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Beyond State Takeovers:
Reconsidering the Role of State Government in Local Financial Distress, with Important Lessons for Michigan and its Embattled Cities

MSU Extension White Paper

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Executive Summary

One provocative pattern to emerge from the Great Recession is that instances of acute local fiscal distress have clustered in certain states and not others. As recently as last year in Michigan, a state appointed Emergency Manager was operating in each of 17 local governments and school districts. A recent California Policy Center report suggests that more than a dozen cities and counties in California – a state that has already experienced three recent, high-profile municipal bankruptcies and a near-bankruptcy in San Jose, the "capital of Silicon Valley" – are on the cusp of defaulting on general obligation bonds

With the generous support of the C.S. Mott Foundation and Michigan State University, we have engaged in a multi-pronged, multi-method research program to assess the crucial but often overlooked role of state governments in shaping the ways in which cities respond to financial difficulties. This report, based on our analysis of a unique, nearly half-century-long dataset of state and local financial and policy information and correspondence with state officials, analysts and legal experts involved in state-local fiscal affairs, elaborates several key findings:

- **Municipal fiscal distress is not simply a *local* problem. State laws and policies provide state governments with extraordinary influence over the ability of cities to balance revenue and expenditure flows.** The common perception that critical taxing and spending decisions are largely within a city government's control tends to conceal this fundamental detail about American state-local fiscal relations.
- **The ways in which state lawmakers act on this influence varies from state to state and over time.** We refer to the complex mix of laws and policies that prescribe the powers, rights and capacities of local lawmakers to respond to their financial conditions as the **state context for local fiscal distress.** Section 1 of this report assesses key elements of this state context for the lower 48 states since 1970.
- **Some states incubate local financial stress by simultaneously driving up spending pressures on their cities while curtailing their capacity to raise critical revenue.** Since the 1970s, the proliferation of state-imposed tax revenue limitations, coupled with recurring cuts to state aid, has fostered a system that limits a city's ability to fund critical services. Some state governments further undermine the fiscal capacity of their cities via state laws and policies that engender steep expenditure-side pressures (e.g., devolving program responsibilities or driving up labor costs). We classify these states as **incubators of fiscal distress.**
- **Michigan incubates financial stress among its local governments.** Michigan's particular mix of stringent limitations on local revenue and its relatively low level of financial assistance to cities, coupled with spending pressures stemming from spiking local service burdens and increased labor costs, creates conditions that drive up the potential for local fiscal distress.
- **Because state governments can foster dramatically different state contexts for local fiscal stress, there is no single model policy for state intervention in distressed cities or for prevention of local fiscal distress.** A policy that does not address a state's unique context is unlikely to help cities escape financial trouble over the long term. State lawmakers must decide which legal and political tradeoffs they are willing to make to support city fiscal health. Michigan lawmakers, for instance, must recognize that the state context contributes to the problem of local fiscal distress. An aggressive intervention policy does little to curtail the consequences of this state-imposed context. Section 2 of this report draws policy lessons from comparable states in an effort to illustrate alternative approaches to state involvement in local fiscal affairs.

This report's practical recommendations are aimed at assisting the C.S. Mott Foundation, state and local officials, and Michigan residents in identifying a more effective policy and legal approach to local fiscal crises. These are not overly startling recommendations, yet they are easy to neglect because policymakers tend to focus more on short-term political gain rather than the histories and unintended consequences of policies that, over time, become increasingly difficult to alter. Some key recommendations:

- **Creating a state agency that coordinates services to local governments and offers technical support and fiscal monitoring.**
- **Raising awareness among citizens and state decision makers that the causes of fiscal distress are not solely at the local level. Though state governments are certainly part of the solution, they can be a big part of the problem as well.**

Introduction

A recent spate of research and media reports suggest that as the fiscal consequences of the Great Recession continue to subside, state and local fiscal conditions are on the upswing. American cities and locales, however, are not yet out of the woods. A recent analysis from the National League of Cities strikes the proper tone of caution when reporting that, though indeed *state* governments have recovered (albeit slowly), "…*local* fiscal health has not yet fully returned to pre-recession levels. … While tax revenues continue to improve, increases in service costs, long-term infrastructure needs, employee wages, and pension and healthcare obligations, along with decreased levels of state and federal aid, continue to constrain the [local] fiscal outlook" (McFarland and Pagano, 2014, p. 1, emphasis added).

One thought-provoking pattern to emerge from the aftermath of the Great Recession is that the fiscal outlook seems to be particularly bleak among local governments in certain states. The city of Detroit's bankruptcy proceedings may have indicated that Michigan is something of a hotbed for local financial disaster. Yet a far more damning indicator is the prevalence of financial distress among the state's other local governments. As recently as last year, 17 local governments and school districts were operating under the control of a state-appointed emergency financial manager. Recently, Michigan's most populous county, Wayne, was recently designated for financial emergency status as well. Michigan does not stand alone. News from California, a state that has already seen four cities enter the municipal bankruptcy process since 2008, is equally discouraging. The authors of a recent report conducted for the California Policy Center argue that more than a dozen cities and counties in California are statistically far more likely than "a typical U.S. city or county" to enter bankruptcy proceedings or default on general obligation bonds, with several cities – such as Compton, King City, Sutter Creek and Ione – are a whopping 20 to 40 times more likely to experience acute financial crisis (Joffe and Larkedring, 2015).

What is it with local governments in these states? When it comes to urban fiscal problems, there is much blame to go around. Some blame a mixture of national and global economic forces beyond the control of state and local policymakers. Others contend that the cities facing severe budget crises have only themselves to blame. The goal of this report is to refocus attention on the crucial but often overlooked role of state governments in determining the ways in which cities respond to financial difficulties. How and in what specific ways do state governments structure this local response? Is it possible to assess the fiscal value that all states – via their mix of policies, laws and institutions – may add to or take away from local fiscal decision making? Is it truly more challenging to gain and maintain fiscal sustainability in certain states than it is in others? And in light of this consideration of the role that state governments play in structuring local fiscal decision making, in what ways do state governments choose to – or choose not to – internalize their role in the design and administration of their fiscal distress intervention policy? In other words, can we identify policy self-awareness among state governments that place particularly onerous fiscal pressures on their local lawmakers?

To respond to these important questions, we, with the generous support of the C.S. Mott Foundation and Michigan State University, set out on a multi-pronged, multi-method research program at a critical time in which a new era seems to be dawning for state-local fiscal relations. This report summarizes the findings of the first stage of this ongoing project.

Section 1 of this report develops an indicator for the state context for local fiscal distress based on the mix of state laws and policies that directly influence the revenue and spending decisions of local governments. This section uncovers a number of compelling patterns in the state imposition of revenue and spending pressures over the past quarter-century. Chief among these patterns is that, although a number of states have taken measures to severely limit the revenue capacity of their local governments (thus reducing the resources available to maintain critical services) and several states have devolved greater service responsibilities (and higher spending burdens) to their local governments, only a small handful of states simultaneously drive up spending pressures while aggressively curtailing local governments' capacity to raise revenue. Taken independently, state-imposed revenue- and expenditure-side pressures can play a determinative role in local fiscal decision making. Taken together, as in states such as Michigan and California, they incubate local fiscal distress and can serve to foster fundamental budgetary imbalances that more fiscally challenged local communities are ill-equipped to overcome.

In Section 2, we draw on interpersonal communications with key personnel in several states to assess key elements of state policies for intervening in fiscally distressed local governments. We set out to identify similarities in intervention policies – of which Michigan's is the poster child – and to learn how other states approach local fiscal crises differently. From our work with the state officials, we illustrate how state governments can more effectively align policy with the nature of the problems faced by cities in distress, as well as how state-imposed constraints hamper cities' abilities to balance revenues and expenditures over the long-term. In Section 3, we combine the lessons from Sections 1 and 2 to outline recommendations that can assist the C.S. Mott Foundation, state and local officials, and Michigan residents in identifying a more effective approach to local fiscal crises.

Section 1: Assessing How States Set the Context for Local Fiscal Distress: Revenue Squeezes and Expenditure-side Pressures

Two essential powers that local officials enjoy are their authority to raise revenues and their power to allocate those revenues as they see fit via public expenditures. In local media and policy research, city officials are sometimes lauded for what are perceived as exciting local policy outcomes, such as when a city makes a significant move up the "America's Greenest Cities" or "Child Well-being and Health" rankings. More commonly, they are chastised for decisions deemed detrimental to the city's future, such as providing generous benefits to the municipal workforce, slashing essential services, enacting a rigid historical preservation agenda or raising licensing fees. Yet the common perception that critical taxing and spending decisions – and, by extension, the apportionment of blame and credit associated with the outcomes of such decisions – are largely within a city government's control conceals a fundamental detail about American state-local fiscal relations: state laws and policies provide state governments with extraordinary influence over nearly every aspect of city budgeting. From the type and level of financial assistance that state governments deliver to state-imposed controls over local revenues; to the growing practice and use of state mandates, preapproval and preemption; to minimum service standards; to the formal or informal consultations, advice or technical assistance that state governments may (or may not) provide, local governments in America, in the words of influential legal scholars Gerald Frug and David Barron (2008, p. 75), simply "do not have anything like the kind of local fiscal autonomy often attributed to them."

States influence local governments' capacity to balance revenue and expenditure flows in a variety of ways. In this report, we focus on two core dimensions of this state context for local financial distress.[1] The first is the degree to which states participate in adding or reducing local revenue capacity via the policy balance between the buoyancy of state-granted aid and shared revenue, and the severity of state-imposed controls over city tax revenues. Although most states exhibit a relatively balanced policy approach to local revenue capacity, some state governments have responded to local revenue challenges by granting greater access to state intergovernmental aid while mostly suppressing financial controls over local taxes. These are revenue "carrot" states. Another group – revenue "stick" states, of which Michigan is a prime example – have responded to local revenue challenges by ratcheting financial controls while offering thin or uncertain compensatory aid. Simply put, we expect it to be far more challenging to maintain a sustainable fiscal outlook in states that simultaneously suppress own-source revenue capacity and transfer very little aid to municipalities, particularly during national or state economic downturns.

State policies and actions also burden the opposite end of local budgetary processes: decisions over public expenditures. Few, if any, local spending responsibilities exist because cities choose to take them on. The state decides.[2] Spending pressures can be subtler. For instance, local labor costs, which account for a large slice of most cities' budgets, are heavily influenced by state policies and regulations concerning municipal employees' wages and level of retirement and health care benefits.[3] This basic fact should give pause to those who instinctively attribute chronic local fiscal distress to "profligate spending on public employees" (Greenhut, 2012, pp. 1-2) or "spiraling labor and pension costs" (Rozansky, 2012). To borrow again from Frug and Barron's seminal work (2008, p. 199), "Although cities are often criticized for granting overly generous pensions and health care to their employees, sometimes they become supporters of municipal employees' benefits because the state requires them to do so." Our more general argument here is that it is foolish to claim to correctly diagnose the causes of local fiscal distress without careful examination of the spending context in which states place their cities. In this paper, we aim to capture a large slice of this expenditure-side context by assessing state public sector collective bargaining policies (specifically, those covering municipal police, firefighters, teachers and other local employees) and public employee union membership coverage.

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1 Formally defined as the complex, multidimensional, legal-policy frameworks that prescribe the powers, rights and capacities of local lawmakers to respond to their financial conditions.

2 Via specific provisions (or the absence of such provisions) regarding local statutory authorization, budgetary constraints or more general interpretations of local governments' home rule authority.

3 For instance, Michigan, even after the adoption of right-to-work legislation in late 2012, mandates binding arbitration for public safety officers in the event that involved parties in a labor contract dispute cannot reach an agreement. Massachusetts pays out benefits to local employees through the State-Boston Retirement System via formulas established by state law. Illinois law does not mandate city or employee benefit or contribution levels, instead favoring local flexibility in the control over pension costs.

The final segment of this section considers how these revenue- and expenditure-side pressures interact within and across all U.S. state governments. As one might expect (or at least hope), these two competing dimensions tend to work against one another. States that are more revenue stick (meaning local tax limitation increases outpace the distribution of state aid) tend not to impose equally exacting expenditure-side pressures, at least in relation to local labor costs. For many states that do drive up labor and service costs via their mixture of policies, these costs are at least partially offset via a more resilient and vibrant aid environment, coupled with limited own-source revenue restrictions. A few states, such as Michigan and California, place strict limits on local own-source revenues while at the same time providing only meager intergovernmental aid and imposing costly labor and service obligations. We contend that these states have structured local fiscal policymaking in a way that effectively incubates local financial distress. These state contexts are the most egregious in hampering the exercise of local fiscal power; yet the nature of the problem for cities may be much worse – state-imposed budgetary imbalances can engender recurring structural deficits and diminished local service capacity, particularly among the states' older, industrial urban areas.

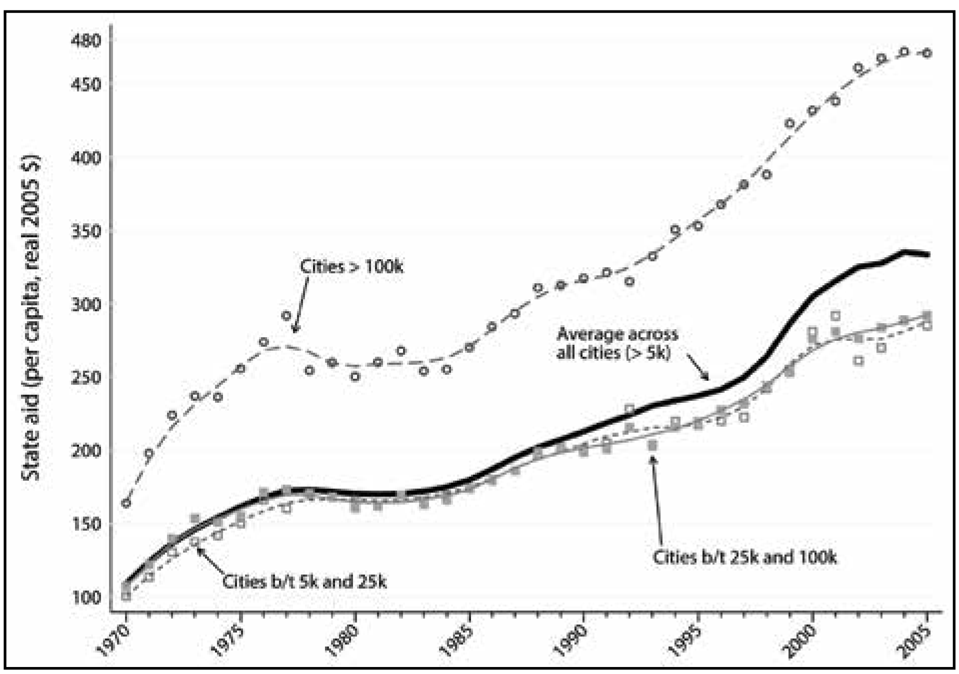
(1) Squeezing Local Revenue Capacity: Thin and Fragile State Aid; Escalating Local Tax Limits

State governments, by virtue of their superior constitutional position, have sweeping legal powers to regulate local finance. Central to our assessment of the state's role in local fiscal distress are state controls over the two dominant sources of city revenue: state aid and local taxes. Local governments occupy a weak position in the American federal system, causing local officials to rely heavily on, in the words of one analyst, "whatever sources of income the states are willing to let them tap into" or "whatever financial assistance" the states are willing to provide (Berman, 2003, p. 89). Sbragia (1983) aptly refers to the condition of American federalism as "the municipal money chase," and in the absence of a vibrant federal aid environment in the United States, state aid – in the form of shared taxes (typically sales, income and gasoline) and restricted or unrestricted grants – continues to be a major source of local government revenue, accounting for roughly a third of local revenue, on average, during the past two decades (Berman, 2003; Urahn et al., 2012).[4]

The importance of a well-designed state aid system is hard to overstate. It allows local officials greater flexibility in responding to economic pressures and the service needs of residents. This flexibility is particularly valuable during periods of economic downturn. Because local governments vary widely in their tax bases and in their ability to raise critical own-source revenues, influential research illustrates the equalizing potential of state aid, particularly in helping to smooth out revenue gaps between wealthier and poorer local jurisdictions (Pelissero, 1984; Stein and Hamm, 1987). In the past few decades, very few states target aid to local governments as a function of local need (Stein and Hamm,

4 Though formulas for the distribution of local aid can vary significantly across states (as well as within states over time), all states provide some form of aid to local governments – often from a historical exchange in which cities would forgo the right to collect certain taxes in exchange for the states returning revenues from those taxes in some form. States typically allocate shared revenue for specific purposes or link it to particular functions of local government. Some shared revenue, however, is unhindered by such state restrictions and can be spent as local lawmakers see fit.

Figure 1. Mapping the Average State Aid Environment Since 1970

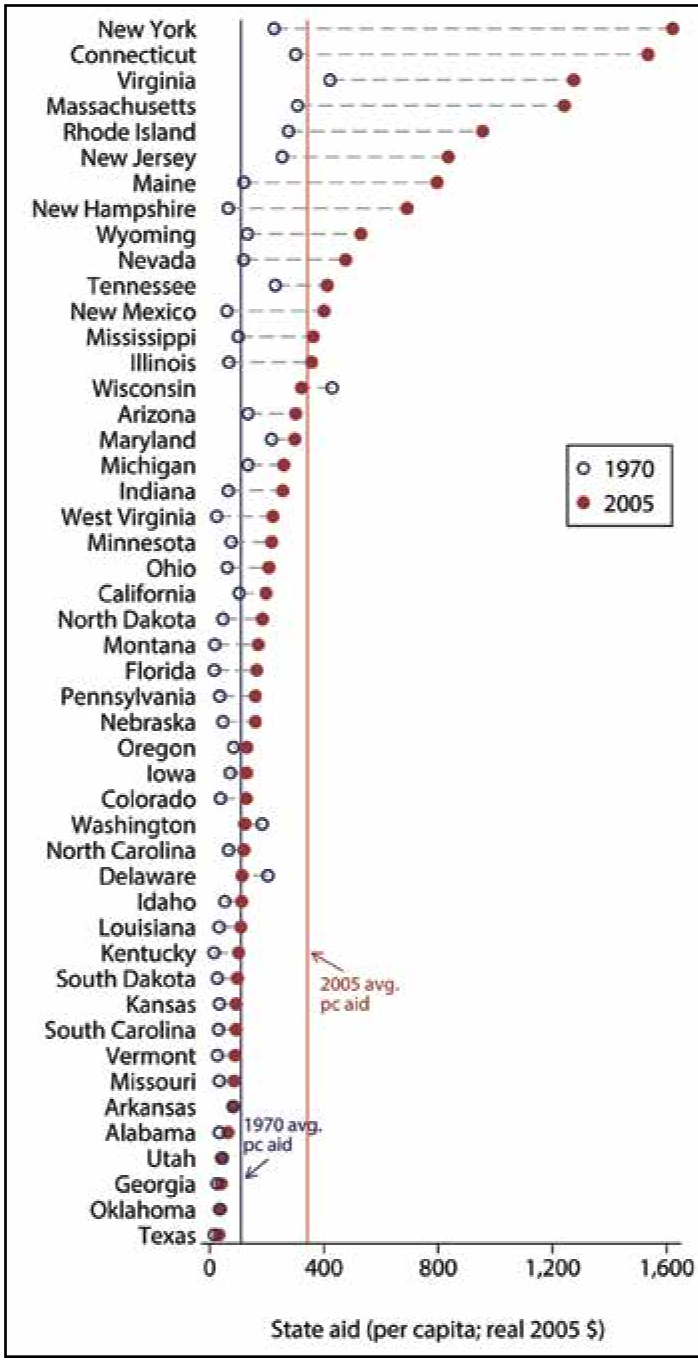


1994). The level of state aid that is available can make it possible for certain jurisdictions – for instance, older, industrial cities experiencing significant job loss coupled with a much reduced tax base – to at least afford minimum levels of services and possibly respond to growing service demands on the heels of a crippling state or national recession (see Ladd and Yinger, 1994).

How then can we characterize the critical state aid portion of the state-controlled revenue environment for American cities? Figure 1, which illustrates trends in per capita state aid to three classes of city governments, shows a steady upward trend in transfers (per capita) received from state governments. Though it is beyond the scope of this project to analyze specific revenue-sharing rules and aid formulas over time and across state contexts, our city financial data allow us to compare important trends in what the Census of Governments classifies as "Total Intergovernmental Revenue from the State Government."[5] In other words, we plot data indicating the fiscal outputs of these rules and decisions. As Figure 1 illustrates, the positive trend over time is particularly strong for cities with populations over 100,000.[6] On average, it would seem that state governments have helped at least larger cities meet increasingly difficult financial conditions through the extension of intergovernmental transfers.

Figure 2, which compares levels and growth of per capita state aid across the contiguous 48 states, paints a bleaker portrait. Consistent with the findings presented in Figure 1, 43 of the 48 states exhibit positive growth rates, meaning that roughly 90 percent of the lower 48 states provided higher levels of aid in the current era than in the early 1970s (mean increase = 256 percent). Figure 1, however, masks the considerable unevenness with which state governments deliver aid. This unevenness is on display in Figure 2, where fewer states provide above average levels of aid, and most states exhibit relatively flat growth in the distribution of state aid.[7]

Figure 2. The Uneven Development of State Aid Environments



5 This includes state grants-in-aid, regardless of basis of distribution; local share of state-collected taxes; payments in lieu of taxes on state property; and reimbursement for services performed for state government (e.g., care of state prisoners in local jails, construction or maintenance of state highway facilities, etc.) (U.S. Bureau of the Census, 2006).

6 In 1970, these cities received roughly $160 per capita (in real 2005 dollars) in state intergovernmental revenue; in 2005, the most recent year in our time series, average per capita aid was $470. Though the growth rate for small and medium-sized cities is not as steep, the steady uptick in average per capita state aid exemplifies a healthier state aid environment than in the past.

7 As is indicated by the maroon-colored vertical line, the average per capita aid provided to local governments in 2005 was just over $340. Texas, Oklahoma, Georgia and Utah provided around $40 per person, on average. New York, Connecticut, Virginia, Massachusetts and Rhode Island, on the other hand, distributed intergovernmental revenue at an annual rate at or around $1,000 per resident.

One key reason for this unevenness is that state aid tends to ebb and flow with changing state-level economic conditions (Berman, 2003, pp. 100-102). More generally, state intergovernmental aid – particularly those discretionary resources distributed via statutory aid policies and unprotected by state constitutions – is inextricably linked to state legislative budget battles. State legislatures and governors, scrambling to balance their own budgets, are simply more likely to risk citizen backlash from significant aid cuts during periods of widespread budget shortfalls. What is more, state lawmakers across the country seem to be looking with decreasing favorability on the idea of, in the derisive words of one Wisconsin legislator, "being an ATM machine for local governments" (Rinard, 1999, p. 1).

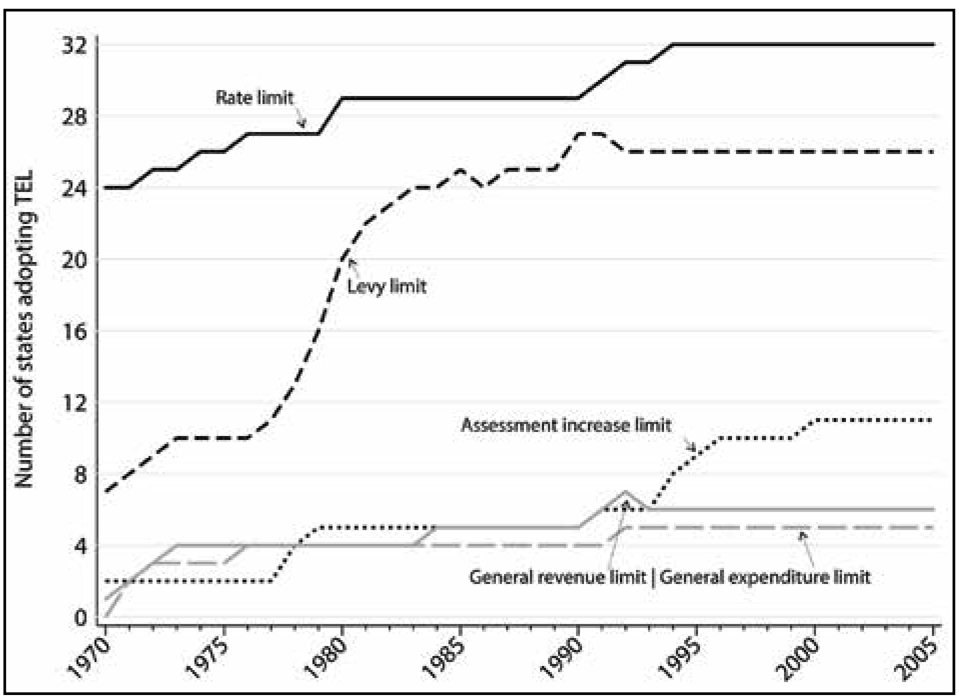
Figure 2, however, illustrates that not all states have chosen to respond to their revenue difficulties by making cuts to intergovernmental aid. A study from Pew's American Cities Project reports that Connecticut, which provides one of the more vibrant aid environments in the country, chose to slightly bolster intergovernmental aid to its local governments on the heels of the Great Recession (in fiscal year 2010) and has not reported a cut since then. Nebraska, on the other hand, canceled all funding to its local governments in 2011; Maryland, California, Arizona, Nevada, Minnesota, Texas, Virginia and Wyoming made 5 to 6 percent cuts that same year. All else being equal, we would expect it to be far less onerous to balance revenue and expenditure flows in city governments in states such as Connecticut, New York or Massachusetts – i.e., states where key state decision makers seem less inclined to shift service costs to local governments via cuts in state aid during times of state financial stress – than in cities facing similar sets of environmental, political or managerial conditions in states that provide lower or more volatile levels of intergovernmental aid.

State policies regarding levels and delivery of state aid are but one piece of an increasingly complex set of structures that govern local revenue capacity. In a classic textbook on American intergovernmental relations, Stephens and Wikstrom (2006, p. 196) remark, "Without doubt, the most important mechanism that the state has for influencing the political behavior of local officials involves financial assistance." This may have been true in the 1970s or 1980s, and to be sure it is a fundamental tenet of traditional models of fiscal federalism, but the most important mechanism for controlling local fiscal behavior in the past quarter-century is the tax and expenditure limit (TEL) – a label that broadly captures state attempts to limit the taxing and/or spending authority of its local governments through constitutional amendment or legislative enactment.

State governments have long imposed some manner of TEL.[8] Figure 3 tracks the adoption of TELs since 1970 across the four most common categories: *rate limits* – which are overall or specific tax rate limits that set the ceiling on the aggregate tax rate, which cannot be exceeded without a vote of the electorate; property tax *levy limits*, which constrain the total amount of revenue that can be raised from the property tax (independent of the property tax rate); *assessment increase limits*, which cap the growth rate of assessed values and is intended to control the ability of local government to raise revenue either by reassessment of property or through escalation of property values; and

8 For instance, the first states to establish property tax rate limits were Rhode Island (1870), Nevada (1895), Oklahoma (1907) and Ohio (1911).

Figure 3. Proliferation and Layering of TELs Since 1970

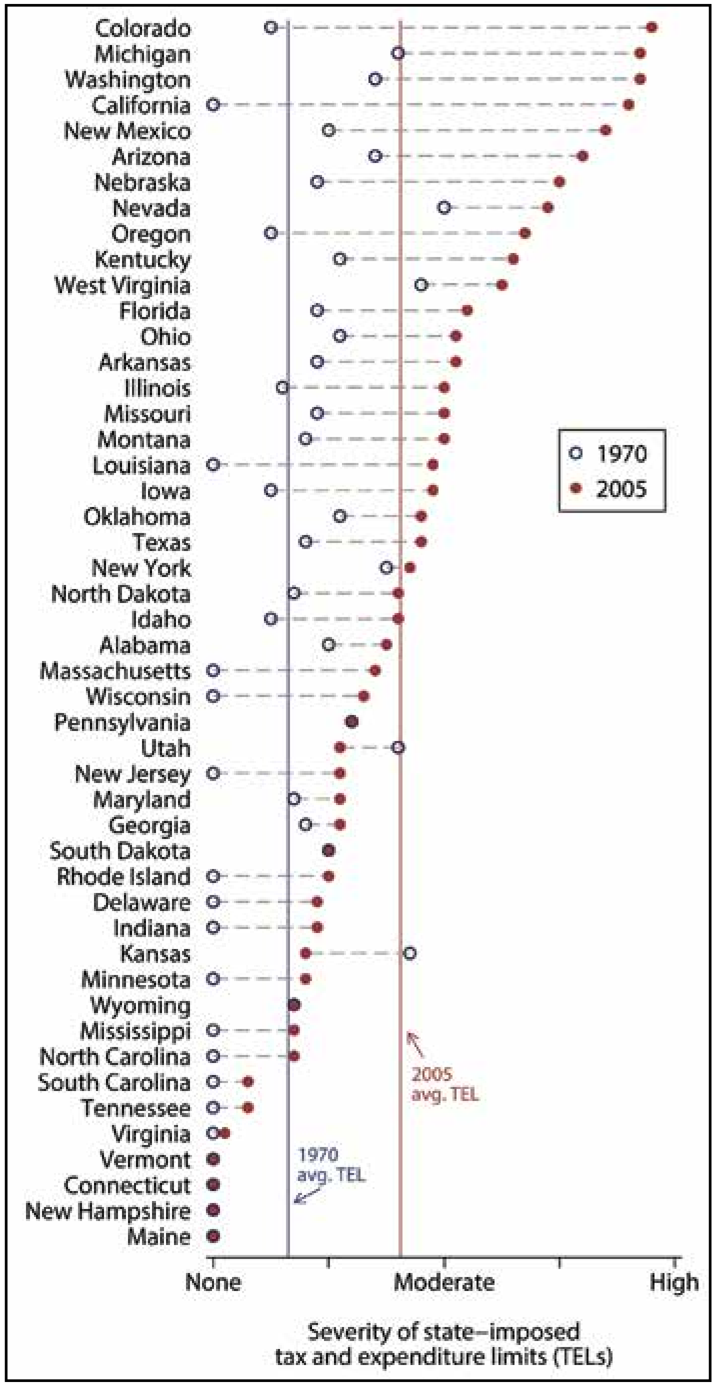


limits on *general revenue* or *general expenditure* increases, which set the maximum growth rate of total revenue or total spending.

Whereas a great deal of research has shown that the appearance of even a single TEL constrains the capacity of local officials to generate revenues on their own (see Poterba and Rueben, 1995; Shadbegian, 1996, 1999; it is the accumulation or layering of fiscal constraints that can be particularly damaging to the revenue capacity of local lawmakers.[9] In single-TEL states, for instance, raising assessments might be employed to circumvent property tax rate limits and vice versa; in states that impose only an assessment cap, this single limitation could potentially be overcome by adopting a higher rate. These methods of circumvention were common early in the 1970s, when 24 of the 29 states adopting some form of TEL imposed only one constraint (mostly rate limits), and a mere five states imposed two revenue TELs. Today, at least 27 of the contiguous 48 states impose multiple revenue TELs. Nineteen states impose two, and eight states – Arizona, California, Colorado, Michigan, Nebraska, Nevada, New Mexico and Washington – apply three local tax limitations.

The number of TELs in a state does not necessarily capture the severity of the limitation(s), though it is reasonable to expect a higher frequency of TELs to create a more restrictive local tax environment. Figure 4 displays a measure of TEL severity (see appendix regarding our research approach beginning on page 25), with the open point illustrating the severity of the state's TEL in 1970, the closed (maroon) point plotting restrictiveness in 2005, and the dashed horizontal line representing the change in severity of the state's tax limitations.[10] Figure 4 reveals some noteworthy patterns that illustrate the reality of state policy choices regarding local tax structures. Michigan, a state that imposes one of the more onerous sets of revenue restrictions, achieved this status via a one-two punch of major constitutional amendments enacted by voters: the Headlee Amendment in 1978 and Proposal A in 1994.[11] The Headlee Amendment capped local property tax millage rates to the rate of inflation. Proposal A – a constitutional amendment quite similar to Proposition 13 in California, a state with a similarly restrictive fiscal relationship with its locales – further limited local property tax revenue growth

Figure 4. TEL Escalations by State



9 Rising adoption rates are on display in Figure 3. So, too, is the increasingly common phenomenon of TEL layering, meaning the imposition of state-imposed controls on multiple elements of the local tax structure. And those controls are growing: in 1970, 29 of the contiguous 48 states had at least one revenue TEL; today, some 41 of 48 states have at least one local revenue limit.

10 The measure of TEL severity, initially proposed by Amiel, Deller and Stallmann (2009), indexes six key characteristics: the type of TEL (see discussion above), if the TEL is statutory or constitutional, growth restrictions, method of TEL approval, TEL overrides and exemptions, and method of override. For a more detailed discussion of this measure, see Amiel, Deller, and Stallmann (2009) and Maher and Deller (2013).

11 Constitution of the State of Michigan, Sections 25-33.

by changing the system of assessment to cap individual property values and prohibiting cities from "rolling up" a millage to the rate of inflation if actual property value growth was lower than inflation.[12] Taken together, these two large TEL ratchets, which came 17 years apart and layered on top of an already aggressive property tax rate limit, placed tremendous pressure on local lawmakers' ability to generate critical revenue (Brunori et al., 2008). Contrast Michigan's approach to that of Massachusetts's Prop 2½, a similarly infamous state-imposed TEL, which was passed by referendum in 1980 and effectively caps local property tax levies at 2.5 percent of real property value. Massachusetts's relatively moderate position on the severity index owes much to the state's choice to apply no corresponding rate, revenue or assessment limits on local lawmakers.

TELs, taken alone, are neither inherently good nor bad. They have been alternately portrayed as necessary evils for taming "Leviathan" city governments (Brennan and Buchanan, 1979; Craw, 2008; Downes and Figlio, 1999), or as just plain evils that stifle cities' abilities to pursue innovative visions for their futures (Frug and Barron, 2008).[13] However, over three decades after the tax revolt movement took hold in a major way in states such as California and Michigan, the widespread adoption of local TELs depicted in Figures 1 and 2 has had two overarching effects: the first is the loss of local revenues; the second is decreasing local reliance on property taxes.[14] There is little evidence to suggest that TELs, however, promote local fiscal sustainability. The reason is that local spending mostly goes unaffected by revenue limits (Dye and McGuire, 1997), particularly in the absence of state-imposed spending lids, which exist in only a small handful of states.[15]

In sum, the proliferation of state-imposed TELs has helped to create a national state-local fiscal system that is simply less conducive to local governments' abilities to fund their own activities.[16] States with more aggressive local TELs – such as Michigan, Colorado and California – hinder the revenue capacity of their local governments. This capacity is vital during even the most moderate of economic downturns because service demands tend to rise and state aid tends to drop. Revenue slack, however, was particularly vital during the most recent recession. In previous downturns, home prices mostly remained stable, thus steadying property tax revenues (particularly in relation to sales and income taxes). In the 2009 recession, property tax revenues, already slowed in certain states via state-imposed TELs, plummeted in simultaneity with state aid. The good news, as we illustrate below, is that a relatively small number of states impose such crippling revenue constraints from both ends: meaning states that both limit own-source revenue capacity while also providing far from vibrant levels of state aid. The bad news is that, for local officials who must operate within those state environments, even small declines in revenues can present tremendous budgetary challenges.

Mapping the Revenue Squeeze: Revenue "Carrot" and Revenue "Stick" States

As property tax revenues continue to erode as a function of state-imposed TELs and local governments have become more reliant on state aid, some observers have suggested that state governments have responded to their expanding role in local fiscal affairs by providing greater levels of intergovernmental revenues (Berman, 2003; Sokolow, 2000; Dye and McGuire, 1997b).[17] This reading of state-local fiscal dynamics is somewhat supported by comparing trends in average levels of state aid to local governments exhibited in Figure 1 and total revenue limit adoptions depicted in Figure 3. However, our data allow for a far more detailed look at how local revenue capacity is being affected by state policies for local governments within each of the lower 48 states.

Figure 5 depicts a rough state-level indicator of the severity of state restrictions on local revenue capacity. States for which our standardized measure of per capita state aid far exceeds our standardized measure of the severity of local revenue limits – such as Connecticut, New York, Massachusetts, New York, Rhode Island and New Jersey – are depicted in orange and labeled revenue carrot states. All else being equal, we would expect the revenue capacity of local governments in these states to be buttressed by their state context. As was pointed out above, a well-structured state aid environment increases the overall fiscal capacity of local governments and, according to Pagano and Hoene (2010, p. 260), can provide "a level of equalization and base support for municipalities that may lack other resources." Additional value to local revenue capacity stems from the fact that critical own-source revenues are

12 Many other provisions of both the Headlee Amendment and Proposal A are related to other parts of the state finance system, and a detailed examination of the depth of both laws would be a paper unto itself. We will discuss the impacts of these types of laws, generally and in Michigan, later in the paper.

13 To be sure, they are a frequent source of local consternation, particularly as fixed costs occupy a larger share of local budgets and demand for services – driven by postrecession unemployment rates, population changes and other factors – continues to rise.

14 Indeed, in many state contexts, forgone property tax revenues have at least partially been recovered via more regressive revenue sources – such as fees and, where allowed, sales taxes.

15 This is an important point that is often obscured by the frequent reliance on the TEL acronym (Tax and *Expenditure* Limits).

16 Amidst the national clamor for government austerity and fiscal responsibility, it is important to point out that these activities – particularly in the states that impose the most formidable set of revenue constraints, such as Michigan, California and Colorado – include essential local services such as public safety and infrastructure maintenance, which are critical functions of local government.

17 Greater local reliance on state aid does not necessarily mean that state officials have "anteed up," a point that, mainly because of data constraints, is too often overlooked.

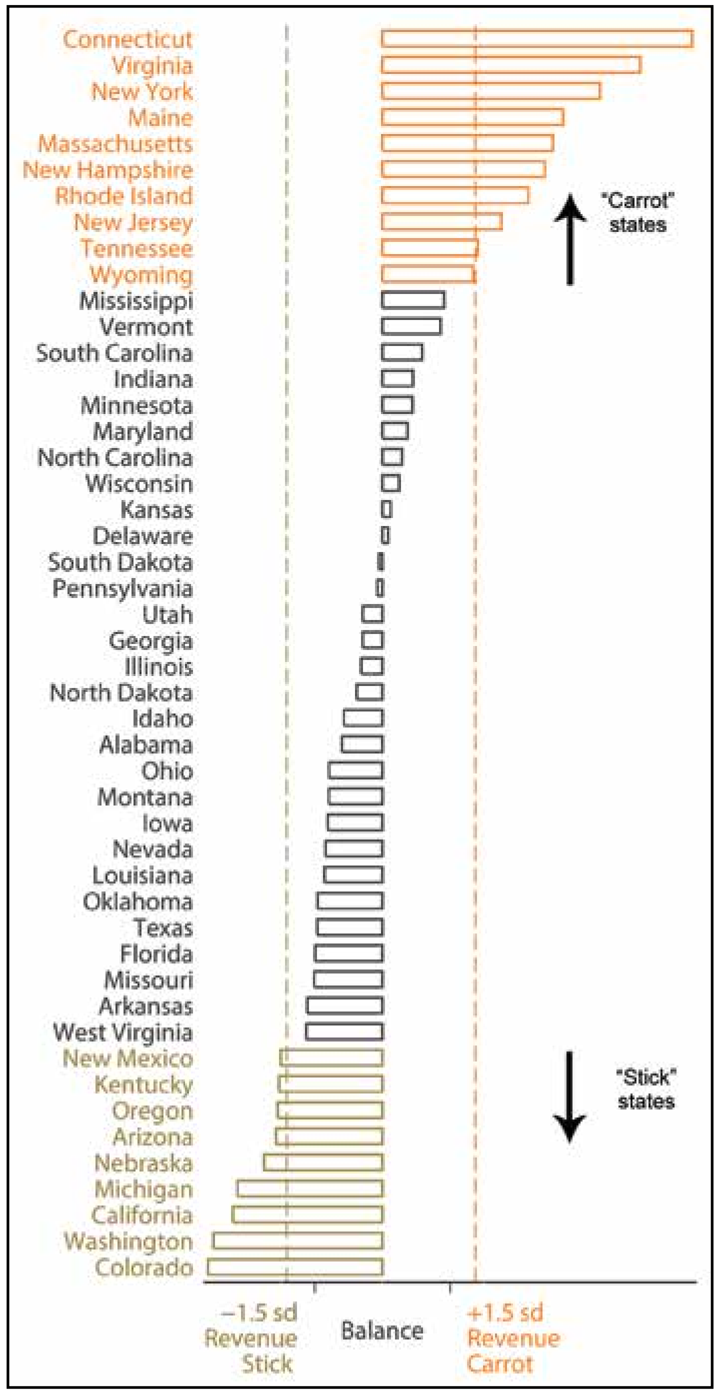
either altogether unencumbered by the absence of state TELs, as in Connecticut; limited only on the margins, as in Rhode Island or Tennessee; or limited via more aggressive TELs offset via significant funding from the state, as in Massachusetts.

Revenue stick states – such as Michigan, Colorado, Washington and California – are depicted in brown. These state governments (or state citizens via the referendum or initiative process) constrain the fiscal autonomy of local government officials rather than buttress it via state aid. An extensive body of research on the local effects of state-imposed TELs strongly suggests that revenue limits have worked: local own-source revenues have been reduced in the states that impose such limitations. Though there is some historical evidence that state legislatures in certain states have offset these limitations via state aid (Mullins and Joyce, 1996), revenue stick states tend to be far less generous in the allocation of intergovernmental revenue. All else being equal, we would expect the revenue capacity of local governments in these states to be constrained by their state context.

Michigan, for instance, has a TEL score well above the most recent annual state average, coupled with slightly below average state aid. The problem with local fiscal sustainability in revenue stick states such as Michigan stems from local governments' heightened reliance on state revenues, which in Michigan is a function of two large TEL ratchets and, in the post-Great Recession period, sharply declining property tax revenues. This high degree of dependency remains in place today. Yet, much like the way that Michigan's Proposition A has exposed critical local education funding to state budgetary battles (Cullen and Loeb, 2004), the state's unyielding property tax rate limits, coupled with special features of the Headlee Amendment that forbid the use of some alternative revenue sources employed in other states (e.g., income, sales and motor fuel taxes), have had the unfortunate side effect of essentially entwining local fiscal health with state legislative politics. As the state economy faltered under a one-state recession throughout much of the 2000s (Darga, 2011), the past decade has seen both clear declines in statutory revenue sharing and heightened levels of uncertainty over revenue-sharing rules (Lavelle, 2014, pp. 2-3).

Michigan's is a precarious fiscal context even for the most well-managed city government. It is particularly onerous for lawmakers in older, industrial cities such as Flint, which has been dealing for some time with sustained job and population loss, waning bureaucratic capacity, and increasingly daunting economic, social and physical challenges (see Doidge et al., 2015). In the words of one local official, if aid is reduced, "It's not rocket science … pretty much raise taxes or cut services. That's what it boils down to" (McDermott and Powers, 2002, p. 12). Local lawmakers in a state such as Michigan, where they operate

Figure 5. Revenue "Carrot" and Revenue "Stick" States



with very limited discretion over revenue capacity, can boil it down even further: reduce or eliminate services or face the prospects of possible financial meltdown. All cities face political constraints on raising tax revenue. And certainly, some cities have managed their financial affairs in the face of economic decline better than others. However, for those seeking to fully grasp the nature of local fiscal health, we must continue to focus on ways in which states effectively create a mismatch between fiscal needs and available resources into their cities' local fiscal decision-making environment.

(2) Expenditure-side Pressures: Labor Costs and State Regulation of Local Public Employee Collective Bargaining

In addition to the revenue squeeze that some states impose on their local governments, state governments also impose a range of expenditure-side pressures that can drive up local costs.[18] As state governments continue to streamline bureaucracies and downsize operations, service burdens have been shifted onto local governments, often "without careful consideration whether this was the correct course" (Gold and Wallin, 1999, p. 73). As one prominent National League of Cities report argues (2003, p. 23), the transference of "program responsibilities from state and federal government, as well as the imposition of state and federal mandates, increase the roles and responsibilities of municipal governments, often without corresponding fiscal capacity or authority." Observers and analysts interested in the expenditure-side burdens that state policies place on local officials typically focus on the effects that costly mandates in areas such as health care and pollution abatement have on local government budgets (see Berman, 2003, pp. 77-83). Far less attention is paid to what we might call *de facto* spending pressures – the hidden but potentially damaging state-level decisions, policies and institutions that can destabilize local governments' fiscal capacity.

Consider, as we do in this report, local governments' large and increasing burden to pay for previously obligated labor costs. Labor costs, including wages and benefits for current employees as well as pensions and other postemployment benefits (OPEB) such as retiree healthcare, currently make up the largest category of operating costs for local governments. As pointed out in a recent MSU white paper (Scorsone and Bateson, 2013), municipalities were not required to measure the total costs of OPEB until an accounting standard was issued in 2004, with implementation beginning in 2007. Now that local governments have calculated and accounted for OPEB, many are faced with a massive commitment. Indeed, MSU's review of Michigan cities facing severe fiscal stress revealed that each city was confronted with a substantial unfunded OPEB liability (Scorsone and Bateson, 2013).

Though local government employee pensions and OPEB are seemingly always in the headlines, few seem to be asking why observers are more able to link labor costs to local fiscal distress in certain states than in others. Why do we hear so much about Michigan, Pennsylvania, California, Rhode Island and New Jersey? The answer, not surprisingly, is that, although city lawmakers are often criticized for overly cozy relationships with public employee labor unions (see, for instance, Gillette, 2014a; Rozansky, 2012; Greenhut, 2012), critical elements of employee benefit costs are structured by state law. State law may require bargaining by the employer, may provide only for a bargaining forum without requiring it or, alternatively, may simply prohibit collective bargaining altogether. State laws vary in the coverage of certain types of local employees. These rules address the types of items that may be bargained over, such as work rules, pay and benefits. Finally, the collective bargaining laws may include a process for dealing with impasses, such as binding arbitration rules. In line with the framework proposed at this report's outset, we view the mix of these rules as a set of processes and constraints that directly influence a municipality's fiscal capacity.

Table 1 places the local public employee collective bargaining environment of the contiguous 48 states into a five-category classification scheme ranging from very weak to very strong. (See the research approach appendix for a more detailed explanation of this measure.) As Table 1 makes plain, states vary with respect to the collective bargaining environment for local public employees. Not surprisingly, states with strong and very strong collective bargaining environments (e.g., those that impose a duty to bargain with strong union security provisions) have comparatively high union membership rates as well, with New York, Rhode Island, New Jersey, Connecticut, Massachusetts, California, Illinois, Oregon, Minnesota, Pennsylvania and Michigan each holding union membership rates in excess of 50 percent of state public employees. Unionization rates in weak and very weak states, such as Mississippi, South Carolina, North Carolina, New Mexico, Wyoming, Utah, Georgia and Virginia, on the other hand, tend to fall around 10 percent.[19]

State laws concerning pensions and health benefits illustrate, in part, how state-imposed structures affect city expenditure choices. Yet recent attention to employee compensation, pension system funding/underfunding and, especially, the cumulative impact of local government employee costs on current municipal cash flows have

18 This general phenomenon has been termed "second-order devolution" – meaning the transfer of program administration and/or substantive policy powers from the federal and state governments to America's cities and municipalities (see Bowman and Kearney, 2011).

19 Statistics from Union Membership and Coverage Database (see Hirsch and Macpherson, 2003).

brought these issues, in particular, into national focus. To be clear, we do not suggest that a non-unionized workforce is the key to a fiscally sustainable city. City governments must compete with other employers for workers, and rules governing bargaining are part of a state's larger labor culture. Our simple argument is that, in light of the sizeable role for local labor costs in local budgeting as well the implementation of new accounting standards, city governments operating within states with more permissive collective bargaining provisions are more likely to face budgetary constraints. It is easy to pin these constraints on lousy decision making, yet these constraints owe much to higher labor costs and the cumulative costs of payment decisions that are, to a large degree, governed by state policy.

(3) The State Context for Local Fiscal Distress: Tension Between Revenue and Expenditure Pressures

Analysis of the interplay of revenue and expenditure pressures allows for a more detailed assessment of the nature of the fiscal context in which states place their local lawmakers. We offer this analysis as something of a corrective to the typical perception that a city's financial destiny is either entirely within or entirely outside of its control. When assessing why certain local governments seem to respond more effectively to their financial problems than others, our research suggests that identifying on Figure 6 (see page 14) the state in which the city is located is a good place to start. The state's coordinates represent an empirical measure of the state context for local fiscal distress – meaning the tension for local lawmakers between state-imposed revenue-side pressures (captured on the horizontal axis) and state-imposed expenditure-side pressures (captured on the vertical axis).[20]

20 More technically, the horizontal axis captures our measure of the revenue pressures that states inflict upon their local governments (standardized TEL severity score minus standardized average per capita aid score). The vertical axis represents a standardized measure of public employee union coverage, an approximation of the severity of the average city's relatively fixed labor costs. The light gray shading represents the distance between one quartile above and one quartile below the median; thus states that appear outside these two intersecting ranges are quite different from average on both elements of the state context. Dark shaded points indicate state governments that authorize state intervention in financially distressed local governments.

Table 1. State Collective Bargaining Environments for Local Public Sector Employees

Collective bargaining environment	States		Brief description
Very strong	Illinois Minnesota Montana Ohio	Oregon Pennsylvania Vermont Wisconsin	Duty to bargain Strong union security provisions Strikes are permitted with qualifications
Strong	California Connecticut Delaware Maine Massachusetts Michigan	New Hampshire New Jersey New York Rhode Island Washington	Duty to bargain Strong union security provisions Strikes are prohibited
Moderate-mix	Florida Idaho Iowa Kentucky	Nebraska Nevada Oklahoma South Dakota	Some bargaining rights Weak union security Strikes are prohibited
Weak	Arizona Arkansas Indiana Kansas Louisiana Missouri	New Mexico South Carolina Texas Utah West Virginia Wyoming	Limited collective bargaining rights Right to work Strikes are prohibited
Very weak	Alabama Colorado Georgia Maryland Mississippi	North Carolina North Dakota Tennessee Virginia	Collective bargaining is prohibited Right to work Strikes are prohibited

Figure 6. Assessing the State Context for Local Fiscal Distress

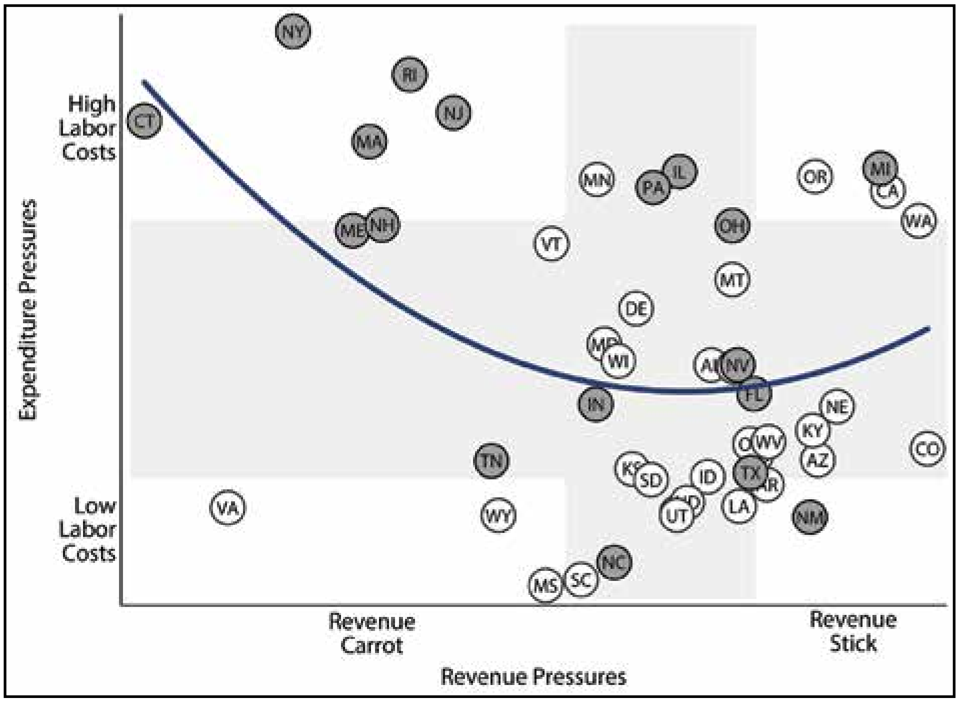


Table 2. Tabulating the State Context for Local Fiscal Distress

State-Imposed Expenditure Pressures	State-Imposed Revenue Pressures		
	Carrot	Balance	Stick
High	Connecticut Massachusetts New Jersey New York Rhode Island	Illinois Minnesota Pennsylvania	California Michigan Oregon Washington
Moderate	Maine New Hampshire Tennessee Vermont	Alabama Delaware Florida Indiana Iowa Kansas Maryland Montana Nevada Ohio Oklahoma Wisconsin	Arizona Colorado Kentucky Missouri Nebraska West Virginia
Low	Mississippi Virginia Wyoming	Georgia Idaho Louisiana North Carolina North Dakota South Carolina South Dakota Texas Utah	Arkansas New Mexico

If state-imposed revenue pressures increased with the severity of expenditure pressures, or vice versa, we would expect a positive "best fit" line (the dark curving line in Figure 6) moving from the lower left-hand quadrant to the upper right. As one might expect (or at least hope), these two elements of the state context tend to offset each other. States such as Colorado and New Mexico – i.e., more revenue stick states (local tax limitation increases outpace growth in the distribution of state aid) – avoid equally exacting expenditure-side pressures, at least when it comes to local labor costs. For states that do structure local collective bargaining in a way that favors higher local labor costs – such as New York, Connecticut and Rhode Island – these costs are at least partially offset by a more resilient and vibrant aid environment, coupled with limited own-source revenue restrictions.

The relationship between these two elements of the state context is negative, but it is not a purely linear relationship. Figure 6's most striking feature is its illustration that states placing extreme limitations on local revenue capacity (meaning they are more than one standard deviation above the state average on the horizontal axis) also tend to impose costly labor and service obligations (more than one standard deviation above the state average on the vertical axis). This relationship between revenue and expenditure pressures creates a best-fit line that resembles a backwards "J". This small handful of states that pull the line upward – which include Michigan and California – cluster in the upper right-hand quadrant of Figure 6. It is no surprise that acute financial emergencies have clustered in these states. We contend that they have structured local fiscal policymaking in a way that effectively incubates financial distress. Table 2 classifies the states in an effort to clearly represent the position of each of the lower 48 states along these two dimensions.

The threat of recurring structural deficits is "baked in" to the state-imposed legal and policy context in which local governments choose how to respond to fiscal problems. For lawmakers in America's older, industrial cities who must operate within these states, that choice is often not theirs to make. As we point out above, these states apply revenue and expenditure pressures on the front end, while also fostering a fiscal environment that exacerbates fiscal stress, links local fiscal health to budgetary battles, and all in all restricts the policy "space" for local fiscal policymaking. Michigan, however, is the only state among the incubators in the top right quadrant of Table 2 and Figure 6 that also intervenes "on the back end" by assertively implementing one of the nation's most powerful fiscal distress intervention policies (Anderson, 2011; Scorsone, 2014).

In light of the clustering of distressed localities within Michigan's borders, it comes as little surprise that Michigan lawmakers would value a policy that allows state officials to help struggling local governments meet conditions of chronic fiscal stress (Scorsone and Bateson, 2011; Doidge et al., 2015). However, as we discuss below, what is quite striking is the relationship between the policy's goals and design – which favors state takeover of local government – and the nature and underlying causes of the problem of acute fiscal distress. The financial consequences of deep-rooted economic and social forces are unlikely to be fully alleviated via temporary suspension of local self-government. Neither are the often overlooked but critically important state-imposed causes analyzed above. In what follows, we survey the state governments with more holistic and self-aware views of local financial distress in an effort to draw important lessons for Michigan lawmakers as they continue to struggle with chronic fiscal stress among the state's localities.

Section 2: If Takeover is the Solution, then what is the Problem? What Michigan Can Learn from the Ways in Which Other States Tackle Problems of Local Fiscal Distress

In the previous section, we make the case that state governments influence how local officials meet their financial problems via a combination of laws and policies that add or take away intergovernmental or own-source revenue capacity and drive up expenditure pressures via the allocation of policy authority over government functions and labor costs. In certain instances, such as when a state government caps property tax revenue and sets near insurmountable override standards, the effects of certain elements of the state context may be more or less direct. A city facing a near identical set of political, institutional, economic and social circumstances that operates in a neighboring state with no such revenue cap at least has the potential to capitalize on this capacity, assuming local political and economic constraints allow for the imposition of a property tax increase. But mostly the effects of this state context are more indirect. The policy balance between revenue restrictions and state aid, for instance, is not so much a direct measure of state policy choice as it is an outcome of a variety of state policy choices – e.g., revenue-sharing rules and formulae, the outcomes of citizen initiatives involving local TELs, legislative-executive budgetary processes, bureaucratic turf battles and so on.

Since as far back as the late 19th century, when the proliferation of railroad bankruptcies prompted states to take action to assist struggling localities (see Dimock, 1935 and 1940), state lawmakers, for fear that "a failing municipality will lower the credit rating of other localities and the state itself" (Berman, 2003, p. 113), have played a far more direct role in responding to local financial distress. The current menu of state policy options for intervening in distressed communities has been reviewed in two recent reports, one by Pew Charitable Trust researchers (Atwell et al., 2013) and a second by one of the authors of this report (Scorsone, 2014). One key shortcoming of these reports is the absence of detailed consideration of state context. Simply put, some states are part of the problem – they incubate financial distress via stringent restrictions on local revenue capacity and state policies precipitating local spending pressures. In other states, local policy options regarding the balance of revenue and expenditure flows are less encumbered by state policies and institutions. This diversity among state contexts is particularly important when reflecting on "best practices" for states dealing with acute local fiscal distress. For instance, close followers of issues of local finance often hear and read about North Carolina's strong oversight and monitoring mechanisms as standards to which state governments should aspire (see, for instance, Mattoon, 2014). But does it make sense for a state such as Michigan or New Jersey, for instance, to adhere to similar policy principles when local fiscal policymaking is structured in such dramatically different ways?

A second shortcoming of these reports is the dearth of detailed comparison among the 18 state governments that currently have an intervention policy. We refer readers to these reports for their quality in cataloguing the formal policy powers of state lawmakers on paper. Neither, however, is as useful at considering these policies in practice. This is a key tension in policy analysis generally and in instances of intervention in particular. The choice of the state's appointed and elected officials to employ the power they have at their disposal and intervene in a distressed community (often meaning the temporary suspension of democratic processes) presents a particular type of implementation dilemma imbued with questions of racial bias, social and economic imbalances, and the legal and political culture that guides state-local relations.

To fully assess the role of state governments in financial distress, we held a workshop for state government officials, analysts and experts with deep knowledge of state operations in local financial affairs. The Workshop on State Intervention in Distressed Communities, held in the fall of 2014 in Detroit, ultimately brought together a diverse group of 28 practitioners and policy experts from six states facing similar sets of local fiscal problems: Michigan, Rhode Island, New Jersey, Pennsylvania, New York and Ohio.[21] The appendix provides a detailed overview of the structure of the event and the types of discussions that were held.

Our primary goal was to provide a venue facilitating the open exchange of ideas and techniques for approaching the complicated problems facing cities in fiscal crisis. Indeed, as we discuss below, one recommendation of this research

21 This portion of the process focused specifically on how states approach intervention. Though many of the participants in the workshop were intimately involved in making decisions at the city level, we intentionally chose participants representing the state perspective rather than that of local decision makers.

report is to continue to advance this and similarly minded endeavors as a means of facilitating what Peter May (1992) refers to as "instrumental policy learning," which can improve state officials' understanding of the benefits and limitations of particular policy approaches or administrative designs. A second goal centers on learning more about the states' implementation processes for deciding whether to designate a city in distress, take it over temporarily or, in the most extreme cases, help shepherd its path to municipal bankruptcy. Our final goal was to investigate the types of "causal stories" (Stone, 2011) that state officials and experts used when considering the fiscal conditions facing their local governments. We held structured discussions about how the problem of local fiscal distress is defined (i.e., who or what bears the responsibility) and the ways in which state governments enshrine this problem definition via the design and implementation of financial emergency policies.

In what follows, we begin with a brief outline of Michigan's approach to local financial emergencies, paying special attention to linkages between the state's policy solutions, the nature of fiscal stress in Michigan's municipalities and the "front-end" context identified in Section 1. We then turn to alternative approaches employed in other key states. We begin with North Carolina, a state whose Local Government Commission, which administers the policy for dealing with financially challenged communities, has received a great deal of national credit. We then move to states facing more comparable sets of local conditions – i.e., with many older, industrial and fiscally vulnerable local governments suffering from population and job loss – that also have a history of state intervention in fiscally distressed communities. The goal here is not comprehensive overview. Rather, we set out to identify key dissimilarities with the new generation of intervention policies – of which Michigan's current policy is the poster child – and to illustrate how state governments facing similar sets of challenges can more effectively align their policy regarding direct involvement in fiscally distressed communities with the nature of problems that these communities face, as well as with state-imposed constraints that hamper their capacity to balance revenue and expenditure flows.

We designed Table 3 (see page 18) to help guide this discussion. The first two columns summarize the state context analyzed in Section 1 of this report. The four rightmost columns depict information summarizing the design and administration of the state's local financial emergency policy. The column labeled "causal story" reflects our assessment of how a state government, via its legislation of state intervention, comes down on the debate over the causes of local financial failure. For some states, the focal point is internal causes – poor management, the incompetence of local leaders, political corruption, the dominance over policymaking by narrow interests, and/or "antidemocratic" structures and processes that favor the whims of local officials over the needs of local residents (Gillette, 2014b). Other states focus on forces external to local management – i.e., socioeconomic conditions that are at once causes and symptoms of diminishing local service capacity and resources (see Kimhi, 2008), such as high and concentrated poverty, older building stocks, residential vacancies, high crime, deep-rooted regional changes, population loss and job loss. The column labeled "policy approach" captures the gist of the state's approach to financially distressed communities and reinforces the causal theory behind the policy's design. We also include information on the administration of the states' policies. Here the focus is on the powers of key administrative actors and their bureaucratic location. In line with a great deal of research on policy analysis and the policymaking process, we structure Table 3 in a way that suggests that key state decisions on goals, administration and implementation flow from how responsibility for the problem is assigned – i.e., the causal story (see Stone, 2011, p. 206). This information is provided for the six states that were represented at the Detroit workshop – Michigan, Rhode Island, New Jersey, Pennsylvania, New York and Ohio – as well as for North Carolina, a state that frequently gains attention for the effectiveness of its intervention policy.

(1) Michigan's Local Financial Stability and Choice Act: A Brave New World for State Intervention

The tenets of Michigan's intervention policy have been well-documented in research reports and news media. After the governor declares a fiscal emergency,[22] four possible courses of action are available to a municipality,[23] though local takeover by an emergency manager (EM) is the most common course of action. This allows a state-appointed manager to "act for and in the place and stead of the governing body and the office of chief administrative officer of the local government" and effectively grants this individual powers beyond those available to local officials.[24] Not only does he or she become responsible for all local fiscal decisions, including development and implementation of a recovery plan (which must be approved by the state treasurer), but the EM can also modify existing collective bargaining agreements, negotiate new union contracts and make personnel changes. The EM can also explore the option of consolidating services with another government entity, sell municipal assets and ask voters to increase the tax rate. The EM remains in this role until the city reaches certain benchmarks within its recovery plan, and a

22 A series of triggers are in place and one must occur – e.g., failure by the local unit of government to pay creditors or make timely pension contributions – prior to a state review of a local unit's finances

23 Consent agreement, emergency management, neutral evaluation or municipal bankruptcy.

24 141.1549, Sec. 9.

Table 3. Intervention Policy in the Context of State-Local Fiscal Relations

State	State Context		Local Financial Emergency Policy			
			Design		Administration	
	Revenue Pressures	Expenditure Pressures	"Causal" story	Policy Approach	Agency/Govt. Branch	Responsibilities
Michigan	Revenue stick (top 5%)	High (top 20%)	Management (internal)	**State-appointed manager furnished with broad tools to restore solvency (mostly on spending side) once distress occurs.** Michigan typically does not intervene in local fiscal affairs until a fiscal emergency is recognized. There is no program of prevention.	Governor Department of Treasury (Office of Fiscal Responsibility)	Declaration of financial emergency and appointment of powerful emergency manager. Monitor emergency management process and approve certain decisions.
New Jersey	Revenue carrot (bottom 10%)	High (top 5%)	Socioeconomic factors (external) Management (internal)	**Support distressed communities.** When/if cities enter distress, the state makes available monetary and technical assistance.	Department of Community Affairs (Division of Local Govt. Services)	Monitor and approve local budgets, certain debt and capital investments; approve of additional aid; advocate for local government interests.
New York	Revenue carrot (bottom 5%)	High (top 1%)	City specific	**Generate city-specific solutions.** The legislature designs and enacts a specific policy for each city in distress. **Prevent distress from occurring.** The comptroller's office has designed an extensive monitoring system, staffed by many state auditors, to help local officials stave off financial emergency.	Legislature Office of the State Comptroller Governor	Legislate and adopt city-specific legislation, including establishing local control board. Preventive monitoring of all local budgets and administration of fiscal monitoring system. Appoint local control board.
North Carolina	Balance/lean carrot (bottom half)	Low (bottom 5%)	Management (internal)	**Central control prevents distress.** North Carolina has a highly centralized system designed to prevent risky decision making and borrowing by municipalities.	Department of Treasury (Local Government Commission)	Review audits, monitor local fiscal health, approve and settle local debt issues, require remediation plan.
Ohio	Balance/lean stick (top 40%)	High (top 25%)	Management (internal)	**Support local control.** Ohio intervenes at the request of local officials; recovery plans are submitted by local officials.	State Auditor (Local Government Services Division)	Train local officials, audit local budgets, classify distressed communities.
Pennsylvania	Balance (bottom half)	High (top 20%)	Socioeconomic factors (external) Management (internal)	**Helps troubled communities "help themselves."** Even in receivership, aims to address causes and prevent relapse, though communities may be unable to exit the state process because of systemic barriers.	Dept. of Community/Econ. Development (Center for Local Government Services)	Place cities under receivership, distribute financial aid to distressed cities, monitor fiscal status of cities.
Rhode Island	Revenue carrot (bottom 15%)	High (top 5%)	Management (internal)	**Restore solvency and prevent further decline once distress is imminent.** Rhode Island has a strong receivership policy. It also offers additional assistance to cities approaching distress to help prevent full-fledged crisis.	Department of Revenue (Division of Municipal Finance)	Monitor all local governments, aid governments in or at risk of distress, appoint receiver.

receivership transition board is appointed by the governor to assist in transition until the official termination of receivership.

The structure of Michigan's successive intervention laws and the powers granted to the emergency manager point to a particular type of causal story – local government mismanagement as the chief barrier to fiscal solvency. The state's solutions and assistance all center on correcting local decisions that led to chronic budget shortfalls, and the main focus of Michigan's law, which is administered by the Department of Treasury, is to ensure a balanced budget. Efforts to achieve short-term fiscal solvency typically center on reductions in cities' financial obligations – e.g., cutting pension obligations, making personnel cuts and contracting out services traditionally provided by local governments. EMs and other state officials have little leeway to affect the revenue side of local governments' ledgers. As Anderson (2011, p. 620) argues, the viewpoint being expressed by the design and implementation of Michigan's policy is "that the current revenue picture of the city is adequate to provide for public safety, debt service, and other core expenses—if only … the city had competent management." Indeed, little or no financial support accompanies state takeover. This is a telling feature of the state law that sheds considerable light on both the degree to which the policy oversimplifies the causes of local fiscal distress and the mismatch between the administrator's toolkit and the nature of the problem.

To respond to the question at the outset of this section: if takeover is the solution, the problem is mismanagement. Michigan codifies this causal story in a way that is less adulterated than in any other state we have surveyed. In other words, the state has adopted and codified a vastly oversimplified story. Even Rhode Island, which granted similarly sweeping powers to its state-appointed emergency managers, offers additional assistance to cities approaching distress to help prevent full-fledged crises. The state has also seen EMs (called "receivers") raise local taxes to generate more local revenue. This less than favorable assessment of Michigan's policy is buttressed by the absence of emergency bailout funding, a traditional feature of the more aggressively implemented state intervention policies (Berman, 1995; Anderson, 2011), as well as meager revenue-raising powers. EMs are empowered to tackle city expenditures as a means of bringing local budgets into equilibrium, but revenue-raising powers are effectively more limited than the powers normally afforded a city's mayor or council member. As has been pointed out elsewhere, for cities such as Flint, Ecorse, Benton Harbor and Pontiac, this is a gross oversimplification of the structural barriers to fiscal sustainability (Doidge et al., 2015). Our aim in this report is not to disprove the notion that mismanagement is the cause. We merely point out that the policy's design and implementation features devalue the considerable constraints that the state places on the revenue capacity of local officials.

(2) The Limited Applicability of "Best Practices": Why Adoption of North Carolina's Policies Won't Work for Michigan

The reentry of Michigan's cities into emergency management and the number of local governments and school districts in trouble have led to suggestions that Michigan should look elsewhere for answers.[25] A Pew Center on the States report suggests that North Carolina's monitoring system has prevented fiscal distress despite a history of crises during the Great Depression and some of highest unemployment rates in the country (Pew Charitable Trusts, 2013).

The Local Government Commission, a division of the North Carolina Treasury Department, reviews cities' independent audits on key fiscal health indicators, particularly the level of fund balance. If a locality fails to meet a specific threshold, it is placed on the commission's watch report and required to submit a plan of improvement. If local officials are unable to return the municipality to an acceptable level on their own, the commission assumes control of all local financial decisions, including taxing issues, until the problem is corrected. Additionally, the commission approves and sells all local bonds for public structure investments, which both increases the level of state oversight and reduces the potential for local mismanagement of debt. Bond agencies assign a premium to this monitoring system, considering it a model system (Coe, 2007).

Features of North Carolina's approach provide intriguing options for Michigan lawmakers, such as a codified, professional state office and extensive front-end monitoring to identify potential crises. However, evaluating these policies in isolation – i.e., in the absence of key contextual factors – is likely to overstate the potential success of North Carolina's policies if they were to be enacted in Michigan.

For instance, according to the U.S. Census Bureau, in 2007, North Carolina had 548 municipalities, no other local general-purpose governments and 100 counties; Michigan had 533 cities and villages (municipalities), 1,242 townships and 83 counties. A consequence of Michigan having three times as many local governments as North Carolina is that the volume of reports that would need to be reviewed for monitoring purposes would be three times as great.[26] Certainly this would require more resources devoted to oversight at the state level, thus putting additional stress on the state budget.

The states differ greatly on other dimensions of the elements of state context identified in Section I. North

25 http://www.crcmich.org/PUBLICAT/2000s/2000/memo1053.pdf.

26 This does not include the additional resources that would be required to monitor school districts, special districts or other governmental units.

Carolina has an obligatory state pension system; Michigan does not. In 1947, North Carolina declared it illegal for local governments to bargain with unions.[27] Conversely, Michigan's local governments have a strong history of collective bargaining and excluded police and fire unions from 2012's right-to-work legislation. Tax and expenditure limits, when averaged from 1970 through 2005, rank Michigan as the third most restrictive state in limits placed on local governments. North Carolina is 38th – a property tax rate limit on counties and municipalities, set in 1973, has remained its only TEL.

The differences in the state policy context between the two states suggest that Michigan should be cautious when drawing lessons from North Carolina as its model for intervention policies. We attribute North Carolina's success in preventing municipalities from entering distress not to the design of its specific intervention policy but rather to a much tighter link between its policy approach and the state-imposed context for fiscal distress.

(3) Rebuilding State-Local Partnerships: Key Insights from Rhode Island, New Jersey, Pennsylvania, New York and Ohio

One of the more striking findings to emerge from our workshop and subsequent research is the difference between Michigan's approach to local fiscal distress and the approaches of comparably situated state governments. These differences are laid bare in Table 3. Plainly put, state policies and institutions effectively incubate budgetary imbalances; yet lawmakers and administrators have ignored potential front-end damage when designing the policy aimed at helping communities in distress. Rhode Island, the state most comparable to Michigan in the priorities of its intervention policy and the powers granted to state receivers, also provides financial assistance to municipalities most in need, targeting aid to communities with a high property tax burden relative to taxpayer wealth through the state's Distressed Communities Relief Fund thus buttressing the revenue capacity of its local governments.[28] With respect to this specific aspect of state context, Rhode Island generally provides higher levels of state aid.

New Jersey and Pennsylvania: A More Comprehensive View of Local Financial Failure

Beyond Rhode Island, Michigan lawmakers have a variety of states from which to learn about the viability of policy alternatives. New Jersey and Pennsylvania have enacted receivership laws that are quite different than Michigan and Rhode Island. Internal mismanagement is not eschewed entirely; rather it is considered alongside the external, structural dynamics with which local lawmakers must contend. This more holistic causal story both reinforces and is reinforced by choices that these states have made regarding implementation and administration.

New Jersey's policy of assisting cities during times of financial crisis originated in the Great Depression. Since that time, the state has built support within its bureaucracy to review and approve city budgets and offer financial and technical assistance as needed to prevent cities from entering bankruptcy. Rather than appointing a state-level official to take charge of a city`s finances (such as an emergency manager in Michigan),[29] New Jersey seeks to assist local officials in alleviating distress. This partnership is reflected in the mission statement of the New Jersey Division of Local Government Services (DLGS), a division of the Department of Community Affairs. It states that the DLGS "serves as an advocate for local Government interests," provides assistance and is responsible for "financial integrity." The DLGS provides advisory services to local governments, both once the community is identified as distressed and on request of the municipality, and also licenses and educates local officials.

Not surprisingly, these two services help establish a partnership between state and local officials independent of the financial position of the municipality. The state requires that all local government budgets and certain financing and purchases be approved by state agencies.[30] The budget review is conducted by department staff members (many hired short-term annually) and is made easier for local units of government by state-provided training and consistent reporting requirements. When these preventive actions fail to ward off systemic financial issues, the state begins a more involved intervention. The community is first placed on a watch list, at which point the state generally channels additional monetary aid to the struggling government. The state also uses its Qualified Bond Act Program, which requires state approval to bond or make capital expenditures, to ensure stability and prevent default. This program can capture and stall state aid for payment of debt services. At the same time, DLGS offers technical assistance to cities to help them solve underlying problems that contribute to fiscal distress.

The most notable example is the consolidation of the Camden police force in 2010. The mayor terminated the entire city police force and contracted with the county to provide those services, with the guidance and support

27 N.C. Gen. Stat. 95-78 to 84 (http://www.nrtw.org/right-work-states-north-carolina).

28 Established in 1990. Municipalities that fall in the bottom 20 percent of three of the law's four indices qualify to receive state aid under the law. In the 2014 fiscal year, seven municipalities received funding through this legislation, a total of $10.4 million

29 Until recently, when Atlantic City was declared to be in fiscal distress and an emergency manager was appointed.

30 Procurements over $5 million must be reviewed by the comptroller, and those over $10 million must be directly approved.

of state officials.[31] Camden illustrates the cooperative efforts of various levels and sectors of the state and local governments. It highlights that preventive efforts to maintain or restore fiscal sustainability are not always sufficient, but that a collaborative approach can assist cities and the state through difficult political decisions. New Jersey's approach indicates that the state views itself in partnership with local governments, with a responsibility to provide a check on risky financial decisions but also to provide ongoing financial assistance to struggling communities.

In contrast to New Jersey's hesitance to use direct state control, Pennsylvania's Act 47 allows the state to place fiscally distressed communities in receivership under the direction of the Center for Local Government Services in the Department of Community and Economic Development. Once a municipality has been placed under receivership, local government officials must have the majority of their decisions confirmed by the receiver, and the receivership board may implement cost-saving or revenue-raising strategies unavailable to local officials. The board has the ability to raise taxes above the legal maximum but has no additional powers in collective bargaining. Principally, the receiver acts as a liaison between the local government and others to improve the financial integrity of the city and is typically able to broker additional state funding for the distressed community. In Harrisburg's recent financial descent, for instance, the receiver was able to facilitate $25 million of revenue to fund a non-profit that would provide infrastructure and economic development.

Receivers in Pennsylvania tend to take a comprehensive view of local financial difficulties as they work with the state to look for alternative partnerships and unique revenue-enhancing and cost-sharing schemes. Proposed financial recovery plans often include recommendations that will improve local governments' economic positions in the future. This approach extends through the process of recovery. It requires more research, more interactions and coordination between parties, and more time to allow for business adjustments and industrial reorganization. Furthermore, it includes a period of weaning cities off the additional funding to which they had access during their most trying times. To officially exit Act 47, cities must follow an extensive process that includes hearings and the department director's signature. As a result, Pennsylvania has had only seven of 28 distressed communities officially conclude the process. Allowing cities to remain in a system with additional structure and support illustrates Pennsylvania's acknowledgement that factors outside of local control contribute to fiscal issues, and that the state has some role in providing additional support.

31 Returning to the role of other state policies in distress solutions, this action would not have been possible without particular provisions within union and employee contracts that allowed for such termination of individual employees.

In all, intervention policies in New Jersey and Pennsylvania are administered by state agencies dedicated to working with local governments. State personnel are involved with municipalities well before distress, and they have resources and authority to assist municipalities. Though administrators are afforded the statutory authority to assume greater control over city finances, this is not the only facet of their relationship with local governments.

New York and Ohio: The Benefits of Monitoring

Similar to New Jersey and Pennsylvania, New York has established a system that supports state and local cooperation and information sharing. As local fiscal crisis deepens, the state becomes more involved in local political and operational affairs. The state's policy approach to local fiscal emergencies is ad hoc\ (rather than multijurisdictional), allowing lawmakers to survey the specific causes of distress for a given community and legislate solutions in line with these problems.

As is well-documented, New York's history of fiscal intervention begins with New York City's near bankruptcy in 1975. Naturally, a crisis of that magnitude spurred state action, but since that time, New York has not been plagued by chronic distress. This is due in part to cities' ability to increase revenues without legal restriction (until 2014, when the state imposed a cap on property tax increases). Additionally, many New York communities have avoided the economic peril that results from a loss of major industries and subsequent economic restructuring.[32] This history is evident in the state's view of municipal distress as an unusual and unique instance that requires customized solutions. New York provides gradual intervention and individualized approaches to distress, with the decisions and the process supervised by state elected officials – the governor, the legislature and the comptroller.

In addition to customized intervention approaches to distressed cities – which could violate the constitutions of states that disallow special legislation – New York is also heavily involved in monitoring the fiscal position of its local governments. The state's Local Government and School Accountability (LGSA) unit of the Office of the State Comptroller operates the Fiscal Stress Monitoring System, which reviews annual financial data of local governments to determine whether each government is facing significant, moderate or probable fiscal stress. Municipalities must submit audit reports, which are reviewed and in some cases conducted by approximately 200 auditors.[33] From annual reports, budgets and audits, the LGSA creates local fiscal measures for benchmarking, trend analysis and

32 Buffalo was an exception and did necessitate intervention proceedings. It should be noted that Buffalo is one of only four New York local governments responsible for operating its own school district.

33 These 200 employees review audit reports of school districts and other local governments as well as municipalities.

general monitoring over time and across local government types. State auditors are also deployed to work with local governments. As a result, state officials may use knowledge of community nuances in evaluating local deviations from sound fiscal indicators and state trends. Such specialization is particularly useful as state intervention becomes necessary.[34]

If a local government is identified as financially unsound, the state must pass special legislation to institute a local control board for the municipality to engage in the formal intervention process. After a local control board is created, primary authority over the struggling municipality is transferred from the comptroller's office to the governor-appointed board.

Each board, by the nature of the process, has different powers. Previous boards have overseen proposed local budgets and set personnel policy, and were granted the final authority to initiate bankruptcy proceedings.[35] That the boards have had no additional taxing authority, ability to renegotiate previous collective bargaining agreements nor authority to make unilateral budget decisions reflects the state's emphasis on local autonomy.

The boards have been particularly useful in coordinating intergovernmental solutions. For instance, the Buffalo Fiscal Stability Authority (BFSA) was established in 2003. It helped Buffalo manage its additional school district responsibility and restructured the city's pension and health insurance plans by joining the respective state-level systems. Finally, the BFSA brokered an arrangement for city parks to be managed at the county level and for 16 libraries to close. Despite the local knowledge and intergovernmental efforts, it took nearly nine years for Buffalo to exit receivership and for the BFSA to transition into an advisory role. Policy specifies that the BFSA will serve in this role until 2037, and the city may revert to full receivership if financial indicators show distress.

At the state level, New York vests its relationship with local governments and the power to intervene in elected officials – the governor, the comptroller and the legislature. This separates the state's ongoing monitoring from its intervention, and though it raises the legislative barrier to intervention by requiring the crafting and passage of legislation, it also provides public accountability and a system of checks and balances. The ability to draft city-specific solutions allows New York to address management issues, economic conditions and the impacts of the state context in different ways in each city, ideally assisting the community to long-term stability.

Ohio, like New York, faced a fiscal crisis in its largest city in the 1970s. Cleveland's default on short-term notes in 1978, which made it the first municipality to default since the Great Depression, led Ohio to develop a comprehensive policy designed to prevent and, if necessary, intervene in distressed cities (Pew Charitable Trusts, 2013; Levine, Scorsone and Justice, 2013). No municipality has defaulted since Cleveland, but Toledo, East Cleveland and other municipalities have entered fiscal emergency status, particularly once the Great Recession exacerbated declining revenue bases and expenditure pressures.

Ohio's Local Government Services Division, located in the state auditor's office, is responsible for training local officials and auditing local budgets. Chapter 118 of the state code,[36] which deals with local fiscal emergencies, grants the Local Government Services Division (the auditor) responsibility for categorizing distressed communities for fiscal caution, fiscal watch or fiscal emergency. The categorization system signals to local officials, bondholders and other stakeholders the extent of the local government's fiscal stress and the ease of financial recovery anticipated. It serves as a useful continuum of distress, recognizing that failing to pass one indicator of financial soundness may not require the same actions as a community failing multiple triggers. Each category has an increasing level of oversight (i.e., requirements for audit depth and financial plan proposals). Once fiscal emergency is declared, an advisory board is created.

Under all three distress categories, local governments are required to submit recovery plans to the Local Government Services Division. If a local government is not compliant with its recovery plan, the only penalty is movement to a higher designation of fiscal distress. It is not until a municipality reaches the fiscal emergency status that penalties are imposed.

As part of the fiscal emergency proceedings, municipal officials must submit a recovery plan to the recovery board for approval. If a plan is not submitted or the local government fails to adhere to a plan, the Office of Budget and Management is supposed to suspend all state funding to that municipality,[37] though this penalty has never been fully enforced.

34 Ultimately, any distressed community implements solutions that are specific to its condition. A universal policy prescription is to reduce expenditures. However, no universal prescription can be made on what account specifically should be limited and in what way. Knowledge of exact inefficiencies, redundancies, slack and so forth is necessary to act. If outside agents are to advise on such actions, their already having some knowledge of the particulars of the city will allow for more expedient and implementable recommendations.

35 Control boards are not granted this authority for New York City.

36 The other elements comprising the law became effective, were revised or added in 1996, 1999, 2001 and 2002 – http://codes.ohio.gov/orc/118 (pdf). The state's approach is consistent with the autonomy allowed Ohio's local governments. Section 118.02 (B) of the state code states that, "[t]he intention…is to enact procedures, provide powers, and impose restrictions …while leaving principal responsibility for the conduct of the affairs…in the charge of its duly elected officials." The effort to maintain local autonomy is demonstrated by the fact that the review process of the Local Government Services Division is initiated by request of local officials as well as at the suggestion of auditors.

37 Although individuals receiving direct state welfare within the community's borders continue to do so.

Ohio, like other states, struggles with assisting communities to achieve permanent fiscal stability. The city of East Cleveland was under fiscal emergency for 18 years. Exiting the process failed to mark long-term sustainable success – East Cleveland was once again placed under fiscal emergency. In late 2014, it was considering entering into bankruptcy proceedings,[38] and the city's mayor filed a petition seeking a merger with the city of Cleveland in the summer of 2015.[39]

38 http://www.morningjournal.com/general-news/20141226/east-cleveland-considers-bankruptcy.

39 http://www.cleveland.com/cityhall/index.ssf/2015/07/east_clevelandmayor_gary_nort.html.

Ohio, like Michigan, illustrates the issues that arise when a state's solution (intervention policy) does not match the causes of distress (context). Local officials retain control of decision making and the plan to resolve distress, but they and the state agency responsible for intervention lack the authority or resources to address the root causes of distress or to circumvent the pressures that the mix of state policies adds to local fiscal policymaking processes.

Section 3: Conclusions and Recommendations

In the previous sections we identified the ways that broad state policies limit or enhance the local governing options and the ways that states with intervention policies match their approach to local financial distress with the reality of city operating environments. Here we conclude our analysis with conclusions and practical recommendations to assist the C.S. Mott Foundation, state and local officials, and Michigan residents in identifying a more effective approach to local fiscal crises.

(1) Conclusions

There is no single model policy for state intervention in distressed cities or for prevention of fiscal distress. Changing Michigan's fiscal intervention law to replicate that of another state would likely provide little improvement for Flint or other cities facing fiscal crises. There is no "best practice" for state intervention in cities. What Michigan can learn from other states and our research is that removing and repairing mismanagement addresses only one cause of fiscal distress. Bringing a structurally imbalanced budget back into balance is an important step to assist cities like Flint, but a policy that does not address a state's unique system of revenue, tax and expenditures, and labor policies may not help cities truly escape financial trouble over the long term. States must decide which legal and political tradeoffs they are willing to make to support city fiscal health. Michigan must also recognize that, in comparison with similar states, it provides a particularly difficult environment for its cities.

Municipal fiscal distress is not just a local problem. State policy choices set the boundaries for local action and the conditions under which cities receive assistance. It is not surprising that these conclusions do not point to simple solutions, executable at the local level. Changing any one part of the state context is politically challenging, and it would be impractical to recommend major policy overhauls of Proposal A, the Headlee Amendment, collective bargaining rules and state revenue sharing. Ideally, Michigan would adopt a more balanced approach to its local governments' fiscal needs, but we are aware that this is unlikely in the short term because of both political will and the high barriers to changing constitutionally enshrined rules. Instead, we offer recommendations that balance improvements that would better support cities in fiscal distress with political feasibility.

(2) Recommendations

Create a state agency that coordinates services to local governments and offers technical support and fiscal monitoring. Establishing a formal place within state government that is responsible for ongoing, cooperative work with local governments on fiscal stability and other issues would help create a partnership and culture of trust between the state and its municipalities. The Department of Treasury does provide some of these services on an individual basis via the Office of Fiscal Responsibility (OFR), but the OFR does not have the resources necessary to provide a comprehensive system of support to all of the state's local governments.

It is important that whatever agency is created be empowered with human resources to sufficiently provide service; financial resources, separate from the state's revenue sharing to local governments, to offer special assistance where needed to communities facing challenges or distress; and a position within the state departmental structure that allows it to be taken seriously when recommending policy and working with other departments to assist local governments. The examples of offices in the other states in our study may provide elements of the agency's design, but the office should be built with Michigan's particular context and culture in mind. It may be appropriate to expand the OFR in its current position, but moving the office to another department, establishing it as a stand-alone agency and other potential structures should be evaluated as well.

Raise awareness among citizens and state decision makers that the causes of fiscal distress are not solely at the local level. Flint is an example that can illustrate this point as the C.S. Mott Foundation and city leaders communicate with the public and state officials. As the city emerges from state control, the budget is balanced for the short term, and the transition advisory board is in place to monitor management and compliance with the plan. Yet revenue projections show the city likely facing a structural deficit in the next five years with little available to cut from the budget. State control has reasonably removed management problems as the cause of deficits, yet the city's fiscal health remains precarious. A focused communications effort highlighting the combined effects of Michigan's expenditure, revenue and labor policies could help broaden the discussion of fiscal distress in the state and create awareness that this is more than a local problem. Rather than being the exception, Flint may be the harbinger of what is to come for Michigan's local governments without changes at the state level.

Appendix

Section 1

The following table lists the key concepts that make up core elements of the state context for local fiscal distress, our empirical measure of the concepts, and the data we brought to bear to generate these measures.

Concept	Measure(s) – by Figure/Table	Data
Revenue Pressures		
State Aid Environment	**Figure 1**: Annual average of per capita state aid in real 2005 dollars to three (population) classes of U.S. cities: (1) population > 100,000; (2) population between 25,000 and 100,000; and population between 5,000 and 25,000. Years: 1970 to 2005. **Figure 2**: Annual average of per capita state aid in real 2005 dollars allocated by each of the 48 contiguous states for the years 1970 and 2005.	U.S. Census Bureau. Annual Survey of State and Local Government Finances and Census of Governments (1970-2005). See: http://www.census.gov/govs/classification/
Tax and Expenditure Limits	**Figure 3**: Annual count of state adoptions of five types of TELs, 1970 to 2005. **Figure 4**: State TEL severity score for 1970 and 2005. Severity score indexes six key characteristics of state-imposed TELs: (1) the type of TEL; (2) if the TEL is statutory or constitutional; (3) growth restrictions; (4) method of TEL approval; (5) TEL overrides and exemptions; and (6) method of override.	Amiel, Deller, and Stallmann (2009). http://www.aae.wisc.edu/pubs/sps/pdf/stpap536.pdf
Revenue "Carrot" and Revenue "Stick"	**Figures 5 and 6 and Table 2**: Displays policy distance between state aid environment and state-imposed TEL restrictions. State aid and TEL z scores were calculated for each state year. (These standardize the relationship to the average of all states and all years and represent how many standard deviations a score is from the average.) The aid measure is per capita state aid in real 2005 dollars for cities with populations over 5,000. The TEL measure is the TEL severity score described above. These scores were then differenced (Aid_z minus TEL_z in Figure 5; TEL_z minus Aid_z for Figure 6 and Table 2) to create the distance measure. The values displayed are the average distances from 2000 through 2005. Carrot states are 1.5 standard deviations above the mean difference; stick states are 1.5 standard deviations below the mean difference.	**Aid**: U.S. Census Bureau. Annual Survey of State and Local Government Finances and Census of Governments (1970-2005). **TEL**: Amiel, Deller, and Stallmann (2009).

Expenditure Pressures		
Collective Bargaining Environment and Labor Costs	**Table 1:** Five-category classification scheme, ranging from Very Weak to Very Strong. The collective bargaining strength of local police, local fire fighters, teachers, and "other" local employees – the four main functional areas of local public employment – are measured along three dimensions: (1) collective bargaining rights for local public employees, ranging from "Duty to Bargain" to "Collective Bargaining Is Prohibited"; (2) Union Security Provisions via the existence of a Right-to-Work Law for local public employees; and (3) Strike Policy Provisions. **Figure 6 and Table 2:** Public sector employee union membership as a percent of all public sector employees in state, 2000-2014. Z scores were calculated to standardize the relationship to the average of all states over this 15-year period. The score represents how many standard deviations a state's percentage is from the average state.	**Collective Bargaining Environment:** NBER Public Sector Collective Bargaining Law Data Set. Valletta and Freeman - original (1988); Rueben - update (2000). See: http://www.nber.org/publaw/ **Labor Costs:** Hirsch and Macpherson. (2003).Union Membership and Coverage Database from the Current Population Survey: Note. See: http://unionstats.gsu.edu/CPS%20Documentation.htm

Section 2

We invited three types of individuals to participate in the Workshop on State Intervention in Distressed Communities held at Detroit's Greektown Hotel and Casino October 16-17, 2014: individuals who were formally involved in various elements of state intervention policy design and implementation, those involved in local fiscal distress and bankruptcy from a legal standpoint, and policy experts and researchers. The following table classifies the participants.

State/Affiliate	No. of Participants
Michigan	4
New Jersey	1
New York	1
Ohio	1
Pennsylvania	1
Rhode Island	1
Attorney's, private practice	2
Unaffiliated policy experts	3
C. S. Mott Program officers	2
Local finance professionals	2
MSU researchers	2
MSU research team	5

The following table provides a detailed agenda of the workshop proceedings:

Session Title	Outline
Setting the Context	Surveying the causes and consequences of local fiscal distress, with particular attention to the relatively weak position of local governments in the U.S. federal system: • Review of structural, economic, fiscal, intergovernmental, institutional, and political causes • Local governments' response to fiscal distress • State policies/institutions' role in local fiscal capacity • State policies designed to help local governments meet their financial problems
State Intervention in Distressed Communities: The View From Michigan	An in-depth view of Michigan's approach to local fiscal distress through the eyes of those closely involved in the policy's design, implementation, and evolution
A Deep Dive Into State Intervention: Policies on Paper v. Policies in Practice	A structured dialogue about the participants' experiences with key elements of state intervention. • *Stage 1: Getting in* Where and when is pre-intervention support offered? How are distressed localities identified? When and how do local governments enter the program? How are decision criteria applied? • *Stage 2: Developing a plan* Who carries out the intervention? What actions may these actors take? What are the specific goals of intervention? What are the chief barriers to effective implementation? • *Stage 3: Exit strategy* How does a local government exit the program? Are triggers well specified? When, if ever, are medium- and long-term fiscal, economic, or service-based objectives discussed?
Detroit, Michigan – Ground Zero for the Changing Fiscal Relations Between State and Local Governments	A detailed view of the City of Detroit's ongoing intervention and bankruptcy processes

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