A Special Economic Zone in Northern Australia

Introduction

There is an increased global demand for northern Australia's abundant natural wealth, resources and strategic access to Asian markets.

Australia faces many challenges to remain an attractive destination for investment in a competitive global economy. Investment remains essential to ensure Australia can meet the expectations of its population by delivering economic prosperity, social cohesion and environmental management.

Despite northern Australia's unequivocal contribution, there is significant untapped potential within the region. The mining sector, estimated to only use 0.01 per cent of land across North Australia, has the potential to sustain growth and continue contributing heavily to northern Australia's economic growth.

Analysis by the Australian Bureau of Resources and Energy Economics (BREE) has found that, as of April 2012, there were 98 major mining projects at an advanced stage of development, with a record capital expenditure of $260.8 billion.

Recently, however, companies such as Rio Tinto and BHP have signalled that they may not go ahead with some planned projects. In May 2012, Rio Tinto CEO Tom Albanese signalled that labour costs, along with a weaker outlook for commodities and growing uncertainty over demand from China may force it to reconsider several projects. These conditions, amongst others, are having a detrimental effect on Australia's potential to attract investment.

Moreover, the Commonwealth Government's National Resources Sector Employment Taskforce concluded in 2010 that an additional 136,000 new jobs would be created over the next five years to support the resources industry but that there will be a gap of 36,000 necessary tradespeople to support activities and projects worth at least $360 billion. And many of these projects will operate in the under-populated and under-resourced north of Australia.

According to the **BREE,** the skills shortages problem reaches further than just the mining industry. The agriculture sector has also had trouble finding and keeping employees. And the impact is compounded with the challenges of an ageing population, poor infrastructure across the nation and debates about the appropriateness of key international investment players owned by sovereign governments.

Currently, these gaps are being filled with the temporary plugs of short-term contract and fly-in, fly-out labour, expensive alternatives to established infrastructure and export backlogs. This situation is not sustainable.

Many of these issues are not new. Governments have faced them before but solutions have fallen short. Instead of re-attempting failed policies Australia needs to start thinking 'outside the box' and looking at different and perhaps radical proposals to address these challenges. Importantly, to solve these challenges Australia needs political leadership and vision.

One proposal to improve the situation is to develop one or more Special Economic Zones to improve Australia's economic welfare, provide new opportunities for growth and employment, and harness the potential of Australia's North.

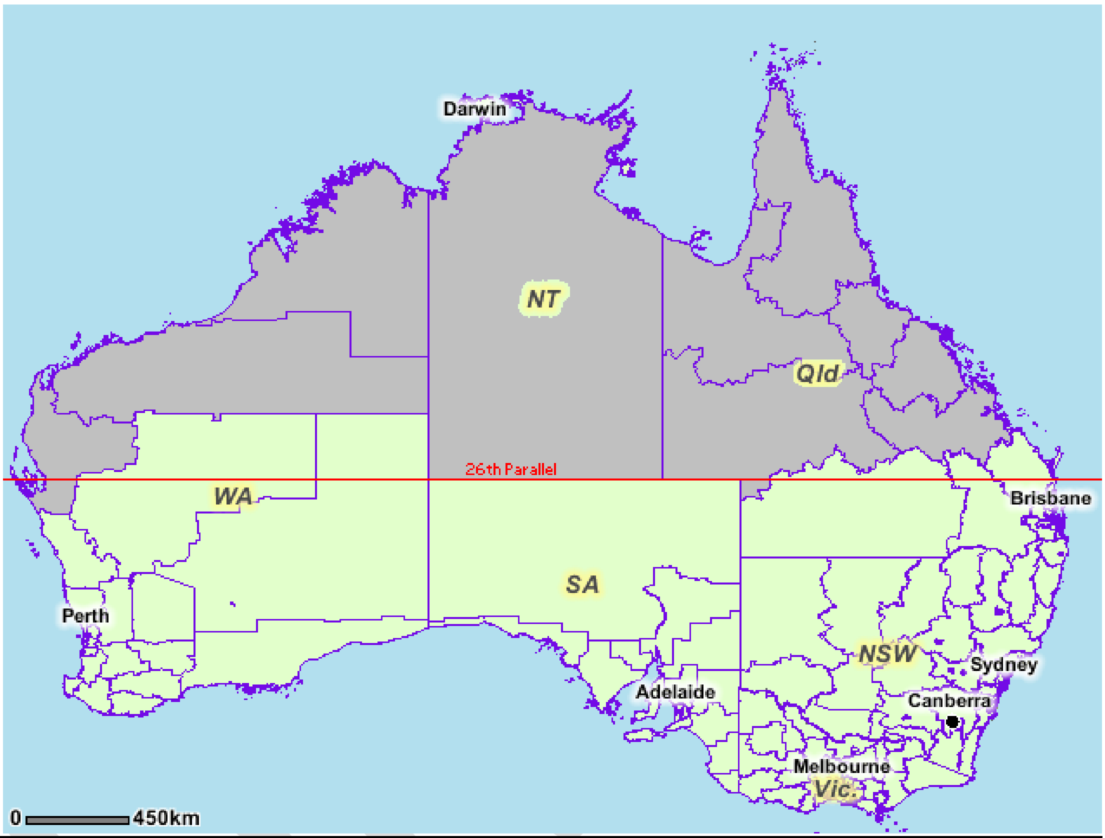
Economic zones are not a new idea as a method to stimulate economic activity and investment and to prompt economic activity and investment where it has not previously existed.

For the purposes of this discussion, northern Australia will be defined as continental Australia above the 26th parallel. While such a classification may appear arbitrary, the 26th parallel has been selected because it ensures all of the Northern Territory is included in Northern Australia and many of the economically under-developed regions of Queensland and Western Australia.

1. About Northern Australia

Containing nearly half of the entire Australian continent, northern Australia above the 26th parallel is an economically, socially and environmentally diverse area, and is also heavily influenced by State and Territory boundaries.

Figure 1 | Northern Australia above the 26th parallel



Source: Adapted from Australian Bureau of Statistics, 2006, *Census Data*, Australian Government, Canberra

Northern Australia's economy

The major wealth-creating industries of Northern Australia are mining and agriculture. Mining has been a major contributor to the economies of all the northern regions in Australia and to the national economy more broadly. In addition to contributing infrastructure and social development programs, the mining industry has a significant impact on the state and national economies through revenue and employment. Agriculture is also a major industry, and like mining, provides inputs for domestic economic activity as well as exports. Other industries such as retail, defence and tourism also make a significant contribution to Northern Australia's economic profile.

Northern Western Australia Economic Profile

Northern Western Australia's three major regions – The Kimberley, the Pilbara and Gascoyne – made up just over 4% of the state's population and yet contributed 6.7% of the state's gross state product in the year 2004-05.[1] In 2010, the region contributed to 8.4% of the state's gross state product in the year 2010.[2]

2011 Census data revealed that the local government area with the highest proportionate increase in Western Australia is East Pilbara, which grew 82.6 per cent to 11,950 people from 6,546 in 2006.[3]

The north of Western Australia has relied heavily on mining to fuel its economy. The total value of mining in the Kimberly was $838 million in the year 2009-10[4], more than double the amount made by the next closest industry, retail.[5] However, in terms of employment mining is a relatively small employer eclipsed by health and community services, retail and wholesale trade, and government administration and defence.[6]

The Pilbara's mining sector, which included iron ore, oil and gas, had a production value of over $20 billion, was the largest income generator in the region by more than $19.6 billion and employed 29 per cent of the working population.[7] In some Pilbara towns like Tom Price and Paraburdoo, between 40 and 50 per cent of the population work in mining. [8] Despite its economic contribution mining covers an estimated 0.1 per cent of land mass in the Pilbara and an 'insignificant' amount in the Kimberley.[9]

Mining was also a major contributor to the Gascoyne economy, in 2009/10 mineral production was valued at $142.3 million.[10] This was mainly due to the demand for high quality industrial salt. It was tourism, however, that created the most wealth for the region

[1] 2005 Population data: Australian Bureau of Statistics, 2010, *National Regional Profiles*, catalogue number 1379.0.55.001, Australian Government, Canberra. Australia.
GSP data Commonwealth Government's National Resources Sector Employment Taskforce : Department of Local Government and Regional Development, 2007, *Indicators of Regional Development in Western Australia: Supplementary Report*, Government of Western Australia, p.6

[2] Deloitte Access Economics,(2011) *Long Term Economic and Demographic Projections, ADF Posture Review pp.24-29* (Note that this statistic includes Geraldton)

[3] Australian Bureau of Statistics, Media release - "2011 Census data shows a snapshot of Western Australia", 21 May 2012.

[4] Government of Western Australia: Department of Regional Development and Lands,(2011) *Kimberley: a region in profile 2011, p.1*

[5] Department of Local Government and Regional Development, 2006, *Kimberley Economic Perspective*, Government of Western Australia, July, p. 2

[6] 2006 Census data: Bureau of Infrastructure, Transport and Regional Economics (BITRE), 2009, *Northern Australia statistical compendium 2009*, Canberra, Australia, p. 4

[7] ibid., p48

[8] 2001 Census data: Rio Tinto Iron Ore, 2007, *Economic Impact of Mining in Tom Price and Paraburdoo,* Rio Tinto, p. 3.

[9] In 2002 mining contributed $14 865 million to the Pilbara economy and $665 million to the Kimberley economy. URS Australia Pty Ltd, 2003, 'Annex A', *Indicators of Regional Development in Western Australia*, , pp. xx - xxxv

[10] Government of Western Australia: Department of Regional Development and Lands (2011), *Gascoyne: a region in profile 2011.p.1*

with 196.7 million.[11] Tourism was the leading employer in the Gascoyne accounting for 22.3 per cent of employment followed by agriculture, forestry and fishing at 16 per cent.[12]

Northern Territory Economic Profile

As a Territory dominated by two towns – Alice Springs and Darwin – the Northern Territory has a relatively small economy. Government administration and defence were the largest employers in the territory with almost 20 per cent of people employed in these sectors.[13] In both Alice Springs and the Darwin region (this includes Palmerston) Public Administration and Safety, Retail Trade and Health Care were among the top employment sectors.[14]

The mining industry contributed roughly a quarter of the Territory's economy in 2007-08, which was followed by property and business services at 9.4 per cent and defence at 7.4 per cent.[15] In addition, over six per cent of the Northern Territory's gross state product was due to tourism.[16]

Northern Queensland Economic Profile

Northern Queensland's economy is more broad-based than the Northern Territory and the north of Western Australia, but still relies heavily on mining as the area's major export. While specific data about Northern Queensland is limited, the State government's 'Blueprint for the Bush' report outlined the major industries of Queensland outside of the south eastern corner and major population centres like Townsville and Gladstone.

A third of the 'bush' economy was attributed to the mining industry,[17] and of that industry, black coal is one of the most important commodities. Black coal primarily comes from the Bowen Basin region, one of the points of Queensland's 'Northern Economic Triangle'.[18] The other two points of the triangle, Mount Isa and Townsville, also play essential roles in the state's mining industry with Mount Isa mining for minerals, base metals and LNG gas.[19]

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[11] 2004/05 Mining and Retail Data; 2003 Tourism Data: Department of Local Government and Regional Development, 2006, *Gascoyne Economic Perspective*, Government of Western Australia, July, p. 2,

[12] 2001 census data: ibid., p 4

[13] BITRE, 2009, *Northern Australia statistical compendium 2009*. p. 48

[14] 2006 data: Department of Business and Employment, 2008, *Workforce NT report 2008,* Northern Territory Government, p. 87 & 225

[15] Department of Regional Development, 2009, Primary Industry, Fisheries and Resources, *Annual Report 2008-2009*, Northern Territory Government, October, p. 12

[16] 2007-08 data. Northern Territory Government, 2010, ', Chapter 14: Tourism' in *Budget Paper: Northern Territory Economy 2010-11*, p. 143

[17] Department of Environment and Resource Management, 2006, *Blueprint for the Bush: Rural economic development and infrastructure plan*, Queensland Government, p. 11

[18] BITRE, 2009, *Northern Australia statistical compendium 2009*, p. 249;
ACIL Tasman, 2009, *Vision 2020 Project: The Australian mineral industry's infrastructure path to prosperity*, prepared for the Minerals Council of Australia, p. 4

[19] ACIL Tasman, 2009, *Vision 2020 Project: The Australian mineral industry's infrastructure path to prosperity*, p. 4

Mount Isa and Townsville alone are said to have contributed up to eight per cent of the entire State's economic output. [20]

Around 14 per cent of Queensland's 'bush' economy comes from agricultural production[21] and behind primary resources, meat, sugar and crops make up the main agriculture exports.[22] The greater focus on crop agriculture in northern Queensland compared with the rest of northern Australia is substantially due to the available water of major river systems in the northern regions of the state.[23]

The exact contribution of tourism to northern Queensland's economy is difficult to measure, though it is clearly important and most visitors to northern Australia spend time in north Queensland above any other part of the region.[24]

Unlike the economic profile, the employment profile of northern Queensland is clearer. Despite both the mining and agriculture industries contributing significantly to the State economy they are ninth and tenth in order of the highest employing sectors.[25] Mining makes up 5.8 per cent of northern Queensland's employment and agriculture 6.2 per cent.

Retail was the largest employer across Northern Queensland, employing almost fifteen per cent of the workforce assumed to result from necessary retail serving workers in the agriculture and mining industries.[26]

<u>Cattle</u>

A vital industry which stretches across all three states is the cattle industry. The North carries about 30 per cent of Australia's cattle and produces 80 per cent of the live cattle export trade worth $300 – 400 million per year. In 2010-11, Western Australia accounted for 38 per cent of live cattle exports, the Northern Territory accounted for 28 per cent and Indonesia was the largest export market for Australia, at 57 per cent of the total in 2010-11, according to Meat and Livestock Australia (MLA).

South East Asia is our biggest live cattle export destination, at 62 per cent. According to MLA, due to rising incomes in developing nations and a growing preference towards more protein rich diets, global demand for livestock will strengthen, particularly in Asia, South America and the Middle East.

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[20] Mount Isa to Townsville Economic Zone Inc., 2009, *MITEZ 2009 Investment Guide,* at <http://www.mitez.com.au/docs/2009_MITEZ_Investment_Guide.pdf> p. 7

[21] Department of Environment and Resource Management, 2006, *Blueprint for the Bush: Rural economic development and infrastructure plan*, p. 11

[22] Queensland Government, 2010, 'Budget Paper No. 2: Budget Strategy and Outlook', *State Budget 2010-11*, p.36

[23] BITRE, 2009, *Northern Australia statistical compendium 2009*, p201

[24] It should be noted that the boundaries of northern Australia in the statistical compendium vary from ours. They take the Tropic of Capricorn to be the demarcation of NA where we take the 26th parallel. Therefore, the statistics they quote may not completely represent northern Australia. BITRE, 2009, *Northern Australia statistical compendium 2009*, Canberra, Australia, p vi

[25] Department of Education, Employment and Workplace Relations, 2006, *Regional Profile for Central and North Queensland Labour Market Region*, Australian Government , Canberra, Australia, p. 7

[26] ibid., p. 7; BITRE, 2009, *Northern Australia statistical compendium 2009*, p 47

According to MLA, live cattle exports totalled 806,855 head in 2010-11, valued at $660.4 million. This is 16 per cent lower than the previous year, in large part due to the federal government's knee-jerk decision to suspend the live cattle trade to Indonesia.

Rapid expansion of the middle class in Asia means Northern Australia is perfectly positioned to take advantage of these emerging markets and to lock in market share. The Food and Agriculture Organisation is confident these demands can be met provided that the "necessary investment is undertaken and policies conducive to agricultural production are put in place."[27]

[27] Food and Agriculture Organisation, *How to Feed the World in 2050*, High-Level Export Forum, Rome 2009, 2.

2. Australia's challenge

As a nation, Australia faces a number of key challenges, including attracting skilled labour, addressing the stress placed on existing infrastructure and developing new infrastructure and attracting investment to develop industries.

To address these challenges Australia needs to consider new and visionary policies, such as the development of Special Economic Zones above the 26th parallel that are designed to attract investment, skilled labour and develop Australia's infrastructure.

Investment challenge

Considering the long-standing dependence on foreign investment to develop Australia's infrastructure and industries, it is vital that Australia have an economic and regulatory framework that attracts investment capital. In numerous international reports Australia ranks modestly as an attractive destination for foreign investment and ranks particularly poorly in select key indicators.

A recent World Bank report highlights that Australia is significantly under-performing as a competitive investment destination in regulatory approvals, poor investor protection and tax rates. And these poor rankings are reflected in the volume of investment capital attracted to Australia.

Even during the global economic crisis when Australia should have been a safe haven for investment and was one of the few markets capable of providing investment returns, Australia had a considerable decline in foreign investment.

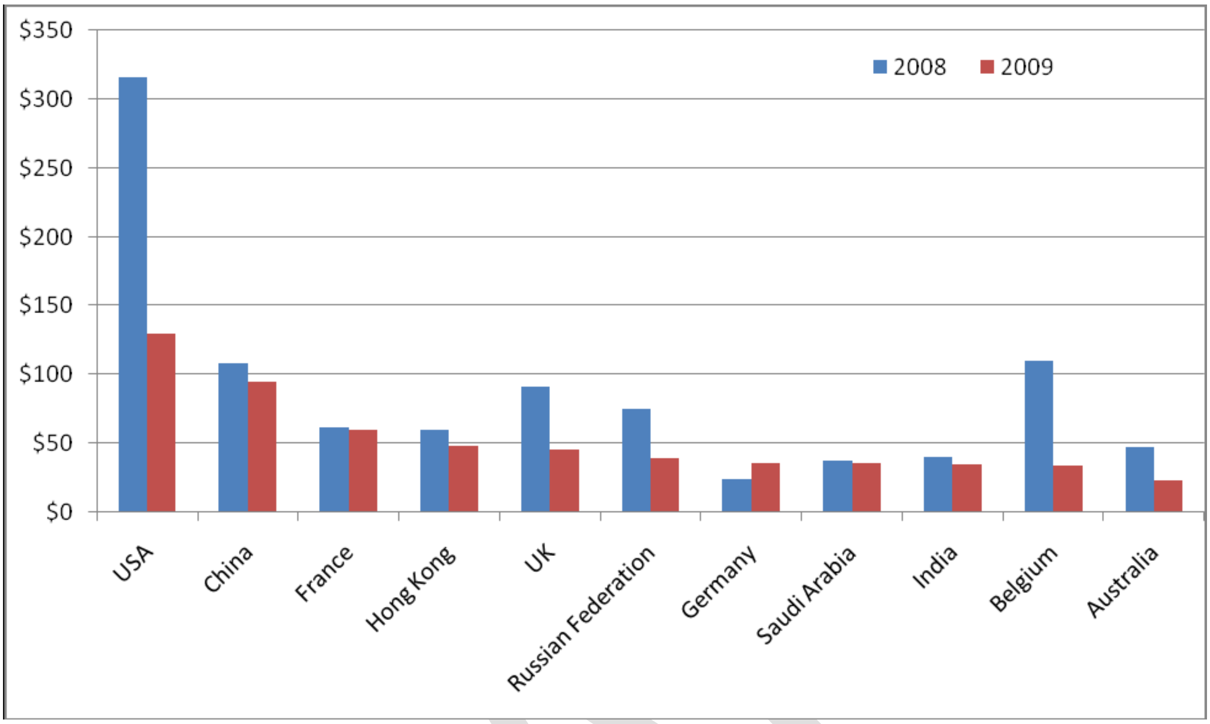
Yet developing the resources sector and other industries requires considerable investment capital. Australia must consider reforms that will ensure it positions itself as an internationally competitive and attractive destination for foreign investment.

As a permanent investment importer, Australia has always required foreign investment to build infrastructure, grow industries and provide Australians with a livelihood. But in a fast paced global economy where investment is attracted to the opportunities for best returns, countries need to be vigilant to ensure their governance framework does not act as an inhibitor to investment.

Australia ranked 15th globally in the World Bank's 'Ease of Doing Business 2011' rankings, down from 9th in 2010. Australian also ranked poorly in a number of key indicators that can act as impediments to foreign investment. As Table 1 outlines, Australia ranked 42nd for dealing with "construction permits", 38th for "registering property" , 65th for "protecting investors" and for "paying taxes" Australia ranked 53rd.

These dismal rankings have a very direct impact on investment especially considering delayed regulatory approvals for construction and registering property add costs to investors and reduce potential returns. Poor protection for investors strikes directly at investor confidence and high taxes diminutions possible returns from investment.

Figure 2 | Top ten destinations for foreign investment by value and Australia, USD$ billions



Source: United Nations Conference on Trade and Development, 2010, *World Investment Report: Investing in a Low Carbon Economy*, United Nations, New York, United States of America, p. 4

And as Figure 2 outlines, Australia is not in the top ten destinations for foreign investment. In 2010, Australia was ranked 17th and competes heavily against key growth economies in the Asia Pacific including the major emerging economies of India and China.

Considering Australia's dependence on foreign investment we must ensure that our economic and regulatory framework is conducive to attracting it.

Table 1 | World Bank's 'Ease of doing business' ranking indicators performance for OECD countries

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Singapore	1	4	3	5	14	8	2	4	1	12	2
Hong Kong SAR, China	2	5	1	4	57	4	3	3	2	5	16
New Zealand	3	1	2	31	3	4	1	36	27	10	18
United States	4	13	17	17	16	4	5	72	20	7	15
Denmark	5	31	10	13	11	24	29	14	7	32	9
Norway	6	41	60	12	8	48	24	27	9	4	4
United Kingdom	7	19	22	60	68	1	10	24	13	21	6
Korea, Rep.	8	24	26	11	71	8	79	38	4	2	13
Iceland	9	37	34	1	11	40	46	35	81	3	11
Ireland	10	13	27	90	81	8	5	5	21	62	10
Finland	11	39	45	25	25	40	65	28	6	11	5
Saudi Arabia	12	10	4	18	1	48	17	10	18	138	73
Canada	13	3	25	156	41	24	5	8	42	59	3
Sweden	14	46	23	8	19	48	29	50	8	54	19
Australia	15	2	42	37	38	8	65	53	30	17	17
Georgia	16	7	4	89	1	8	17	42	54	41	109
Thailand	17	78	14	9	28	67	13	100	17	24	51
Malaysia	18	50	113	59	59	1	4	41	29	31	47
Germany	19	98	15	2	77	24	97	89	12	8	36
Japan	20	107	63	26	58	24	17	120	16	34	1

Source: The International Bank for Reconstruction and Development, 2011, *Doing Business: Economic Rankings*, The World Bank, Washington D.C., United States of America, at http://www.doingbusiness.org/rankings/ (accessed 01/08/12)

Australia's population and skilled labour challenge

Australia also faces a considerable skills and labour supply shortage. With an ageing population resulting in a decline in the ratio of working to non-working Australians, industry will increasingly find it harder to secure labour. The problems faced by industry will become more acute for skilled labour, especially if government policy is to slow migration into Australia.

A Commonwealth government taskforce recently concluded that an additional 136,000 jobs will be created to support the mining industry alone and that there could be a gap of nearly 36,000 tradespeople needed to support the resources sector within the next five years. Skilled labour shortages also impact other industries which are vital to the northern Australian economy, notably agriculture. Similar figures have also been put forward by the Minerals Council.[28]

If the skills shortage continues, Australia will not be able to grow industries or to be internationally competitive.

Without establishing options for improving the skills of Australians as well as increasing the volume of skilled migration industry faces potentially severe shortages that could seriously inhibit the development of Australian industries.

Over the next 40 years the makeup of Australia's population is expected to create significant challenges for the Australian economy. As has been highlighted by the Federal government's 2010 Intergenerational report, with life expectancy continuing to rise, the nation's finances will be strained as the ratio of non-working Australians to working Australians is expected to increase.[29]

With a population nearing 22.5 million, Australia is already experiencing population density issues, a lack of affordable housing and strained infrastructure. With a population projected to be 36 million by 2050 these problems will be exacerbated and require new solutions to either build up our existing cities, establish new cities or reverse the trend of population drifting from rural and regional areas to capital cities.[30]

Australia's defence challenge

While not currently involved in conflicts, northern Australia remains a vastly under-populated and under-resourced section of Australia's continent. The absence of a population, major industries and infrastructure reduces the capacity for Australia's defence forces to operate effectively.

[28] Minerals Council of Australia, 2010, *Submission to Inquiry into Regional Skills Relocation*, Submission to the House of Representatives Standing Committee on Employment and Workplace Relations,, Commonwealth of Australia, Canberra, Australia.
[29] The Federal Treasury, 2010, *Australia to 2050: future challenges*, Australian Government, Barton, Australia, p. 5-7
[30] The Federal Treasury, 2010, *Australia to 2050: future challenges*, p. 155

To secure the defence of Australia’s north, economic development and an increased population will likely deliver increased export infrastructure, such as ports, and other supportive infrastructure which can improve Australia’s defence capacity.

The recent Defence Force Posture Review stated that an enhanced and more visible presence in the North West is warranted.

According to the Department of Defence, “strategic interest is the security, stability and cohesion of our immediate neighbourhood, which we share with Indonesia, Papua New Guinea, East Timor, New Zealand and the South Pacific island states. While we have a wide range of diplomatic, economic, cultural and other links with those countries, from a strategic point of view, what matters most is that they are not a source of threat to Australia, and that no major military power, that could challenge our control of the air and sea approaches to Australia, has access to bases in our neighbourhood from which to project force against us”.[31]

Another key defence challenge Australia faces as a consequence of the size of its land mass and population is the “lack of ‘mass’ in our armed forces in comparison to the armed forces of some other nations.”[32]

Following on from the White Paper, the Defence Force Posture Review was released in May 2012. The report clearly highlights the increasing importance of the North West’s resource sector to the Australian economy, noting that mining exports now account for 12.5% of Australia’s annual GDP.[33]

The report states that though vulnerability to such attacks can be exaggerated, "the potential for terrorist attacks against oil, gas and other resource industry infrastructure in the North West is also an important consideration."[34]

The Review found a widespread perception in the resource sector and local communities in the North West that there is insufficient ADF presence and concluded that "an enhanced and more visible presence in the North West is warranted.”[35]

[31] Department of Defence, 2009, *Defending Australian in the Asia Pacific Century Force 2030*, Australian Government, Canberra, Australia, p. 12
[32] Ibid., 66.
[33] Ibid., ii.
[34] Ibid., ii.
[35] Ibid., ii.

3. Precedents for Northern Economic Zones

Special economic zones are not a new idea as a policy instrument to increase investment, labour supply and infrastructure. Special economic zones have existed in various forms for nearly two millennia as a method of stimulating economic activity, investment and attracting workers.

Precedents already exist in State and Federal government regulations and tax rebates to give preferential treatment in areas of Northern Australia that are designed to encourage increased economic activity.

The closest experience Australia has had to developing a special economic zone was in Darwin. While the Darwin special economic zone failed primarily because of over-interference from government, inadequate governance and incentives for prospective investors, special economic zones can be designed to match Australia’s unique conditions.

Internationally special economic zones are common and Australia’s lack of a special economic zone makes it unique in the Asia Pacific region. Prominent examples of SEZs in our region include Shenzhen in China and Iskandar in Malaysia. There are also several new Enterprise Zones in the United Kingdom.

International Examples

Australia can learn from the failed Darwin Zone and instead establish an SEZ which follows more closely the success stories of SEZs from around the world.

Some key points emerge from an examination of successful SEZs around the world.

Location at or near a competitive advantage

Usually the competitive advantage of an SEZ is its geographic location which can provide easy access to nearby markets. It can also be, however, an existing successful industry or the presence of natural resources.

An Australian Special Economic Zone's competitive advantage would be a combination of its natural resources and its proximity to Asian markets.

Iskandar in Malaysia benefits from its location at the southern tip of Malaysia because of its access to global sea lanes from three established ports on the coast.

The Shannon Free Zone in Ireland, moreover, the world's oldest Export Processing Zone, is located at Shannon international airport. Aviation is one of the key industries within the zone and the airport offers easy access to European markets, especially for its large number of US investors. Shannon Free Zone companies make a major economic contribution to the Irish economy. Collectively, they contribute over €600 million to the Irish and Shannon region economy each year.[36]

[36] Shannon Development, *An Economic Overview of Ireland's Shannon Region*, February 2012, 14.

There are countless examples of strategically located SEZs around the world, including in the new Bristol Temple Quarter Enterprise Zone in the United Kingdom. The aim of zone is to promote business in the region, especially in the vehicle production and design industry, for which Bristol already has a strong reputation.

Infrastructure

Appropriate infrastructure is crucial to the development of an SEZ. Hard infrastructure such as quality road and rail networks are important on a practical level, for transportation, as well as being a key part of attracting investment to the region.

At its most basic level, infrastructure links producers to markets and successful SEZs have tailor made infrastructure to suit the nature of the industries within the zone.

There must also be appropriate soft infrastructure. That is, the right policies and processes must be in place so that registration and licensing and other administrative processes are timely and efficient.

Investor-friendly administration

The administrative setting of the SEZ is crucial and a smoothly functioning one-stop-shop will often be a catalyst for investment.

Shenzhen is an example of an SEZ which has been very successful in attracting foreign direct investment (FDI). Since it was established, more than US$30 billion in foreign investment has gone into both foreign-owned and joint ventures. In 2008, Shenzhen utilised US$3929.58 million FDI.

The policies which have attracted this investment, include the streamlined administrative control which is facilitated by the one stop service which guides companies through the initial investment procedure and any subsequent taxation, infrastructure and import/export details.

Shenzhen's success can also be attributed to its continual evolution. According to Yeung, Shenzhen has consistently been at the cutting edge of reform; eschewing undue reliance on limited-term government incentives, Shenzhen instead focused on private sector led sustainable self renewal and technological up scaling to improve its competitive position.[37]

Leading authorities on Special Economic Zones at a conference in Malaysia in March 2012 unanimously agreed that One-Stop-Shops and the requisite streamlined, fast-tracked approvals and minimal regulation and red tape were essential for the success of an SEZ.

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[37] Yeung et. al, "China's Special Economic Zones at 30", *Eurasian Geography and Economics*, 2009, 50, No. 2, 226.

Government support and facilitation, but not excessive involvement

The nature and extent of the role of government is also key to the success of a Special Economic Zone. Clearly, SEZs are not viable with too much government intervention. If the government is too heavily involved, as was the case in the Darwin Trade Zone, the situation becomes artificial and the SEZ cannot function as it is supposed to, as a privately driven economic zone.

Nonetheless, government support for an SEZ is crucial and there is a role for it to play, especially in the initial stages of development of the zone. In general, governments should have a hands-off, yet supportive role.

A good example of this is provided by the Iskandar SEZ in Malaysia. The level of government investment, in relation to private sector investment, has been considerably reduced over the first six years of the zone.

At the beginning of the project, the government decided that it needed to intervene in the region to a certain extent. Its aim all along, however, was to scale back its involvement and adopt a facilitative role, rather than an interventionist one. The private sector has invested heavily in Iskandar and in six years, the ratio of private vs. public investment has risen from 1:1 in 2006, to 12.5:1 in 2012.

In addition to these characteristics, successful Special Economic Zones tend to offer attractive fiscal incentives for investment, such as reduced rates of corporate and payroll taxes and reduced or non-existent export duties. Evidence suggests, however, that incentives alone will not guarantee investment and that they will only attract investment when offered in conjunction with the other important elements of an SEZ.

4. Design of Northern Economic Zones

Australian Special Economic Zones must be designed for Australian conditions. In order to do this:

- SEZs should be developed above the 26th parallel based on Australia's unique economic, social and environmental conditions.
- SEZs should be trialled to assess different incentive and governance models.
- SEZs should be established through cooperative legislation by State and Federal governments and be privately owned and operated.

In addition:

- For activities inside economic zones State and Federal governments should remove and/or rebate corporate taxes, income taxes, payroll taxes, land taxes and stamp duty.
- For activities inside economic zones the Federal government should liberalise investment regulations, except for investments that may meet very narrow definitions of national security concerns.
- The Federal government should either amend exiting visa regimes, or create new visa regimes for labour to migrate to support activities within SEZs.
- As mentioned in the previous chapter, SEZs should learn from international best practice.

5. Benefits of Northern Economic Zones

Designed well, economic zones promote investment, create jobs and can transform depressed areas into areas of considerable economic activity. In an Australian context, the development of Special Economic Zones above the 26th parallel have the potential to address the challenges Australia faces.

Economic

The success and economic benefits of Special Economic Zones are dependent on the incentives offered for workers, employers and prospective investors to boost economic activity.

Incentives include cutting taxes, streamlining regulation processes, removing regulatory restrictions to investment and increasing skilled labour supply to ensure an attractive investment environment.

Extensive literature has demonstrated that lower taxes correlate with stronger economic growth and higher rates of investment. By comparison high tax rates correlate with impede economic growth and the capacity to attract foreign investment.

Northern Australia relies heavily on the mining industry for wealth and employment. Currently there are a significant number of mining project proposals that are being delayed or cancelled due to tax and regulatory burdens. By introducing SEZs, these burdens would be significantly reduced. These would, in turn, lead to an increase in available jobs and would advance the mining industry's impact on northern economic growth.

To justify the establishment of economic zones there needs to be a clear case that it will deliver economic dividends. There are both income and substitution effects associated with the establishment of economic zones. In the first instance a reduction of government intervention in the economy has the effect of stimulating economic activity leading to a rise in income. At the same time, however, some economic activity simply relocates to the economic zone to benefit from reduced regulation and taxation. While this is not problematic per se, it is not new economic activity.

Table 2 outlines the potential benefits resulting from economic zones. The static benefits of a Special Economic Zone are likely to be more immediate and more obvious. In the first instance Northern Australia is currently under-populated. An expansion in economic activity in the region will attract potential employees and their families to the region. It is well known that higher wages need to be paid to attract individuals to remote areas in the first instance. This will have the effect of raising wages across the entire economy with the effect that has on profitability, prices and increased government revenue. The dynamic effects will work, more or less, to offset the static effects of an increase in wages and prices. Those increased wages and prices will encourage skill upgrading in the local population leading to greater formal economic participation for those individuals. Direct employment is the most obvious benefit of special economic zones.

Table 2 | Benefits delivered from a Special Economic Zone

Static	Dynamic
• Direct employment creation and income generation • Export growth and export diversification • Foreign exchange earnings • Foreign direct investment • Government revenues	• Indirect employment creation • Skills upgrading • Female employment • Technology transfer • "Demonstration effect" arising from application of "best practices" • Regional development

Adapted from: Foreign Investment Advisory Service, 2008, *Special Economic Zones: Performance, lessons learned, and implications for zone development*, World Bank, Washington, United States of America

Table 3 | Direct employment from special economic zones, 2007

Region	Zone jobs (millions)
Global	68,441
Asia and the Pacific	61,089
Americas	3,084
Western Europe	179
Central and East Europe and Central Asia	1,590
Middle East and North Africa	1,458
Sub-Saharan Africa	1,040

Source: Foreign Investment Advisory Service, 2008, *Special Economic Zones: Performance, lessons learned, and implications for zone development*, World Bank, Washington, United States of America.

An Institutional Theory of Economic Growth

The intended benefit of economic zones is to increase in economic growth. Economists have been thinking about economic growth for over 200 years. In that time some ideas and concepts have become widely accepted.

- Economic growth follows from the division of labour. As individuals specialise and trade so opportunities for economic growth are enhanced.
- Economic growth is a function of investment and savings.
- Sustainable economic growth must be enhanced by innovation and technical progress.

Government has the power to enhance economic growth or to retard that growth by its interference within the market. The most obvious mechanisms whereby government interferes within the market is by regulation and taxation. Regulation can inhibit specialisation by over-regulating labour markets, while taxation can inhibit innovation by reducing profitability.

Economies grow when individuals are more or less free to pursue their self-interest. Entrepreneurs and consumers go about their business with little impediment from the government, but within a framework of rules that assist them by reducing the costs of doing business (economists often refer to these as being transactions costs). The Economic Freedom Index measures the extent to which individuals are free to pursue their self-interest and thee separate channels are used to do so.[38] First, economic freedom enhances open markets. Freedom of entry and exit ensures that business is able to meet the changing needs of consumers at low costs. Rivalry to earn profit by meeting consumer demand stimulates innovation and entrepreneurship. Finally there is a very strong relationship between economic freedom and investment.

The east-Asian precedent

The notion that government can take action to promote economic activity isn't as controversial as some might think. It is widely recognised that prudent government intervention contributed to the massive and rapid growth experienced in east-Asia after the mid-1960s. While the notion of east-Asian exceptionalism has declined since the crisis of the late 1990s, nonetheless the lessons of the region are important when examining the interaction between government policy and economic activity.

Factors such as luck, geography, and culture have played some role in promoting growth in the region. Those factors, however, do not explain the increase in economic activity after the 1960s.

According to the World Bank there are three potential explanations for east-Asian growth.[39]

- The neoclassical view: This perspective suggests that government simply created an environment where entrepreneurs could thrive.
- The revisionist view: This perspective suggests that government deliberately intervened in order the 'get prices wrong' and engender economic development. In the one area where this perspective does describe the east-Asian experience, viz. exchange rates, getting prices wrong lead to several distortions that exacerbated the east-Asian crisis.
- The market-friendly view: This perspective suggests that growth is associated with 'carefully delimited government action'. According to the World Bank 'the appropriate role of government in a market-friendly strategy is to ensure adequate investments in people, provision of a competitive climate for enterprise, openness to international trade, and stable macroeconomic management.'[40]

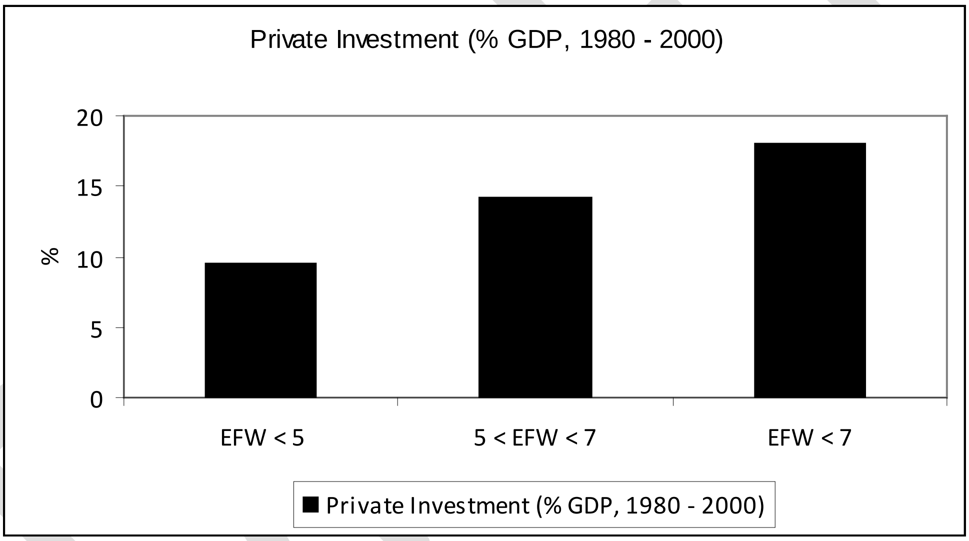
The World Bank makes the argument that beyond basic functions the government is more likely to do harm than good. While not emphasising a specific set of policies, the World Bank does highlight that openness to international trade, investment and ideas

[38] This is published each year by the Fraser Institute and the 2004 report contains information about the links between economic freedom, investment and growth. James Gwartney & Robert Lawson, 2004, *Economic Freedom of the World Annual Report*, Economic Freedom Network, Washington D.C, United States of America
[39] World Bank, 1993, *The East Asian Miracle: Economic growth and public policy*, Oxford University Press, United Kingdom.
[40] ibid., p. 84.

is an important criterion for success. Export performance in particular is an important benchmark for measuring policy success.

According to the Fraser Institute, those economies with higher levels of economic freedom attract higher levels of investment than those that do not have higher levels of economic freedom. One estimate is that high economic freedom economies have 12 times more investment per worker than those that have low freedom. This relationship between economic freedom and investment is very important because of the well-known relationship between investment and economic growth. Many economists have found that a higher levels of investment is associated with higher levels of economic growth. Similarly, economists find that a higher level of government consumption is associated with lower levels of economic growth.[41] Australia's Economic Freedom Index score is 7.89 placing Australia as the ninth highest ranked economy in 2007. As can seen in Figure 3 below there is a strong and positive relationship between Economic Freedom and private investment.

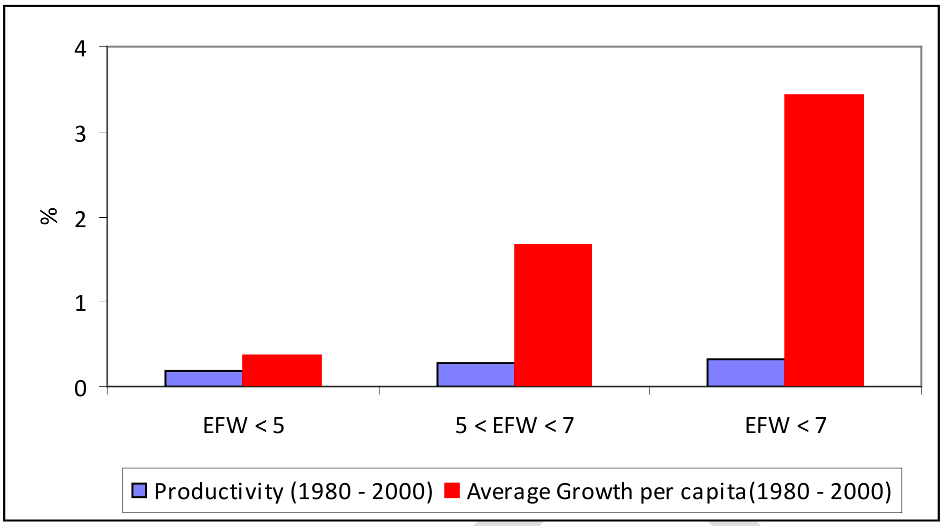
Figure 3 | Economic Freedom and Private Investment



Source: Laffer, Moore & Williams, 2004, *Economic Freedom of the World: 2004 Annual Report*, p. 31

[41] See, for example, Robert Barro and Xavier Sala-i-Martin, 1995, Economic growth, McGraw-Hill, Australia & New Zealand.

Figure 4 | Economic Freedom, Productivity and Economic Growth



Source: Laffer, Moore & Williams, 2004, *Economic Freedom of the World: 2004 Annual Report*, p. 30 & 32

While it is well known that investment is very important for economic growth to occur, it is also the case that investment alone is not enough to generate economic growth. Productivity is also an important factor. The Fraser Institute is able to show that a one percent increase in investment, ceteris paribus, increases the growth rate in per capita GDP by 0.33 percent for economies like Australia with high levels of Economic Freedom. It is quite clear that improvements in Economic Freedom lead to better economic outcomes. Based on the Economic Freedom Index Australia scores poorly in taxation (especially payroll tax rates), labour market regulation and also on business regulation.

Table 4 | Selected Economic Freedom Scores (top ten economies)

Country	Top marginal income and payroll tax rates	Labour Market Regulations	Business Regulations	SUMMARY INDEX
Hong Kong	10	8.1	7.5	8.97
Singapore	10	7.0	8.0	8.66
New Zealand	5	7.6	7.7	8.30
Switzerland	7	7.4	7.0	8.19
Chile	7	7.9	7.0	8.14
United States	8	8.4	6.7	8.06
Ireland	4	6.5	6.9	7.98
Canada	5	7.2	7.1	7.91
Australia	5	7.2	6.7	7.89
United Kingdom	6	7.2	6.6	7.89

Source: Laffer, Moore & Williams, 2009, *Economic Freedom of the World: 2009 Annual Report*. Ratings are from 0 – 10 with higher scores indicating a better rating.

A key industry that could be impacted by economic reform to drive growth is mining.

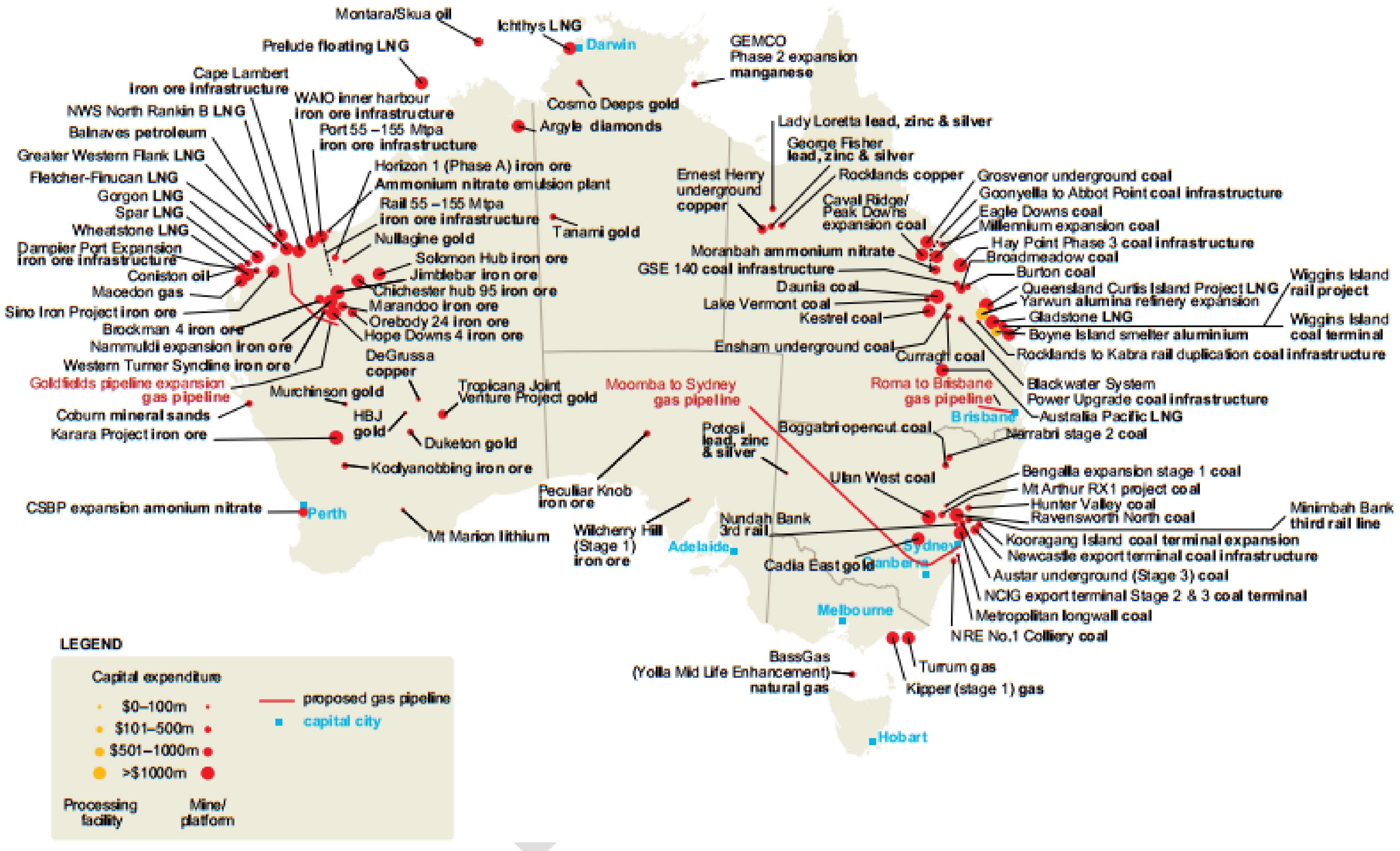
According to BREE, at the end of April 2012, there were 393 mining industry projects. Of these, there were 98 projects at an advanced stage of development and 295 projects, or 75 per cent, classified as less advanced and which therefore, remain uncommitted.

According to BREE, "less advanced" projects are "either undergoing a feasibility (in some cases, prefeasibility) study, or have not yet been subject to a final investment decision since the completion of a feasibility study".[42] By removing unnecessary tax and regulatory burdens on "less advanced" projects their capacity to progress to "advanced" and provide economic and employment opportunities, as well as new revenue sources for government, is significant.

Notably 72 per cent of all projects in the "less advanced" stage are located in Australia's north. While they would not all operate above the 26th parallel, Figure 5 outlines that most of the projects in Western Australia and Queensland do, and especially the larger projects. Some of the projects will go ahead, but for many their progress will be halted if the projects do not become economically viable, as some prominent mining companies have recently indicated.

[42] Australian Bureau of Resource and Energy Economics, 2011 *Mining Industry major projects*, Canberra, Australia, at <http://www.bree.gov.au/documents/publications/resources/Mining-Industry-Major-Projects.pdf>

Figure 5 | Advanced projects by location - April 2012



Source: Australian Bureau of Resource and Energy Economics, Mining industry major projects, Australian Government, Canberra, April 2012, at http://www.bree.gov.au/documents/publications/resources/Mining-Industry-Major-Projects.pdf

6. Other benefits of Economic Zones

Skill and labour supply shortages

Through incentives designed to attract labour, Special Economic Zones can address labour shortages in Australia’s north. For Australian workers appropriate tax rebates can increase the flexibility of workers to work in Australia’s north, and with research demonstrating that wages in economic zones are competitive or higher than those outside economic zones.

Special Economic Zones can also provide the policy framework to increase skilled migration through new or existing visa categories to address labour and skills shortages.

Infrastructure

Current infrastructure backlogs are limiting the potential of Australia’s economy. Special Economic Zones can increase the level of investment and demand for significant infrastructure in Australia’s north which will provide direct benefits for industries operating within Special Economic Zones, as well as increasing the infrastructure options available for existing industries.

Improved infrastructure also provides options to improve the attractiveness of Special Australia as a population destination to reduce population in existing Australian capital cities.

Social

Northern Australia currently faces social challenges, including the lack of economic participation of indigenous Australians and the consequences associated with fly-in, fly-out communities.

By establishing greater infrastructure and more stable employment opportunities the dependence on fly-in, fly-out labour as well as the negative consequences associated with it are likely to decline.

Similarly, through the economic development of Northern Australia, economic participation opportunities will increase access to services for indigenous Australians living in remote communities. Further increased economic activity will open opportunities for indigenous Australians to develop small businesses to support new economic growth flowing from Special Economic Zones.

Special Economic Zones are not a silver bullet to all of Australia's economic and social challenges. However, increased economic activity in Australia's north will deliver dividends to the areas directly affected and have a spill-over benefits for the rest of Australia.

Conclusion

Considering the under-development of northern Australia, State and Federal governments need to attract investment and exploit Australia's resource wealth. The proven way to attract investment is to remove regulation and taxes through the development of economic zones.

Designed well, Special Economic Zones can promote economic development, improve social challenges faced in Australia's north and can manage the environmental consequences of rapid economic development. Economic zones also have the potential to improve the environment through greater investment in environmental management.

Australian Special Economic Zones do need to be designed for Australia's unique conditions, and should continue to meet reasonable regulatory standards. However significant improvements can be made in fast processing regulatory applications to reduce costs and make Northern Economic Zones attractive for foreign investment

State and Federal governments would also need to support Special Economic Zones together through the enacting of legislation that will provide economic zone management and investors with confidence. State and Federal governments would also need to work together to devise incentive packages to remove and/or rebate taxes to attract investment.

While Australia does have some limited experience in the development of Special Economic Zones, to attract and maintain political support it would be wise to trial the introduction of Northern Economic Zones. These trial zones could also act as incubators for different incentive and management regimes.

Special Economic Zones must also be developed based on international best practice standards and operate consistent with Australia's international obligations under World Trade Organisation and International Labour Organisation Agreements.

Annex | History of special economic zones

Special economic zones are not a new idea. They are a constant feature of European and world history. As Richard Thoman has pointed out, the idea of special economic zones has "followed the routes of colonial and subsequent international shipping to all continents but Australia."[43]

They have been used as an economic weapon in geopolitical disputes, and as explicit mechanisms for economic development, both on a national level and as an extension of social policy.

But most importantly, special economic zones have been used as 'escape valves' to mitigate against trade and industry-restricting policies in their host country or empire. Tariffs and other trade barriers are lower in most special economic zones because of a recognition within a country that those policies are harming the country's overall economic performance.

Differing names for Special Economic Zones

- Customs zone
- Customs free zone
- Duty free export-processing zone
- Export free zone
- Export processing free zone
- Export processing zone
- Enterprise zones
- Foreign trade zone
- Free banking zone
- Free economic zone
- Free export-processing zone
- Free export zone
- Free port
- Free production zone
- Free trade zone
- Free zone
- Industrial export-processing zone
- Industrial free zone
- Investment promotion zone
- Joint enterprise zone
- Maquiladora
- Privileged export zone
- Special economic zone
- Tax free trade zone
- Tax free zone
- Urban enterprise zone
- Zone of joint entrepreneurship

Nevertheless, special economic zones vary enormously in the extent of regulation and taxation imposed within them, and as a consequence have been given different titles, for political or ideological reasons.

But they first appear in the historical literature as 'free ports' – special economic zones centred in ports, often matched by substantial economic and political autonomy. In the twentieth century free ports became more modest, often placed in isolated areas and as far as possible excluding resident populations. One legacy of the free port is the duty free zone in modern airports. Another is the "bonded warehouse", where imported goods can be held without incurring duty, either as long term storage or for re-export.

[43] Richard Thoman, Free Ports and Foreign Trade Zones, 1956, p2

But historically, free ports functioned like special economic zones function today. They commonly included areas where imported and exported products could be "value-added" – enclosed in the free port areas would be manufacturing and distribution firms, and residents.

The unique legal framework in free ports has historically not been limited to questions of tariffs and trade barriers. The need to encourage population growth in free ports has meant that these areas were islands of religious toleration and relative liberalism. The need for infrastructure development has also necessitated different approaches by national governments to the legal framework governing free ports. The need to encourage employment has lowered labour regulation, and the need for urban renewal has led to the elimination of planning controls.

Major design categories of Special Economic Zones

Categories	Synopsis
Classical free ports and free cities	Special economic zones first appear in the historical literature as 'free ports'. These free ports from a modern perspective can also be described as 'free cities', as they were granted substantial economic and political autonomy from their host jurisdiction. A ruler would nominate a city or village to be free of a range of regulatory burdens – particularly tariffs – and delegate authority of development of the free port to an agent. These free ports commonly encouraged the import, export and, critically "value-adding" of goods, as well as residents. As we shall see, a critical question for historical free ports was how to encourage population growth, and as a consequence social innovations such as freedom of religion were introduced. Modern examples of the free city include Singapore and Hong Kong under British rule.
Free ports and foreign trade zones	In the twentieth century, the phrase "free port" is used to describe a much more modest venture. These free ports – also called in the United States "foreign-trade zones" were areas in ports, isolated, fenced areas, which excluded as far as possible resident populations. The free port could sometimes have limited manufacturing – in the American system such manufacturing needs to be licensed by the surrounding jurisdiction – and no autonomy. One further legacy of the free port is the duty free zone in modern airports. Another is the "bonded warehouse", where imported goods can be held without incurring duty, either as long term storage or for re-export.
Enterprise zones	Enterprise zones are an application of the special economic zone principles to urban development. Spurred by the decline of traditionally industrial towns in the United Kingdom and United States, enterprise zones seek to lower the regulatory and taxation levels in urban or

	suburban settings.
Special economic zones	Contemporary special economic zones can focus on any number of the features of their historical counterparts. Typically designed to encourage large scale manufacturing, they have found their greatest and most prominent successes in China. They often feature tax breaks and tax holidays, lower wage regulation. Rarely are they given the sort of autonomy of policy that characterised free cities of the past.

The historical record is littered with free ports and free zones spurring economic development. Giving a village, suburb, city, or region free port or free zone status is a mechanism repeatedly used by national governments to exert power or to counteract trade-restricting public policy. Historically, free port status elevates often small and obscure towns to global prominence.

The antecedents of special economic zones

Delos: a free port in the ancient world

One of the first historical examples of a special economic zone is the island of Delos.[44] Delos is a small island in the middle of the Cyclades islands, and an important archaeological site in modern Greece.

Rome used Delos as an economic weapon against the nearby port of Rhodes – which had been, until Roman times, the commercial centre of the Greek east. When, for political reasons, Rome wanted to punish Rhodes, Rome made Delos a free port, with the express intention of challenging Rhodes' regional economic prominence. The Delos port was to be open to all international trade, and ships unloading in Delos would be free the two per cent port duties being levied in nearby Rhodes.

For Rome, the free port strategy was wildly successful. Trade shifted rapidly from the port of Rhodes to Delos. Polybius reports the petition of a Rhodian embassy complaining that Delos was choking its previous revenue stream:

> The revenue we drew from our harbour has ceased owing to your having made Delos a free port, and deprived our people of that liberty by which our rights as regards our harbour and all the other rights of our city were properly guarded. It is not difficult to convince you of the truth of this. For while the harbour-dues in former times were farmed for a million drachmae, they now fetch only a hundred and fifty thousand, so that your displeasure, men of Rome, has only too heavily visited the vital resources of the state.[45]

[44] This account of Delos' free port status is drawn from Gary Reger, *Regionalism and Change in the Economy of Independent Delos*, University of California Press, Berkeley, 1994.

[45] Polybius, the Histories, Book 30

Delos' free port status 'decoupled' the island from the rest of the Cyclades, as the source of its economic wealth became focused on regional trade rather than the local cottage industries which had sustained it. Both the city and the port expanded rapidly.

Gary Reger writes that "The flood of Italians, Phoenicians, and other traders devoted to moving goods west to Italy and uninterested in the local economic scene undoubtedly swamped the local traders who had traditionally moved goods around the archipelago." As a free port, Delos attracted a substantial migration inflow. The growth of the island's economic community included traders, tradesmen, bankers, pilgrims, and settlers.[46] The port attracted much itinerant labour as well as permanent settlers – one of the primary ways we know about labour movement in the Roman empire is on the extent of the records found in Delos.[47]

The Roman Empire did not conceive of itself as a commercial empire. The decision to make Delos a free port was a political one. Yet it had profound regional economic consequences, which Rome intended.

Special economic zones in the medieval world

In many ways the medieval town is an example of a special economic zone. Towns in the medieval period were administratively separate from the feudal system. The collapse of European trade after the long fall of Rome had depopulated most towns of their industrial bases – along with imperial administrators, merchants and artisans who were no longer to be found in the towns that dotted the European landscape.[48]

The revitalisation of towns in the tenth and eleventh centuries was accompanied by legal and administrative changes to town life and commerce. Towns were distinguished from their surroundings by distinct legal frameworks which governed commerce, individual liberty, and labour within each towns' limits.

The first distinction between the rural areas and towns was the institution of serfdom. Landless peasants naturally gravitated towards towns. It was those peasants who originally made up the commercial classes. But customary town law also provided an incentive for bonded peasants to migrate to the towns: the German phrase "city air makes a man free" refers to the custom that serfs who spend one year and one day in the towns were granted their liberty. One Benedictine historian described the towns as "detestable communes" for their lack of hierarchy and order.

Henri Pirenne wrote that the freedom of labour was critical in developing medieval commerce, and that the expanding needs of commercial practice reinforced the desire for that freedom:

[46] Erich S. Gruen, *The Hellenistic World and the coming of Rome*, v1, p 304
[47] M.I. Finley, *The Ancient Economy*, university of California Press, 1999.
[48] Much of this is drawn from Henri Pirenne, *Economic and Social History of Medieval Europe*, Taylor & Francis, 2006.

> Without liberty, that is to say, without the power to come and go, to do business, to sell goods, a power not enjoyed by serfdom, trade would be impossible. Thus they claimed it, simply for the advantages it conferred… Freedom became the legal status of the bourgeoisie, so much so that it was no longer a personal privilege only, but a territorial one, inherent in urban soil just as serfdom was in manorial soil.[49]

Free labour was not the only privilege held by towns. In England, Italy, France, and Germany, towns achieved judicial autonomy. This was necessary to facilitate the legal procedures for a commercial society; traditional law – which included archaic and ritualistic methods of dispute resolution like ordeals – was not suited to the new towns.

The mechanism and levels of taxation in towns was also different. Tax outside the towns was collected by manorial lords, with both the amount and the time levied arbitrarily, often equally, among all potential taxpayers. The tax was collected for the lord's personal benefit. In the towns, the need for common expenditure – on things like defence and infrastructure – meant that towns typically featured a regular system of taxation, levied proportionately to each taxpayer's income. A by-product of this taxation system was its creation of the certainty needed to conduct commerce.

Towns in the medieval world have all the pertinent features of special economic zones. They were administratively separate from the rest of the state. They had different mechanisms of taxation. Their legal framework was unique. Their labour supply was freer than in the surrounding area. And these distinguishing features were designed to facilitate commercial practice and trade.

In this context, it is worth briefly looking at the great trade fairs – a regular feature of the medieval economic world. While each town had its own local markets which were held once or twice a week for the town residents and local rural population to buy and sell goods, the medieval fairs were held every six months or annually. They serviced very large regions. The biggest, held in the Champagne region of France, could last up to six weeks and was a genuinely pan-European market.

Trade at the fairs also commonly featured unique legal rights. The peace of the fair was guaranteed by the hosting town, and legal contracts were guaranteed by special fair courts. A degree of labour freedom was granted: the "franchise" provided merchants with immunity from crimes committed or debts contracted outside of the fair. It was also a low regulation environment. The medieval prohibition on usury – lending with interest – was lifted for the duration of the fair. Certainly, the prohibition was replaced by a legal maximum on the rate of interest that could be charged, but that was still a substantial regulatory concession.

The golden age of free cities

Economic policy in Europe in the 17th, 18th and early 19th century was unsympathetic to free trade. The dominance of mercantilism led to warfare in the pursuit of economic and trading

[49] Henri Pirenne, *Economic and Social History of Medieval Europe*, p51-52

advantages. States conferred monopolies on regional trade, and discriminatory policies designed to give preferential treatment meant that trade between competing nations and imperial powers was restrained.

In this environment, cities which were granted free port status flourished. Free ports – often described in this context as “free cities” - were social, industrial, and cultural incubators.

The polyethnic, cosmopolitan free port of Trieste

Trieste is situated in north east Italy, a strategic location which joins the Slavic, Latin and German worlds.[50] Until the eighteenth century, Trieste was a small town, with no more than 8,000 inhabitants, focused on small volume trade. The city came under the Austrian Habsburg Empire in the fourteenth century.

Charles VI, who ruled from 1711-1740, saw the future of the Habsburg Empire as a maritime power, and oriented the economic and military focus towards the Mediterranean. Venice, however, was a declining but still strong economic power, and largely dominated the commerce of the region.

It was under these circumstances that Charles VI proclaimed Trieste’s free port status in 1719. Tariffs would not apply on the import, export, or exchange of goods entering Trieste by sea. Critically, persons of “any nation, condition, and religion” were permitted to enter, settle, and trade, within the free port zone. The Habsburg empire had restrictions on non-Catholic economic activity, which were explicitly waived for Trieste.

The Habsburg empire provided defence, and immunity from crimes committed elsewhere. The free port status originally only applied to the city’s marketplace, but in 1769 it was extended to all of Trieste and its vicinity, being dubbed a “free maritime city”.

There was resistance to the free port status. As well as complex administrative questions – would the port be managed from Vienna, or as a separate entity? The rapid expansion of Trieste after 1719 necessitated substantial infrastructure investments. There was also opposition from existing businesses, who would prefer to avoid the new competition. This was, after all, an economic world where mercantilism was the dominant ideology. One local Trieste businessman asked “How can commerce be a motive for departing from our own local laws and for a change in government?”[51]

Lois C. Dubin points out that a large part of the benefits for the Habsburg Empire of the Trieste port were realised as legal and administrative changes were made throughout the Empire. For example, the lowering of internal customs barriers allowed goods to shift throughout the Empire. Similarly, commercial treaties to open markets overseas – notably Ottoman and Russian markets – helped build export capacity within Habsburg.

[50] Much of this is drawn from the administrative account of Trieste’s free port status in Lois C. Dubin, *The port Jews of Habsburg Trieste: absolutist politics and enlightenment culture*, 1999.
[51] Dubin, *The port Jews of Habsburg Trieste*, p13

The success of the free port of Trieste depended on its ability to attract a sufficient population. Trieste's lack of restrictions on the rights of religious worship, of economic participation, and of the construction of civil society organisations, was immensely appealing to migrants. In the eighteenth century, Europe was still highly religiously divided, and the economic status of religious groups was prescribed by often harsh legislation. This was nowhere as true as in the Habsburg Empire.

Yet Trieste welcomed an enormous variety of religious belief and practice. Dubin describes the merchant class in Trieste as "multireligious, polyethnic, and cosmopolitan." There were formal organisations of Jews, Greek Orthodox, Armenian Uniates, Servians, Protestants, Calvinists, Lutherans, and of course Catholics. One eighteenth century estimate had the foreign-born population of Trieste at around eighty per cent. In the revolutionary era, Trieste was a refuge for those fleeing violence in France.

By 1760, Trieste – a small provincial town in 1717 – was seriously competing with Venice. A visitor to the city in 1820 remarked that it seemed to have arisen out of nowhere: "as if by charm, in a miraculous instant". Another wrote:

> The past is dead… At the pinnacle of the new society there will shine no longer the noblemen of our ancient lineages, but [rather] the bankers, the industrialists, the shipowners, and the merchants … at Trieste true pioneers are all those who have gathered from the most diverse lands to remake their lives … [Trieste] is the Philadelphia of Europe, the city typical of pioneers of our old continent, the port where the shipwrecked find welcome and a promising new life.[52]

<u>State development in the free port of Odessa</u>

Another demonstration of the social impact free port status can have is provided by the Ukrainian city of Odessa.

Odessa is in many ways an artificial construction of public policy. Originally named Khazhibei, the Russian government was seeking to establish a commercial port on the Black Sea, and it was renamed Odessa in 1795, once it had been taken by the Russians during the Russo-Turkish war.[53]

The early development of the city was funded by a combination of subsidy and inducement. The government sponsored the development of a Greek settlement with housing and other buildings just outside the city to attract Greek migrants. Freedom of religion was guaranteed. Migrants to Odessa were granted tax free status for their first ten years, and were exempted from otherwise-compulsory military service. In 1803, the population amounted to about 8,000 residents.[54] By 1851, it had well over 70,000 residents.[55]

Odessa was granted free port status by the Russian government in 1817.

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[52] Dubin, *The port Jews of Habsburg Trieste*, p18
[53] Much of this is drawn from Steven J. Zipperstein, *The Jews of Odessa: A Cultural History, 1794-1881*
[54] Robert Lyall, Travels in Russia, the Krimea, the Caucasus, and Georgia, p165
[55] Zipperstein, *The Jews of Odessa: A Cultural History, 1794-1881*, p29

This had been aggressively lobbied for by the Duc de Richelieu, a French émigré who fled the French Revolution, and had been governor of the city between 1803 and 1814. Richelieu had met Adam Smith, and was a passionate free trade liberal.

This trade strategy was extremely successful. Odessa – a small town in 1789 when it was conquered – was, over the next half century, to play a primary role in the extension of the Russian grain trade. As Russian grain began to dominate European markets, Odessa displaced St. Petersburg as the biggest grain exporter. The free port status also helped cement Odessa's position in global trade. Odessa became the port of entry for Asian goods being sold to Europe.

All this trade necessitated substantial secondary industry, and much of Odessa's growth was centred around its financial and insurance industries.

One prominent strategy of Richelieu to attract visitors to Odessa was his aggressive encouragement of cultural enterprises. Odessa – still a tiny city during Richelieu's administration – had a major Opera house and cultural centre. This, it has been argued by Soviet historians, was part of the cities' commercial strategy.[56] Richelieu believed that simply having extensive commercial and trading facilities would be insufficient to attract the sort of investment and attention he felt the city required. Cultural landmarks were developed seeking a place for Odessa on the international stage. The strategy was apparently successful – by the 1820's it was known as the "Russian Florence" and "St. Petersburg in miniature".[57]

Free port status converted Odessa to a cosmopolitan city. As early as 1819, only a quarter of the population was Russian. By 1851 that proportion had declined to 1 in 7, but this was primarily due to further commercial benefits residents could get from naturalising as Russian citizens. Substantial numbers of Odessa residents came from European commercial hubs, but also the United States, Turkey, Egypt, and Persia. Odessa, wrote one visitor in 1843, "is the most motley mixture of nationalities I have ever seen". The cultural variety was such that some theatre performances were performed in five different languages in the same theatre.[58]

Like Trieste, this cosmopolitan atmosphere, religious toleration, and commercial importance meant that Odessa became a major centre for the Jewish community.

One of Richelieu's successors, Count Michail Vorontsov – governor-general from 1822 to 1855 – was also a passionate liberal free trader. Steven Zipperstein writes that Vorontsov "believed emphatically that freedom was as essential to healthy commercial life as were capital turnover and moderate governmental protection."[59]

[56] Elena Druzhinina, cited by Zipperstein, p27
[57] Zipperstein, *The Jews of Odessa: A Cultural History, 1794-1881*, p27
[58] Ibid., p30
[59] Zipperstein, *The Jews of Odessa: A Cultural History, 1794-1881*, p28

One English visitor to Odessa remarked the city had “arisen as if by magic”.[60]

Colonial free ports in Asia: Singapore and Hong Kong

Free ports were one of the primary mechanisms Britain used to control and encourage British trade with China. Two of the largest and most economically dominant cities – Singapore and Hong Kong – owe their premier position in the world economy to the British free port strategy.

The free ports of Singapore and Hong Kong were founded by a colonial power, but were not a form of colonisation. As Steve Tsang points out, in Hong Kong, there was no serious attempt to “civilise the natives” – to impose the institutions and cultural structures of Victorian England - on the other side of the world, in stark contrast to the practise of other colonies. Hong Kong and Singapore were free ports carved out in Asia and left by the British government to grow relatively unhindered.

The naval station of Singapore was founded in 1819 in order to assert British influence over the southern entrance to the Straits of Malacca, a vital shipping alley between the Malay Peninsula and Sumatra. Singapore from the first was conceived as a trading port – at first to import opium into China, and to export tea out of China to Britain.

Singapore acted as a buffer to avoid trade regulation. The East India Company had a legal monopoly on trade between India and China. The existence of a friendly port in Singapore allowed private ships to circumvent this monopoly. Traders would transfer their cargoes between ships at Singapore before sending it on its final leg of the journey, thus remaining within the letter – if not the spirit – of the law.[61]

However it was Singapore’s status as a free port, along with Penang and Bencoolan, decreed by the first administrator, Stamford Raffles, which gave Singapore its early power. The free port status was used by the British to draw away trade from rival Dutch ports, which, within a decade, were adopting free port status as well. By 1852, the Dutch had made ten of their ports in the region into free ports.[62]

Singapore’s position in the region was, however, maintained by its lower regulatory burdens. Dutch free ports still gave Dutch ships priority over ships under foreign flags. The negative effects of this were recognised at the time, as one Dutch writer wrote in 1849:

> If, in 1816, the monopoly system adopted and vigorously maintained by the Company had been abandoned without any reservations, and if the new government had had the happy and salutary idea of allowing no restrictions in free trade in the [Indonesian spice islands of] Moluccas; if, since then, [the Dutch port of] Macassar had been

[60] Robert Lyall, *Travels in Russia, the Krimea, the Caucasus, and Georgia*, p165
[61] William J. Bernstein, A splendid exchange: how trade shaped the world, p292
[62] Wong Lin Ken, “Singapore: Its growth as an Entrepot Port, 1819-1941”, *Journal of Southeast Asian Studies*, v9 n1 1978

> declared a free port, it is probably that Singapore would never have attained the degree of prosperity which, as a free port, it has enjoyed up to now.[63]

Singapore was a remarkable commercial success. Acting as an artificial meeting place for regional and international traders, Chinese trading agents provided an intermediary for European and Asian goods. As Wong Lin Ken writes, Singapore was a different beast:

> Singapore represented what an alien creation, sited on an island, with no economic hinterland, could accomplish with private enterprise, if unfettered by indigenous customs and institutions, or governmental interference in trade.[64]

For the first few decades, Singapore's free port status was not absolute – there were periodic attempts by Singapore's administrators to derive revenue from the vast trade which travelled through the port – but these were resited, and by the 1870s its status as a free trading hub was sacrosanct. Between 1870 and 1915, imports and exports in Singapore increased ten-fold.[65]

Hong Kong, the small island in the south of China, was first occupied by the British in 1841. Like Singapore, the occupation was for more than just settlement, but to develop an economic and trade outpost in the Far East. The decision had been long agitated for by British traders looking for a port on China's southern coast. Learning from the extraordinarily successful Singaporean experience, it too was to be a free port, in contrast with competing imperial ports in the region. As one English-language newspaper in China, the Canton Register, editorialised that the combination of liberalised trade and Hong Kong's optimal deep water port could undermine the dominance of the Portuguese in the region:

> If the lion's paw is to be put down on any part of the south side of China, let it be Hong Kong; let the lion declare it to be under his guarantee a free port, and in ten years it will be the most considerable mart east of the Cape. The Portuguese made a mistake: they adopted shallow water and exclusive rules. Hong Kong, deep water, and free port for ever.[66]

Hong Kong very rapidly became the central point for regional headquarters of British and other international firms trading with China. While the free port status provided British merchants relief from the discriminatory regulations of Portuguese and Dutch ports, Hong Kong doubly benefited from being a preferred trading place for Chinese merchants, who were penalised by restrictive regulatory frameworks within China. Nineteenth century Hong Kong was not just an outpost of European trade, but one which was used by Chinese traders supplying regional customers. Migrant Chinese workers provided the vast bulk of the labour in Hong Kong.[67]

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[63] C.J. Temminck, *Coup-d'ocil general sur les Possessions Neerlandaises dans I'Inde Archipelagique, III* (Leyden, 1846-1849), 32-33. Quoted in Wong Lin Ken, "Singapore: Its growth as an Entrepot Port, 1819-1941", *Journal of Southeast Asian Studies*, v9 n1 1978

[64] Wong Lin Ken, "Singapore: Its growth as an Entrepot Port, 1819-1941", *Journal of Southeast Asian Studies*, v9 n1 1978

[65] Ibid.

[66] Quoted in Tak-Wing Ngo, *Hong Kong's History: State and Society under Colonial Rule*

[67] Steve Tsang, *A Modern History of Hong Kong*, p57

By the early 20th century, the free port status of Singapore and Hong Kong had made them into substantial regional metropolises. It was however only after the Second World War and the resolution of political conflict in China that the two cities came to dominate world trade.

The 20th Century: Special economic zones as a policy tool

Free ports in 20th Century Europe: modest and limited

Europe in the twentieth century held a large number of free ports. These free port areas have been relatively small – limited to subsections of the ports themselves. Richard Thoman describes them as “free port customs complexes”.[68] Indeed, they bear little resemblance to the free port cities of the 18th and 19th century, nor to Hong Kong or Singapore, although in the debates that accompanied the introduction of European and American free ports in the 20th century, the economic success of the great free ports has been an intellectual touchstone.

Historically, the most important has been the free ports of Hamburg and Bremen. The amalgamation of Germany into a customs union in 1888 was accompanied by the subsequent shrinking of the free zone of the city into a fenced and isolated zone in the port complex. In 1954, the free port zone constituted roughly 20 per cent of the total area of Hamburg port, but a vast majority of the cargo operations.[69]

These zones allowed essentially unlimited import, export, transit, warehousing, manipulation, and sorting. They also allowed a large degree of manufacturing to be conducted within the zone, if that manufacturing was for the purpose of transit or re-export. In the German free ports, shipbuilding was permitted.

The advantages of manufacturing in the zones are substantial. For goods imported to the United States out of the zone, importers can choose whether their tariff liability is assessed on the “raw” material that entered the zone, or on the “finished” product that leaves it. Goods used in manufacture of products, and left in the zone as waste or are destroyed, are duty free.

However, unlike the free cities which they replaced, limited, customs-focused free ports restricted intensive retail trade - only a small amount of trade on a small quantity. It also kept private residences to a minimum, that is, only those necessary for the operation of the port. In Hamburg, the expansion of the port zones in the early 20th century placed further restrictions – particularly the prohibition on manufacturing – in the new areas. In Bremen, manufacturing was completely prohibited.

Nevertheless, these limited free ports have dominated shipping. In 1953, they were responsible for 70 per cent of exports and 60 per cent of imports to and from the German Federal Republic.[70]

[68] Richard Thoman, *Free Ports and Foreign Trade Zones*, p21
[69] Ibid., p39
[70] Richard Thoman, Free Ports and Foreign Trade Zones, p23

The Scandinavian free ports were modelled explicitly on the German experience. Fearing that Scandinavian trade would suffer from the expansive German free ports, local authorities set up a free port in Copenhagen in 1895, seven years after the declarations at Hamburg and Bremen. The Copenhagen port is a similarly free port customs complex as its German counterparts.

A Swedish national committee commenced a series of inquiries into free ports even predating the German experience, and another major inquiry after Copenhagen declared its free port, but it wasn't until 1919 that the Stockholm free port was active. Free ports in Gothenburg and Malmö began operation in 1922.

<u>Foreign trade zones in the United States</u>

Free ports had been discussed in the United States since 1911, focusing on the German experience of the Hamburg port.[71] Nevertheless, it took a policy upheaval during the Great Depression in the 1930s to emphasise the importance of free ports, albeit free ports limited in scope and intent.

The Great Depression was accompanied by a dramatic contraction in international trade, and the resurgence of protectionism. In the United States, the Smoot-Hawley tariff raised trade barriers to their second highest ever level. The tariff had a devastating impact on trade, particularly after much of the world followed with retaliatory tariffs targeting American exports.

Traffic in the biggest American ports declined precipitously, which had consequences for the port communities and labourers relying on the continued operation of the ports.

One American attempt to ameliorate the consequences was the introduction of free ports.

The attempt was initially modest. The Foreign Trade Zones Act was passed in 1934, establishing a Foreign Trade Zones Board which could establish areas near Customs ports of entry which were outside of the United States for tariff purposes. These areas were essential free trade areas, free of tariffs. They were not, however, subject to more liberal legal frameworks in other areas – unlike the great free ports of history. People working in the zones are not exempt from United States immigration laws. Critically, under the 1934 Act, there was no manufacturing permitted in the zones.

While some minor operations could be done on foreign goods imported into the zone for import into the United States, the 1934 Act was essentially an extension of the bonded warehouse system, designed to facilitate the re-export of goods, and the lowering of compliance costs on import while maintaining the existing tariff system.

One interesting feature of the Foreign Trade Zones Act is its name. The protectionist intellectual climate of the first half of the twentieth century was inhospitable to the phrase "free trade".

[71] See, for example, Edwin J Clapp, 'The Free Port as an Instrument of World Trade', in Elisha M Friedman (ed.) American Problems of Reconstruction, 1918.

Congressional support was not forthcoming for legislation which was seen as beholden to a then-anachronistic ideology.[72] One sponsor of the bill stated that "A free port has nothing to do with free trade".[73] Indeed, it was the desire to maintain domestic protection that led to the restriction on manufacturing within zones.[74]

The original bill achieved modest success – facilitating the re-export of imported goods – but it was the Boggs Amendment of the Foreign Trade Zones Act in 1950 that sparked the substantial growth of free zones in the United States. The Boggs Amendment, and the subsequent regulatory changes in 1952 to authorise "subzones" with specialised purposes, removed the restriction on manufacturing within zones. Rather than a defensive measure against the pernicious effects of the Great Depression, the Boggs Amendment was explicitly a measure to harness the moderate success of the zones. Stated one Congressional supporter:

> This manufacture would permit not only the importation of foreign merchandise and work thereon by American labour, but would also provide opportunity for American raw materials and partly manufactured goods to be joined with foreign commodities in the production of final products read and useful either for home consumption or for markets abroad.[75]

Nevertheless, it seems that the impact of allowing manufacturing in the zones would be moderate.

The consequences of the foreign trade zones for American manufacturing were substantial. Before the Boggs Amendment there were only half a dozen foreign trade zones in the United States – New York, Mobile, New Orleans, San Francisco, Los Angeles, and Seattle. New zones were introduced during the 1950s and 1960s, but it was in the 1970s that the zones really took off, partly in response to changes in international trade patterns.[76] By 1982, there were ninety-one zones. Many of these zones were located outside of major seaports, both smaller ports, and even inland areas, where their imports and exports are serviced by airfreight.

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[72] John J. Da Ponte Jr. "United States Foreign-Trade Zones: Adapting to Time and Space", *Maritime Lawyer*, v5, 1980.

[73] Emanuel Celler, quoted in Donald E. deKieffer & George W. Thompson, Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End? Vanderbilt Journal of Transnational Law, v18 n3, 1985

[74] Donald E. deKieffer & George W. Thompson, Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End? Vanderbilt Journal of Transnational Law, v18 n3, 1985

[75] Quoted in Emanuel Celler, quoted in Donald E. deKieffer & George W. Thompson, Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End? *Vanderbilt Journal of Transnational Law*, v18 n3, 1985

[76] John J. Da Ponte Jr. "United States Foreign-Trade Zones: Adapting to Time and Space", *Maritime Lawyer*, v5, 1980.

One year later, the value of economic activity within the zones was estimated at around $3.9 billion.[77]

One barrier to the success of zones in the United States has been the existence within the enabling legislation of a “public interest” requirement for all activity conducted within the zone. The Foreign Trade Zone Board’s assessment of what constitutes public interest has been intermittently controversial.

In one case in 1984, a bicycle manufacturer applied to operate within a zone, importing foreign parts for assembly within a zone, and importation into the United States. The board granted the company permission to operate within the zone, but imposed a limitation on the amount of imported parts it could use. However, in response to domestic manufacturing pressure, Congress then legislated to “prevent foreign-origin bicycle parts from receiving the benefits conferred by a zone”.[78] This example shows that the capacity of limited foreign trade zones to benefit the economy is subject to political will.

<u>Enterprise zones: special economic zones as urban development</u>

Foreign trade zones in the United States have been restrained – even after the Boggs Amendment, manufacturing has been legislatively limited, and many of the features of special economic zones, such as lower zone-wide regulation, migration incentives, and lower overall tax rates, have been absent.

But such special economic zones were not absent from the United States. The idea of special economic zones has been used as an urban development strategy, first in the United Kingdom and imported to the United States by free market think tanks.

Innovative approaches to urban development in the United Kingdom dates back fifty years. In the aftermath of the Second World War, many urban centres were left devastated from German bombing. The 1946 *New Towns Act* gave Development Corporations control over separate urban areas to develop and manage semi-independently, in order to develop the designated areas to a level whereby they could be sold and returned to public management.[79] These were moderately successful, but, more importantly, built an intellectual tradition in urban policy which gave unique zones latitude for policy innovation.

Full-blown special economic zones for urban planning were born thirty years later. The problem the New Towns were designed to tackle was post-war rebuilding. In the 1970s, the problem faced by the British government was urban blight and economic decline. Many major cities saw sharp population decline as the nation de-industrialised. This was accompanied by spikes in urban unemployment.

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[77] Quoted in Emanuel Celler, quoted in Donald E. deKieffer & George W. Thompson, “Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End?” *Vanderbilt Journal of Transnational Law*, v18 n3, 1985

[78] John Patrick Smirnow, “From the Hanseatic Cities of 19th Century Europe to Canned Fish: The Radical Transformation of the Foreign Trade Zones Act of 1934”, *Thomas M. Cooley Law Review*, v10, 1993

[79] A.G. Ling, James Rouse, W.A. West, Marian Bowley, Nathanniel Lichfield, *Private Capital for New Towns*, Institute for Economic Affairs, Occasional Paper 28, 1969

Facing this, Peter Hall, an urban planning professor and socialist, argued that the free port concept be extended to the urban environment. In a speech in 1977 to the Royal Town Planning Institute, Hall argued that the basic principles of free ports – low regulation, low taxation and laissez-faire development – could provide a path for development and the re-invigoration of urban areas. By rejecting the then long-dominant model of top-down urban planning, which sought to micromanage the industrial, commercial and residential layout of urban areas, Hall called his idea the 'non-plan'. Later dubbed 'enterprise zones', they would be:

> …an essay in non-plan. Small, selected areas of inner cities would be simply thrown open to all kinds of initiate, with minimum control. In other words, we would aim to recreate the Hong Kong of the 1950s and 1960s inside inner Liverpool or inner Glasgow.[80]

Central to the enterprise zone concept was a widespread recognition of the importance of small business as a driver of employment. Hall described the enterprise zones as "fairly shameless free enterprise". Like free ports and historical free cities, goods produced in enterprise zones could be imported free of duty, and subject to low or no sales tax. Restrictions on the operation of foreign businesses would be lifted within the zones, and foreign capital would be similarly welcome.

Corporate and personal taxation would be kept to a minimum. Union restrictions on labour would not apply, and there would be no minimum wage within the zone.[81]

Hall's model, and the enterprise zone subsequent models, were recognitions of the role of economic liberty in developing opportunities for employment and production.

Hall's model was radical, but designed to be applied on a small scale, and in areas that were almost entirely denuded of population.

The idea was eagerly adopted by the Conservative opposition looking for a new approach to urban development. The then opposition spokesman on economics saw enterprise zones are being relatively more modest, but adaptable to existing urban areas in decline, not just the completely depopulated areas of Hall's model.

In the Howe model, building codes, health and safety standards, and anti-pollution laws would be lower in the enterprise zones. There would be no planning controls. There would be no rent control – at that time a substantial burden on the property sector. Councils owning property would have to sell it. Property taxes would be either eliminated or substantially reduced.[82] Howe wrote that:

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[80] Peter Hall, Speech to the Royal Town Planning Institute, 15 June 1977
[81] This section is drawn from Stuart M Butler, *Enterprise Zones: Pioneering in the Inner City*, The Heritage Foundation, 1980
[82] Stuart M Butler, *Enterprise Zones: Pioneering in the Inner City*, The Heritage Foundation, 1980, p23

> Traditional policies of intervention have not succeeded in bringing life back to these black spots on the economic map. I personally believe in a new approach: cut bureaucracy, ease the tax burden and leave market forces to life these areas up to the point of economic take-off. The problem is that too often the gap between a productive idea and a foreseeable profit has widened into a bureaucratic jungle. The same jungle all too often stands between a youngster and the prospect of a job. Cut through it and everyone benefits, not simply the entrepreneur who has taken the initial risk.[83]

Howe's plan may not have been as radical as Hall's, but it was still extremely radical in practice and intent. Howe envisioned the zones are more than just economic development, but places for social experimentation as well.

> I believe it would be worthwhile ensuring that part of any Enterprise Zone could be available to non-commercial groups who wished, for example, to establish experimental workers' cooperatives … [If the] Socialist Workers' Party wanted part of an Enterprise Zone to themselves – well, why not?[84]

When it gained government in 1979, Howe, now Chancellor of the Exchequer, introduced enterprise zones. Seven sites, in Newcastle, Liverpool, Belfast, and London, were selected.

The idea was exported to the United States by the Stuart Butler, a British policy analyst working for the US think tank the Heritage Foundation. The enterprise zone concept was embraced more enthusiastically than in the United Kingdom. In 1982, the state of Connecticut set up the first enterprise zone. By 2008, enterprise zones were found in 40 separate states. Ohio in 2008 had 482 separate designated zones.[85]

The American zones have varied wildly in their characteristics. Far from the radical model of Hall, or even Howe, the benefits conferred by these zones can be limited to the reduction or elimination of sales tax for purchases within the zone, or the reduction or elimination of property tax within the zone.

With such limited benefits conferred by the enterprise zones in the United States, it is not surprising that the evidence as to their efficacy has been mixed. Nevertheless, a 2009 study found that the enterprise zones had a statistically significant beneficial impact on the unemployment rate, the poverty rate, and income levels.[86]

The mixed successes of the enterprise zones in the United States and Britain have allowed policymakers to reach some conclusions about the concept. Enterprise zones need to provide a substantial enough benefit to businesses to make it worth it. The financial

[83] Introduction to Butler, p iv
[84] Cited in Butler, 1980, p23
[85] John C. Ham, Ayşe İmrohoroğlu, Charles Swenson, 'Government Programs Can Improve Local Labor Markets: Evidence from State Enterprise Zones, Federal Empowerment Zones and Federal Enterprise Communities', March 2009
[86] Ibid.

incentives have to be significant enough to counter the costs of setting up in an economically depressed area. Similarly, the regulatory barriers need to be low enough.[87]

Enterprise zones in the United States can also be mixed with elaborate subsidy programs – in cases where subsidies and development programs are present, the enterprise zone scheme becomes less an experimental "fairly shameless free enterprise", and more an extensive government program directed at development. Enterprise zones are designed to harness market processes to develop – if those market processes are distorted by the external stimuli of government programs, their effectiveness can be reduced.

Special economic zones in China

The extraordinary revitalisation of the Chinese economy in the last thirty years started with that country's establishment of free trade zones: dubbed, in the Chinese context, 'special economic zones'. Special economic zones were the primary mechanism by which the Chinese government sought to reinvigorate its trade relations with the rest of the world; to transform Chinese industry from inward-looking and self-reliant, to integrated with the global economy. The intention of Deng Xiaoping modernisation programs was to use capitalist means to help the Chinese economy.

Special economic zones became a way to isolate and test deregulatory "capitalism" without risking the complete upheaval of the economic and political system. The reason for the decision to institute special economic zones in economically-depressed regions was two-fold: first, to provide needed stimulus to those areas, and, perhaps more importantly, second, to allow for the possibility that the experiment may need to be abandoned.[88] Nevertheless, the economic zones were supposed to have national effects; to improve the lives and material well-being of Chinese citizens outside the boundaries of the zones.

Like much of the China's opening up policy, special economic zones were arrived at in an atmosphere of policy experimentation. As the Chinese Vice-Premier, Li Lanqing, wrote: "Our country, having no model upon which to pattern its opening-up policy, had to grope its way through trial and error."[89] Unsurprisingly, Hong Kong was the major influence. A Hong Kong-based, Chinese-owned, company, the China Merchant Steamship and Navigation Company, proposed in 1978 to open a factory in China's Guangdong Province, with limited regulatory restraints. The proposal was accepted, and, as the Vice-Premier Li Xiannian told a head of the company, "Don't count on me for money to buy ships and build docks. You've got to get it done by yourselves. Live or die, that's your business."[90]

The new Shekou Industrial Zone, approximately one square kilometre in Shenzhen, chosen for its close proximity with Hong Kong, had its economic laws modelled on Hong Kong, allowing the company to make infrastructure and labour decisions of its own.

[87] Don Hirasuna, Joel Michael, *Enterprise Zones: A Review of the Economic Theory and Empirical Evidence,* Policy Brief, Minnesota House of Representatives, 2005
[88] Wei Ge, *Special economic zones and the economic transition in China*
[89] Li Lanqing, *Breaking through: the birth of China's opening-up policy*, 2009
[90] Ibid.

The enthusiasm within the Chinese government for economic modernisation led to the rapid designation of another four, much larger special economic zones. Three in Guangdong Province, on China's southern coast, Zhuhai, Shantou, and a larger Shenzhen economic zone encompassing the Shekou zone, and one the Fujian Province, Xiamen. Even at their early stages, these were substantial areas – the Shenzhen zone was 327.5 square kilometres, or one-third the size of Hong Kong. Shenzhen now covers nearly 2,000 square kilometres, and Hainan, which was designated in 1990, covers 34,000 square kilometres.

While there was much discussion at the time as to the relationship between China's special economic zones and the US and European limited free trade zones, the closer analogy is to the free cities of the 18th and 19th century. Such large zones harboured existing residents as well as encouraged migration from Hong Kong and other Chinese regions.

The liberalisation of industry within the zone necessitated the liberalisation of other things. While residential quarters were soon forthcoming, the facilities needed to service the population. One particular sticking point was retail shopping. Foreign residents demanded foreign products and retail imports, yet retail in China was a government monopoly, and, consequently, suffered much the same shortages as the rest of the Chinese economy at the end of the 1970s. A joint-venture shopping centre was set up, after the intervention of then-Vice Minister of State Import and Export Commission Jiang Zemin, and consumer products were allowed to be imported into the zone free of duty. As Li Lanquing writes, the first shopping centre in Shenzhen "with its endless array of commodities and bustling grows, compared favourably with its Hong Kong and Western counterparts and stood in stark contrast to the hinterland stores where the stacks were virtually empty."[91]

Infrastructure development was a major challenge. As special economic zones were developed in the most depressed areas of an economically backward country, infrastructure lagged. In the entire Shenzhen area, there were only two engineers reported as residents in 1979 – 80 per cent of households derived their primary income from fishing or agriculture, and there were just a dozen automobiles.[92]

One particular problem was telecommunications. As Zemin said, "We can't afford to let this problem hold us back when we are building factories in collaboration with foreign investors. It is said that telephones are common in Hong Kong, where there is one telephone to every four persons. Our country is lagging behind in this field". The regulatory framework governing telecommunications had to be altered – taken out of control of the Ministry of Post and Telecommunications – in order to resolve the infrastructure backwardness.[93] As in retail, the challenges of special economic zones necessitated further reform and liberalisation to succeed.

Firms operating within special economic zones enjoyed substantial benefits compared to the surrounding areas. Company tax was set at 15 per cent, compared to the 30 per cent tax rate of private companies in the rest of China. There were tax holidays for firms depending on their sector. Agriculture, industry, and transportation had their corporate income tax

[91] Li Lanqing, *Breaking through: the birth of China's opening-up policy*, 2009
[92] Wei Ge, *Special economic zones and the economic transition in China*, p48
[93] Li Lanqing, *Breaking through: the birth of China's opening-up policy*, 2009

waived for different periods. Like the traditional and modern free ports, exports and imports were exempt from duties. Income tax was lowered. Wages were freed from the rigid Chinese centralised wage-setting system. Instead, wages were set by the market. The political and governance arrangements were also altered within the zones to reduce bureaucracy and red tape. As Wei Ge writes,

> Centred on redefining the relationship between government and society, the reforms, sometimes referred to as a model of "smaller government and larger society," called for government to move from dictating virtually every aspect of people's daily economic life to becoming mainly a servant of society; to switch from direct administrative control over the economy to more indirect market-oriented economic management. To facility the reform experiments, the SEZs were granted greater autonomous power in developing municipal regulations and legislation, including local tax structure and standards for tax rates, reductions, and exemptions.[94]

The economic impact of the zones was nearly immediate. In 1980, Shenzhen accounted for 0.5 per cent of the total exports of the Guangdong Province, and 0.6 per cent of its GDP. In 1985, it accounted for 19 per cent of total exports, and nearly 5 per cent of GDP.[95] Shenzhen's GDP is now larger than the rest of the province. Migrants now account for 83 per cent of the total population.[96]

The four special economic zones originally designated in 1980 were joined by Shanghai's Pudong district, and Hainan, both designated in 1990, and the Newly Developed Area of Tianjin Binhai, designated in 2006. Each of these areas are located on the coast and as near as possible to existing industrial and economic powers: near Hong Kong, Macau, Taipei, Korea, and Japan.

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[94] Wei Ge, *Special economic zones and the economic transition in China*, p53-54
[95] Ibid., p47
[96] Wanda Guo and Yueqiu Feng, *Special Economic Zones and Competitiveness: A Case Study of Shenzhen*, Asian Development Bank.