Thurs. April 10, 2014

Pennsylvania Senate
Local Government Committee
Re: Hearing on Senate Bill 1157, amendments to the Municipalities Financial Recovery Act

Chairman Eichelberger and members of the committee:

Thank you for the opportunity to join in your discussion about Pennsylvania's role in assisting its distressed local governments. My comments will focus mainly on similar efforts by other states. I will also discuss some of Pew's recommendations for states considering intervention programs.

My comments are informed by research that Pew has conducted over the past two years, culminating in our July, 2013, report, "The State Role in Local Government Financial Distress." This research examined the range of state involvement in local government finances. It drew on current literature, statutes, a survey of state officials, and interviews with government finance analysts. The research identified the characteristics of local financial distress, how difficulties can escalate to state intervention or in extreme cases, bankruptcy, and the relevant laws states have in place. The study also considered the history of state intervention in the financial practices of embattled cities, why it matters to states, and how practices differ. Finally, the report profiled seven states with and without oversight programs, including Pennsylvania.

The findings are explored in detail in the report, but briefly Pew's research shows:

- Fewer than half of the states have laws allowing them to intervene in municipal finances.
- Practices vary among the 19 states that have intervention programs.
- In most cases, states react to local government financial crises instead of trying to prevent them.
- States intervene to protect their own financial standing and that of their other municipalities, to enhance economic growth, and to maintain public safety and health.
- Among states that intervene, some are more aggressive than others about stepping in to help.
- Local officials often resent state officials infringing on their right to govern their own affairs.

I would like to begin by mentioning the seven states we profiled. **Alabama**, home of the largest county bankruptcy in U.S. history, and **California**, where Stockton's bankruptcy generated recent attention, were chosen as examples of states that historically do not assist local governments. **New Jersey** historically has offered financial assistance to its troubled cities, including its capital of Trenton, though in recent years has pared aid back and is trying to figure out the state's role going forward. **North Carolina** has the country's oldest intervention program, emphasizing centralized, state-level monitoring. **Michigan**, where Detroit filed for bankruptcy in July, 2013, and where four other cities and three school districts are under emergency managers, and **Pennsylvania**, where Harrisburg until recently had been run by a receiver, are deeply involved in local government finances but are affected by changing economic conditions out of their control that make it harder for cities to rebound. **Rhode Island** strengthened a weak intervention program after the budget emergency in Central Falls, adding a first-of-its-kind provision protecting investors in city bonds.

Of the states we studied, Pennsylvania has one of the more varied intervention programs. You have the Act 47 program for most of the distressed cities, but a separate program for Philadelphia, with its oversight board. Harrisburg is an Act 47 city where the state took the rare step of naming a receiver.

If Pennsylvania's goal is, as the law says, "to foster fiscal integrity" of its local governments, Act 47 has had modest results. Only seven of the 27 cities have successfully emerged from the program, and a dozen others have been distressed for more than 10 years. Johnstown has submitted six recovery plans since joining in 1992. Aliquippa and Farrell, the first two Act 47 cities, are still in the program 26 years later.

I spoke to Gov. Corbett for our report and he told me, "One thing I've noticed is there's no clear path to getting out of Act 47."

We concluded that however well intentioned the act may be, Pennsylvania demonstrates how a combination of forces beyond a state's control as well as outdated state policies and local governments' mistakes can block progress in helping cities rise from a cycle of despair.

The drop in manufacturing jobs in Pennsylvania that led to a lot of distressed local governments was caused by external events, including increased foreign competition, advances in worker productivity, and a series of crippling recessions. Natural disasters cannot be prevented by local governments either. In Plymouth, extensive flooding from the remnants of Hurricane Ivan in 2004 heightened the borough's financial crisis. Three months later, a fire swept through the Municipal Building, disrupting operations for months and delaying Plymouth's recovery. Then there are legal decisions that local officials cannot always control. Westfall Township took the rare step of filing for bankruptcy protection in 2009 after a federal judge awarded $20 million to a developer whom local officials had refused permission to build houses and a hotel. The township brings in only about $1 million a year in revenue. There was the 2011 state Supreme Court ruling in a Scranton case saying that a city's Act 47 recovery plan did not negate Pennsylvania's law promising binding arbitration to public unions. In Harrisburg, it was not external events but poor decisions by local officials involving the trash incinerator that led to its financial challenges. Our conversations with local officials also turned up frustration about Pennsylvania's tax structure, that much of cities' land is exempt from taxes. We learned that half of the land in Harrisburg is exempt from real estate taxes, for example.

The Pew Charitable Trusts is a non-profit, research-based organization. We know you are considering a series of changes to the Act 47 program. While we believe it is up to each state to make those decisions about whether to have an intervention program and what to include in it, we do have some recommendations that may help as you consider legislation.

Our report recommended that states considering intervention programs should make sure that all stakeholders involved in a local financial crisis are included in discussions about solutions. I recently heard a presentation by the emergency manager of two cities and one school district in Michigan. She emphasized the need to engage the community. She held a series of town hall meetings. I also heard the first receiver of Harrisburg say how much he worked to gain the trust of the community, which initially resented him being there.

We also say if a state decides to take over a local government, officials should return the city to local control as soon as possible to smooth the hard feelings that often accompany interventions. The receiver overseeing the Central Falls, Rhode Island bankruptcy said involving the unions and other stakeholders, and returning the city to local control as soon as possible, were key reasons why the bankruptcy only took 13 months. I know one of the goals of your legislation is to reduce the time a city is in the Act 47 program. I heard a presentation by the Pittsburgh finance director making a case why Pittsburgh should be out of Act 47. You could tell the city was at odds with the state over whether it should still be in the program.

Probably the best advice we can offer is the need to monitor local government finances, which is a proactive measure to reveal budget distress. We found that most of the 19 states with intervention laws react to local crises before it is too late. Many analysts praise North Carolina's tracking system, which involves local governments periodically sending financial data to the state that has been reviewed by independent auditors. A state agency called the Local Government Commission puts together a financial profile of each city and county that is posted on a public database. If the numbers show a potential shortfall, the commission staff takes a series of steps to intervene, including the rare action of running the city.

New York, where many upstate communities have been declining economically for years, much like Pennsylvania, the state comptroller recently implemented a stricter monitoring system. It involves a stress-scoring system similar to one used in Michigan that classifies levels of distress. After Detroit filed for bankruptcy, the New York comptroller, Thomas DiNapoli said New York's "'early warning' system will reveal a realistic account of local government finances to help foster much needed public discussions at the local level about fiscal stress so that corrective actions can be taken."

We are also advocates of budgeting for more than one or two years, which is the current practice in most states.. Doing that allows you to identify long term trends such as the number of people you are going to have retiring, the demographic changes in your city or state that may drive up your costs. Budgeting for the long term allows you to set financial goals instead of just building incrementally based on last year's budget. It also allows you to identify potential financial challenges you are going to have in the future because you are thinking years out instead of getting by from year to year.

We found that no single intervention approach fits every state. There are too many differences between states. Still, there are promising practices that states should consider in adopting or altering their intervention programs. It is clear that local governments will continue to confront slow revenue growth and spending pressures in the near term. States should not merely react to local crisis. Instead states need to be proactive in monitoring local government finances and institute long-term financial planning.

In conclusion, I would like to thank you for allowing Pew to take part in this discussion. A summary of Pew's recommendations is available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_State_Role_in_Local_Government_Financial_Distress.pdf. My colleagues at The Pew Charitable Trusts and I would welcome the opportunity for further conversations at any time.

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