Investment Commentary

Richard Bernstein

Turn America into a giant ‘enterprise zone’

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If there are two things most economists can agree on they are that government policies cannot re-inflate bubbles and that the US economy has to move away from a levered, consumption-focused economy to one focused more on production and exports.

Despite that general agreement, both sides of the aisle in Washington remain focused on the stale policies that have led to the current problems in the US. Post-recession fiscal and monetary stimulus programmes attempted to re-ignite early-cycle sectors of the economy such as housing and consumption, which were the sectors most over-capitalised during the bubble. History clearly shows that bubbles cannot be re-inflated, and these programs proved remarkably impotent.

Traditional tax cuts seem similarly naïve because they do not ensure that the US economy directly benefits from the reduction in government revenue. In an open global economy, US policymakers must create tax incentives that unequivocally focus on benefiting the domestic US economy. The tax cuts of the past decade arguably benefited the emerging markets more than they promoted growth in the US.

One solution might be to make the US a giant “enterprise zone”, a geographic area in which government grants businesses special incentives to build new facilities and hire. In the US, such zones have generally been in blighted urban areas, but the concept should be extended to the entire country.

Any non-financial, non-retail company domiciled anywhere in the world could be granted full federal investment tax credits for the cost of building new production facilities in the US by a certain date (i.e., within five years). In addition, new equipment installed in the facility could qualify for accelerated depreciation. Individual states could compete using further tax incentives, funds for community college workforce training, or improved logistical infrastructure.

A national enterprise zone could shrink the budget deficit because there is no government spending involved and because no taxes would have been collected in the first place (i.e., the facilities and their related jobs do not currently exist). Tax revenue would increase from the jobs created building and fitting the facilities, and from the workers in the new facilities. Those jobs, in turn, would spur state and local sales and real-estate tax revenues.

Capital investment could be partly funded through repatriation of overseas corporate profits. It seems rather disingenuous for US policymakers to argue for the repatriation of corporate profits under the guise of job creation if repatriated funds are used for dividends and share repurchase (neither of which directly create jobs) or for mergers and acquisitions (which destroy jobs). It would make much more sense to tie repatriation of corporate profits to new investment put in place within the US.
Perhaps the most important aspect of the enterprise zone solution is that it is apolitical, and it does not cost anything to try.

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If an enterprise zone program failed, the government and the economy would be no worse off. There are no lost revenues, there are no arbitrary tax breaks that might never be recovered or that favour specific industries, and there is no government spending or sponsorship. No business is rewarded unless it does something positive for the domestic US economy within a specified time frame.

An enterprise zone plan could present some interesting and broad-based investment opportunities. US engineering and construction companies, machinery, job training, and commercial real-estate firms could be immediate beneficiaries. However, if enterprise zones sizably contribute to growth, a more normal cycle could ensue. Traditional early cycle stocks, such as retailing and autos, might be additional beneficiaries. Municipal bonds and high-yield bonds might also perform well as government and domestic corporate cash flows expand. If enterprise zones are not adopted, then the current economic malaise is likely to continue. Treasuries would probably remain a core holding.

There are two inputs to production: labour and capital. The US cannot compete with most other countries on the cost of labour, and it is hard to envision US workers accepting emerging market pay scales. However, the US can certainly compete on the after-tax cost of capital. The combination of a cheap cost of capital, a highly-educated and trained workforce, and clear history of political stability without fear of nationalisation could be a very potent combination.

The problem for the US economy right now is that both sides of the aisle in Washington are stuck in their old ways. Democrats want to fuel housing and consumption, and Republicans want to give open-ended tax cuts. It’s time for a new approach, and for America to wake up and truly start competing in the global economy. A nationwide enterprise zone might be the starting point.

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