Business Incentive Controls and Political Bargaining: Performance Agreements and Clawback Clauses in American Cities*

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Abstract: This study examines factors that influence the use of performance agreements with clawback clauses as a means of controlling economic development incentives. The author advances a bargaining model based on networks as a lens for understanding development subsidies and controls. While a financially weak local government and local governments that primarily interact with private organizations tend to more loosely implement performance agreements and clawback clauses, local governments in areas with a business sector dominated by large companies and local governments that interact with public organizations tend to more strictly apply them. Another interesting finding is that bargaining conditions based on network relationships play an important role in the decision to always implement performance agreements with clawback clauses and that poor bargaining conditions result in local governments negotiating less binding arrangements. The results verify the utility of a bargaining approach and suggest that local governments can help to encourage more accountable and cost-efficient economic development by carefully managing bargaining conditions and networks.

Keywords: bargaining, networks, performance agreements, clawback clauses

INTRODUCTION

Local governments provide businesses with development incentives such as tax abatements and subsidized loans to stimulate local economic development, expecting
that these incentives will increase job creation and local tax bases (Sullivan & Green, 1999; Marlin, 1990; Fleischmann & Green, 1991). However, some studies argue that these incentives expose local governments to high levels of risk (Sullivan, 2002) and do not ultimately result in more local jobs or expand the tax base as much as anticipated (Koven & Lyons, 2003, pp. 27-43).

While it has been asserted that development incentive offers can persuade firms to relocate (Wassmer & Anderson, 2001, p. 132), the difficulty in predicting the results of development subsidy offers leads to economic and political risk and uncertainty (Sullivan & Green, 1999; Sullivan, 2002; Bachelor, 1994). Thus, many local governments implement business incentive controls such as performance agreements and performance agreements with clawback clauses (Peters, 1993; Ledebur & Woodward, 1990). By instituting these controls, local governments reduce the problem of moral hazard in granting business incentives and make businesses more accountable. For these reasons, performance agreements with clawback clauses are a primary mechanism for managing development incentives.

Nevertheless, there is considerable variation across cities when it comes to the stipulation of performance agreements with clawback clauses (Sharp & Mullinix, 2011, pp. 1-4). Why do some cities uniformly institute business incentive controls, while others do so inconsistently? Understanding this variation may help local decision makers efficiently apply these business incentive controls to private development. Furthermore, local governments might use this understanding to reduce a variety of administrative costs and secure the expected benefits of development incentives (Sullivan & Green, 1999).

Previous studies provide many useful insights. Gray Green and his associates are pioneers in empirical studies on variation in development incentive controls and have promoted an understanding of how local governments manage business incentives. Their studies take into account the influence of economic and demographic conditions as well as the bureaucratic capacity of local governments (Green, 1995; Fleischmann et. al., 1996; Sullivan & Green, 1999; Sullivan, 2000; 2002). However, these studies have not systematically accounted for the use of business incentive controls (Peters, 1993; Ledebur & Woodward, 1990; Sharp & Mullinix, 2011; Sands, Reese, & Kahn, 2006; Dalehite, Mikesell, & Zorn, 2005; Oden & Mueller, 1999; Weber, 2002), and they have also failed to systematically consider the influence of political institutions and a city’s organizational network activities on local economic development. Political institutions can operate either to reinforce or undermine economic constraints in development policies (Wong, 1988). Development policies and activities are filtered by local political institutions, whose particular rules, power arrangements, and perceptions of the governmental marketplace affect their approach to development policies.
Therefore, businesses and governments engage in formal and/or informal bargaining using networks that exist between local governments and other stakeholders (Steinacker, 2002; Kantor & Savitch, 1993, pp. 232-234).

Ha and Feiock (2011; 2012) have recently examined how bargaining conditions and organizational networks influence the use of performance agreements and the application of fiscal analysis to development subsidies, respectively. Their studies verify that the presence of development resources, public-private organizational networks, and a strong bargaining position on the part of the local government make it more likely that a performance agreement will be effected or that fiscal analysis such as cost-benefit analysis and fiscal impact analysis will be carried out. However, they do not consider performance agreements with clawback clauses that are ex post controls to reduce risk and moral hazard. The research here thus advances an integrated model for investigating the extent to which political institutions and organizational networks, in addition to the bargaining powers of governments and businesses, influence the decision as to whether to require a performance agreements and clawback clauses. A generalized ordered logit model has been estimated using the 2004 Strategic Economic Development (SED) Survey and other archival data. The results show that the bargaining conditions of governments and businesses, along with the organizational networks within which a city is embedded, influence the extent to which performance agreements and clawback clauses are applied.

**PERFORMANCE AGREEMENTS WITH CLAWBACK CLAUSES**

Local governments craft a variety of controls to manage development subsidies.¹ Performance agreements and clawback clauses are ex post control mechanisms that minimize moral hazard and thus reduce the risk associated with business incentive offers (Sullivan & Green, 1999; Sullivan, 2002, p. 117; Miller, 1992, pp. 120-127).

Performance agreements and clawback clauses operate as an integrated control mechanism, contractually requiring a firm that accepts an incentive for relocation or expansion to create or retain a certain number of jobs over a defined period of time or make some kind of compensation payment to local or state governments (Peters, 1993). Performance agreements can specify investment, employment, and output standards,

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¹. Development subsidies include tax abatement, low-interest loans, grants, infrastructure, job training, and so on (Bartik, 1992; Sullivan, 2002; Anderson & Wassmer, 2000; Cashin, 2000).
and local governments may specify penalties for failure to perform through clawbacks. Local governments can apply clawback clauses to a part of the subsidy equal to the stream of unrealized benefits or to the entire subsidy (Ledebur & Woodward, 1990; Peters, 1993, pp. 329-330). Therefore, the bargaining power and accountability of local governments play a critical role in the systematic implementation of these controls.

However, because performance is an intangible and abstract concept given unexpected or invisible losses or hidden assets (Ha and Feiock, 2012), performance evaluation can be subjective and political and its targets may be loosely defined (Sullivan, 2002, pp. 117-118). Thus, there are strong incentives for businesses to behave opportunistically. If businesses cannot achieve the benefits that local governments expect, they may attempt to strategically avoid the performance required (Trivedi, 2003). Therefore, the application of incentive controls is a daunting task that requires sophisticated analysis and expertise along with considerable monitoring, and the administrative costs may be high owing to measurement and implementation difficulties (Sullivan, 2002; Ledebur & Woodward, 1990).

Even when local governments apply performance agreements to business incentive offers, these offers do not always include clawback clauses. Although many local governments want to include clawback clauses with performance agreements in order to enhance accountability they are also reluctant to penalize firms that underperform because they do not want to risk losing a development opportunity (Sharp & Mullinix, 2011). It is difficult to evaluate when clawback penalties should be waived, when they should be enforced, and the extent to which they should be enforced (Peters, 1993). According to Peters (1993, p. 339), many program directors believe the imposition of penalties would have no effect on the business climate and would require high administrative costs. For these reasons, performance agreements with clawback clauses are more often attached to business incentives as a result of political bargaining between local governments and businesses, through a variety of network routes, rather than uniformly enforced through performance evaluations of all subsidies.

BARGAINING AND NETWORKS BETWEEN LOCAL GOVERNMENTS AND BUSINESSES

Existing studies have empirically verified factors that are influential in the establishment of incentive controls, focusing on development resources and community conditions.² However, business incentive controls can be the product of bargaining

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² Previous studies suggest that economic forces and the demands and political pressures of
between businesses and governments (Steinacker, 2002; Kantor & Savitch, 1993, pp. 232-233). Each party seeks to maximize their self-interest, using development resources and the given circumstances to gain bargaining advantages (Kantor & Savitch, 1993; Kochan, 1975; Jones & Bachelor, 1993; Steinacker, 2002; 2004).  

In addition, decision makers defined by political institutions can also generate bargaining power (Ha & Feiock, 2012, pp. 3-4). When considering political and economic risks, decision makers from different political institutions may approach bargaining in differing ways (Clingermayer & Feiock, 2001, pp. 35-58). As a result, political institutions can play a critical role in encouraging or constraining the bargaining power of local governments in connection with local economic development.

Local actors also utilize networks inside and outside a community to facilitate the flow of information, manipulate public support, and influence opinion and decision processes (Rogers, 2003, pp. 330-342; Valente, 1999, pp. 31-48). Established formal and informal network relations between external organizations and local governments can substantially influence bargaining costs (Feiock & Park, 2005). Information sharing and credibility accumulation can strengthen or weaken the use of incentive controls.

Three factors can be said to influence the extent to which local governments generally enact performance agreements, those with clawback clauses in particular: how much bargaining power businesses and governments wield, the ability of political institutions to constrain or enhance bargaining power, and the nature of the organizational networks in which local governments are embedded.

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3. For example, if a city has active market sites that appeal to local businesses, the city’s bargaining position is relatively stronger than that of other cities (Swanstrom, 1985, pp. 236-237). In addition, manufacturing businesses that require high sunk costs tend to occupy inferior bargaining positions (Kantor & Savitch, 1993, p. 235). Steinacker (2002; 2004) extends the bargaining approach by identifying how economic, political, and institutional factors shape political risk aversion and the time horizons of local government officials. While competition with other contending locations can reduce the local government’s bargaining power, local governments’ bargaining position in relation to businesses is strong if they have high levels of economic growth and wide latitude to offer tax concessions.
Government and Businesses’ Bargaining Conditions

Government bargaining power varies based on fiscal and economic conditions, willingness, expertise, and the business environment (Kantor & Savitch, 1993; Reese, 1991; 1993; Feiock, 2002). For instance, sufficient experience provides some cities with advantages in managing subsidies. Wealthy communities are not desperate to attract businesses and can more freely negotiate performance agreements with clawback clauses, even if they loosen the terms of those agreements on some projects. On the other hand, local governments that are experiencing economic hardship may seek to provide a variety of conveniences and incentives to businesses while applying fewer restrictions. In addition, as competition for local economic development increases among local governments, businesses may have more alternatives when it comes to moving or relocating to other jurisdictions.

Financial condition of local governments. Fiscal stress substantially affects business incentive offers and thus may influence the extent to which governments institute controls (Green & Fleischmann, 1991; Rubin & Rubin, 1987; Hawkins, 2010). Because of their economic need, poor cities may attempt to attract businesses in a less critical and discerning manner (Feiock, Jeong, & Kim, 2003, pp. 621-623; Steinacker, 2002, pp. 120-139). Therefore, their governments may be less likely to require performance agreements with clawback clauses. However, by the same token, poor governments may also decide to stipulate performance agreements with clawback clauses to reduce financial waste. On the other hand, some cities in healthy fiscal condition might feel less need to put controls in place because of their sufficient financial resources and therefore might loosely institute performance agreements and clawback clauses. However, because many businesses competitively strive to locate in these cities, fiscally healthy governments might be less generous with businesses in bargaining for development incentive offers and be more willing to impose performance agreements with clawbacks (Ha & Feiock, 2012).

Hypothesis 1.1: Fiscally healthy cities are more likely require performance agreements and clawback clauses than cities in poor fiscal condition.

Economic condition of communities. Decision makers regard economic growth as a contributing factor in their career advancement, as it helps them to get reelected or hired into better positions (Cable, Feiock, & Kim, 1993, pp. 619-620). Therefore, economic hardship, measured by statistics such as high unemployment rates, generates political risk for local policy makers and puts local governments into an inferior bargaining position vis-à-vis businesses. Local governments experiencing high unemployment.
rates are thus likely to uncritically provide subsidies to businesses and may not implement clawback controls (Wolman and Spitzley, 1996, pp. 121-124). Consequently, cities suffering from economic hardship will be less likely to impose performance agreements and clawback clauses.

Hypothesis 1.2: Local governments experiencing economic hardship are less likely to require performance agreements with clawback clauses than cities with low unemployment rates.

Experience of local governments. Local governments’ experience can provide both knowledge and practical skills for exercising subsidy controls. Such experiences can be accumulated through trial and error in utilizing a variety of incentives, and local governments can thus learn and develop better bargaining strategies in the process (Reese, 1993; Rubin & Rubin, 1987, p. 37-39). Therefore, frequent bargaining with a variety of businesses will provide local governments with strategies and skills to efficiently handle negotiations with new businesses, enabling them to make incentive offers and institute controls in such a way as to maximize local economic performance (Ha & Feiock, 2012, p. 5). Although there will be governments that irrationally promise more than they can deliver, typically a city that offers more incentives likely has more of the resources necessary to make good on those incentives and will have had more opportunity to negotiate with businesses and thereby acquire experience in managing businesses. In addition, offering a number of different kinds of development incentives will help local governments to accumulate expertise and experience, which will put them in a superior bargaining position in relation to businesses and enhance their ability to enforce subsidy controls (Rubin & Rubin, 1987).

Hypothesis 1.3: Cities that offer a wider set of development incentives will be more likely to require performance agreements and clawback clauses than cities that offer a narrower set of development incentives.

Business sector composition. In general, larger businesses have a greater capacity to properly manage the obligations that local governments demand to them when they offer business incentives than do small businesses (Bowman, 1987) and can better absorb the risk of clawback obligations (Feiock 2002, p. 131). The burden of accepting such obligations is a significant entry barrier to small businesses that seek to obtain development subsidies, and so those businesses with fewer than 20 employees might not even have the chance to receive them. Therefore, performance agreements and clawback clauses are more likely to be imposed on large businesses. In addition, an
increase in the number of larger businesses in a jurisdiction promotes competition for development subsidy benefits among the businesses, which in turn means that while the bargaining position of businesses decreases, the bargaining power of local governments increases. Furthermore, a more specialized economy can enhance government bargaining power since competing cities may not be able to provide the same specific infrastructure and agglomeration economies. More specialized economies are most prevalent in communities with greater number of large-scale firms. On the other hand, large businesses could have more resources with which to lobby local governments against implementing performance agreements with clawback clauses. Nevertheless, this study supports the idea that local governments with a greater proportion of large businesses are likely to stipulate performance agreements with clawback clauses more frequently.

**Hypothesis 1.4:** Cities with a greater proportion of large businesses are more likely to require performance agreements with clawback clauses than cities with a smaller proportion of large businesses.

**Intergovernmental competition.** Even though not all cities prefer to compete with other cities for local development, development-oriented cities at least are likely to compete with one another to attract businesses and maximize their economic position (Peterson, 1981, pp. 17-37; Feiock, 2002). Therefore, increasing competition between local governments for economic development will lead local governments to offer a variety of incentives so as to attract more businesses. In addition, competition between local governments for economic development can lead decision makers to offer more generous incentives. Since businesses will also seek to avoid local government control, competition between local governments will diminish local governments’ bargaining power in contracting with businesses. Businesses will thus find themselves in a superior bargaining position, as the competition between local governments will mean there are more opportunities for them to move to other jurisdictions that provide better benefits (Feiock, 2004). In such an environment, local governments are less likely to impose performance agreements and clawback clauses.

**Hypothesis 1.5:** Cities that compete with other local governments for economic development are less likely to require performance agreements and clawback clauses than cities that do not face competition from other local governments.
Political Institutions

Officials from different political institutions make deals and cope with political risks in different ways, and what requirements they seek to attach to business incentives will depend on their particular bargaining position (Clingermayer & Feiock, 2001; Feiock & Park, 2005). Most local governments in the United States are either of the council-manager variety or the mayor-council form. The mayor-council variety can either feature a weak mayor or a strong mayor. This study proposes that council-managers tend not to impose performance agreements, while the strong-mayor-councils do.

Strong mayor-council. Elected mayors attempt to achieve greater performance ratings within a given term in office so as to improve their chances of reelection by providing development subsidies for large, highly visible projects (Steinacker, 2002; Wolman & Spitzley, 1996, pp. 140-142). For this reason, they tend not to effect ex ante subsidy controls, such as cost-benefit analysis and fiscal impact analysis, because these controls can restrict their political power or delay development projects. Instead, they prefer to impose ex post controls. Since performance agreements with clawback clauses are useful ex post controls that can encourage businesses to perform better and heighten their accountability, these are the ex post control of choice among elected officials. On the other hand, managers in council-manager governments seek to advance their careers and improve their reputations by developing skills in efficient management (Clingermayer & Feiock, 2001). Therefore, city managers might prefer not to provide subsidies to visible projects without a guarantee of performance regarding efficient management of budgets and projects. In order to screen out opportunistic businesses, they tend to more frequently make use of ex ante controls such as fiscal analyses before providing development incentives to businesses (Ha & Feiock, 2012). While the strategy adopted by strong-mayor-council forms of governments of preferring performance agreements with clawback clauses to the exclusion of ex ante controls such as cost-benefit analysis and fiscal impact analysis is costly, it reduces political risk.

Hypothesis 2.1: Local governments with strong mayors are more likely to require performance agreements with clawback clauses than cities with other governmental forms.

Professional administrators. Whether or not local governments have professional administrative officers can significantly influence mayoral development policies and their implementation (Abney & Lauth, 1986, pp. 154-175). Professional administrators are interested in efficiently managing city administration with given budgets and formal...
power (Abney & Lauth, 1986, p. 154), paying attention to economic and financial risk rather than political risk (Clingermayer & Feiock, 2001). Moreover, in terms of individual benefits, a record of efficient management and fiscal conservatism can also provide career opportunities for professional administrators hoping to move to local governments that offer better compensation (Ha & Feiock, 2012). These administrative officers attempt to neutralize themselves politically and to focus on professional management (Abney & Lauth, 1986, p. 139). Accordingly, professional administrators will promote performance agreements with clawback clauses. The extent of their discretion will significantly influence whether or not their local governments impose performance agreements with clawback clauses. Performance agreements with clawback clauses will be enacted more frequently if professional administrators play an important role in economic development decisions.

**Hypothesis 2.2:** Cities with professional administrators that play a pivotal role in decision making related to economic development are more likely to implement performance agreements with clawbacks than cities with professional administrators that play a relatively less important role in such decision making for economic development.

**Organizational Networks**

Networks within or outside local governments can promote the exchange of information resources by encouraging interactions between organizations that help forge stronger relationships between them (Scott & Davis, 2003; Flora & Flora, 1993). In this way, networks have an impact on the resources that are available in bargaining over development incentive controls.

Although public and private economic activities are theoretically separate, in reality they are highly interdependent. The private sector produces economic resources that are necessary for the safety of the political community. Public sector interventions in the market are necessary for the promotion of economic enterprise that the private sector cannot provide on its own. These interventions include benefits such as tax abatements and credits and the resolution of private conflicts that threaten economic activities (Kantor & Savitch, 1993, pp. 232-233). These exchanges and interactions between the private sector and the public sector are achieved through network routes. Networks can secure the bargaining power of local governments and businesses and determine whether local governments effect development subsidy controls or not (Ha & Feiock, 2012). The three types of organizational networks examined in this study are public, public-private, and private.
Public organizational networks. Public organizational networks facilitate interactions between a local government and higher-level or nearby governments focusing on the public interest in economic development (Bozeman & Bretschneider, 1994). State governments, for example, provide financial aid and offer advice and technical assistance to local governments in addition to constraining them, primarily on financial matters. Cities also are dominant service providers for substantial numbers of functions in nearly all states. Therefore, even though the agency or policy field of the state administrator affects which local governments he or she interacts with and how frequently, the overall frequency of state-local interactions is significant (Wright, 1988, pp. 317-326). Therefore, this study takes into account local government’s networking with state government officials and agencies in addition to its networking with other public organizations such as officials or agencies in other cities, county government officials and agencies, and government councils. Public organizational networks usually have two objectives: obtaining financial or political support from higher-level or nearby governments and sharing strategies and information to create development policies and control businesses (Garnett, Marlowe, & Pandey, 2008). Such networks allow information and strategies that can address a variety of problems that arise during the implementation of business incentive controls to be shared, and they can provide a financial and legal support for implementing business incentive controls. Public organizational networks are also likely to engage in accountability-oriented interactions based on formalized relationships (Herranz, 2007, pp. 8-11). Local governments can enhance their bargaining position in negotiations with businesses over development incentives and make businesses more accountable by sharing information and obtaining political and financial support from other public organizations. The support that networking with public organization provides makes local governments that engage in such networking more likely to promote the use of performance agreements with clawback clauses.4

Hypothesis 3.1: Cities with more expansive public organizational networks are more likely to require performance agreements and clawback clauses than cities with less expansive public organizational networks.

4. On the other hand, however, local governments might rely too extensively on financial or physical support from higher-level or nearby governments and therefore fail to efficiently manage development subsidies. Public organizational networks might then, in part, provide local governments with reasons to not require businesses to sign performance agreements as a condition of accepting an incentive offer.
Public-private organizational networks. Public-private organizational networks facilitate interactions between local governments and quasi-governmental development agencies and advisory groups that are not tied exclusively to public or private organizational networks. These networks can play a pivotal role when the private sector or the governmental sector fails to deliver high quality but low-cost services in critical economic areas (Wart, Rahm, & Sanders, 2000). These networks synthesize the information available from private and public organizations, and the alliances among these networks may help to expose businesses’ opportunistic strategies. In addition, since public-private development organizations tend to be development oriented, they are likely to believe ex post controls could constrain their plans. Therefore, local public-private development organizations may prefer not to implement performance agreements with clawback clauses. In addition, advisory organizations deliver citizens’ opinions regarding specific community issues to their governments and help their governments understand citizens’ demands and perspectives. Specifically, citizen advisory groups can be sounding boards for testing plans and ideas and providing local governments with citizens’ and businesses’ opinions of the use of business incentive controls. These organizations heighten transparency between businesses and local governments and strengthen each party’s accountability and credibility. For these reasons, if a local government interacts primarily with public-private organizations, it may feel less need to require businesses to sign performance agreements with clawback clauses as a condition of accepting a development incentive.

Hypothesis 3.2: Cities with more expansive public-private organizational networks are less likely to require performance agreements with clawback clauses than cities with less expansive public-private organizational networks.

Private organizational networks. Local governments often form relationships with private organizations such as chambers of commerce and real estate or property developers in order to promote economic development through partnerships (Barnekov & Daniel, 1989, pp. 212-215). These organizations can provide useful information regarding businesses that may not be easily accessible from other sources and may also offer financial support to support business development when local governments cannot raise enough funds (Ha & Feiock, 2012). Therefore, local governments also seek to retain close partnerships with businesses. Businesses generally prefer quick action and response and thus seek as few development subsidy controls as possible by cultivating political relationships with governments (Barnekov & Daniel, 1989). Over time, relationships between local governments and businesses tend to become symbiotic. Therefore, private organizational networks might be used as a mechanism to dissuade
local governments from insisting that businesses sign performance agreements with clawback clauses.\textsuperscript{5}

**Hypothesis 3.3:** Cities with more expansive private organizational networks are less likely to require performance agreements with clawback clauses than cities with less expansive private sector networks.

### METHODS

#### Data Sources

This study uses the 2004 SED survey conducted by Florida State University and Claremont Graduate University, combined with archival data from the U.S. Census Bureau, the *Municipal Year Book*, and City-Data.com. In the fall of 2004, the SED survey was conducted in 900 cities from U.S. metropolitan areas with populations over 10,000, and the overall response rate of the survey was 42.89\% (386/900 cities).\textsuperscript{6} However, 113 observations from the respondent data include missingness and four observations were eliminated as outliers. As a result, survey data from 269 cities and the 2004 archival data from the responding cities are used in this study.\textsuperscript{7} However, the study uses 2002 data for the business sector composition variable because of a limitation of data collection in the 2004 survey. The survey was sent to top executive officers with general responsibility for economic development.

\textsuperscript{5} However, local governments might have superior bargaining power over businesses if their site is appealing or they possess fixed capital because then they would be in a position to choose which businesses to offer incentives to and to implement subsidy controls (Kantor & Savitch, 1993). In these scenarios, local governments may use private organizational networks as a mechanism by which to obtain information that they can use to restrict and control businesses’ opportunistic behaviors and strategies. Private organizational networks under these circumstances might encourage local governments to negotiate performance agreements with the businesses they are offering incentives to.

\textsuperscript{6} Even though the data collected from 2004 SED survey tend to be outdated, the data set is useful for addressing the question of local government’s use of business incentive controls because it focused on national level and strategic economic development tools.

\textsuperscript{7} The survey randomly selected 900 cities with populations over 10,000 in their metropolitan areas from the 50 U.S. states, including D.C. Since some metropolitan areas span state boundaries, this study focuses on cities that are in metropolitan areas, such as New York-northern New Jersey-Long Island, Los Angeles-Long Beach-Santa Ana, Chicago-Joliet-Naperville, Dallas-Fort Worth-Arlington, and Miami-Fort Lauderdale-Pompano Beach.

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Measure of Independent and Dependent Variables

Independent variables are categorized into government and business bargaining conditions, political institutions, and organizational networks. For government and business bargaining conditions, the financial condition of local governments is measured by 2004 total revenue per capita and the economic condition is measured by the 2004 unemployment rate. Experience of local governments is measured by the product of the variation of negotiating with new businesses and the number of incentive policies for economic development that local governments offer. The incentive policies are based on 13 incentive programs, and the extent to which city negotiated incentive packages was determined by posing the question “How often does the city negotiate specific incentive packages with new businesses?,” answers to which were coded on a scale from 1 (never 1) to 3 (almost every time). Businesses sector composition is measured by the percentage of business establishments with 20 or more employees in 2002 divided by the total number of business establishments within the jurisdiction of a local government. Intergovernmental competition is measured by the extent to which cities are perceived as competing for new development, coded on a scale from 1 (not at all a problem) to 5 (very severe problem).

The role of political institutions in the decision of local governments to stipulate performance agreements is measured by the presence of a strong-mayor-council form of government and the importance of professional administrators in local economic development policy activity. This study codes a mayor-council government without appointed administrators as 1 and other forms of government as 0. In addition, the position of the professional administrator is coded on a scale from 1 (not important) to 3 (most important).

The three types of organization networks are measured as additive indices based on the frequency of the interaction of local governments with these three types of networks.

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8. Examination of correlation among independent variables reveals that even though correlations between public organizational networks and private organizational networks (0.52) and between public organizational networks and public-private organizational networks (0.59) are a little high, these types of organizational networks have theoretically different attributes and functions. Therefore, despite the correlations being high, this study treats the types of organizational networks as discrete. The highest correlation observed between the other variables was 0.34.

9. The Census Bureau provides a percentage of business establishments with 20 or more employees. Those with fewer than 20 employees are considered to be small businesses. Therefore, this study identifies small businesses as those with fewer than 20 employees.
organizations, using a five-scale range from 0 (no contact) to 4 (weekly). The influence of public organizational networks is measured by the number of interactions between a local government and county government officials/agencies, state government officials/agencies, officials or agencies in other cities, and government councils. The influence of public-private organizational networks is measured by the number of interactions between a local government and local public-private development organizations, county/regional public-private development organizations, citizen advisory groups, and churches/religious organizations. The influence of private organizational networks is measured by the number of interactions between a local government and chambers of commerce, real estate or property developers, private consultants, and private lending institutions.

The use of performance agreements with a clawback clause is measured by integrating responses to two 2004 SED survey questions. The first was whether the local government required a performance agreement (e.g., a certain number of jobs created) as a condition for providing business incentives. The second was how often a local government that required a performance agreement included a clawback clause in it that obligated businesses to return government incentives if they did not fulfill the performance agreement. Integrating the two survey questions and reflecting the variation of two controls, this study again operationalizes the scale of response in an ordinal variable from 1 to 3 as follows: performance agreements and clawback clauses are not always required (1); performance agreements are always required but clawback clauses are not always required (2); and both performance agreements and clawback clauses are always required (3). These variables are summarized in appendix 1.

Estimate Procedures

First, this study detected the sample’s Pearson residuals. According to the analytical results, when dependent variables are grouped in categories 1 and 2 and category 3, four observations showed standardized residuals greater than ±2.5 and thus were eliminated from the data set.

10. The response categories for each question were “never,” “sometimes,” “usually,” and “always.” Responses were coded on a scale from 1 to 4 respectively in order to measure the extent to which a control is employed.
11. “Not always required” means performance agreements and clawback clauses are usually, sometimes, or never required in connection with development incentives.
12. The four cities are Bristol (CT), Champaign (IL), Avon Lake (OH), and West Allis (WI), and the standardized residuals of the cities are -3.08, -3.07, -2.93, and -2.64, respectively.
Since the dependent variables were measured on an ordinal scale, the author tested the parallel regression assumption using an approximate LR test. When the parallel regression assumption is not rejected, this test can provide more confidence in the results of residual analysis in an ordered logit model (Long & Freese, 2006, p. 201). However, this model was found to violate the parallel regression assumption, as Chi2 (10) = 20.73 and Prob > Chi2 = 0.0230 at the level of p < 0.05. Therefore, the study adopted a generalized ordered logit model. Equation (1) presents a basic generalized ordered logit model.

\[
P(Y_{i}>j) = g(X_{i}\beta_j) = \frac{\exp(\alpha_j + X_{i}\beta_j)}{1+\exp(\alpha_j + X_{i}\beta_j)}, \quad j = 1, 2, \ldots, M-1
\]

\(M\) represents the number of categories of the ordinal dependent variable. The probabilities that \(Y\) will take on each of the values are equal to

\[
P(Y_{i} = 1) = 1 - g(X_{i}\beta_1)
\]

\[
P(Y_{i} = j) = g(X_{i}\beta_{j-1}) - g(X_{i}\beta_j), \quad j = 2, M-1
\]

\[
P(Y_{i} = M) = g(X_{i}\beta_{M-1})
\]

The number of categories (\(M\)) of the dependent variable used in this study, based on this theoretical logic, is 3, and thus \(j\) is 2. Therefore, the generalized ordered logit model is equivalent to a series of two binary logit models. For \(j = 1\), category 1 is contrasted with categories 2 and 3. For \(j = 2\), the contrast is between categories 1 and 2 versus 3. The generalized ordered logit model is less restrictive than the ordered logit model based on the parallel regression assumption but is more parsimonious and interpretable than when estimated by nonordinal methods such as multinomial logistic regression. The generalized ordered logit model first estimates an entirely unconstrained model and then performs a series of Wald tests on each variable individually to see whether or not the variable meets the parallel regression assumption. If the Wald test is statistically insignificant for one or more variables, the variable with the least significant value on the Wald test is constrained to have equal effects across equations. The model is then reestimated with constraints, and the process is repeated until there are no further variables that meet the parallel lines assumption. A Wald test is then run on the final model with constraints versus the original unconstrained model (Williams, 2006). Since the data set under study in this article did not satisfy the parallel regression assumption, this model cannot be estimated in a model. As a result, this study estimated the analytical results by dividing three categories of dependent variables into two panels,
like two binary logit models, based on less restrictive assumptions. The data set has thus been analyzed by a generalized ordered logit model.

RESULTS

This study found variation in how often local governments stipulate performance agreements and clawback clauses. Table 1 reports that while 27.88% of cities always require performance agreements with clawback clauses, 54.65% of cities do not always require them. In addition, 17.47% of cities always require performance agreements but do not always require clawback clauses. Thus these statistics reveal that around 45% of cities always require business to negotiate performance agreements and that many other cities intermittently implement controls, including clawback clauses.

Table 1. Use of Performance Agreements and Clawback Clauses with Business Incentives

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<th>Degree of Use of Performance Agreements/Clawbacks</th>
<th>Frequency</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Performance agreement and clawback are not always required (1)</td>
<td>148</td>
<td>54.21</td>
</tr>
<tr>
<td>Performance agreement is always required, but clawback is not (2)</td>
<td>49</td>
<td>17.95</td>
</tr>
<tr>
<td>Performance agreements with clawbacks are always required (3)</td>
<td>76</td>
<td>27.84</td>
</tr>
<tr>
<td>Total</td>
<td>273</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Note: Clawbacks are generally an optional tool for strengthening performance agreements. Therefore, if a local government does not require a performance agreement, it will not stipulate a clawback. However, if a local government always requires performance agreements, it might or might not include clawback clauses in the performance agreements.

In addition, this study analyzes the data to understand the characteristics of its sample. The results indicate that per capita total revenue and the unemployment rate are low. However, while the products of frequency of negotiating with new businesses, the number of incentive programs provided to businesses, and the percentage of business establishments with 20 or more employees indicate a wide dispersion, their means are not high. In addition, local governments experience competition with other governments and recognize its seriousness. In respect to political institutions, while the number of local governments with a strong mayor is very low, professional administrators play pivotal roles in local economic development policy activities. Lastly, local governments interact frequently with other organizations to promote local economic development; they do so most frequently with private networks, less frequently with public networks, and least frequently with public-private organizational networks.
Table 3 reports the estimates of a generalized ordered logit model on the extent to which local governments have required performance agreements and clawback clauses. This model shows an appropriate fit with data based on LR Chi2 and Prob > Chi2. Financial condition and business sector composition of government/business bargaining conditions are statistically significant in both model 1 and model 2. However, contrary to what the author expected, financial conditions such as per capita total revenue have a negative influence on the use of performance agreements and clawback clauses. This study expected that fiscally healthy local governments would impose more stringent performance agreements and clawback clauses because they usually have greater bargaining power relative to businesses. However, cities with higher total revenue per capita are less likely to require performance agreements and clawback clauses. The reason for this unexpected result might be that fiscally healthy cities are less sensitive to fiscal problems and waste. In addition, when the local business sector is composed of a higher percentage of large firms, local governments are more likely to require performance agreements with clawback clauses. Specifically, as the number of large manufacturing businesses increases, the cities are more likely to negotiate performance agreements with clawback clauses. While small businesses might not even have the chance to receive development subsidies, large firms can more easily accept the government’s requirements. As the number of large businesses increases in a jurisdiction, they have to compete with one another more to obtain development subsidies.
### Table 3. Estimations with respect to the Factors That Influence the Use of Performance Agreements and Clawback Clauses

<table>
<thead>
<tr>
<th>Explanatory Variables</th>
<th>Model 1 (category 1 versus categories 2 and 3)</th>
<th>Model 2 (categories 1 and 2 versus category 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coef. (Std. Err)</td>
<td>Odds Ratio (Std. Err)</td>
</tr>
<tr>
<td><strong>Government/Business Bargaining Conditions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial condition of local governments</td>
<td>-0.319* (0.167)</td>
<td>0.727 (0.121)</td>
</tr>
<tr>
<td>Economic condition of communities</td>
<td>0.021 (0.048)</td>
<td>1.021 (0.049)</td>
</tr>
<tr>
<td>Experience of local governments</td>
<td>0.021 (0.019)</td>
<td>1.021 (0.019)</td>
</tr>
<tr>
<td>Business sector composition</td>
<td>0.024** (0.010)</td>
<td>1.024 (0.010)</td>
</tr>
<tr>
<td>Intergovernmental competition</td>
<td>-0.127 (0.096)</td>
<td>0.881 (0.084)</td>
</tr>
<tr>
<td><strong>Political Institutions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strong Mayor-council</td>
<td>-0.001 (0.299)</td>
<td>0.999 (0.298)</td>
</tr>
<tr>
<td>Professional administrator</td>
<td>0.219 (0.208)</td>
<td>1.245 (0.259)</td>
</tr>
<tr>
<td><strong>Organizational Networks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public organizational network</td>
<td>0.056 (0.048)</td>
<td>1.057 (0.051)</td>
</tr>
<tr>
<td>Public/private organizational network</td>
<td>-0.082 (0.050)</td>
<td>0.921 (0.046)</td>
</tr>
<tr>
<td>Private organizational network</td>
<td>-0.004 (0.048)</td>
<td>0.996 (0.048)</td>
</tr>
<tr>
<td><strong>Gamma_2</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public organizational network</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Private organizational network</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>_Cons</td>
<td>0.553 (0.778)</td>
<td>0.057 (0.448)</td>
</tr>
<tr>
<td><strong>Number of Obs</strong></td>
<td>269</td>
<td></td>
</tr>
<tr>
<td><strong>LR Chi2(12)</strong></td>
<td>28.31</td>
<td></td>
</tr>
<tr>
<td><strong>Prob &gt; Chi2</strong></td>
<td>0.0050</td>
<td></td>
</tr>
</tbody>
</table>

Note: * p < 0.1, ** p < 0.05, *** p < 0.01. Unstandardized coefficients with standard errors appear in parentheses. Model 1 contrasts category 1 (both performance agreement (PA)/clawback clauses (CC) are not always required) with categories 2 (PA is always required and CC is not always required) and 3 (both PA and CC are always required); model 2 contrasts categories 1 (both PA/ CC are not always required) and 2 (PA is always required and CC is not always required) with category 3 (both PA and CC are always required). Gamma_2 presents the differences between models 1 and 2 of the three variables that do not satisfy the parallel regression assumption.
Therefore, although large businesses have a better chance of receiving business incentives, an increase in the number of large businesses will promote competition among them and thus reduce their bargaining power with governments, putting local governments in a position to more freely demand performance agreements with clawback clauses as a condition of firms’ accepting development subsidies. However, this study does not find that the economic condition of the community, experience in negotiation, or intergovernmental competition significantly influence the use of performance agreements and clawback clauses.

In addition, neither variable for political institutions had a statistically significant impact. This result may imply that the use of performance agreements and clawback clauses is likely to be substantially determined by factors beyond the positions of decision makers, such as the political influence of several stakeholders. On the other hand, the control variable might be routine day-to-day managing, which street-level officials generally are more responsible for; decision makers may barely intervene in such matters. This issue needs to be explored more in future studies.

Although public and private organization networks do not have a statistically significant influence in model 1, the variables significantly influence the use of performance agreements with clawback clauses in model 2, as can be seen in gamma_2. The results demonstrating statistically significant networks in model 2 but not model 1 indicate that an increase in the interaction between a local government and public organizations makes it more likely that performance agreements with clawback clauses, as opposed to no performance agreement at all or a performance agreement with no clawback clause, will be stipulated. On the other hand, an increase in the interaction between a local government and private organizations makes it less likely that performance agreements with clawback clauses, again, as opposed to no performance agreement at all or a performance agreement with no clawback clause, will be required.

Public organizational networks not only provide a variety of information with which to efficiently manage businesses in the use of development incentive controls but can also serve as tools through which to obtain financial or political support from higher-level and nearby governments. These networks also make it more difficult for firms to play one government against another to secure a better deal. On the other hand, private organizational networks can be used as instruments for advancing private developers’ interests and making policy makers more empathetic to businesses’ desire to reduce the regulatory requirements of subsidy controls and thus can be routes by which businesses might minimize the complicated regulations and controls of local governments and maximize their own interests. This possibility implies, critically, that local governments need to promote public organizational networks in order to efficiently implement ex post controls such as performance agreements and clawback clauses.
while carefully constraining private organizational networks. However, public-private organizational networks are not a statistically significant influence on performance agreements and clawback clauses, even though the networks have significant influence on ex ante controls such as cost-benefit analysis and fiscal impact analysis (Ha & Feiock, 2012). This result might indicate a significant distinction between ex ante controls and ex post controls. This issue also needs to be systematically investigated in future studies.

CONCLUSION

This study explores what accounts for variation across local governments in the use of performance agreements with clawback clauses in their business incentives. The author employs a bargaining approach integrated with a consideration of the role of networks and political institutions. The results verify the utility of a bargaining approach and imply that local governments can make economic development more accountable and cost efficient through carefully managing bargaining conditions and networks.

This study expected that the fiscal condition and experience of local governments, along with business sector composition, would have a positive influence on the stipulation of performance agreements and clawback clauses but that economic conditions and intergovernmental competition would have a negative impact. According to the results, fiscal health and business sector composition significantly influence subsidy controls. Financial condition, contrary to the author’s expectations, has a negative influence on the use of performance agreements and clawback clauses because fiscally healthy cities are not likely to be sensitive to fiscal problems and therefore tend to be more generous in bargaining with businesses. However, as large businesses become dominant in local economic districts, competition between large businesses becomes more serious, and thus local governments may have more opportunities to stipulate performance agreements and clawback clauses. As a result, fiscally healthy local governments need to be monitored more systematically by higher-level governments, including a central or federal government. In addition, local governments with many large businesses need to build institutional systems to manage efficient and responsible implementation of these incentive controls, minimizing government failures.

In addition, this study assumed that both strong-mayor-council governments and local governments with professional administrators would have a positive impact on use of performance agreements and clawback clauses. However, the findings did not show that the variables produce statistically significant differences. From these findings, this study postulates that factors beyond the political attributes and positions of decision
makers, including collective action among a variety of stakeholders, might influence the use of performance agreements and clawback clauses.

This study also assumed that public organizational networks would have a positive impact on the use of performance agreements and clawback clauses but that public-private organizational networks and private organizational networks would have a negative influence. According to the findings, there are extremely significant differences across network types. Public organizational networks stimulate the use of performance agreements with clawback clauses, but private organizational networks have the opposite effect. This finding suggests that local governments need to carefully manage organizational networks in order to foster economic development. These results may help justify the role of local governments in helping promote efficient and accountable economic development. In addition, significant differences between the conditions under which local governments always require performance agreements with clawback clauses and the conditions under which they negotiate other less binding arrangements show the importance of network-based bargaining. Therefore, if decision makers seek to minimize administrative costs and maximize expected benefits, the influence of network-based political bargaining needs to be given more careful consideration. We especially need to pay attention to businesses’ effort to constrain the use of incentive controls through networks. Excessive use of incentive controls might promote lobbying and cause businesses to behave more opportunistically, thereby generating more administrative costs. Governments should carefully consider the relationship between networks and incentive controls. Accordingly, the results of this study at least suggest that political bargaining and networks can become useful tools in promoting accountable and cost-efficient local economic development activities.

Finally, even though this study sought to explore the influence of several critical factors on local governments’ ex post controls for business subsidy offers, the limitation of prerecession data needs to be carefully considered. Macroeconomic conditions for local governments, such as unemployment rates, government budgets and revenues, and market price mechanisms, have been continuously changing, and local government’s use of performance agreements and clawback clauses might be influenced by these conditions. This study did not systematically consider these changing conditions, and so they need to be studied with longitudinal data. In addition, the findings of this study suggest a couple of questions for future research and the author anticipates that these problems and issues will be systematically examined in such future research.
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## Appendix 1

### Explanations of Independent and Dependent Variables

<table>
<thead>
<tr>
<th>Concepts</th>
<th>Variables</th>
<th>Sources</th>
<th>Date</th>
</tr>
</thead>
</table>
| **Dependent variables: performance agreements and clawback clauses** | Performance agreement and clawback clauses are not required (1)  
Performance agreement is required but clawback clauses are not (2)  
Performance agreements with clawback clauses are required (3) | Strategic Economic Development Survey (SEDS) | 2004   |
| **Government/Business Bargaining Conditions**       |                                                                                                                                              |                                               |        |
| Financial condition of local governments           | Total revenue per capita                                                                                                                  | Census Bureau                                | 2004   |
| Economic condition of communities                  | Unemployment rate                                                                                                                          | City-Data.com                                | 2004   |
| **Experience of local governments**                | The product of the number of location incentive programs used by a local government and frequency with which they negotiate incentive packages with new businesses  
Location incentive programs: property tax abatements, sales tax abatement or rebates, tax credits to businesses, tax increment financing, grants to businesses, infrastructure improvements, free land/land write-downs, subsidized buildings, job training subsidies, utility rate reduction, low-cost loans to businesses, city-issued bonds, relief from development fees  
Incentive packages: how often does the city negotiate specific incentive packages with new businesses? (never (1), half of the time (2), almost every time (3)) | SEDS                                           | 2004   |
<p>| <strong>Business sector composition</strong>                    | The percentage of business establishments with 20 or more employees divided by total number of business establishments of the local government | Census Bureau                                | 2002   |
| <strong>Intergovernmental competition</strong>                  | How severely does your city experience competition from nearby communities? (not at all a problem (1) to very severe problem (5)) | SEDS                                           | 2004   |</p>
<table>
<thead>
<tr>
<th>Concepts</th>
<th>Variables</th>
<th>Sources</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Institutions</td>
<td>Mayor without appointed administrators (1), others (council-manager, commission, representative town meeting, town meeting forms of government) (0)</td>
<td>Municipal Year Book</td>
<td>2004</td>
</tr>
<tr>
<td></td>
<td>Please rate the importance of the city’s chief administrative officer in the city’s economic development policy activity (not important (1), important (2), very important (3))</td>
<td>SEDS</td>
<td>2004</td>
</tr>
<tr>
<td>Organizational Networks</td>
<td>Interaction between a local government and four other government organizations (state government officials/agencies, county government officials/agencies, officials or agencies in other cities, and government councils) (0-16)</td>
<td>SEDS</td>
<td>2004</td>
</tr>
<tr>
<td></td>
<td>Interaction between a local government and public-private development organizations (local public-private development organizations, county/ regional public-private development organizations, citizen advisory group, and churches/religious organizations (0-16)</td>
<td>SEDS</td>
<td>2004</td>
</tr>
<tr>
<td></td>
<td>Interaction between a local government and private partner organizations (chamber of commerce, real estate or property developers, private consultants, and private lending institutions) (0-16)</td>
<td>SEDS</td>
<td>2004</td>
</tr>
</tbody>
</table>