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## Pew: The State Role in Local Government Financial Distress.

Detroit's bankruptcy has added urgency to the discussion of how state and local governments should respond when a municipality faces financial distress. The Motor City's revenue shortfall is unusually large, mirroring its sharp population decline, but Detroit isn't alone in its struggle to balance its books after years of poor fiscal management and excessive reliance on debt. Tenuous finances have pushed other municipalities to the brink of receivership or bankruptcy, often requiring state policymakers to decide whether to intervene and, if so, when and how.

A small number — about 10 — of the nation's 55,000 local governments and special tax districts file for Chapter 9 bankruptcy protection each year. In addition to Detroit, recent high-profile examples include Jefferson County, Ala.; Stockton and San Bernardino, Calif.; and Central Falls, R.I. While fiscal distress usually builds up over several years, a variety of events or factors can push local governments into financial crisis. In Jefferson County, it was a failed sewer project. In the California and Rhode Island cities, it was escalating public-pension costs. Detroit's situation was more complex, the result of decades of decline in its tax base and the restructuring of the automobile industry.

In a recent Pew Charitable Trusts report, "The State Role in Local Government Financial Distress," we found that 19 states have passed laws allowing them to intervene in local-government fiscal crises. In dire cases, states have set up advisory commissions, receivers, emergency managers and financial control boards to oversee the local governments. These mechanisms are intended to prevent bankruptcy, which officials consider to be so harmful that only 12 states specifically authorize local governments to file for bankruptcy protection. In a state such as Alabama, which has no law to authorize intervention in local-government financial emergencies, the city or county is on its own to resolve a crisis. Jefferson County and the city of Prichard sought bankruptcy protection as a last resort.

Regardless of the approach that states choose, it's prudent for officials to monitor local governments' budgets and borrowing practices. North Carolina, a state hit hard by the Great Recession, has proved that this practice works. Local governments must send financial data at regular intervals to the state, which compiles profiles of each city and county and posts them in a public database. If the budget numbers show a potential shortfall, the state steps in to make sure that local officials resolve the problems. If necessary, the state can assume control of day-to-day operations — an action it has taken five times since the 1930s. North Carolina also approves and sells local-government bonds through a state commission.

In New York state, where upstate communities have struggled economically for years, Comptroller Thomas DiNapoli has begun issuing scores for local governments' level of fiscal stress based on about two dozen financial indicators submitted by local officials. Outgoing California Controller Bill Lockyer has called for a similar early-warning system in that state to prevent future Stocktons and San Bernardinos.

Monitoring also underscores the need for local governments, as well as states, to adopt long-term financial plans that align revenue and expenses over several years. These plans should include projections of public-pension and retiree-health-care costs, which are increasing pressure on governments at all levels with the retirement of the Baby Boom generation.

Failure to oversee finances and embrace multiyear budget plans can produce harsh consequences, as seen in the bankruptcies in Detroit and elsewhere: service cuts, government-employee layoffs, high property taxes, lower public-pension checks, losses for bondholders and higher borrowing costs. Instead of putting themselves in the position of having to react to local-government fiscal crises, states should work harder to stop them from happening in the first place.

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