EMERGENCY FINANCIAL MANAGEMENT IN SMALL MICHIGAN CITIES: SHORT-TERM FIX OR LONG-TERM SUSTAINABILITY?

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ABSTRACT

Emergency financial management is a relatively recent and unique form of municipal governance that is designed to address local fiscal crises by concentrating the decision making power in the hands of a temporarily appointed chief executive. In this paper, we examine practices of emergency financial management in three Michigan cities in the Detroit metropolitan area to understand the role of emergency financial managers in helping the cities to address chronic fiscal distress. Through the analysis of data from comprehensive annual financial reports, we show that emergency financial management tends to produce budgetary-level improvements in fiscal condition. We also discuss policies that can assist emergency financial managers in bringing longer-term fiscal health to struggling cities.

Key words: emergency financial management, fiscal stress, fiscal sustainability

INTRODUCTION

As a form of municipal governance, emergency financial management offers a window of opportunity for local governments to implement sweeping operational and organizational changes. Unlike an elected mayor who is accountable to the residents or a city manager who is accountable to the elected council, an emergency financial manager (EFM) is typically accountable to the state governor and legislature that intervene to prevent or remedy a municipal bankruptcy. A state mandate to improve local fiscal condition and independence from voter control are two unique features of emergency financial management that set it apart from the conventional forms of municipal governance. Since the appointment of an EFM is politically costly and is often viewed as a threat to local democracy, an assessment of the outcomes of emergency financial management is important for determining whether the benefits of an EFM justify the costs and also for legitimizing emergency financial management as a governance tool if it is found to be effective. Little empirical evidence on the processes and outcomes of emergency financial management has been collected to date.

Academic literature recommends a range of actions for EFMs who find themselves steering a fiscally distressed municipality (Mallach & Brachman, 2013). But since local circumstances differ, no standard operating procedures for emergency financial management exist. As a result, EFMs take actions that they see fit in given circumstances. In this study, we are interested in analyzing practices of emergency financial management and linking these practices to the manager effectiveness in achieving local short-term and longer-term fiscal health. Using both qualitative and quantitative data for 2003-2014, we show how three Michigan cities went through emergency management and how their key fiscal health indicators evolved over time. We conclude that emergency financial management holds promise for improving long-term fiscal health, with the success resting on the EFM's long-term vision and the flexibility they are afforded. Importantly, we show that chronic fiscal stress in Michigan cities may have resulted from mismanagement no less than from structural and demographic pressures.

The study is structured as follows. First, we present background information on municipal fiscal stress in Michigan and discuss the role of the state in municipal financial emergency management. Second, we briefly review studies on the form of municipal government and discuss theoretically expected effects of emergency financial management on local fiscal condition.

Next, we review the literature on measures of fiscal condition and select four indicators that capture important short-term and long-term aspects of fiscal health: unrestricted general fund balance, annual required pension contribution, pension funded ratio, and long-term debt. Then, we discuss emergency management practices in the municipalities over FY 2003-2014 and accompany the narrative with an analysis of changes in the four selected indicators. We conclude by discussing aspects of emergency financial management that are likely to be conducive to a longer-term fiscal health of legacy cities.

BACKGROUND

Since the decline of the automotive industry and manufacturing in Michigan in the 1970s, many Michigan municipalities have experienced chronic fiscal stress and ongoing budgetary pressures (Skidmore & Scorsone, 2011). These challenges have been exacerbated by changes in revenue sharing arrangements such as a reduction in state aid and by state limits on local revenue growth and property taxation (Skidmore & Scorsone 2011). In 1990, in the context of the general economic malaise of its municipal governments, Michigan passed Public Act 72, a law that authorized state interventions in local fiscal affairs by allowing the governor to appoint emergency financial managers for cities in dire fiscal straits. The law and its subsequent iterations - Public Act 4 of 2011 and Public Act 436 of 2013 - were designed to aid local fiscal crises but were met by voters with hostility, setting off a firestorm of controversy over the laws' implications for democracy and municipal governance.

The original Public Act 72 of 1990 specified triggers for state intervention into local affairs,[15] which included a failure to service debt, pay payroll, or contribute to pension plans. The law authorized the state to appoint an Emergency Financial Manager (EFM) to oversee local operations (§§141.1201-141.1291). Though the EFM did not unseat democratically elected leaders,

[15] Public Act 101 of 1988 had permitted the state to intervene only in the financial affairs of the City of Hamtramck. Public Act 72 of 1990 extended the state's ability to intervene in all local governments.

they had the administrative power to hire and dismiss city employees, renegotiate labor contracts, alter departmental structures, amend the budget, sell municipal assets, and initiate Chapter 9 bankruptcy. Elected officials retained little decision-making power under EFM and could even be removed from office if they refused to provide assistance to the EFM.

Public Act 4 of 2011 was a short lived attempt to expand EFM discretion because it was defeated at the polls in 2012. Public Act 436 of 2013, a modified version of Public Act 4, was eventually passed and gave cities greater flexibility in addressing financial emergencies. The new law gave the city's elected officials four options for handling the emergency. They could (1) enter into a formal agreement with the state to take prescribed actions that rectify the emergency, (2) accept an EM appointment, (3) agree to mediation with creditors, or (4) file for bankruptcy (§§141.1501-141.1531). It also expanded the list of triggers for state financial review to include a failure to comply with a state-ordered deficit elimination plan, a violation of local budgeting rules, a very low credit rating, a petition of citizens or local elected officials, a severe budget deficit, or any other condition threatening the city's fiscal stability as determined by the State Treasurer. These additional triggers permitted the state to intervene sooner. EFM discretion was also expanded: they were now authorized to renegotiate or cancel collective bargaining agreements on behalf of fiscally stressed cities.

As of this writing, all Michigan cities have home rule and enjoy a high degree of fiscal autonomy. The state also closely monitors cities' fiscal conditions and has a constitutional provision to take over a city, township, or school district on the brink of collapse and manage its finances until the fiscal emergency has passed. Michigan is not unique in this respect. In eighteen other U.S. states, the state government can intervene in local activities in a looming fiscal crisis (Pew, 2013). The remaining 31 states, however, lack statutory authorization for state intervention (Pew, 2013). Of the states that actively intervene in municipal fiscal affairs, a majority prefer to offer technical assistance, assist in debt issuance or restructuring, provide emergency loan programs, or support changes in tax and fee structures; only seven permit restructuring of labor contracts and three may dissolve or consolidate a local government (Pew, 2013). Michigan's financial management laws permit state-appointed financial managers to employ all but one of the above strategies: EFMs are not authorized to increase taxes or fees on behalf of a local unit.

Out of the 533 Michigan municipalities, Detroit and Flint have made most of the news headlines as cities in fiscal distress. In all, however, thirteen municipalities in the state have experienced financial emergencies in the last decade and a half. Of these, the four have required multiple state interventions: Hamtramck, Highland Park, Ecorse, and Flint. This study focuses on the three of these municipalities: Hamtramck, Highland Park, and Ecorse. The three cities are comparable because they are similar in size and located close to one another. We exclude Flint because it has a much larger population than the other three cities, is located outside the Detroit metropolitan area and is, therefore, subject to the influence of different social and economic forces than the three neighboring cities.

FORM OF GOVERNMENT AND LOCAL FINANCE

In the studies on the form of government and local finances, researchers have suggested that differences in the incentives for managers and mayors may affect financial management outcomes. Some argue that managers may maximize governmental efficiency in the interest of job security (Hayes & Chang, 1990) and spend less than mayor-council cities (Chapman & Gorina, 2012; Lineberry & Fowler, 1967). Others, on the contrary, suggest that mayor-governed cities spend less in the interest of reelection (Coate & Knight, 2011) and incur lower capital expenditures (Nunn, 1996). Still others find no differences in local spending by form of government (Deno & Mehay, 1987; Campbell & Turnbull, 2003; MacDonald, 2008; Morgan & Pelissero, 1980). The relationship between the form of government and municipal retrenchment strategies in a fiscal crisis has also been examined. Elected officials were found to be more likely to manage fiscal stress without reducing services and more likely to look for new revenue sources; city managers were found to pursue more innovative approaches to cutback management such as contracting out and reorganizations (Levine et al., 1981, Morgan & Pammer, 1988). The researchers have also suggested that fiscal retrenchment strategies become less predictable for cities with both forms of government as fiscal stress becomes more severe (Morgan & Pammer, 1988).

Unlike a mayor or a city manager, an emergency financial manager does not have set term of office and is not subject to similar incentives or electoral pressures. Typically, when a fiscal emergency has passed, the emergency manager's tenure is over. By design, the position of emergency financial manager is suited for making relatively swift changes in local operational and organizational management. It is so because the decisions of an EFM, though often under public scrutiny, are not subject to public approval and can take effect quickly. In addition, unlike a directly elected mayor or a city manager who is accountable to an elected council, an emergency financial manager does not risk their career if they become unpopular with the voters. Given these two relative advantages of the EFM position, we expect cities under emergency financial management to take politically unpopular policy actions to address fiscal distress and to produce dynamic positive changes in fiscal indicators.

Though PA 436 requires that "the financial conditions of the local government [be] corrected in a *sustainable* fashion" (§141.1549; emphasis added), it establishes no statutory standards of EFM success besides the elimination of an operating deficit and the adoption of a biannual budget. For a financial emergency to be over, the Governor must agree with the opinion of the EFM that the financial emergency has passed. No formal quantitative indicators are used to benchmark EFM performance. Since a balanced budget is a fundamental requirement in government financial management and often the first priority under emergency financial management, we expect budgetary-level indicators of fiscal health to show relatively more improvement than indicators of longer-term fiscal health under EFM. In cities with longer EFM tenures, we expect to see gradual improvements in longer-term indicators of fiscal health as well.

MEASURES OF FISCAL HEALTH

Local fiscal health is a multidimensional concept that broadly manifests as a balance of revenues and spending (ACIR, 1973; Berne & Schramm, 1986; Hendrick, 2004; Kloha et al., 2005; Wang et al., 2007). This balance may be challenged by a variety of factors. Chapman (2008) classifies these factors into three types: structural, cyclical, and intergovernmental. Fiscal stress sets in when there is a decrease in government revenues without a corresponding decrease in public demand for services, an increase in public demand for services without an increase in revenues, or unfunded mandates in which the state or federal government requires a local government to provide a service but does not increase intergovernmental transfers (Chapman, 2008). In the Michigan context, all three types of pressures created severe fiscal challenges for many localities: the loss of manufacturing in the 1980s created structural pressures, reduced state support to localities created intergovernmental pressures, and the recessions of 2001 and 2007-2009 represented cyclical pressures.

Scholars have distinguished between several types of responses to fiscal challenges (Hendrick, 2011; Jimenez, 2014; Levine et al., 1981; Maher & Deller, 2007). Examples of near-term responses and ways of buying time include delays of capital spending, drawing down capital spending, and fund transfers. Medium-term strategies for addressing relatively prolonged fiscal stress include salary freezes, across-the-board cuts, decreases in pension contributions, issuance of debt for operating spending. Longer-term options for handling severe fiscal stress involve asset sales, termination of programs, layoffs, furloughs, facility closures, contracting out, and tax increases (Hendrick, 2011). Typically, cities that enter emergency financial management have been in the state of severe fiscal distress for a long time. Therefore, to address their problems successfully, we expect EFMs to pursue the longer-term options for handing severe fiscal distress.

Since the 1970s, many indicators of local fiscal condition have been developed (Brown, 1993; Crosby & Robbins, 2013; Coe, 2008; Hendrick, 2004; Justice & Scorsone, 2012; Kloha et al. 2005; Mead, 2006; Nollenberger, 2003; Skidmore & Scorsone, 2011;). One of the most comprehensive systems of fiscal condition analysis by Groves and Valente (1994) (updated by Nollenberger et al. in 2003) includes over 30 indicators and sorts them into four categories of solvency: cash solvency (liquidity and cash management), budgetary solvency (capacity to raise sufficient revenue to pay current liabilities), long-run solvency (ability to meet long-term obligations without unduly encumbering future citizens), and service solvency (delivery of reasonable public services at correspondingly reasonable tax rates). This comprehensive framework highlights the short and long-term perspectives that should be applied at the same time in a comprehensive analysis of local fiscal health. No research to date has yet applied any of these indicators to study effects of emergency financial management.

After a careful analysis of many measures that can be constructed from Comprehensive Annual Financial Reports (CAFRs), we select four indicators that, in our view, most efficiently summarize local short-term and long-term condition. These measures are: unrestricted general fund balance, annual pension contribution, pension funded status, and long-term debt. We choose them for the following reasons. Unrestricted general fund balance reflects the history of past budgetary balances and characterizes local ability to address unexpected decreases in revenues or increases in expenditures. The higher the level of fiscal slack, the higher the probability of budgetary-level solvency in a given year. Similarly, annual pension contributions demonstrate short-term health that is the ability of a government to fund the current portion of long-term obligations. In contrast, pension funded status and long-term debt show the level of indebtedness of future tax payers and characterize the city's longer-term fiscal health. A juxtaposition of these four indicators on a graph offers a broad yet comprehensive view of local financial management. It also shows whether emergency financial management prioritizes short-term fiscal health over long-term fiscal health. The four selected indicators of fiscal health are operationalized as follows.

Unrestricted general fund balance. The unrestricted general fund balance is measured as a percent of general fund revenues. In years prior to GASB 54 in 2009, unrestricted general fund balance corresponds to the unreserved undesignated general fund balance. In years following the implementation of GASB 54, the unrestricted fund balance[16] is the sum of committed, assigned, and unassigned general fund balances. The Government Finance Officers Association (GFOA) recommends governments to hold a two-month operating funds balance (17 percent of general revenues) as unrestricted reserves (Gauthier, 2009). Though many local governments hold significantly higher reserves, we will view the 17 % as a benchmark against which we will compare the balances of the cities we examine.

Pension funding. Similar to Plerhoples and Scorsone (2011) and Maher and Nollenberger (2009), we use two variables to assess the cities' ability and willingness to fund pension obligations. The annual required contribution (ARC) measures the percentage of annual pension cost contributed to the pension plan in a given year. The funded ratio measures the percentage of actuarially accrued pension plan liabilities covered by the pension plan assets. Though the American Association of Actuaries views any level of funding below 100% as unreasonable and unsustainable (AAA, 2012), the 80 percent funding level is often viewed as healthy among local government finance professionals (GAO, 2007). These indicators provide an understanding of a municipality's ability to fund its future obligations to current employees, as well as its current obligations to former employees. Declining funded ratios and ARCs of less than 100 percent indicate a deterioration of longer-term fiscal health. All three cities studied herein participated in the Michigan Municipal Employee Retirement System (MERS) during their EFM tenure, though Highland Park terminated its participation in MERS in 2007 and took internal control of its largest pension plan.[17] This study discusses the funded ratios and

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[16] In contrast, restricted funds are those that are legally restricted by outside parties, constitutional provisions, or enabling legislation for use for a specific purpose.

[17] After 2007, Highland Park's largest pension plan was known as the "Former MERS Plan," and while the city overtook management from the state, the plan's recipients and structure were retained and it was managed separately from the city's other plans. This study analyzes Highland Park's MERS figures

ARCs only for the MERS plans and the Highland Park's general employee plan after its exit from MERS.

Long-term debt. We measure local debt burdens as the total general obligation debt divided the city's population. Municipal debt displays significant variation across the United States. In 2002, U.S. average debt per capita in cities was $1,860 with a standard deviation of $1,660; by 2012, the average debt per capita decreased slightly to $1,820 while the standard deviation went up to $2,012 (U.S. Census Bureau 2002, 2012). The analysis of debt burdens will highlight the positions of the cities relative to the national averages.

While business-type activities are an important aspect of local operations, in this study, we focus on the condition of governmental funds only. We acknowledge the importance of looking at government-wide financial statements and measures of fiscal health that include enterprise funds (Crosby and Robbins 2013). Yet, we work with cities that did not produce government-wide statements until the late 2000s. Therefore, we are not able to conduct a longitudinal analysis of government-wide indicators. In all the three cities, business-type activities consist of water and sewer enterprise funds. In Ecorse and Hamtramck, these funds are in a better condition than government activity funds. In Highland Park, enterprise funds are in a worse condition than government activity funds and add fiscal stress to the general government. This additional stress is reflected in the city's general fund balance due to transfers from the general fund to enterprise funds.

ANALYSIS OF EFM PRACTICES IN THREE CITIES

In this section we examine EFM practices and their effects on fiscal condition. For each city, we describe when and why an EFM was appointed and what actions they took. Then, we present trajectories of the four indicators of fiscal condition graphically. The data for this analysis are manually collected from the cities' financial statements. Finally, we interpret the changes in the indicators by linking them to EFM actions.

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for years up to and including 2007 and Former MERS Plan figures for 2008 and beyond.

Ecorse lies at the southern edge of the city of Detroit, whereas Hamtramck and Highland Park are located within the City of Detroit and share a short common border. Like all other cities in Michigan, these cities collect taxes for geographically overlapping but otherwise independent governments such as counties, school districts, and special authorities (CRCM, 2015). All three cities have experienced severe economic distress over the past decades. Table 1 highlights their demographic and economic hardships.

Table 1
Socio-economic characteristics of the sample

Locality	Population 2010*	Population change 2000-2010*	Per capita income 2009-2013**	Unemployed 2009-2013**	Poverty rate 2009-2013**
Ecorse	9,512	- 15.3%	15,564	15.1 %	32.5 %
Hamtramck	22,423	- 2.4 %	10,890	10.7 %	43.4 %
Highland Park	11,776	- 29.7 %	13,539	15.2 %	51.1 %
Michigan state	9,883,640	- 0.6 %	25,681	7.8 %	16.8 %
U.S. total	308,745,538	9.7 %	28,155	6.2 %	15.4 %

Sources: * - U.S. Census Bureau 2000 and 2010 Decennial Censuses; ** - American Community Survey 2009-2013.

Hamtramck

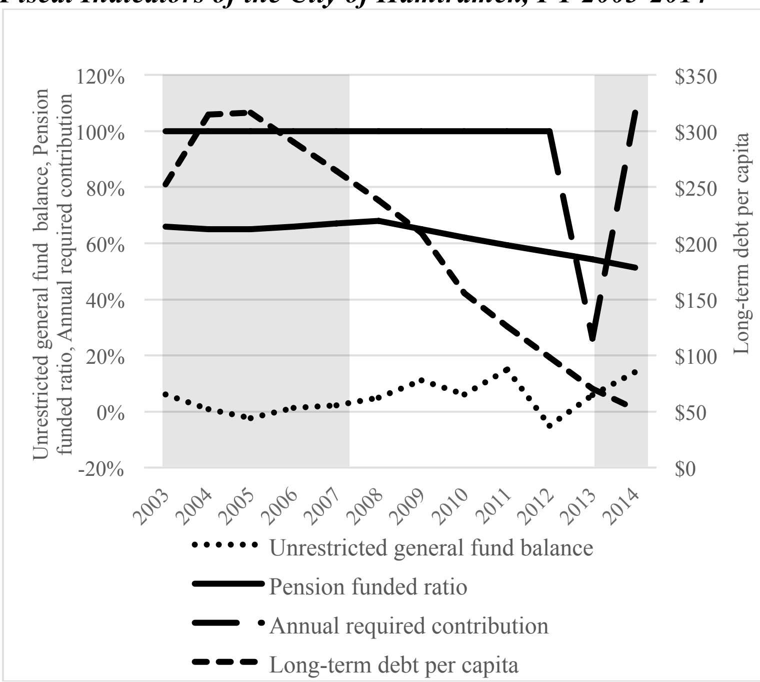
Hamtramck went through emergency financial management from 2000 to 2007 and from 2013 to 2014 with Louis H. Schimmel and Cathy Square serving as EFMs, respectively. As a native of Pontiac, Michigan, and a graduate of the Michigan State University, Schimmel was well versed in the challenges of Michigan legacy cities by the time he was appointed Hamtramck's EFM in 2000. As Executive Director of the Municipal Advisory Council of Michigan, Schimmel had extensive experience in municipal debt issuance by the time of the appointment. In addition, Schimmel had served as the Receiver for the city of Ecorse in the late 1980s. As

Hamtramck's EFM in 2000, Schimmel documented the city's escalating financial problems that previous leaders had kept quiet or ignored (Schimmel, 2005). These problems included accounting and recordkeeping ineptitudes, a dearth of technology, and a general fund deficit of $2.9 million for a total annual budget of $16 million. The public works systems were failing, the public safety and library buildings were crumbling, and unsettled legal matters were threatening to precipitate the city's financial peril. The economic environment did not fare much better: high unemployment and slow economic development constantly posed a threat to the city's tax base.

As Hamtramck's EFM from 2000 to 2007, Schimmel pursued three primary routes to improve the city's operations: professionalization, privatization, and infrastructure investment. He immediately hired a controller and other key professionals to run the main operations and consolidated departments to reduce the city's workforce (Reed, 2002). By 2002, the Department of Public Works was pared down to eight employees, with the majority of the services contracted out to the lowest-bidding private companies (LaFaive, 2002). When these operations were outsourced, unused equipment and even the Department's building were sold. Instead of contracting out public safety as originally planned, Schimmel reduced staff and renegotiated police and fire contracts to reduce growth in annual pay. While the departmental consolidation and outsourcing may suggest that Hamtramck's EM took a "fire sale" approach to address fiscal distress, Schimmel also strategically invested in infrastructure. Many city buildings and city-owned parking lots were renovated; parking meters, water meters, and fire hydrants were replaced or repaired. The utility billing system was upgraded to ensure timely billing and collection of payments from delinquent accounts.

With an eye to managing fiscal shocks, Schimmel oversaw the establishment of a budget stabilization fund. About $3.65 million in proceeds from a one-time tax settlement were deposited in the fund to alleviate future revenue shortfalls. After the EM's exit in 2007, the budget stabilization fund transferred resources to the general fund on two occasions: the first transfer of $1.65 million made up for the decline in property tax revenues in 2008, and the second transfer of $2 million in 2011 resulted from a reclassification of the budget stabilization fund into the general fund pursuant to GASB 54.

Figure 1
Fiscal Indicators of the City of Hamtramck, FY 2003-2014



Note: The shaded areas indicate years of emergency financial management.

Schimmel's activity had a distinct effect on the city's fiscal indicators: the EM lowered the city's debt burden while keeping the other indicators of fiscal health relatively stable. Hamtramck's unrestricted general fund balance was positive for nine of the eleven years examined, hovering above zero in all years of Schimmel's emergency management except 2005, reaching a high of 15 percent in 2011 and a low of negative five percent in 2012. Large operating deficits of 2005 and 2012 significantly decreased the city's fiscal slack, and the six percent positive balance in 2013 obfuscated a missed pension payment. As acknowledged in the 2013 CAFR, had the ARC been made, it would have resulted in a general fund deficit.

In 2002, Schimmel facilitated the issuance of $2.5 million in general obligation bonds, followed by $2.9 million refunding bond in 2004, which refinanced general obligation debt from 1992 at a lower interest rate. The city did not issue long-term debt following Schimmel's exit and its debt burden fell in every subsequent year. Likewise, long-term debt per capita has fallen every year since 2005, from a high of $316 to a low of $52 in 2014. Hamtramck made full annual required contributions into its pension plans every year but 2013. The city's pensions were funded at a high of 68 percent in 2008, the year following Schimmel's exit. Remarks included in the MD&A section of the 2008 CAFR suggest that the city was poised to develop a strategy to address the growing burden of funding its pension obligations. However, the funded ratio fell to a low of 51.2 percent in 2014. When the city failed to make its ARC in 2013, the state initiated financial review and found that the city had also amassed a general fund deficit over $750,000 in 2012 and had delayed pension contributions of approximately $2.2 million to manage cash flow.

When Hamtramck underwent yet another state financial review in 2013, the Financial Review Team found evidence of poor financial management and concluded that the city's fiscal challenges, which precipitated declaration of a new financial emergency, were "neither precipitous nor unforeseen." "[T]he City's worsening financial condition was obvious to City officials, but they were either unwilling or incapable of taking resolute action to address the matter" (Hamtramck Financial Review Team, 2013, p. 7). The financial review also determined that frequent turnover of City Managers and poor communication in the city leadership significantly contributed to the financial emergency. The predominant belief among city officials was that a new EM could quickly remedy the financial emergency and return the city to local control; however, the Review Team contended that the "managerial and operational dysfunction" would be likely to remain despite an EM's efforts (Hamtramck Financial Review Team, 2013, p. 9). In 2013, Governor Snyder appointed Cathy L. Square as the city's EM and Hamtramck was under her control until the end of 2014.[18]

Highland Park

Highland Park underwent emergency financial management from 2001 to 2009. The small, densely populated city had historically depended on the Chrysler Corporation for tax revenues and was pushed to financial ruin by a combination of city mismanagement and Chrysler's decision to relocate its headquarters out of the city in 1993. A certified public accountant with experience as a county auditor, Ramona Pearson was the city's EFM from 2001 to 2005. Similar to Schimmel in Hamtramck, Pearson pursued cost savings via privatization of public services and reducing city workforce. In addition, she contracted out accounting and legal services, reduced public services by closing a city library and recreation centers, and devolved police services to Wayne County. From 2001 to 2005, Highland Park cut its operating deficit by 30 percent but operated on a skeleton staff and relied on the issuance of $5 million in pension bonds to provide short-term solvency to its pension plans.

In April 2005, after significant public outcry over Pearson's actions as EFM, including accusations of cronyism and racism (Gross, 2011), Pearson stepped down and Arthur Blackwell, II, entrepreneur and son of former Highland Park Mayor Robert Blackwell, was appointed as Highland Park's second EFM. As made clear in the letters of transmittal that prefaced the CAFRs submitted during his administration, Blackwell explicitly prioritized deficit elimination and focused on balancing the operating budget. Blackwell reversed many of Pearson's outsourcing decisions and replaced contractors with city employees. He emphasized community development and sale of city-owned property (owned due to tax delinquency) to build the tax base, and attempted to improve employee morale by renovating city buildings. To reduce Highland Park's long-term debt, Blackwell managed to negotiate an exceptional $8.6

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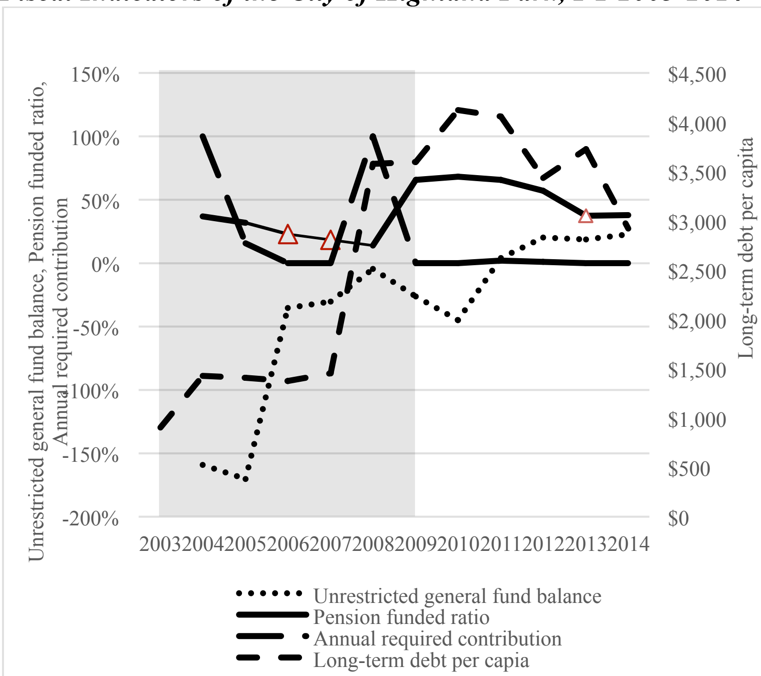
[18] Square continues to oversee Hamtramck's daily operations in conjunction with the Receivership Transition Advisory Board, which was appointed in December 2014 to guide the city's return to local leaders' control.

million debt write-off with Daimler Chrysler in 2006 and directed an audit of city books which resulted in another write-off of $1.45 million owed to former employees. In 2007, Blackwell brought police functions back in-house and facilitated a seven-percent increase in property tax rates.

Blackwell's efforts, in combination with emergency loans from the state, resulted in an operating surplus in 2007; however, the laser focus on deficit elimination left no resources for pension payments and capital outlays. To address the pending insolvency of the city's pension plans, voters approved an unlimited millage to fund pension debt in 2007 and Highland Park issued $27 million in pension bonds in 2008. Together with the pension bonds and the issuance of $3 million in general obligation bonds in 2008, Highland Park eliminated its budget deficit for the first time in a decade. However, Blackwell was accused of embezzlement and relieved of his EM duties in April 2009. Blackwell was replaced with Robert Mason, a former auto executive, and Management Consultant. In a matter of three months, Mason balanced the city budget without issuing debt or taking out emergency loans, developed plans to eliminate debt and cut utility costs, and invested the pension bond proceeds. After three months in office, Mason returned Highland Park to local elected leaders' control, though the state never declared an end to the city's financial emergency.

Figure 2.
Fiscal Indicators of the City of Highland Park, FY 2003-2014



Note: The shaded area indicates years of emergency financial management. Not all fiscal records are available in Highland Park CAFRs for 2003-2014. We interpolate pension funded ratios for FY 2006, 2007, and 2013 and report unavailable ratios for FY 2003 as missing.

The effects of policy changes and EM turnover reflect in the fluctuation of its fiscal indicators. Two of Highland Park's EMs prioritized deficit elimination and worked toward this goal. Yet, deep deficits kept the city's unrestricted general fund balance in the negative until 2011. In 2012 and 2013, the unrestricted fund balance exceeded the 17% threshold recommended by GFOA due to operating surpluses. Since 2008, however, the has city neglected its pension payments and transferred millions of dollars annually to its failing water and sewer department, negating progress made in establishing a positive unrestricted fund balance.

Long-term debt and pension funding trends suggest that the city has financed current expenditures by encumbering current and future residents. Despite Blackwell's pursuit of large-scale debt reduction by way of write-offs, Highland Park debt skyrocketed because it was used as a primary tool for financing day-to-day operations and recovery efforts. Further, the write-offs were dwarfed by the debt issued by Highland Park during the EMs' tenure, and both Pearson and Blackwell indicated in their CAFR transmittal letters that the city had borrowed the maximum amount of debt allowed by law. Between 2003 and 2010, long-term debt per capita more than quadrupled going from $904 to $4135 due to the issuance of pension bonds, general obligation bonds, and the receipt of emergency loans from the state. The issuance of $33 million of pension bonds from FY 2004 to FY 2008 highlights the weakness of the city's pension plans. The 2008 pension bond proceeds had been drawn on each month to pay that month's pension obligations, and were set to be exhausted by 2016. In FY 2014, the pension bonds were called by the bank; the remaining $7.7 million bond proceeds were seized by the bank, and the $17.5 million liability was converted to long-term debt.

Despite the return of control to local leaders, Highland Park has been closely monitored by the Department of Treasury. In 2013, it underwent another state financial review. The Review Team documented unbudgeted expenditures, failure to comply with the state-mandated deficit elimination plan, inept billing in the water and sewer department that rendered the department broke, and little political will to correct these ongoing problems (Highland Park Financial Review Team, 2014). City officials responded to the Review Team with arguments of path dependency: state interventions of the previous decade had not resolved the city's structural problems. In 2014, pursuant to PA 436, the city entered into a neutral evaluation process wherein it could negotiate with its creditors under the supervision of a third-party mediator.

Ecorse

Once an industrial powerhouse, Ecorse has experienced an enduring economic decline since World War II. As one of

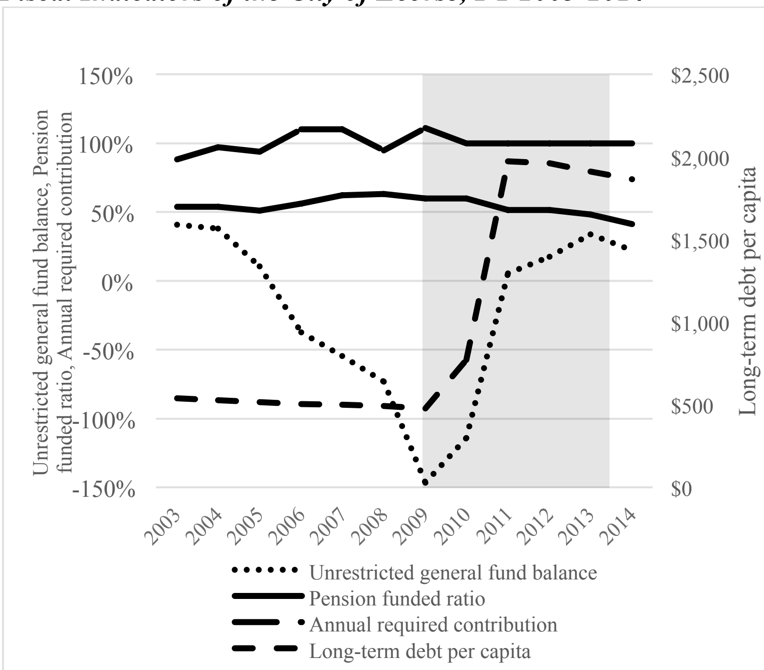
Detroit's industrial, inner-ring suburbs, Ecorse has suffered a similar fate of its larger neighbor: a loss of major employers accompanied by a decline in property values and population. Ecorse has struggled with large structural budget deficits, multiple iterations of state financial oversight, and corruption convictions of its mayor and controller. In 1986, after observing the city's long-lasting inability to manage its way out of fiscal distress, the Wayne County Circuit Court appointed a Receiver to manage the city's finances (Daddow, 1993). The receivership lasted until 1990, but the State of Michigan continued to oversee Ecorse's finances for another ten years thereafter.

While state oversight prevented Ecorse's bankruptcy, it did not cure the city's financial ills. In 2009, the Ecorse Board of Education requested that the Department of Treasury commence a preliminary review of Ecorse's finances. The review team found that the city had been using interfund transfers to cover operating expenses, failed to file audit reports and distribute property taxes to schools in a timely manner, and possessed internal control deficiencies (Ecorse Financial Review Team, 2009). Based on the Review findings, Governor Granholm declared a financial emergency in Ecorse. The Local Emergency Financial Assistance Loan Board appointed Joyce A. Parker as the city's EFM. By the time of the appointment, Parker was a career civil servant with over three decades of city management experience in small and medium Michigan cities. Parker served as Ecorse's EFM for the entire three and a half years of emergency oversight and returned control of the city to elected leaders under the supervision of the Receivership Transition Advisory Board in 2013.

Within three months of appointment, Parker established a five-year deficit elimination plan and took a $3 million loan from the Michigan Emergency Loan Board to cover operating expenses. Like Schimmel in Hamtramck, Parker addressed the city's administrative capacities by reorganizing city operations and professionalizing staff. Parker immediately terminated the city's controller and assumed hiring authority for the city. On behalf of Ecorse, Parker accepted state emergency loans. The loans had a caveat: for the 20 years of debt repayment, the city committed to employing a City Administrator. Parker established qualifications for the Administrator position, which included a minimum of five years of experience in municipal government administration. When PA 4 became law in 2011, Parker used her expanded power over collective bargaining agreements to reformulate the contract between Ecorse and its firefighters. She reorganized the fire department, eliminated eight of fourteen full-time positions, cut hourly wages, privatized ambulance services, and eventually consolidated the police and fire departments into a single public safety department (Scheiber, 2013).

Parker actively promoted efforts to redevelop blighted areas, encourage private investment, and return city-owned properties to the tax rolls. Over the repeated objections of the Ecorse City Council, she pursued the sale of city-owned property to private owners. (The City Council had ignored the recommendations of the city's Real Estate Committee regarding the sale of city-owned property.) In 2010, realizing that over 100 parcels of Ecorse real property were contributing to blight and could be redeveloped, Parker issued a blanket order that authorized an EFM to sell any parcel of property valued under $25,000 without the City Council's consent. While these sales did not result in sizable profits, the properties' return to the tax rolls still represented positive gains and, more importantly, reflected a strategic vision of economic development.

Figure 3
Fiscal Indicators of the City of Ecorse, FY 2003-2014



Note: The shaded area indicates years of emergency financial management.

Parker's activities produced positive changes in local short-term health but also increased Ecorse's debt burden. When Parker took office in 2009, she inherited soaring budget deficits. Ecorse's unrestricted general fund balance held above the GFOA-recommended 17% threshold in 2003-2004, but dropped to 10% in 2005, and fell into negative territory for 2006 and onward. When Parker assumed control of the city, the balance had reached a negative 147%. Over her three and a half year tenure, Parker oversaw the general fund balance growth and ushered the figure into positive territory for fiscal years 2011 and beyond.

Like the EFMs in Highland Park, Parker used long-term debt issuance to improve Ecorse's financial position. Besides accepting $5 million in state emergency loans, Parker advocated the issuance of $9.5 million in recovery bonds and used them to pay off outstanding debts to Wayne County and the Ecorse

Public School District.[19] As expected, long-term debt per capita jumped from $478 in 2009 to $775 in 2010 to $1,977 in 2011, and remained above $1,900 for fiscal years 2012 and 2013.

Ecorse's pension funding reached its high point of 63 percent in 2008, but has fallen each subsequent year. In 2006, the city combined its better-funded police and fire pension plan with its municipal employees retirement plan (MERS) which temporarily raised the funded level of the latter. The funding declined by the time Parker took office in 2009 and continued to decline in subsequent years. In FY 2013, the city's accumulated plan assets covered only 43.6 percent of the pension liabilities. Ecorse has, however, made its annual required contributions consistently, regardless of whether the EM or local elected officials led the city.

In 2013, Parker informed Governor Snyder that Ecorse fiscal emergency had been rectified. Parker's tenure as EM ended the next day. Besides improving the city's short-term financial position, Parker's management helped raise the city's general obligation bond rating from "junk" (i.e. below "BB+") to an "A" status (Parker, 2013).

DISCUSSION

In Hamtramck, Highland Park, and Ecorse, emergency financial management strategies mirrored methods of fiscal retrenchment identified by Maher and Deller (2007) in their study of Wisconsin municipalities: the cities professionalized staff, contracted out services, and pursued targeted budget cuts. In accordance with our expectations and existing literature (Hendrick, 2011; Levine, Rubin and Wolohojian, 1981), the cities also pursued less popular retrenchment strategies such as asset sales, reductions in public services, department consolidations, and across-the-board budget cuts. Few options were out of the question in addressing severe fiscal stress.

All three cities displayed positive dynamics in the unrestricted general fund balance. Even though Highland Park did not achieve a positive balance under its EFMs, the trajectory

[19] The recovery bond issuance even won the Deal of the Year award from *Bond Buyer Magazine*.

of this indicator for all the three cities shows that EFMs do make an effort to improve the short-term fiscal position. The combination of EFM efforts, including targeted budget cuts, renegotiation of contracts, contracting out city services, and improvement of the professional capacity of city employees, had generally positive effects on the city's unrestricted general fund balance. In Hamtramck and Ecorse, the maintenance of positive unrestricted general fund balances suggests that the cities may be in relatively better positions to withstand future financial difficulties.

All three municipalities issued debt, though Hamtramck's debt issuance pales in comparison to that of its counterparts. From 2009 to 2014, Ecorse's debt burden increased from \$540 to \$1,865 per capita, approaching the national average level of debt in municipalities. As Figure 3 demonstrates, after debt issuance the fund balance improved significantly. Ecorse's debt for operating and infrastructure maintenance needs effectively brought unrestricted general fund balance into a positive territory. Highland Park also relied on debt to improve its operating position. However, a significant increase in debt over the EM tenure still did not produce a positive general fund balance. What can explain the differences in these outcomes?

First, when the cities entered emergency management, Highland Park had weaker indicators of pension plan funding than Ecorse and the challenges of funding pension obligations continued to thwart any improvements in the general fund balance. Second, emergency management decisions in Highland Park were made by three different EMs, putting the city in a state of inefficient and costly policy changes. For example, the reversal of Pearson's outsourcing decisions by Blackwell had financial costs associated with the hiring of city employees anew. The financial and administrative resources that went into this hiring process could have been used for the alleviation of fiscal distress. Finally, Highland Park's failing infrastructure, specifically its water and sewer systems, drained its general fund of any funds that could be put toward a general financial recovery. Given that almost all cities across the country often use their self-sustaining utility funds to aid the general fund, Highland Park's failure to manage its water and sewer systems demonstrates the depth of its local management ineptitude.

As a result of emergency management, none of the cities improved their pension funded ratios in a sustainable way. Over its EM tenure, Hamtramck saw a slight increase in the ratio, followed by a decline from 2007 to 2014. Even though Ecorse has remained committed to making pension contributions in full over 2003-2014, its funded ratio declined in the years of EM tenure: from 60% in 2009 to 48% in 2013. Highland Park witnessed a jump in its funded ratio from the 14% to 66% as a result of the issuance of pension bonds. That jump, however, was followed by missed pension ARCs from 2009 to 2014, which led to a graduate decline of the funded ratio by 2014 to its 2004 level of 38%.

Unlike the other two cities, following the issuance of modest general obligation and refunding bonds, Hamtramck actively reduced its debt burden during and after the EM tenure. As a result, in spite of the missed pension contribution in 2013 that triggered state financial review and put the city into emergency financial management, the overall trajectory of Hamtramck's fiscal indicators suggests a path to recovery. The city's biggest advantage relative to its neighbors is its low level of debt. An issuance of additional debt for infrastructure projects can still be used as a powerful strategy to foster economic development. Even though the decline of the funded ratio of the city's pension plan will not be reversed overnight, it is bound to improve as the city's revenue position strengthens.

Based on the analysis, Highland Park's failure to service its pension obligations in the years after the EM exit, a weakness of the fund balance, and exorbitant levels of debt, we conclude that the city faces another fiscal calamity in the near future. Since no city leader has presented a comprehensive vision for changing the city's course, Highland Park is very unlikely to recover, incrementally or otherwise, under the leadership of its elected officials. While filing for bankruptcy[20] may be a necessary condition for correcting course, it will not be sufficient for alleviating distress in the absence of visionary leadership.

[20] Following the governor's declaration of financial emergency in 2014, city leaders elected to enter into mediation with the city's creditors.

In the case of Ecorse, where the financial emergency management started in 2009 and ended in 2013, the EM's reliance on debt issuance helped to pull the city out of the decline. Even though the debt has increased and pension funding problems are not entirely gone, the city's fiscal indicators suggest that it may have corrected course: the positive unrestricted fund balance of 22% in 2014 is still above the GFOA recommended level of 17% and shows the city's capacity to withstand unforeseen financial troubles in the near future; debt per capita appears to be at a manageable level, and the city has continued to make its ARCs in a timely fashion. However, the debt level cannot go much higher; therefore, the much needed revenue generation will rely on the economic revitalization of the city area.

It is also noteworthy that prior to EFM appointment, all three cities had the mayor-council form of government whereas at the end of the EFM tenures, two cities made changes to its form of government. Hamtramck adopted a new charter and became a council-manager city in 2005. Following the change, Hamtramck's city council hired three City Managers between 2005 and 2014. The first served from 2005 to 2008, surviving Schimmel's departure in 2007; the second held his post from 2008 to 2012; and the third served from 2012 to 2014. Ecorse saw the position of a City Administrator established. This position did not change the form of government officially, but was established to ensure city management by a professional, appointed executive. In contrast to the experience in Hamtramck, after the departure of Ecorse's EFM Parker in 2013, Ecorse filled the City Administrator position four times within a year and a half. Turnover proved disruptive because none of the administrators was retained long enough to complete the work they had started. Ecorse continues to suffer "due to a lack of continuity in its operational leadership" (RTAB annual evaluation, 2014, p. 2). Ecorse's City Council proved to be particularly wary of the city administrator initiatives and vigorously tried to retain its decision-making power, even in the environment of deep fiscal distress. In Highland Park, the Mayor remains the CEO. Overall, the city is less transparent with its citizens and does not prioritize broadly available web-based communication. Therefore, Highland Park's management activities are much less visible than are those of the other cities. To our knowledge, there have been no attempts to create a city manager/administrator/controller role within the city.

WHAT HAVE WE LEARNED?

The recurrence of fiscal emergency and reappearance of Hamtramck, Highland Park, and Ecorse in emergency financial management suggests that economic environment is a powerful exogenous stressor, and that prior state intervention did not correct the cities' long-term fiscal paths. The analysis of EFM practices suggests that the economic and demographic hardships of the cities are often amplified by the lack of a clear vision of the cities' future. As a result, improvements in local fiscal health tend to be short-term and unstable. To produce change, an important shift must take place in the vision of the city leaders and in local administrative structures. Rather than viewing emergency management as an administrative act to balance a budget and leave town, emergency management ought to be viewed as a window of opportunity to effect sustainable policy changes.

First, the main benefit of an appointed position of emergency financial manager is in its *power to implement otherwise unpalatable political changes*. EFMs can make decisions that elected officials are reluctant or unable to make for political reasons. When EFMs exit, however, local officials, both elected and appointed, must possess the political will to continue making tough choices, such as, for example, maintaining austere spending behaviors or implementing prolonged user fee increases. Following their initial bouts of state financial management in the 1980s and early 2000s, respectively, local leaders in Ecorse and Hamtramck succumbed to old habits and failed to ensure long-term stability under the pressure of rising labor costs (Ecorse) and financial management that drove the city to fiscal distress by underutilizing its capacity to issue debt (Hamtramck). In the case of Ecorse, the EFM's ability to restructure public safety agencies' collective bargaining agreements, which was previously deemed politically unpalatable by the city's elected leaders, contributed to the city's recovery. Similarly, Highland Park's leaders, including both elected leaders and the appointed EFMs, restricted their vision to short-term matters and failed to develop viable strategies to combat structural stressors. In short, if local leaders lack the will or cannot withstand public pressure, they risk returning to the same behaviors that led them to a financial emergency.

Second, financial management in a challenging economic climate requires *professional staff committed to lasting institutional change*. In all three cities, emergency financial management started with changes to local administrative structures and staffing. In 2005, under Schimmel, Hamtramck adopted a new city charter that effectively replaced the mayor-council form of government with the council-manager form of government. Similarly, EM Parker personally managed the daily operations in Ecorse and then established a City Administrator position so that professional management strategies might be sustained over the long term. Relatively more successful emergency financial management in Ecorse and Hamtramck concur with the findings of Callahan and Pisano (2012), on a decisive role of management capacity in the diverging trajectories of San Bernardino City, which filed for Chapter 9, and San Bernardino County, which did not, when both faced similar economic pressures.

Third, emergency financial managers' success in improving cities' long-term fiscal health depends in part on their ability *to jumpstart local economies*. Despite his managerial faux pas, Blackwell astutely observed that prioritizing deficit reduction above all else rendered Highland Park incapable of shaping its long-term future. Conversely, Schimmel's infrastructure investment in Hamtramck and Parker's efforts to 'right-size' the city by selling off buildings and vacant land were decisions with a longer-term impact. Unlike Mallach and Bachman (2013) who view "strategic incrementalism" as the most promising way to alleviate fiscal distress in legacy cities, we doubt that the small legacy cities can recover incrementally. These smaller municipalities do not have diversified economies or capital assets such as universities or medical centers to use them as building blocks of a new economy; nor do they have human capital to develop export-oriented economies that Mallach and Bachman (2013) recommend as a focus of incremental economic development for legacy cities. Therefore, we believe that in addition to incrementalism, local tax policy may be used more actively to incentivize businesses. In the short run, tax incentives may decrease municipal budgets but in the long run, they may be the most powerful engine for diversifying revenue streams and preventing future fiscal crises.

CONCLUSIONS

By comparing three Michigan cities, we show that emergency management can improve fiscal indicators in disadvantaged economic environments. State-appointed manager actions suggest that EFMs do make more difficult policy choices than local leaders. We find, however, that emergency financial managers tend to produce improvements mostly in short-term fiscal health. We conclude that unless these legacy cities implement administrative reforms and pursue a invest into long-term development, emergency financial management is a lost window of opportunity to break their path dependence.

The most important implication of this study is that emergency financial management must be based on a solid vision of longer-term fiscal health and guided by EFMs who want to implement lasting change. This vision should focus on the professionalization of city staff, right-sizing of city physical forms, and attracting business. Since Michigan EFMs have the authority to determine when a financial emergency has passed, elements of performance management may be used to improve EFM accountability. For example, EFMs may be asked to declare policy objectives at the beginning of their tenure and report on the achievement of these objectives at the end of their tenure.

Importantly, since the concentration of power in the hands of state-appointed emergency managers may be problematic normatively, state-appointed EFMs need to find ways to explain and legitimize their policies through public information campaigns, conventional and social media, and other tools. Parker's policy of posting executive orders on the city's website is a good example of how the problem of legitimacy of state-appointed emergency managers can be alleviated. Since an EFM receives a decision-making carte blanche from the people and maintains independence of voter control for a prolonged period of time, the delegation of power should not be taken lightly. The EFM selection process should be competitive. And at the very least, the state should mandate that the EFM's resume with full educational background and work experience become available or the city website upon appointment.

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Appendix A: EFM Education and Experience

Name and EFM tenure	Education and experience prior to the EFM appointment
Ecorse	
Joyce Parker Tenure: 2009 - 2013	Master of Public Administration Flint/Ann Arbor University of Michigan City Manager, City of Elgin, MI 1997-2002 City Manager/Assistant City Manager, City of Saginaw, MI 1992-1997 Township Manager/Personnel Manager, Buena Vista Charter Township, MI 1989-1992 Assistant City Manager, City of Jackson, MI 1979-1989
Hamtramck	
Louis Schimmel Tenure: 2000 - 2007	Graduate of the Michigan State University Emergency Financial Manager for Ecorse, 1986-1989 President of the Bond Club of Detroit Executive Director of the Nonprofit Municipal Advisory Council of Michigan Entrepreneur
Cathy Square Tenure: 2013 – 2014	MA in International Affairs from Ohio University/Athens, Ohio Chief Operating Officer for the City of Detroit Director of the Department of Public Works, City of Detroit Director of the Greater Detroit Resource Recovery Authority Superintendent of the Department of Public Works, City of Hamtramck
Highland Park	
Ramona Henderson Pearson Tenure: 2000 - 2005	Certified Public Accountant Auditor General for Wayne County, Michigan Member of the Michigan State Board of Accountancy
Arthur Blackwell Tenure: 2005 - 2009	Educational background not available Work experience information not available
Robert Mason Tenure: 2009	Educational background not available Executive Strategy and Management Consultant, public and private sectors.

Appendix B: Summary of Primary Emergency Manager Activities

Hamtramck (2000-2007):

- Debt issuance: general obligation bond ($2.5M), refunding bond ($2.865M)
- Professionalization of city staff: addition of controller, change in the form of government to council-manager
- Privatization of public works services
- Infrastructure investment: city office technology, parking meters, fire hydrants, utility billing system
- Establishment of budget stabilization (“rainy day”) fund
- Sale of public works building and equipment

Highland Park (2001-2009):

- Debt issuance: pension bond ($27M), general obligation bond ($5M), fiscal stabilization bond ($11.7M)
- Elimination of city positions
- Privatization/contracting-out of city services
- Elimination of city services, e.g., library, recreation centers
- Financial audits and debt write-off
- Missed pension ARCs

Ecorse (2009-2013):

- Debt issuance: financial recovery bond ($9.45M), emergency loans ($5M)
- Professionalization of city staff: addition of a city administrator position
- Reorganization: police and fire departments combined into the public safety department
- Renegotiation of public safety contracts Reduction of elected leaders’ compensation
- Sale of city-owned property