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RESEARCH SUMMARY

MUNICIPAL FISCAL EMERGENCY LAWS
Background and Guide to State-Based Approaches

Recently, the Great Recession exposed serious problems in many local governments' books, even though fiscal crises are not a new phenomenon. Declining revenue, increased spending, and decreases in pension portfolio values threaten the fiscal sustainability of local governments. In response to both specific and general concerns over local governments' fiscal health, state governments have passed municipal fiscal emergency laws, which require local governments to make dramatic changes in their budgets and, in some cases, may lead to state takeovers of municipal governments.

In a survey of the 16 states that have passed these laws to date, economist Eric A. Scorsone takes a comprehensive look at the structure and requirements of each specific law from a historical and legal perspective. In most of the 16 states, the legislature has passed a general law that allows intervention in any fiscal emergency that meets specific criteria. In three states, the legislature passed laws dealing with specific local governments. While common themes run across all versions of these laws, they vary in scope and power. Additionally, the factors that may have influenced the adoption of fiscal emergency laws vary for each state and are also explored in the paper.

To read the study in its entirety and learn more about the author, see "Municipal Fiscal Emergency Laws: Background and Guide to State-Based Approaches."

WHY DO LOCAL FISCAL EMERGENCIES OCCUR?

Fiscal emergencies occur when there is a lack of cash to pay ongoing commitments, such as vendor, pension, payroll, or bond payments. A government may face a drop in revenue due to a national, regional, or local economic downturn. A government may also be poorly managed or corrupt. In response to falling revenues, a government may furlough employees, defer capital expenditures, and impose travel, training, and hiring freezes to conserve cash. If the downturn is extended, a government may terminate employees, cut programs, or increase taxes, while also borrowing more money from bond markets or deferring pension payments. Once a government has turned budget

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insolvency (when revenues are exceeded by expenditures) into cash insolvency (simply being unable to make payments), a state fiscal emergency law may be triggered.

WHY DO STATES ENACT FISCAL EMERGENCY LAWS?

Some states have strong historical and legal protections for local governments, called home rule or local control, which make these governments important in their own right. A state may take a hands-off approach to local fiscal problems. Other states, however, have had a history of local fiscal emergencies and may be more likely to intervene. State governments may fear that a fiscal crisis in one municipality could cause problems in other local governments or in the state as a whole. Different states' laws have evolved together and in similar fashion, but states have often innovated as well, experimenting on different policies in response to the changing nature of fiscal problems over time.

The Framework for Understanding Local Fiscal Emergency Laws

Municipal fiscal emergency laws share many characteristics:

- They define the conditions that trigger a crisis.
- They identify the steps the state government and local governments should take when a trigger is observed.
- They delineate the powers available to the state once the crisis is established.
- In some cases, they outline an exit strategy.

Within this framework, however, there is a good deal of variation among states. For example, some states allow specific agencies to manage the crisis while others may let the local government handle it. The budgeting and debt management powers are also different among the states. States with fiscal emergency laws also may treat collective bargaining rules, local governmental personnel decisions, tax policy, and economic development funding differently.

The states can be divided into several categories based on their differences:

- Sixteen states have explicit fiscal emergency laws; thirty-four states do not.
- Not all states with a fiscal emergency law grant the same powers to the same types of officials. Some (e.g., Florida and Illinois) allow local governments to make changes under state supervision, while others (e.g., Michigan and Pennsylvania) remove control from local officials and appoint a receiver.
- Three states (Massachusetts, New York, and Connecticut) deal with fiscal emergencies via specific legislation for each local government.
- Some states allow alterations in contracts, collective bargaining procedures, and even tax increases or the creation of new taxes.

- In a few states, the end result of a state takeover may even be dissolving the local government and allowing the county government to absorb its territory and debt.

Factors Influencing State Adoption of Municipal Fiscal Emergency Laws

Reasons for adopting a fiscal emergency law vary among the states. They may include home rule and local autonomy, state tax and spending limits, collective bargaining and unionization laws, and previous fiscal emergencies in the state.

CONCLUSION

Many states adopt fiscal emergency laws to respond to incompetent local management and corruption, which are seen as driving causes of a fiscal crisis. States differ in the specific approaches they take to crises: some adopt specific laws for certain governments, while most enact laws that can address a wide range of problems. Some states allow aggressive state action to correct a fiscal emergency, while others defer to the local government.

Critically, these laws may not address structural problems in the government. After state control has ended, a local government may soon repeat its past poor performance due to the public finance system, economic development problems, or social pressures. Stronger laws, such as those passed in Michigan, may be necessary to allow a state to make dramatic changes, including dissolving or merging local governments, pursuing revenue options, and reforming pension or mandate systems. As long as they avoid long-term structural problems, such as pension costs or retiree health care costs, municipal fiscal emergency laws will only address local management failures, leaving the harder problems alone and risking a future fiscal crisis.