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RESEARCH SUMMARY

Fiscal Distress in Local Government: Predicting Future Emergencies from Past Performance and Local Economic Conditions

As highlighted by the bankruptcies of Detroit, Michigan, and San Bernardino, California, the Great Recession of 2007–2009 plunged some local governments across the country into severe fiscal stress. It also generated a body of work on fiscally struggling communities. Evgenia Gorina, Marc Joffe, and Craig Maher make a distinct contribution to that work in "Using Fiscal Ratios to Predict Local Fiscal Distress."

BENEFITS OF A NATIONWIDE SAMPLE

Recent studies have focused on specific cities, municipalities within a given state, or local governments within a few states. This makes generalizations about fiscal distress challenging. Gorina, Joffe, and Maher work with a large national sample that includes more than 1,500 local debt issuers and covers 10 years of financial data.

This larger sample allows the authors to

- develop a regression model that identifies the fiscal and economic variables that are most closely associated with fiscal distress; and
- propose a "fiscal condition" scoring system that can differentiate distressed from nondistressed cities and counties to help predict financial emergencies before they occur.

FACTORS THAT CONTRIBUTE TO FISCAL DISTRESS

Consistent with the existing research on local fiscal distress, the study identifies the following factors to be statistically associated with municipal defaults and bankruptcies:

- *Unreserved general fund balances and unrestricted net assets*. Higher levels of both are associated with lower odds of fiscal distress.
- *Long-term obligations*. Higher levels of total liabilities are associated with greater odds of financial distress. These liabilities include pension debt and other postemployment benefits.
- *Local unemployment*. High unemployment rates are associated with greater fiscal distress.

KEY TAKEAWAYS

Local elected officials should engage in prudent fiscal management to prevent fiscal emergencies and ensure provision of municipal public services. This includes policies and discipline to maintain appropriate levels of reserves and debt as well as strategic planning for local economic development that sustains employment.

Decreases in general fund reserves, unrestricted net assets (the difference between the government's assets and liabilities), and increases in debt and unemployment can signal changes in local financial conditions and make governments more vulnerable to a fiscal crisis such as bankruptcy or default.