

Informing the Debate

Michigan Applied Public Policy Brief

Emergency Managers in Michigan: Just What the Doctor Ordered?

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Informing the Debate

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Emergency Managers in Michigan: Just What the Doctor Ordered?

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Executive Summary

Do Emergency Managers offer a cure for Michigan's ailing municipalities and school districts, or is this remedy simply dulling a pain that will come back later? The State of Michigan has enacted a law that allows state government to intervene in local government affairs in the case of financial dire straits. Public Act (PA) 436 of 2012, also known as the Local Financial Stability and Choice Act, took effect on March 28, 2013, and applies to all municipalities and school districts within the State of Michigan. PA 436 is intended as the successor to three previous financial intervention acts in Michigan. Since PA 436 and its predecessor acts were enacted, they have faced considerable criticism from some citizens and even sparked a gubernatorial recall effort under a previous version of the Act. In addition, some local officials worry that the power to run their government will be stripped from them in favor of an all-powerful state government.

Despite a great deal of political discussion regarding PA 436 and its predecessors, two questions remain unanswered: when should the state intervene in local government fiscal affairs, and what are the empirical effects of state fiscal intervention on local governments in Michigan? We theoretically explore when intervention should occur, and empirically investigate the effects using popular financial indicators. We find transaction cost theory is useful in determining when states should intervene. We also find that fiscal intervention is associated with some positive fiscal outcomes, but these positive outcomes tend to be short-term. We also find that not all cities have experienced positive results. We believe these variations in outcomes can be explained using transaction cost theory.

Based on our findings, we recommend that the State of Michigan approach intervention in the future using transaction cost theory, which means specifically:

- 1) State intervention should occur only when an inefficiency exists at the local level, such as a lack of training or expertise or an obvious mismanagement issue. Long-term socioeconomic problems such as population decline or a declining tax base are not appropriate problems for state intervention to address.
- 2) Emergency managers should avoid solving short-term problems by using solutions that create long-term problems. Specifically, emergency managers should avoid the issuance of long-term debt to fund short-term operations or deficits.
- 3) Before the State of Michigan ends its intervention in a given municipality, the State should ensure that proper management is in place to ensure the long-term sustainability of a municipality. Simply correcting an inefficiency and then restoring power to management that continues to practice inefficient behavior will not result in long-term financial sustainability.

Background of PA 436 and Fiscal Intervention in Michigan

The State of Michigan has long monitored local governments' fiscal condition. In 1988, Public Act 101 was passed to allow emergency intervention in the City of Hamtramck. In 1990, a stronger law, known as Public Act 72 of 1990, was passed and allowed the State to appoint Emergency Financial Managers to both distressed municipalities and school districts (Michigan Radio, 2011; Scorsone, 2012).

PA 72 of 1990 operated for over two decades in Michigan before major changes occurred. In an effort to strengthen financial intervention in Michigan in the face of extremely distressed municipalities, Public Act (PA) 4 of 2011, also known as the Local Government and School District Fiscal Accountability Act, was approved by Governor Rick Snyder on March 16,

2011, and applied to all municipalities and school districts within the State of Michigan (State of Michigan, 2011). PA 4 allowed broad financial and management authority by a state-appointed Emergency Manager based on a system of 17 “triggers,” described in Table 1, that the state viewed as fiscally troublesome.

1	The governing body or the chief administrative officer of a unit of local government requests a preliminary review.	10*	A municipal government or school district has ended a fiscal year in a deficit condition or has failed to comply with the requirements for filing or instituting a financial plan to
2	The State Financial Authority receives a written request from a creditor with an undisputed claim that remains unpaid 6 months after its due date against the local government that exceeds the greater of \$10,000.00 or 1% of the annual general fund budget of the local government.	11	The State Financial Authority receives written notification from a trustee, paying agent, bondholder, or auditor engaged by the local government of a default in a bond or note payment or a violation of 1 or more bond or note covenants.
3	The State Financial Authority receives a petition containing specific allegations of local government financial distress signed by five percent of voters from the last gubernatorial election.	12	The State Financial Authority receives a resolution from either the State Senate or the House of Representatives requesting a preliminary review.
4	The State Financial Authority receives written notification that a unit of local government has not timely deposited its minimum obligation payment to the unit of local government pension fund as required by law.	13	A unit of municipal government is delinquent in the distribution of tax revenues, as required by law, that it has collected for another taxing jurisdiction, and that taxing jurisdiction requests a preliminary review.
5	The State Financial Authority receives written notification that the unit of local government has failed for a period of seven days or more after the scheduled date of payment to pay wages and salaries or other compensation owed to employees or benefits owed to retirees.	14	A unit of local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan.
6	The local government has violated a requirement of, or a condition of an order issued pursuant to the revenue bond act of 1933, the revised municipal finance act of 2001, or any other law governing the issuance of bonds or notes.	15	A court has ordered an additional tax levy without the prior approval of the governing body of the unit of local government.
7	A municipal government has violated the conditions of an order issued by the local emergency financial assistance loan board pursuant to the emergency municipal loan act of 1980	16*	A unit of local government has been assigned a long-term debt rating within or below the BBB category or its equivalent by one or more nationally recognized credit rating agencies.
8	The local government has violated a requirement of sections 17 to 20 of the uniform budgeting and accounting act of 1968	17*	The existence of other facts or circumstances that in the sole discretion of the State Treasurer for a municipal government are indicative of municipal financial stress, or, that in the sole discretion of the Superintendent of Public Instruction for a school district are indicative of school district financial stress.
9	The local government fails to timely file an annual financial report or audit that conforms with the minimum procedures and standards of the state financial authority		* indicates trigger was new as of 2011

Table 1: Municipal Conditions that Trigger PA 436 (State of Michigan 96th Legislature, 2011)

The passage of PA 4 of 2011 sparked public outcry, primarily because of the power given to Emergency Managers that would allow them to break union contracts and override elected leaders' decisions (the differences between PA 72 of 1990 and PA 4 of 2011 are shown in Figure 2). PA 4 was repealed in the November 2012 election by a ballot initiative, and PA 72 of 1990 again took effect.

Item	PA 72 of 1990	PA 436 of 2012/ PA 4 of 2011
Number of triggers that can prompt state action	14	17
Operational power (hire staff, direct existing staff, eliminate or consolidate departments, amend budgets)	Yes	Yes
Power over Elected Officials	No	Yes
Can break union contracts	No	Yes
Can dissolve or disincorporate government	No	Yes

Table 2: A Comparison between PA 72 and PA 436/PA 4

Shortly after the repeal of PA 4, in December 2012, PA 72 of 1990 was replaced by a third emergency financial manager act, known as Public Act 436 of 2012 (Egan, 2012). PA 436 of 2012 took effect March 28, 2013. In a number of respects, PA 436 is similar to PA 4, and in fact PA 436 uses the same triggers as PA 4. However, under PA 436, an Emergency Manager is one of four choices that a local municipality faces to solve fiscal crises (the determination of whether a crisis exist is made by the State of Michigan). Other choices now include filing for bankruptcy, mediation, and a consent agreement (a legal agreement between the state and local government regarding actions that must be taken to resolve the emergency). In a financial

emergency, municipalities must choose one of these four options; doing nothing is not allowed (Scorsone, 2013).

Purpose and Intended Impact Model of Financial Intervention

The purpose of financial intervention, broadly, is to address municipal financial issues that have not adequately addressed by local units of government. For example, the City of Detroit was for years mentioned as a candidate for a state takeover after “years of ignoring the city's budget deficit, declining revenue and increasing expenses” (Kaffer, 2010). Similarly, the City of Benton Harbor was taken over in April 2010 after years of failed attempts to address recurring budget deficits (French, 2011).

In addition to addressing governments that have ignored fiscal problems, PA 436 is also designed for municipalities that have tried to solve their own fiscal problems but have been unable to do so. One example of such a municipality is the City of Hamtramck. After repeated cuts to nearly every municipal service such as snow plowing, the City recently “slashed money for boarding up abandoned houses — aside from circumstances like vagrants or obvious rats” (Davey, 2010). The City Manager explained that bloated personnel costs are in large part to blame for the cuts: “the city goes on spending 60 percent of its total general fund to pay for its police and firefighting forces - 75 current police officers and firefighters and about 240 former workers and spouses now on pensions” (Davey, 2010). Adding to the problem, “repeated efforts to renegotiate contracts have failed” (Davey, 2010). Under PA 436, the State is able to intervene in a case such as Hamtramck.

An illustration of how PA 436 is designed to impact municipalities is shown in Figure 1. Impact begins with treasury staff, political leaders, and state and local resources. As PA 436 is a law, several processes are delineated in legislation; however, some latitude is left up to

individuals. For example, the selection of the emergency manager is left to the governor, and he or she serves at the pleasure of the governor.

As shown in Figure 1, emergency manager implementation is meant to improve local financial condition. Emergency managers have a wide variety of tools they may use to pursue this outcome, such as complete personnel control including the ability to break union contracts. Labor is often one of the largest expenses for local governments, and as such the ability to directly manipulate its cost, as PA 436 allows, allows a rapid change in outputs.

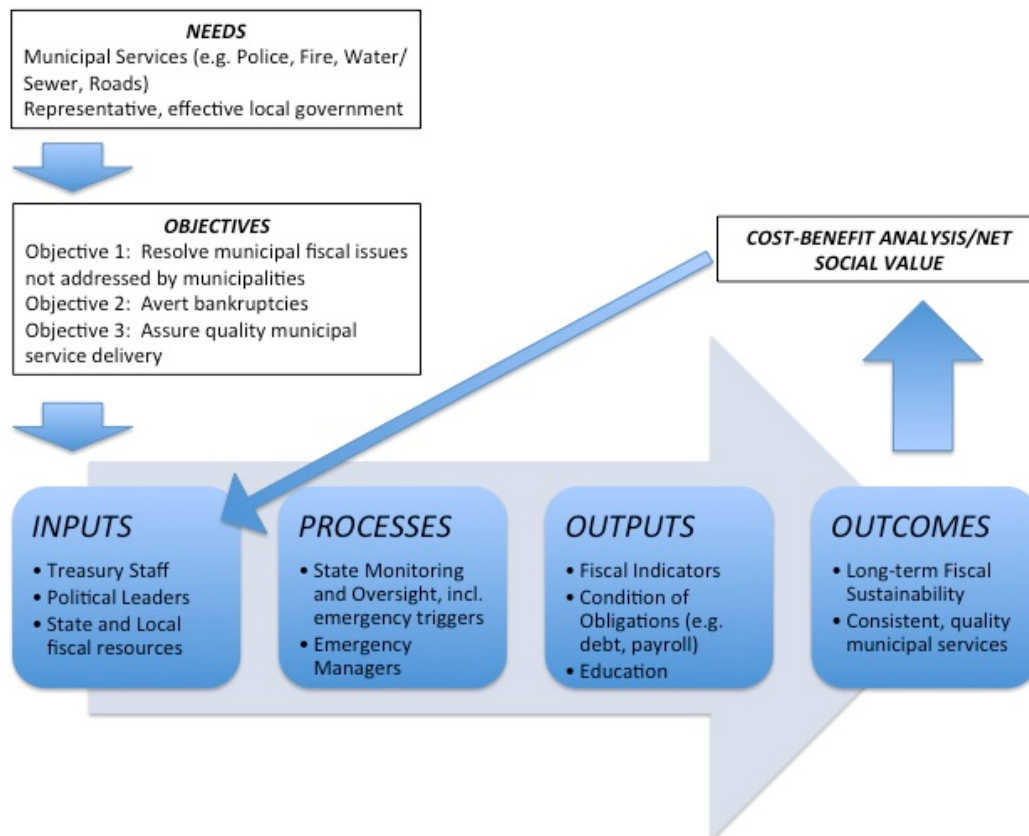


Exhibit 1: Expected PA 436 Impact (Adapted from Nagarajan & Vanheukelen, 1997, p. 17)

Testing PA 436: Is the Doctor In?

Although an intense political debate has occurred around PA 436 and its predecessors, few previous studies have investigated the theoretical basis for state intervention or the empirical effects of such intervention.

When Should States Intervene? An Exploration of Transaction Cost Theory

First, we explore when states should intervene in local government fiscal affairs. Transaction cost theory provides us with a useful theoretical lens to examine state intervention in local government fiscal affairs. We believe this framework is particularly useful in the case of PA 436 in Michigan. Transaction costs are defined as the costs of exchanging goods and services, whether across markets or within organizations (Williamson 1975). A rational agent will try to minimize costs by changing organizational structure or entering into contractual agreements (Ouchi 1980).

Feiock (2008) contends that state-local governance structure is situated on a continuum between complete vertical integration and delegation. Essentially, public services in a local community could either be carried out by local government or a central government (e.g. the State of Michigan). For example, police protection could be provided by a local police department, but could also be provided by the Michigan State Police. With vertical integration, or centralization, the state controls all policy without local government input, and with complete delegation, local governments are free to enact policies that minimize local transaction costs. Intervention in local government finance is a move from delegation toward centralization.

We argue that transaction costs should guide state government's decision of intervening local fiscal affairs, and the form of the intervention. Crosby (2016), based on Feiock (2008), argues that intervention should occur when inefficiencies exist at the local level. Inefficiencies

could range from inadequate staffing or staff training to corrupt decisions made by local elected officials.

For example, smaller local governments in particular may have staff that possess a relatively small amount of training in financial management (Honadle, 2003). If such a local government does not have adequate staff capacity to perform tasks such as revenue and expenditure forecasts, this lack of training may cause that government to set spending at a level where deficits might occur. As such, this scenario would both be inefficient and a situation in which state government should intervene according to transaction cost theory. The idea behind this intervention would be that state government could step in and correct inefficiencies; for example, state consultants may be able to provide financial training to local staff (Crosby, 2016).

Inefficiency would not, however, include environmental factors such as population loss. Crosby (2016) notes that interventions in local governments triggered by underlying economic conditions may not be in a state's best interest. Put simply, there is no inefficiency to correct in these scenarios: whereas a state consultant may be able to train local staff to perform financial analyses, this same consultant cannot turn around population loss. Similarly, state intervention would not be expected to quickly resolve accumulated problems such as long-term debt. As debt is the accumulation of years of financial decision making, intervention would not be expected to remedy high debt levels.

Empirical Results of Intervention: PA 436 and Popular Financial Indicators

In addition to investigating when states should intervene in local government fiscal affairs, we also investigate the empirical effects of state intervention using popular financial indicators. Generally, financial indicators can be placed into three categories: measures that look at an organization's ability to pay its bills immediately (called cash solvency), an organization's

ability to pay its bills in the near term (called budget solvency), and finally an organization's ability to pay its bills in the long run (called long-run solvency) (Crosby & Robbins, 2013).

We specifically investigate two indicators of near-term fiscal health (a municipality's revenue-to-expenditure ratio and fund balance to expenditure ratio), and one indicator of long-term financial health (the debt to net asset ratio).

Revenue-to-Expenditure Ratio

We first investigate the effect of PA 436 on municipalities' revenue to expenditure ratio, which is a near-term measure of fiscal health. The revenue-to-expenditure ratio measures the proportion of expenditures covered by revenues. If the ratio equals 1.00, this indicates that revenues are exactly equal to expenditures. If the ratio is greater than 1.00, this indicates a municipality has a surplus. For example, if the revenue to expenditure ratio of a given municipality is 1.05, this would indicate that the municipality's revenues cover 105 percent of its expenditures. If the ratio is less than 1.00, this indicates a municipality has a deficit. Although small deficits may be expected from time to time, a ratio of 0.95 or lower is considered a financial concern (Crosby & Robbins, 2013).

Revenue/ Expenditure Ratio	-3	-2	-1	0	1	2	3
Detroit	0.98	1.00	0.96	1.04	1.07		
Flint	0.76	0.96	0.84	0.99	0.88	1.10	1.10
Benton Harbor	0.81	0.89	0.89	0.96	0.92	1.07	1.17
Pontiac	1.00	1.00		0.96	0.89	0.51	1.20
Allen Park	1.01			1.13	1.11	1.27	
Ecorse	0.78	0.79		0.90	1.12	1.15	1.17
Hamtramck		0.99	0.91	1.02	1.13		
Inkster	1.03		0.80	0.87	1.03	1.16	
Lincoln Park	0.99	0.90	0.91	1.01			
Mean	0.92	0.93	0.88	0.99	1.02	1.04	1.16

Table 3: Revenue to Expenditure Ratio of PA 436 Municipalities

Table 3 illustrates the revenue to expenditure ratio of municipalities that have been involved in PA 436 before and after state intervention. Specifically, the table looks at the three years before intervention (a value of -3), the year of intervention (value of 0), and three years after intervention has begun (value of 3).

We see in Table 3 that overall, the mean revenue to expenditure ratio is below 0.95 for cities three, two, and one years before state intervention. This is not surprising as these municipalities were all considered for state intervention, and therefore they would be expected to have deficits. We notice that the revenue to expenditure ratio rises slightly during the year of intervention (perhaps due to contact with the State of Michigan) and then the ratio rises considerably after intervention, to a mean of 1.04 two years after intervention and 1.16 three years after intervention.

Fund Balance to Expenditure Ratio

The second indicator we investigate is fund balance to expenditure ratio, which is another near-term measure of fiscal health. This ratio measures how long a municipality might be able to sustain operations if its revenue sources were threatened. We can think of a municipality's fund balance as a "savings account" of sorts. If a municipality runs a surplus in a given year, it may increase its fund balance or "savings," just as a person might increase their personal savings if he or she had extra income in a given period.

Also similar to personal finance, fund balances can be used in case of financial strain. For example, if a municipality runs a deficit in a given year, it may use monies in its fund balance to cover such shortfalls. For this indicator, a ratio of 0.25 or lower is considered a financial concern (Crosby & Robbins, 2013). A ratio of 0.25 would indicate that 25 percent of a municipality's annual expenditures are available in "savings."

Fund Balance/ Expenditure Ratio	-3	-2	-1	0	1	2	3
Detroit	0.05	0.06	(0.03)	0.08	0.19		
Flint	0.08	0.07	(0.07)	(0.00)	(0.11)	0.07	0.23
Benton Harbor	(0.12)	(0.24)	(0.34)	(0.19)	(0.16)	(0.10)	0.36
Pontiac	0.19	0.24		0.24	0.49	0.10	0.45
Allen Park	0.30			0.09	0.11	0.31	
Ecorse	(0.46)	(0.76)		0.17	0.35	0.56	0.73
Hamtramck		0.31	0.13	0.25	0.46		
Inkster	0.27		(0.04)	(0.05)	(0.04)	0.12	
Lincoln Park	0.29	0.20	0.12	0.14			
Mean	0.07	(0.02)	(0.04)	0.08	0.16	0.18	0.44

Table 4: Fund Balance to Expenditure Ratio of PA 436 Municipalities

Using this indicator, we notice that again, financial condition was poor in the years leading up to state intervention. We also notice that, like revenue to expenditure ratio, financial improvement does occur under PA 436, although some municipalities do not reach a “safe” level in this indicator until year 3. This is perhaps also not surprising, given that building a fund balance, unlike adjusting expenditures, happens more gradually.

Debt to Net Asset Ratio

Finally, in addition to near-term solvency, we examine long-term financial position using debt to net asset ratio. This indicator describes how much of a municipality’s assets are financed by debt. We can again draw a parallel to personal finance using this indicator. For example, a person might live in a house, but a certain proportion of that house may be financed through debt (in this case, a mortgage). A value of 0.25 would indicate that over 25 percent of a municipality’s assets are financed through debt, and lower values generally indicate stronger financial condition. Here, a value of 0.25 or greater is considered a concern. (Crosby & Robbins, 2013).

Debt to Net Asset Ratio	-3	-2	-1	0	1	2	3
Detroit	(7.96)	(7.01)	(5.87)	(4.83)	(72.10)		
Flint	0.70	1.13	2.45	4.96	7.82	6.71	6.18
Benton Harbor	0.56	0.69	0.88	0.89	1.48	1.65	1.36
Pontiac	1.05	1.15		1.51	1.20	0.99	1.84
Allen Park	0.17			0.60	1.10	1.16	
Ecorse	(1.73)	(1.49)		(2.03)	(2.76)	(2.65)	(2.89)
Hamtramck		0.86	1.12	1.73	1.56		
Inkster	1.86		9.85	(20.20)	(518.75)	12.32	
Lincoln Park	0.53	0.66	0.81	1.06			
Mean	(0.60)	(0.57)	1.54	(1.81)	(72.56)	3.36	1.62

Table 5: Debt to Net Asset Ratio of PA 436 Municipalities

Unlike the short-term financial indicators, we see that the debt-to-net asset ratio varies widely from year to year, and does not show immediate progress as a result of PA 436 intervention. This is likely due to the fact that debt, and particularly long-term debt, cannot be immediately reduced in a municipality outside of bankruptcy proceedings.

In addition to examining the effects of PA 436 on cities broadly, we explore two cities individually: Flint, Michigan and Benton Harbor, Michigan. Our goal in exploring these cities individually is to further show the effects of PA 436 in detail.

Case Study: Flint, Michigan

The City of Flint, Michigan illustrates the usefulness of transaction cost theory applied to state intervention. Once intervention occurred, some short-term ratios improved, while other long-term ratios did not. For example, as shown in Figure 1, in the City of Flint, after emergency management was implemented in 2011, the City's short term financial indicators improved.

We first examine Flint's revenue to expenditure ratio. Prior to intervention, Flint was running considerable deficits, as evidenced by a revenue to expenditure ratio that dipped below 0.80 in 2008 (indicating that revenues in 2008 covered less than 80 percent of expenditures).

After intervention began in 2011, however, the City's revenue to expenditure ratio quickly improved. For example, Flint's revenue to expenditure ratio not only rose to over 1.00 (the threshold for fiscal balance), it reached approximately 1.1 in both 2013 and 2014, a level the City had not seen since 2004.

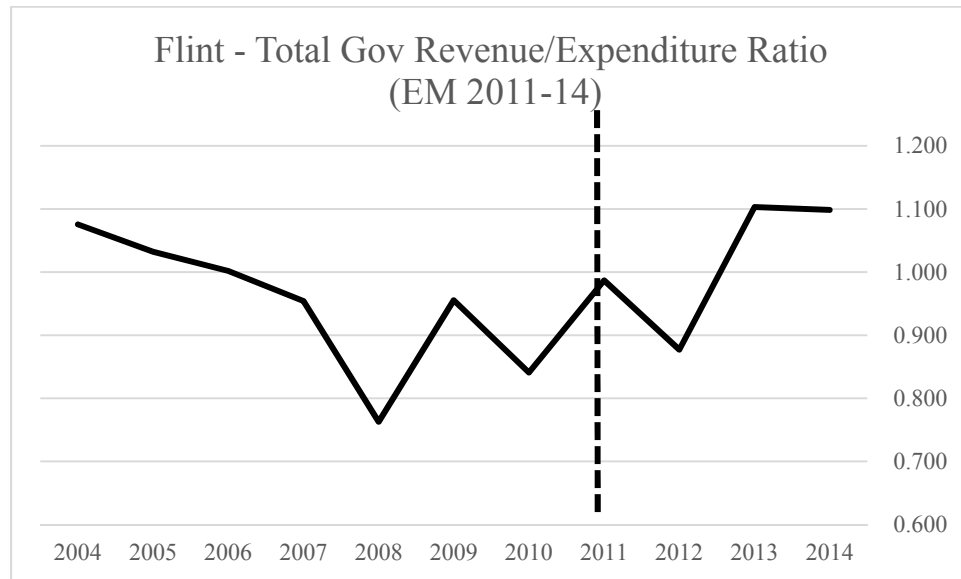


Figure 1: Revenue to Expenditure Ratio in Flint

Similarly, Flint's Fund Balance to Expenditure Ratio rose dramatically during the same period. As shown in Figure 2, Flint had a negative fund balance in both 2011 and 2012, but by 2014, the City had over 23 percent of its annual expenditures in fund balance. Although this level is still slightly below the level recommended by Crosby and Robbins (2013), Flint has clearly made progress toward fiscal stability in this respect.

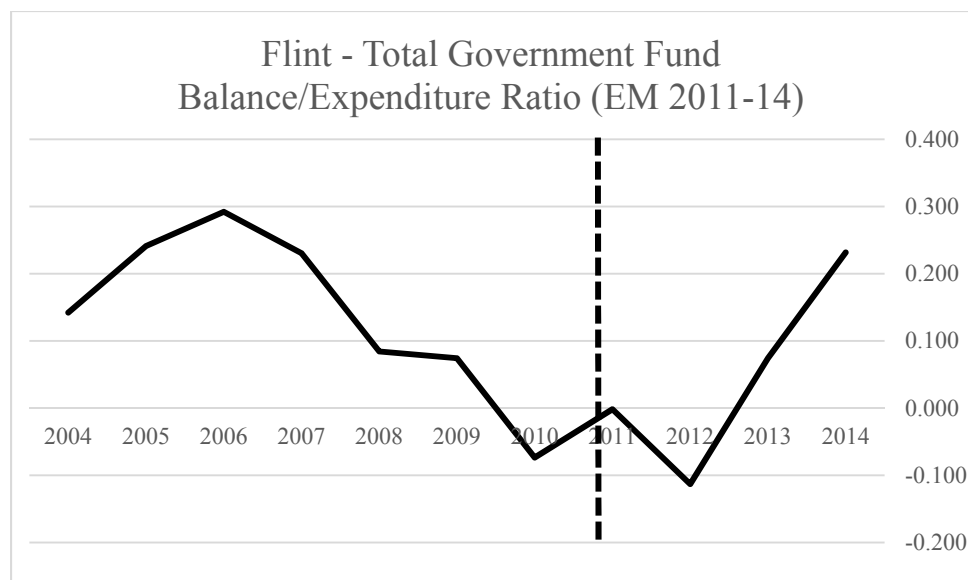


Figure 2: Fund Balance to Expenditure Ratio in Flint

At the same time, the City's long-term financial indicators, although somewhat improved, show perhaps a long path ahead. We notice that prior to intervention, through 2006, Flint had an acceptable debt-to-net asset ratio of less than 0.25 (Figure 3). This ratio rose dramatically from 2007 until intervention in 2011, and continued to rise in 2012. Although Flint's ratio has since declined to 6.18 as of 2014, this ratio is still well above the level considered financially stable. In fact, three years after intervention, a ratio of 6.18 indicates that the City's debt is over 600 percent of its net assets. This is an extremely precarious long-term financial position.

A further examination of the use of debt in Flint hints also hints at longer-term financial concerns. Flint has long used debt to attempt to solve its short-term financial woes, much like an individual might use credit cards or loans to finance personal deficits. In 2004, Flint issued \$8 million in financial recovery bonds under the leadership of a previous Emergency Financial Manager (under PA 72 of 1990). Flint paid off this bond in Fiscal Year 2011, but also in 2011, it requested authorization from the State of Michigan to borrow again: this time, \$20 million in financial stabilization bonds (a special type of bond that can be used to fund operations deficits)

to address cash flow issues. Although authorization was granted, the bond issuance was limited to \$8 million (Scorsone & Bateson, 2011). Nevertheless, Flint once again was millions in debt for current operations spending.

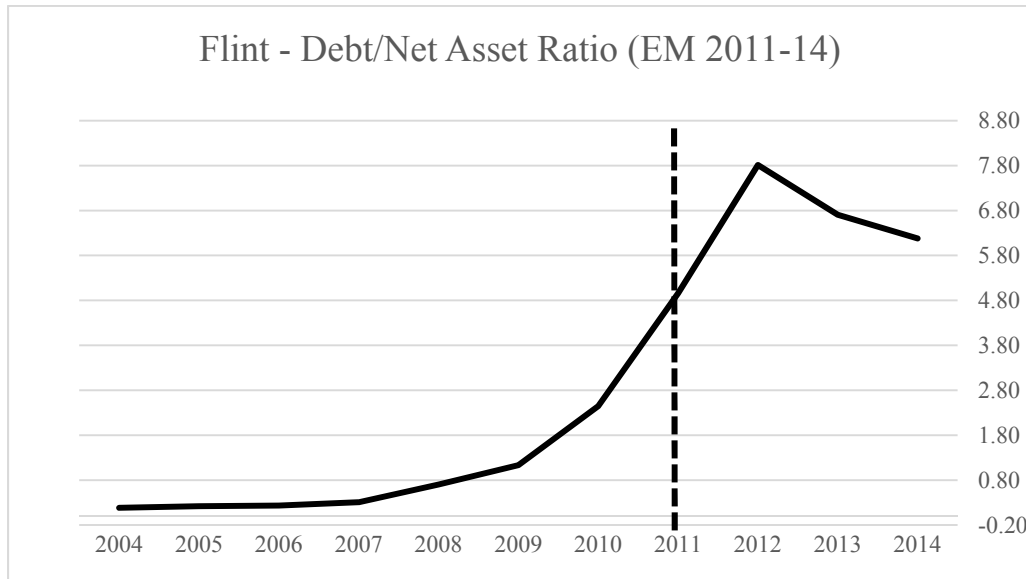


Figure 3: Debt to Net Asset Ratio in Flint

These concerns are illustrated further by exploring Flint's total liabilities per capita. Although Flint's total liabilities per capita stopped rising after emergency management was implemented, and in fact declined slightly in 2014, they remained essentially unchanged in the years after intervention. As shown in Figure 4, in 2011, inflation-adjusted liabilities per capita were \$1,878, and by 2014, they had decreased only slightly to \$1,749. Although Flint's drop in liabilities per capita is a positive financial development, the 2014 figure is still nearly six times the \$292 per capita in liabilities Flint had in 2004.

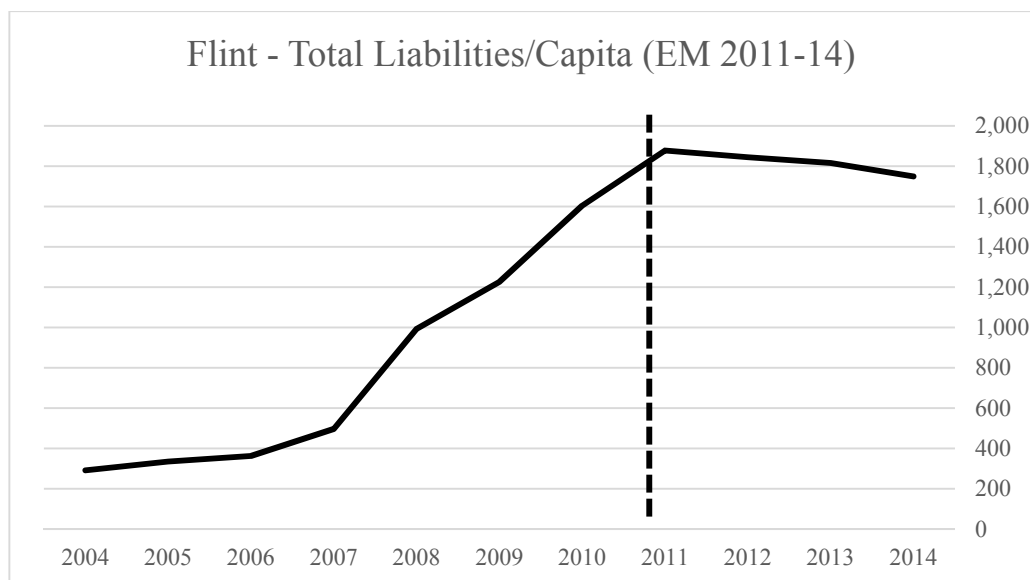


Figure 4: Total Liability per Capita in Flint (inflation-adjusted, 2014 Dollars)

Case Study: Benton Harbor, Michigan

The City of Benton Harbor, Michigan also highlights the usefulness of transaction cost theory. Similar to Flint, once intervention occurred, short-term ratios improved, while other long-term ratios did not. Like Flint, we first examine the revenue to expenditure ratio for Benton Harbor. Benton Harbor’s revenue to expenditure ratio was well below 0.95 for several years prior to intervention (Figure 6). Just before state intervention, the city’s short-term finances had reached a tipping point. Once council member explained, “When [the emergency manager] was appointed...we couldn't make payroll. The city couldn't borrow enough money for a popsicle” (qtd. in French, 2011, p. A1).

After intervention occurred in 2010, however, Benton Harbor’s revenue to expenditure ratio rose above 1.00 in 2013 for the first time since 2004. The City’s ratio continued to improve in 2014 to nearly 1.17, placing the city on at least short-term financially solid ground.

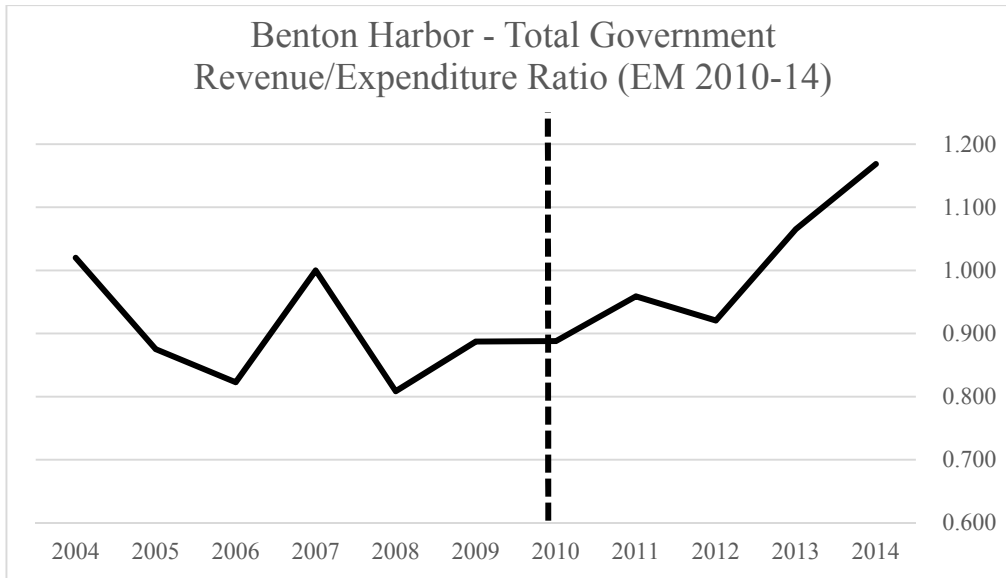


Figure 6: Revenue to Expenditure Ratio in Benton Harbor

Similar quick progress occurred in Benton Harbor's fund balance to expenditure ratio. Benton Harbor's fund balance to expenditure ratio was even lower than Flint's ratio at its low point in 2010 (when it reached -0.339). However, after intervention, the City's fund balance to expenditure ratio not only rose about zero, but to 0.36 by 2014 (Figure 7). This ratio was not only the highest fund balance to expenditure ratio since at least 2004, but also at a level that would be considered financially sound.

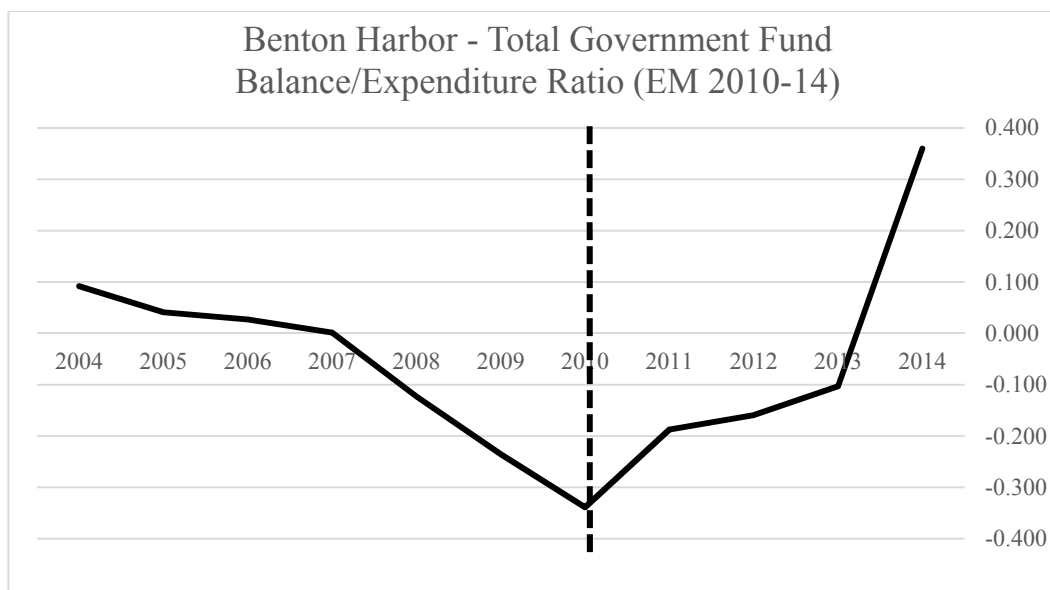


Figure 7: Fund Balance to Expenditure Ratio in Benton Harbor

Like Flint, however, emergency intervention in Benton Harbor has not yet brought complete relief to long-term financial indicators. It had an acceptable debt-to-net asset ratio in both 2004 and 2005. However, the City's ratio then rose dramatically, peaking at 1.65 in 2013 (Figure 8). Although Benton Harbor's maximum 1.65 ratio is considerably lower than Flint, this ratio still indicates that debt represents 165 percent of the City of Benton Harbor's assets. Again, similar to Flint, Benton Harbor's ratio did improve after intervention, but remains at 1.36 as of 2014, well above the 0.25 guideline that would indicate good fiscal health.

Also like Flint, Benton Harbor has also borrowed to finance continuing operations, although against the wishes of its city council. In 2014, the State of Michigan loaned the City \$2.3 million to pay vendors, restructure debt, and eliminate a deficit. Benton Harbor commissioners attempted to block the borrowing, but with the City under the authority of an Emergency Manager the borrowing proceeded anyway (Smith, 2014).

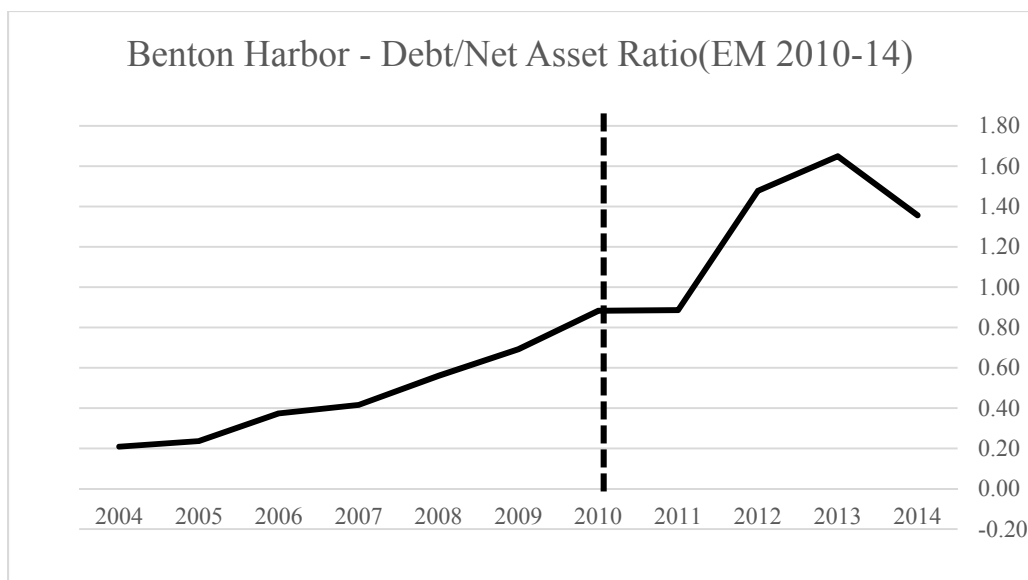


Figure 8: Debt to Net Asset Ratio in Benton Harbor

Benton Harbor also shows similar results to Flint in terms of its total liabilities per capita. As shown in figure 9, Benton Harbor's liabilities per capita grew considerably from 2004 to 2014. Immediately following intervention in 2010, Benton Harbor did see a small drop in liabilities per capita, but soon after, liabilities continued to grow. The 2013 Fiscal Year marked Benton Harbor's highest liabilities per capita since at least 2004. Liabilities per capita did decrease slightly in 2014, but remain well above the level of liabilities per capita in 2010.

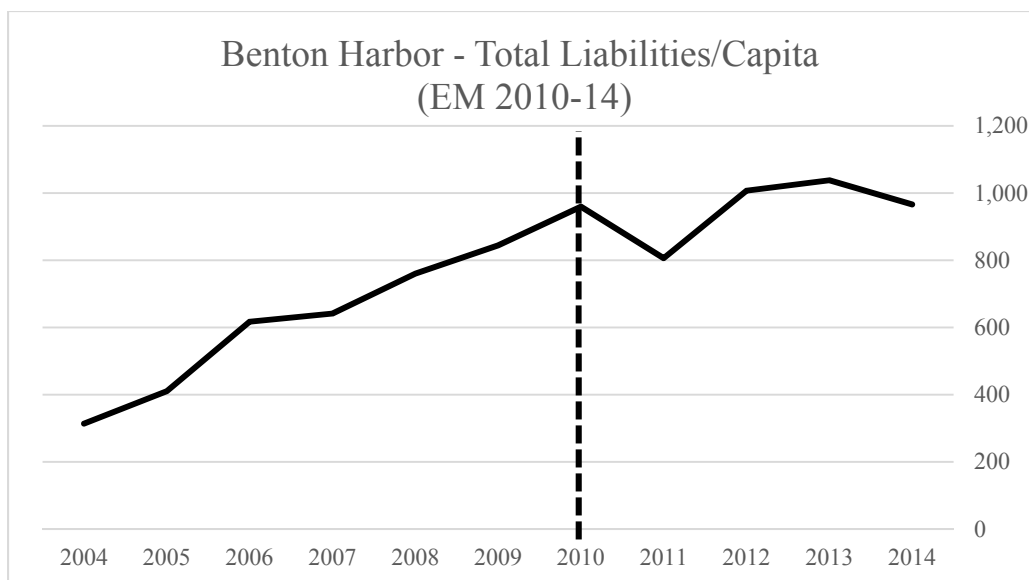


Figure 9: Total Liability per Capita in Benton Harbor (inflation-adjusted, 2014 Dollars)

Conclusion

Ultimately, our research shows both the value of using transaction cost theory in determining when states intervene in local government fiscal affairs and the empirical effects of state intervention. Flint and Benton Harbor, in particular, illustrate that state intervention can improve financial condition in the short term (for example, eliminating annual deficits) but may struggle to improve financial condition in the longer term (for example, reducing accumulated debts). These two cities illustrate what could be a cautious tale for the State of Michigan: intervention simply may not be appropriate to address long-term financial issues that have often been created over years or even decades.

With regard to application of the current policy, we suggest that the State of Michigan consider the long-term finances of municipalities in its interventions in addition to the short-term finances that are already considered under PA 436. Borrowing for short-term operations is a recurring theme in the cities we have examined, and although borrowing may allow municipalities to exit short-term financial stress, these same municipalities may find themselves

in the position of needing additional state assistance down the road. Benton Harbor illustrates this scenario, with the State of Michigan borrowing even against the wishes of its councilors, who warned at the time that the City's financial emergency was not over and that borrowing would actually add to the City's deficit (Smith, 2013). In the long term, borrowing for operations is simply not sustainable, and we would discourage the State of Michigan from continuing this practice in municipalities under emergency management.

Similarly, when an intervention has restored fiscal health, the State of Michigan should ensure that a management system is in place to maintain financial health before it restores local control. Flint again is an excellent example of why this needs to occur: the City exited emergency management in 2004, only to find itself back under state control just seven years later. Simply exiting a local government after fixing short-term financial indicators (often with a loan, as described in both Flint and Benton Harbor) runs the risk of recurring interventions.

Our research is not without limitations. One such limitation is our relatively short timeframe. For example, reducing accumulated debts may be possible in the long term for municipalities such as Flint and Benton Harbor. However, our data do not contain a sufficient period by which we could measure potential improvements in this category. We do note, however, that intervention is generally designed to be a short-term measure; emergency managers are not meant to stay in office for decades. As such, long-term improvement in financial indicators such as debt would likely not be the direct result of intervention.

These limitations also highlight the need for future research on the topic of state intervention in local government fiscal affairs. Although Michigan has now had various forms of intervention in local government fiscal affairs on the books for nearly 30 years as of this writing, the greater authority given to emergency managers under PA 4 and PA 436 is still

relatively new; only since 2011 have state interventions included the level of power given today. As such, future study on the longer-term effects of intervention would be helpful.

Similarly, future research on the effects of interventions in other states may be useful. Although some authors do research individual states other than Michigan (e.g. Crosby, 2016), a broader assessment of the effects of such interventions would be extremely useful. For example, an investigation into the differences in the amount of power given to state government in the intervention process could be useful in determining whether certain powers are particularly useful in the intervention process.

Still another direction for future research would be to investigate municipal service levels. Although we point out that financial indicators can be classified into three categories (cash, budget, and long-run solvency), Hendrick (2011) argues that a fourth category of solvency is important to consider: service-level solvency. This solvency refers to the ability of a municipality to provide adequate services to its residents; for example, health, safety and welfare (Hendrick, 2011). For example, what are the effects of intervention on police response times? What are the effects on parks and recreation? These are certainly important questions and should be investigated in future research.

Ultimately, we believe this research is the beginning of improved theoretical and empirical work in the field of fiscal federalism, and offers important policy implications to both state policymakers and local government officials.

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