropriations. However, state and local jurisdictions are free to allocate their discretionary federal funds to enterprise zones or to appropriate any additional funds to the zones. Basically, the program intends to provide: relief from federal, state and local taxes; regulatory relief at the same levels of government, although relief from federal regulation is constrained; improved public services; and private sector, local, and neighborhood involvement in the program.[2] Presumably, the program will be influenced greatly by the way it is administered and especially through the process of designating areas to become enterprise zones.

In addition to insuring that state and local contributions are to be made towards the above features of the program, the designation process itself is supposed to be governed by criteria which are designed to help insure that: (1) efforts be made to improve the "infrastructure" of the area and provide such things as job training or activities which might reduce business insurance costs; (2) disadvantaged workers and those suffering from long-term unemployment be available within close proximity of the zone and that job opportunities for these workers be available in the zone; (3) private entities make commitments to the zones; (4) efforts be made to help insure that new economic activity is stimulated; and (5) other conditions be satisfied which might be determined by the Secretary of Housing and Urban Development, which are consistent with the intent and philosophy of the

[2]*The Administration's Enterprise Zone Proposal* (The White House: Office of the Press Secretary, March 23, 1982), p. 3.

Enterprise Zone Program, and which might help minimize the unnecessary loss of tax revenues to the federal government.[3]

Aside from the administration of the program, which presumably will be conducted in accordance with the above criteria, the federal contribution is largely limited to the provision of special tax credits. This characterization appears to be valid since federal regulatory relief is provided only by discretion, and the set of regulations that can be relaxed is limited significantly. This restricted use of regulatory relief diverges from the basic concept of enterprise zones.

It may be that Sir Geoffrey Howe was initially as much interested in the adverse effects of regulation and other bureaucratic procedures on business activity as he was in taxation. Certainly, the early discussion by Peter Hall and others emphasized a reliance upon free enterprise and stressed the possibility that the regulatory bureaucracy may have "run amuck," thus effectively stifling the private market. For example, Hall summarizes his proposal by stating:

> 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.[4]

In other words, Hall had in mind not only tax incentives but the broad relaxation of regulations, including minimum wage requirements.[5]

It would be difficult to deny at least a widespread belief among businessmen that the absence of regulation might have a positive effect upon their plans. However, perhaps for valid political reasons, the administration chose to back away from the notion of removing regulatory constraints by proposing that discretionary authority to relax or eliminate regulations within enterprise zones be given only at the request of state and local governments, and that regulations affecting civil rights, safety, and health (including possible environmental matters), as well as those specifically imposed by statute such as minimum wage requirements, be exempted from the act.[6] However, state and local governments are encouraged to provide relief from their own regulations. In fact, the relaxation of state and local

[3]Ibid., p. 5.

[4]Hall, p. 6.

[5]Hall also stressed the free movement of labor and capital, and placed a special emphasis on entrepreneurship and the creation of new enterprises.

[6]*The Administration's Enterprise Zone Proposal*, p. 15.

regulations is among the items administratively considered in the selection of enterprise zones.

The contribution from federal tax "expenditures" includes the following: (1) an investment tax credit of three or five percent for capital investments in the zone and a credit of 10 percent for the construction or rehabilitation of commercial, industrial, or rental housing structures within the zone; (2) a 10 percent non-refundable tax credit for employers for payroll paid to qualified zone employees up to a maximum credit of $1,500 per worker; (3) a non-refundable tax credit for employers for wages paid to zone employees who were also disadvantaged individuals when hired; (4) a five percent non-refundable income tax credit for taxable income earned in zone employment (up to a maximum of $450 per worker) for zone employees; (5) the elimination of capital gains taxes on the sale of qualified zone property; (6) the continued utilization of industrial development bonds for small businesses within the zone; and (7) the provision for operating loss carry-over.[7]

Clearly, these provisions of the program are intended to be incentives to stimulate private-sector economic activity. Essentially, the program amounts to special incentives for designated areas. It should be analyzed in light of these incentives.

III. The Relevance of Experience from Other Programs

If the philosophy behind the Enterprise Zone Program is different from previous efforts to create jobs and revitalize urban areas, and the rhetoric certainly contrasts with that associated with other programs, then how can the experiences of those previous efforts provide any guidelines for evaluation? The answer lies in the similarities of the components of the Enterprise Zone Proposal to the components of previous programs.

Previous federal, state, and local programs have been designed to encourage economic activity, revitalize deteriorated urban areas, and create jobs. Some programs have provided tax concessions while others have provided direct subsidies. While the Enterprise Zone Proposal examined in this paper primarily provides a tax incentive package, previous efforts that involve tax incentives as well as those that involve direct subsidies are relevant. Both tax concessions and direct subsidies decrease the cost of doing business at a particular location. Since the expected monetary value of a tax concession may be calculated, tax concessions and direct subsidies can be compared.

[7]Ibid., pp. 6–7.

There is, of course, literature on the effects of taxation on business location. Since the federalism of the American system has provided different tax rates across many municipalities, and the idea of state and local governments providing tax incentives to encourage economic development is not new, this literature is extensive and may provide some insight as to the expected impacts of the incentives provided in the Enterprise Zone Proposal. Portions of the relevant literature are reviewed in the next section. In addition, there have been several programs designed to revitalize deteriorated sections of urban areas. There are many similarities between these efforts and the current proposal. In section five, we review parts of the relevant literature on previous revitalization programs and compare these efforts with the current proposal. Finally, there have been many previous programs designed to create jobs. There is an extensive literature on the relative merits of these programs. In section six, we examine parts of this literature in order to evaluate the expected impacts of the employment portions of the Enterprise Zone Proposal.

IV. Effects of Taxation and Fiscal Variables upon Economic Development

Businessmen are fond of saying that they are hampered by unduly high taxation. In fact, it is argued often that tax policy has an important impact on the decisions made by firms. Those who have had the experience of sitting on state and local tax reform commissions, for example, often hear business representatives espouse the view that state and local tax policies may be important for economic development. They are told that favorable tax laws or tax breaks can be powerful inducements to attracting business.

State and local governments typically have expressed considerable interest in stimulating economic development within their borders. Often these governments have utilized a wide variety of fiscal tools in an effort to attract new businesses. The tools available to these governments include industrial revenue bond financing and other state and local subsidized loans for new businesses; tax exemptions or at least moratoriums on the taxation of land, capital improvements, equipment, and even machinery; and, in some states, accelerated depreciation on state corporate income taxes.

Given our decentralized system of government, at least two experiments have been ongoing which concern the effects of tax policy upon business location and the creation of new enterprises. First, there are the special efforts made by state and local governments to attract new business activity and to promote economic development. Second, there is the natural variation in tax policy that exists among state and local governments, given American federalism. In making the intraurban location decision, for example, firms may be expected to consider relative tax burdens and public services provided by various local jurisdictions.

While there has not been much written on specific state and local programs to promote economic activity, there is an extensive literature on the determinants of business location. A subset of this literature examines the effects of differences in fiscal variables on business location. What can be learned from studies of actual business location or relocation?[8] In contrast to the rhetoric, there appears to be a general agreement in this literature that fiscal variables do not play an important role in determining business location. As an example, in his study of manufacturing firms choosing between opening new branch plants and on-site expansion of existing plants, Schmenner found that firms consider relative labor costs, availability of skilled labor, coverage of geographic market territory, transportation and logistics costs, economies of scale, and other such variables.[9] Fiscal variables were hardly mentioned. Similarly, in a statistical analysis aimed at separating the characteristics of movers from stationary plants, variables such as room to expand, marketing considerations, and labor considerations appeared, but fiscal variables did not seem to be important. Schmenner concludes:

> There seems to be an actual competition between states and between cities on which jurisdiction can devise the broadest package of tax and financing inducements: property tax holidays, property tax abatements, property tax rollbacks, state income tax breaks, sales tax exemptions, loss carry forwards, manpower training assistance, guaranteed loans, industrial revenue bonding. . . . In point of fact, however, tax incentives are either not applicable or of low concern to the typical relocating plant around a metropolitan area.[10]

Schmenner's results are consistent with most of the literature on the determinants of business location. The general conclusion of this literature is that tax and fiscal variables are generally overwhelmed by other influences upon location such as the available labor force, its quality, degree of unionization, and loyalty; market advantages and openings; transportation considerations; and availability of raw materials.

[8]There is not an overwhelming volume of literature devoted to this topic. Roger W. Schmenner, *The Manufacturing Location Decision*, Economic Development Research Report from the Harvard Business School to the Office of Economic Research (Boston: Economic Development Administration, U.S. Department of Commerce, 1978) contains an excellent bibliography.

[9]Ibid.

[10]Ibid., pp. 5–26, 5–27.

There is a tradition for the study of the location of economic activity in the public finance and urban economics literature. Much of this work focuses on the intraurban location decision. What factors are most important to a firm that is choosing among various sites within an urban area? To what extent do the relative tax burdens and various public service packages provided by local jurisdictions influence this location decision? In a recent study, Erickson and Wasylenko examine the site choice, among various suburban communities, of firms relocating in the Milwaukee SMSA. Erickson and Wasylenko conclude:

> In summary, the findings here indicate that relocating firms in all industries choose suburban sites on the basis of agglomeration economies and proximity to an available work force. Construction and wholesale trade firms seek less expensive land, while manufacturing firms tend to locate along interstate highways. Manufacturing firms also locate in municipalities in which there is a relatively large amount of vacant land, probably for convenience of expanding the plant on site at a later date.
>
> Fiscal variables do not appear to be an important factor in firms' site selection decisions.[11]

It should be stressed that this study examines only the choice among suburban communities and not the choice between the central city and suburban communities where fiscal variables may be expected to be more important.

In a recent survey of the literature on intraurban industrial location, Oakland finds little evidence to suggest that local tax policies influence industrial location decisions.[12] However, Oakland hesitates to conclude that local taxes have little influence on the location decision. He argues that since most studies have ignored other constraints placed on firms by local governments, such as zoning, it may be difficult to draw valid conclusions from this evidence. Given this concern, Wasylenko reexamined his data, excluding from his sample all local jurisdictions that zone out industry.[13] His new results suggest that local taxes have a significant impact on manufacturing and wholesale trade firms that are choosing among suburban locations. Local

[11]Rodney A. Erickson and Michael A. Wasylenko, "Firm Relocation and Site Selection in Suburban Municipalities," *Journal of Urban Economics* 8 (1980): 83.

[12]William Oakland, "Local Taxes and Intra-Urban Industrial Location: A Survey," in George Break, ed., *Metropolitan Finance and Growth Management Policies* (Madison, Wisconsin: University of Wisconsin Press, 1978). Schmenner, *The Manufacturing Location Decision*, also references much of this literature.

[13]Michael J. Wasylenko, "Evidence of Fiscal Differential and Intrametropolitan Firm Relocation," *Land Economics* 56 (1980): 339–349.

taxes remain insignificant for construction, retail, finance, and service firms.

While these results are interesting, it is still difficult to conclude that taxes have a major impact on firms choosing among sites within an urban area. Most of the literature on this topic suggests that taxes have little impact on the location decision. While Wasylenko finds some impact on manufacturing and wholesale firms, it is difficult to generalize from empirical evidence from one urban area. Zoning laws vary widely across local jurisdictions. In many cases, zoning laws are not enforced or are changed easily to accommodate business plans, especially when new jobs are involved. As a result, it is difficult to dismiss the evidence presented in most of the literature.

Finally, although the rhetoric surrounding the Enterprise Zone Proposal encompasses new business starts and a revival of small business activity, there is a real lack of solid empirical research on the conditions necessary for above-normal levels of entrepreneurial activity. Although we know that in our history various areas in the United States have been locations for significant entrepreneurial activity – Pittsburgh at the turn of the century, Boston in the post-war years, and recently the San Francisco Bay Area — there is little solid understanding of why these concentrations of activity occurred. We know of no evidence which suggests that fiscal variables might have caused these concentrations of entrepreneurial activity.

V. Evidence from Programs Aimed at Urban Revitalizations

Since World War II, there have been several federal initiatives designed to encourage economic development. The central goal of these efforts has been to revitalize the physical and economic conditions within an urban area. The Enterprise Zone Proposal represents the Reagan administration's attempt to achieve this goal. While the rhetoric and underlying rationale associated with this proposal are quite different from those associated with previous efforts, a closer examination of the components of the Enterprise Zone Proposal shows many similarities between this program and other efforts. In order to illustrate our point, we will briefly consider two other major federal efforts to revitalize urban areas—Urban Renewal and Urban Development Action Grant Programs (UDAG)—and compare these programs with the Enterprise Zone Proposal.

Under the urban renewal program, local redevelopment authorities used federal funds to buy and clear land in urban areas, with the goal of selling it at below market prices to private developers. This reduction in price was to provide the incentive for the private sector to develop particular sections of the urban area. The relative merits of this program have been studied extensively.[14] The success of the urban renewal program was rather mixed. In some cases, private developers bought the cleared land from the local authorities and successfully developed the land. In other cases, local redevelopment authorities bought and cleared land but could not interest developers in the acquisition of the land. As a result, some of the sites remained vacant or eventually were used for public facilities.[15]

The UDAG program was enacted in 1977 as the Carter administration's proposal to revitalize urban areas. The program is designed to provide funds to economically and physically deteriorated cities. In order to be eligible for UDAG funds, a city must meet eligibility criteria based on the age of the housing stock, incidence of poverty, unemployment, growth in population, and growth in retail and manufacturing employment. As part of the application for UDAG funds, city officials must present a project which involves the cooperation of the city government and private investors. In other words, before UDAG funds are provided, there must be a commitment from private investors to participate in the project.[16] This requirement of a prior commitment from private investors distinguishes the UDAG program from previous efforts under urban renewal. As a result of this requirement, the investor can influence all aspects of the project design, including the choice of location of the development site. It is this flexibility that is considered to be the major advantage of the UDAG program over its predecessors.

Since the UDAG program is relatively new, there have not been many evaluations of the success of the program. Webman examines the extent to which the UDAG program subsidized private investment in the most distressed urban areas and to what extent the program sparked new investment that would not have occurred in the absence of the program. He concludes from the evidence that more distressed areas received more of the UDAG funding, but the development activity within these areas was consistent with existing

[14]See Jerome Rothenberg, *Economic Evaluation of Urban Renewal* (Washington, D.C.: The Brookings Institution, 1967); Otto A. Davis and Andrew Whinston, "The Economics of Urban Renewal," *Law & Contemporary Problems*, Winter 1961; and James Q. Wilson, ed., *Urban Renewal* (Cambridge, Mass.: MIT Press, 1966).

[15]Jerry Webman, "UDAG: Targeting Urban Economic Development," *Political Science Quarterly* 9, no. 2 (Summer 1981): 192.

[16]Ibid.

trends. In other words, "UDAG projects build on existing locational advantages rather than attempt to create new ones."[17]

There are similarities between the Enterprise Zone Proposal and the urban renewal and UDAG programs. The Enterprise Zone Proposal is place specific—a specific geographic area rather than a specific project is designated. Thus, firms considering participation in the program must accept the location as given. In this respect, the proposal is similar to the urban renewal program. As already stated, urban renewal was an entitlement program with direct federal subsidies, while the current proposal provides tax incentives. Since the expected monetary value to firms of the tax incentives is a relatively straight-forward calculation, it is possible to compare these incentives with direct subsidies.

In order for a jurisdiction to be eligible for the designation of an enterprise zone, the jurisdiction must meet the eligibility criteria set forth in the UDAG program as well as additional criteria proposed in the Enterprise Zone Bill. However, all areas that meet the eligibility criteria are not necessarily designated as enterprise zones. The Secretary of HUD evaluates eligible applications from state and local governments and chooses among these applications to fill the available designations in a given year. Under the UDAG program, private sector commitment to the project is required before a project can be approved. The enterprise zone backs away from the requirement somewhat. While the level of private sector commmitment is one of the criteria for selection as a zone, it is certainly not a requirement for designation. As a result, a zone may be designated but not generate economic activity. The Enterprise Zone Proposal has an advantage over urban renewal in that no federal dollars are spent unless firms locate within the zone. Currently, the UDAG program is still in operation, but there is little said in the enterprise zone discussion about efforts to coordinate the UDAG and enterprise zone programs.

Finally, as noted earlier in this paper, the goal of revitalizing specific portions of urban areas may be somewhat inconsistent with the goal of generating employment opportunities for disadvantaged workers living within or in close proximity to the zone. Successful revitalization efforts have often resulted in displacement of low-income households, and there is little evidence to suggest that significant numbers of employment opportunities were provided through these revitalization efforts for these households. However, the enterprise zone package does include specific incentives for creation of low-skilled jobs. These incentives may be viewed as analogous to many of the previous federal programs on employment. We will now

[17]Ibid., p. 206.

examine the experience of some of those programs in order to begin to evaluate the expected impact of the Enterprise Zone Proposal.

VI. Evidence from Programs Aimed toward Employment

Certainly, the major instruments of the Enterprise Zone Proposal are aimed at employment. This is an area, of course, in which the nation has had considerable experience, not all of which has been favorable. We might classify previous employment programs in three categories: public sector employment programs, training programs, and programs for employment in the private sector. Most of our experiences have involved some combination of two or more of these types.

Public employment has been a very popular strategy in attempting to address the nation's unemployment problem. With the exception of what this experience might indicate about the nation's ability to put the disadvantaged to work, these programs have no implications for the Enterprise Zone Proposal.

The second type consists of training programs. There have been a variety of these. By far the most widely known and best studied is the Job Corps. Training programs vary from programs aimed at qualifying disadvantaged individuals to become members of craft unions, which is the purpose of such institutions as the Pittsburgh Plan, to programs associated with institutions such as Opportunities Industrialization Centers. The latter includes efforts aimed at particular jobs as well as general vocational training programs.[18] The literature about some of these programs raises issues which have relevance to the proposal under consideration.

Finally, there have been efforts to stimulate employment in the private sector itself. One kind of effort has involved direct subsidies, while the other has been mostly tax allowances.

Unfortunately, it is very difficult to assess the true impact of job creation programs on aggregate employment. For example, the direct subsidies to public bodies for the employment of the disadvantaged probably did create jobs. However, the impact is probably much less than the number of people supported by the program. Over time, workers can be substituted one for another. Tasks once supported by

[18]There is a host of literature which is relevant here. For a general background see, for example, Peter B. Doeringer, *Programs to Hire the Disadvantaged* (Englewood Cliffs, N.J.: Prentice Hall, 1969); G. L. Mangiern, *MDTA: Foundation of Federal Manpower Policy* (Baltimore: Johns Hopkins Press, 1968); and A. R. Weber, F. H. Cassell and W. L. Ginsberg, eds., *Public-Private Manpower Policies* (Madison, Wis.: Industrial Relations Research Association, 1969).

one budget can be turned over to those on another playroll. This substitution effect becomes of paramount importance in trying to assess the impact of the creation of employment in the private sector. Do the efforts to stimulate private sector employment simply replace one kind of worker with another? Hence, economists have been very concerned with trying to estimate the impact of the programs on the supply of labor.[19]

Even the simpler direct effects are difficult to determine. For example, do initial jobs tend to lead to continued employment or does the effect tend to wash out over time so that even the same individuals may not experience lasting impact from these programs? Further, one would hardly expect lasting impacts to be independent of particular experiences and the variety of efforts that may have gone into the employment opportunities which the programs may have created. Strategies do appear to matter.[20] Some kinds of training and support services have more direct impacts than do others. Similarly, there is a general consensus that efforts marginally to upgrade employment possibilities are more likely to be successful than efforts to change the so-called "hardcore" unemployed into productive workers. In other words, programs designed to provide relatively small movements up the occupational ladder appear to be more successful than attempts to make giant steps. Long-term impacts also appear to vary according to the characteristics of the workers. For example, gains for females in terms of job status and wage differential as a result of training appear to be more lasting than those for males who participated in Manpower Development and Training Act programs.[21]

In addition to all the above, training efforts often have effects which might not be fully anticipated or appreciated. An evaluation of the Job Corps, for example, found that not only did participants make less use of other public efforts, such as welfare and education programs, but they also tended to commit fewer crimes. Indeed, the effect upon criminal behavior was a substantial benefit, at least if one

[19]Two recent publications cover many of the topics which are addressed in the rather large literature. See John L. Palmer, ed., *Creating Jobs: Public Employment Programs and Wage Subsidies* (Washington, D.C.: The Brookings Institution, 1978); and Robert H. Haveman and John L. Palmer, eds., *Jobs for Disadvantaged Workers: The Economics of Employment Subsidies* (Washington, D.C.: The Brookings Institution, 1982).

[20]See, for example, Otto A. Davis, Peter M. Doyle, Myron Joseph, John S. Niles and Wayne D. Perry, "An Empirical Study of the NAB-JOBS Program," *Public Policy* 21 (1973): 235–262.

[21]Orley Ashenfelter, "Estimating the Effect of Training Programs on Earnings," *Review of Economics and Statistics* 60 (1978): 47–57.

believes the results of this particular evaluation.[22] These effects were in addition to observed increases in long-run employability which resulted in increased output as well as reduced antisocial behavior in later years.

There is probably a consensus that employment programs result in some substitution of low-skilled for higher-skilled workers.[23] Such an effect, of course, follows directly from a simple application of microeconomic theory, and it appears to be consistent with empirical estimates. There is controversy over the effects of wage rate subsidies and other programs which redistribute income upon the net labor supply. On the other hand, a portion (perhaps one-third) of the budget cost of an employment subsidy may be recouped by reductions in other transfer payments and by increased taxes.

There also appears to be an emerging consensus that employment programs do add jobs to those otherwise sustained by the economy. One estimate has it that one-half to two-thirds of a percentage point of reduction can be obtained in the aggregate unemployment rate by such programs without having an impact upon the inflation rate.[24] Although most of the literature on employment subsidies has focused on subsidies paid to employers, there is some evidence that subsidies to employees may be at least, and perhaps more, effective in stimulating labor supply. Both kinds of subsidies are involved via the tax mechanism in the Enterprise Zone Proposal.

All in all, this literature suggests that jobs programs do add to the aggregate employment in the economy. While there is little consensus about the effectiveness of these programs and much less consensus about the precision of the reported estimates, a good guess is that the costs in terms of either budgetary outlays or forgone revenues amounts to somewhere between $10,000 and $50,000 per job created across the range of efforts that have been observed in our experience with these programs. A large majority of the estimates range in the lower half of this interval.

The Enterprise Zone Proposal provides tax credits to firms that locate within a designated zone for every disadvantaged individual

[22]David A. Long, Charles D. Maller, and Craig V. D. Thornton, "Evaluating the Benefits and Costs of the Job Corps," *Journal of Policy Analysis and Management* 1 (1981): 55–76.

[23]This discussion largely summarizes (maybe not accurately) results reported in papers by Donald A. Nichols, "Notes on the Noninflationary Unemployment Rate"; Ronald I. Herman, "A Comparison of Employer and Worker Wage Subsidies"; and David M. Betson and John H. Bishop, "Wage Incentive and Distributional Effects," in Haveman and Palmer, *Jobs for Disadvantaged Workers.*

[24]See Nichols.

hired. Since this is a major part of the incentive package, firms with relatively low-skill labor needs may be expected to be attracted to such locations to a greater extent than firms that require highly skilled labor. The evidence reviewed in this section suggests that such credits may create new jobs. However, there is likely to be substitution in the employment mix. Thus, the net impact of these credits will be less than the number of credits claimed by firms that locate in the zones.

VII. Concluding Remarks

The Enterprise Zone Proposal has two desirable goals: the creation of jobs for disadvantaged workers and the revitalization of economically and physically distressed urban areas. The proposal was introduced amid statements that would lead one to believe that an entirely new approach was forthcoming. Indeed, the creators of the original proposals may have had something akin to libertarian ideals in mind. However, the administration's proposal appears to have been framed under influences that, perhaps understandably, seem more akin to practical politics than the original ideals. While the original concept put forth by Howe, Hall, and others proposes the designation of zones which are free from government regulation and taxation, the administration's proposal falls far short of total relief on either score. In the case of regulatory relief, the proposal backs away from the original idea of eliminating regulations in the zones, especially at the federal level. Essentially, the regulatory relief portion of the proposal boils down to encouragement of state and local governments to relax their regulations in the zones. As a result, the central component of the proposal is a tax incentive package to encourage economic activity within the zone and to create jobs.

Previous and existing state and federal programs have provided monetary incentives aimed at business location and job creation. Hence, we have attempted to summarize and review the relevant literature in an effort to use the lessons drawn from those experiences to provide insight as to the expected impacts of the Enterprise Zone Proposal.

Our review indicates that previous efforts which provided incentives for the revitalization of distressed areas do not provide evidence which creates optimism that this proposal will encounter great success. Nor do studies which examined the effects of tax and other monetary incentives on the locational decisions of enterprises cause one to believe that there will be an impressive or even significant flood of businesses into areas designated as enterprise zones. Taxes are only one of many elements that have an influence upon retained profits. Unfortunately, perhaps, the empirical evidence appears to indicate that these other factors are so much more important in locational decisions that the possible effects of observed tax differences are simply overwhelmed. Unfortunately, there is little evidence available on the factors which lead to the creation of new enterprises and nothing, to our knowledge, that links the creation of new business to tax incentives.

The evidence which is most favorable to the Enterprise Zone Proposal comes from the literature which examines the efforts to employ the disadvantaged and otherwise unemployed. Although this rather large literature documents many failures, there may be a tentative consensus that jobs programs can have an impact upon aggregate unemployment. Yet, the lessons from the literature relating to employment may not be of great comfort to advocates of the Enterprise Zone Proposal. While there may be some success on this score, the net impact in terms of the number of jobs created will be less than the credits claimed. Those that expect significant reductions in unemployment in close proximity to the zones may be disappointed.

Perhaps the greatest problem with the Enterprise Zone Proposal lies in its definition of goals. The proposal is designed to achieve at least two major goals: to create jobs for the disadvantaged and the chronically unemployed, and to revitalize economically and physically depressed areas. While these are both laudable goals, they are aimed at large and complex problems. Is it possible to pursue both goals in one program?

Finally, some supporters of the Enterprise Zone Proposal emphasize its experimental nature. There is merit to experimentation in public programs. Indeed, experimentation, especially if conducted in a carefully considered manner, may even be sufficient to support particular public programs. The logic is even more convincing when the proposed experimental programs are accompanied with associated efforts to evaluate and learn from the experiments. The evidence drawn from the above literature suggests that such a justification, rather than the promise of nirvana, would be a more prudent basis for a proposal such as the one under discussion here.

ENTERPRISE ZONES: SOME EMPIRICAL OBSERVATIONS

Wayne E. Ruhter

Davis and DiPasquale let other commentators discuss whether the administration's Enterprise Zone proposal truly reflects a "free enterprise" experiment. They also set aside the question of whether some assistance should be given to economically distressed areas. Instead they take the program at face value and offer a quantitative judgment: Experience indicates that there will be few employment and economic development results. This comment follows their empirical lead.

To support their pessimism Davis and DiPasquale marshall evidence from earlier job-creation programs. Here the existing research, fairly well-grounded in price theory, does suggest that there will be changes in employment from the proposal's wage subsidy features, but they probably will not be substantial. The effects, however, could be enhanced if the wage subsidy increases local economic development, and if the other parts of the proposal also have an appreciable effect on that development.

Considering the possibility of increased zone business activity, Davis and DiPasquale argue that previous research strongly suggests that fiscal variables do not matter significantly for economic development. They therefore conclude that this component of the Enterprise Zone proposal will be ineffective. Their conclusion, however, is questionable. In reviewing the literature, one does find many arguments that taxation does not play an important role in business location decisions. Questions arise, however, about the applicability of this literature and the evidence for its supposed conclusions. Actually, little is known about the measures of taxation's effect on

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the birth of firms—a key part of the Enterprise Zone proposal. Even less seems to be known empirically about taxation's role in the demise of firms.

The most common method of studying business location decisions has been to question company executives. The usual finding of these studies has been that state and local taxation rank low on the list of location determinants. Commentators typically have used this ordering to claim that taxation is not an important factor in a firm's choice of location. Yet when other variables have been properly controlled, these surveys often show that fiscal variables do influence site selection.[1] This occurs, for instance, when a firm has apparently chosen a region for non-tax reasons, and local tax differences become an intraregional site determinant. But even this approach to identifying tax effects on business location lacks the ability to detect the subtle adjustments commonly observed in economic behavior. It would be very surprising if local taxation and business location have the distinctive role of being outside the sphere of equimarginal principles.

Given the well-known problems in predicting business behavior from what business people say influences their decisions, surprisingly little published work attempts to relate observed local economic development to fiscal and non-fiscal variables. Noteworthy exceptions include the articles by Carlton, Erickson, and Wasylenko.[2] Although these studies generally failed to detect significant tax effects, a review of them would indicate a number of plausible explanations. Rather than attempt to treat these here, we refer the reader to Robert Newman's most recent research.[3] His study finds that differences in interstate corporate income taxes have a very significant effect on business location.

Despite Newman's evidence, the Enterprise Zone program may be a disappointment in fostering economic development. Urban development may be hampered by the risk that the lower taxes, supplemental project funding, and regulatory relief intended to attract firms to urban enterprise zones may unexpectedly be withdrawn in

[1]For example, see T. E. McMillan, "Why Manufacturers Chose Plant Locations vs. Determinants of Plant Locations," *Land Economics* 41 (1965): 239–46.

[2]Dennis Carlton, "Why Firms Locate Where They Do: An Econometric Model," in W. C. Wheaton, ed., *Interregional Movements and Regional Growth* (Washington, D.C.: The Urban Institute, 1979), pp. 13–50; Rodney A. Erickson and Michael Wayslenko, "Firm Relocation and Site Selection in Suburban Municipalities," *Journal of Public Economics* 8 (July 1980): 69–85; Michael J. Wasylenko, "Evidence of Fiscal Differentials and Intrametropolitan Firm Location," *Land Economics* 56 (August 1980): 339–49.

[3]Robert Newman, "Industry Migration and Growth in the South," *Review of Economics and Statistics* (forthcoming).

the future. A recent case in Oklahoma illustrates this point.[4] General Motors claims it located a plant there because of special tax breaks, but now faces increased taxes of $100 million following a ruling by the new state attorney general, who declared the tax reductions unconstitutional. Such reneging is more tempting the less mobile the enterprise zone businesses are. Correspondingly, the anticipation of such political opportunism can influence the type and amount of business developed in enterprise zones. A significant part of the program will be its features to inhibit such opportunism.

In announcing its Enterprise Zone proposal, the administration estimated the program's expense at $124-310 million per year initially in lost federal tax revenues. Since 10 to 25 zones will be designated annually, quick arithmetic suggests that the Treasury believed each zone will on average cost $12.4 million. Apparently the Treasury believes this measure approximates the tax receipts that will be lost as businesses move to the zones, activities that would otherwise have occurred elsewhere. Since such a move entails no net stimulation of economic activity, the estimated tax loss reflects a conservative view of the enterprise zones' potential to generate local business activity. Once we raise legitimate questions about the strength of firms' responses to the zones' proposed federal tax incentives and to the yet-to-be revealed state and local inducements, any estimate of federal tax losses can only be a rough guess. But consider a back-of-the-envelope exercise to draw out the implications of the Treasury's estimate.

Suppose federal tax breaks for enterprise zone businesses reduce average tax rates by 50 percent and that current tax rates average 25 percent. If we expect the tax loss per zone to average $12.4 million per year, this implies that on average each zone will gain about $100 million in annual business activity ($12.4 million/.125 ^ $100 million). Although this is a crude calculation, which depends on the assumed changes in tax rates, it does provide a rough measure of the prospective economic activity an average enterprise zone could experience.[5]

One intriguing feature of the Enterprise Zone proposal is that suitable zones can be designated Foreign Trade Zones (FTZs), even

[4]"Oklahoma Populist Stirs Up Bitter Fight Over Tax, Financing Breaks for Business," *Wall Street Journal*, June 29, 1982, p. 29.

[5]It must be noted, however, that this gain in business activity in the enterprise zone is assumed to be offset by a loss of business activity outside the zone. If the increase in economic activity within the zone *exceeded* the loss of activity outside the zone, tax losses would, of course, be less than the Treasury's estimated $12.4 million.

if they fail to meet existing requirements. At present FTZs are located at ports of entry within the United States and its territories and offer opportunities for businesses to reduce United States customs duties and trade restrictions. FTZs have exhibited dramatic growth in recent years, providing a useful example of how tax breaks and deregulation can be used to stimulate economic development.

Prior to 1970, however, FTZ incentives did not apparently generate the desired economic growth.[6] Thus, we must wonder about the immediate relevance of the FTZ experience for the Reagan administration's Enterprise Zone proposal. In concluding with this skeptical point, we can appreciate Davis and DiPasquale's pessimism. The lack of strong empirical evidence about the expected benefits of enterprise zones and speed with which they can be achieved, coupled with the political uncertainties about the program's implementation, must temper overly enthusiastic claims for immediate measures of the program's success.

[6]FTZs have existed since 1934.