Abstract

The escalation of ince … jor concern in state and local devel … eglected part of the bargaining proce … and offices. Just as private business tran … cks provide some recourse to reclaim all or some of a financing package when a firm fails to meet performance requirements. Besides analyzing clawbacks, the authors identify three related areas for policy intervention: penalties, recisions, and recalibrations. The aim of this article is to show that U.S. policymakers can avoid expensive mistakes if they tie incentives to written guarantees of job creation and other benefits. European regional policymakers have used a carrot-and-stick approach to industrial recruitment. Increasingly, state and city governments in the United States also recognize that public-private bargaining requires some form of reasonable, guaranteed quid pro quo.

1.
1. A review of the literature on the use of industrial development incentives in the United States can be found in William Luker, Jr., " 'Buying Payroll': Industrial Development Incentives and the Privatization of Economic Development," (Paper presented at the Annual Meetings of the Western Social Science Association, Lyndon B. Johnson School of Public Affairs, University of Texas at Austin, April 1988, Mimeographed).
2.

2. For details see Norman J. Glickman and Douglas P. Woodward, *The New Competitors: How Foreign Investors Are Changing the U.S. Economy* (New York: Basic Books, 1989), especially ch. 8. See also Martin Tolchin and Susan Tolchin, *Buying Into America: How Foreign Money is Changing the Face of Our Nation* (New York: Times Books, 1988), ch. 4.

3.

3. See Georgina Fiordalishi, "How To Avoid A Bum Deal When Using Incentives to Win Businesses, Jobs," *City & State,* 19 June-2 July 1989, pp. 11-12.

4.

4. See, for example, Tolchin and Tolchin, chap. 4.

5.

5. A decade earlier the state offered Volkswagen a multimillion dollar incentive package following a fierce bidding war with neighboring Ohio. The package included $30 million for rail and highway connections to the plant and a $40 million loan not due until ten years after the plant closed.

6.

6. During the 1980s, major cutbacks affected most federal programs designed to stimulate local economies. Under the Reagan administration, real spending on Urban Development Action Grants and Economic Development Administration programs fell about 53%. Even the popular Community Development Block Grant program was cut 20% (after adjusting for inflation) from 1980 through 1986. See Susan S. Fainstein and Norman Fainstein, "The Ambivalent State: Economic Development Policy in the U.S. Federal System Under the Reagan Administration," *Urban Affairs Quarterly,* 25, No. 1 (1989): 41-62.

7.

7. The best known examples are enterprise zones used to stimulate economic development in depressed urban areas. This centerpiece of Reagan's urban policy was never implemented nationally, but became popular with states and communities.

8.

8. It is difficult to assess how the size of incentives has grown over time. For 1985, the dollar volume of state incentive programs is presented in *National Association of State Development Agencies, Directory of Incentives for Business Investment and Development in the United States: A State-by-State Guide* (Washington, DC: The Urban Institute Press, 1986).

9.

9. Herbert J. Rubin, "Shoot Anything That Flies; Claim Anything That Falls: Conversations with Economic Development Practitioners," *Economic Development Quarterly,* 2, No. 3 (1988): 236-251.

10.

10. Blaine Liner and Larry Ledebur, *Foreign Direct Investment in the United States: A Governor's Guide,* prepared for the 79th meeting of the National Governors' Association (Washington, DC: Urban Institute, July 1987), p. 5.

11.

11. A good summary of the literature is found in John P. Blair and Robert Premus, "Major Factors in Industrial Location: A Review," *Economic Development Quarterly* 1, (1987): *72-85.* For a review of early research, see Benjamin Bridges, Jr., "State and Local Inducements for Industry, Parts I and II," *National Tax Journal,* March 1965 18 No. 1, 1-14 (Part I); and June 1965 18 No. 2, 175-92. A recent empirical study of industrial development effectiveness tested a broad range of general state programs, including some of the plant location inducements considered in this article. It found that land and building

subsidies, tax programs, postsecondary education assistance, advertising and other outreach programs, and research and development support are either too small to have an impact on state economic performance or are inherently ineffective. The author concludes that they tend to waste resources. See Michael I. Luger, "The States and Industrial Development: Program Mix and Policy Effectiveness," in *Perspectives on Local Public Finance and Public Policy,* Vol. 4, ed. John Quigley (Greenwich, ClT: JAI Press, 1987), pp.29-63.

12.

12. Schmenner's 1980 survey of Fortune 500 plant openings and relocations demonstrated "fairly convincingly that tax and financial incentives have little influence on almost all plant location decisions." See Roger W. Schmenner, *Making Location Decisions* (Englewood Cliffs, NJ: Prentice-Hall, 1982), p. 51. More recently, the 1989 Grant Thornton survey found that manufacturers ranked state incentives 17th out of 21 factors that companies consider when deciding on locating new sites. See Grant Thornton, *The 10th Annual Manufacturing Climates Study* (Chicago: Grant Thornton, June 1989).

13.

13. See Barry M. Rubin and C. Kurt Zorn, "Sensible State and Local Economic Development," *Public Administration Review,* March/April 1985, 333-339.

14.

14. As for the impact of taxes on intrametropolitan and interstate location, one exhaustive review of pertinent empirical research concluded that the issue is an "open rather than a settled question." See Robert J. Newman and Dennis H. Sullivan, "Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know, and How Do We Know It?" *Journal of Urban Economics,* 23 (1988): 215-234. At the urban level, studies have shown that once available land, properly zoned, is accounted for, general tax levies may influence final manufacturing location decisions. See Michael J. Wasylenko, "Evidence of Fiscal Differentials and Intrametropolitan Firm Relocation," *Land Economics, 56,* No. 3 (1980): 341-49.

15.

15. North Carolina claims to have only four types of tax breaks, with strict limitations, and one type of financial assistance. South Carolina, by comparison, offers ten categories of tax breaks and 11 varieties of financial assistance. Greg Myers, "Bidding Wars," *Business and Economic Review,* January-March 1987, 8-12.

16.

16. See W.E. Morgan and M.M. Hackbart, "An Analysis of State and Local Industrial Tax Exemption Programs," *Southern Economic Journal* 41 (1974): 200-5; and Bennett Harrison and Sandra Kanter, "The Political Economy of States' Job-Creation Business Incentives," *Journal of the American Institute of Planners,* 44 (1978): 424-35.

17.

17. W. Warren McHone, "Factors in the Adoption of Industrial Development Incentives by States," *Applied Economics,* 19(1987): 17-29.

18.

18. In one case during the late 1970s, a maker of hydraulic equipment announced that it would close its Columbus, Ohio facility after the city government subsidized a West German competitor with a large tax break. See William A. Testa and David R. Allardice, "Bidding for Business," *Chicago Fed Letter,* 16 (December 1988). More recently, auto parts suppliers have complained that subsidies to foreign companies are driving them out of business.

19.

19. See Douglas Yuill and Kevin Allen, *European Regional Incentives* (Glasgow: Centre for the Study of Public Policy, University of Strathclyde, 1980) and subsequent volumes of this catalog for a discussion of clawbacks in European incentive programs. The clawback schemes discussed in this article are drawn from this catalog.

20.

20. The economic myopia of some mayors and governors may ultimately prove to be politically short-sighted. The mayor of Flat Rock, Michigan was voted out largely because of anger about the 14-year tax holiday given to Mazda Motor Corporation.

21.

21. Edward V. Regan, "Government Inc.: Creating Accountability for Economic Development Programs," (Washington, DC: Government Finance Research Center of the Government Finance Officers Association, April 1988; Mimeographed).

22.

22. For information on the cost-effectiveness of alternative forms of industrial incentives see William Hamilton, Larry Ledebur, and Deborah Matz, *Industrial Incentives: Public Promotion of Private Enterprise* (Washington, D.C.: Aslan Press, 1985); Marc Bendick, David Rasmussen and Larry Ledebur, "Evaluating State Economic Development Incentives from the Firm's Perspective," *Journal of Business Economics,* 17, No. 3, (May 1982): 23-29; and David Rasmussen, Marc Bendick, and Larry Ledebur, "A Methodology for Selecting Economic Development Incentives," *Growth and Change, 15,* No. 2 (January 1984): 18-25.

23.

23. This assumption of constant annual costs of the subsidy is probably unrealistic. If infrastructure costs are entailed in the subsidy plan, these costs are likely to be front end costs, whereas costs of maintenance and service would increase with the scale of operations of the firm. Further, if the total tax liability of the firm were abated, the cost in terms of tax revenues foregoing would increase as the value of the property increased.

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