

Tenants at Will of the Legislature:
An Exploratory Case Study of Michigan's Emergency Manager Statutes

Matthew R. Jones

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ABSTRACT

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In July 2013, the city of Detroit filed for bankruptcy, representing the largest filing for municipal bankruptcy in the history of the United States. The public administrator behind the filing, Emergency Manager Kevyn Orr, was not a resident of Detroit, or the state of Michigan, and was never elected by residents of Detroit or Michigan to any public office. However, under Michigan law, Mr. Orr possessed the roles of both the executive and legislative branches of government for the city of Detroit. Orr was not the first emergency manager in Michigan, where an experiment in state intervention of local government financial emergencies has taken place since 1988. Unelected emergency managers have become a sole source of power in financially distressed cities across Michigan. The experiences and results of these emergency managers have important implications for the study of intergovernmental relations and public administration. This dissertation research project will present a qualitative, exploratory case study and theoretical inquiry that will examine how the actions of public institutions and key policy players account for the placement of emergency managers in local governments in Michigan, culminating in the state takeover of Detroit. The intergovernmental implications of the complete state takeover of local governments in financial emergency will be analyzed. The study will also seek to understand how the placement of an emergency manager in a financially distressed local government accounts for the larger socioeconomic causes for the local government's financial crisis. The values of local government democracy are pitted against the values of local government fiscal sustainability. This presents a challenging question - in a local government financial emergency, who should rule? This case study is exploratory, with the objective to provide a foundation for future research in this emerging field of inquiry.

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Chapter One: Introduction

On July 18, 2013, the city of Detroit filed for bankruptcy, representing the largest filing for municipal bankruptcy in the history of the United States. The public administrator behind the filing, Emergency Manager (EM) Kevyn Orr, was not a resident of Detroit, or the state of Michigan, and was never elected by residents of Detroit or Michigan to any public office. However, under Michigan law, Mr. Orr possessed the roles of both the executive and legislative branches of government for the city of Detroit.

Orr was not the first emergency manager in Michigan, where an experiment in state intervention of local government financial matters has taken place since 1988. Unelected emergency managers have become the sole source of power in financially distressed cities across Michigan. The experiences and results of these emergency managers have important implications for the study of public administration. This phenomenon presents a compelling case and a need for an exploratory case study to better understand the statutes, their implementation, and possible consequences in the intergovernmental system.

Since 1988, a series of successive laws have been passed in Michigan relating to state intervention in local governments experiencing a financial crisis. These laws may be referred to as the “emergency manager statutes.” Under its current form, Public Act 436 of 2012 - The Local Government Stability and Choice Act - the law contains controversial provisions that provide broad powers to a state-appointed emergency manager that replaces the executive and legislative branches of any Michigan local government. The city of Detroit was appointed an emergency manager by the state of Michigan in March of 2013. Kevyn Orr, a bankruptcy lawyer and partner with the Jones

Day law firm, was appointed by Republican Governor Rick Snyder to serve as the emergency manager of Detroit (Michigan Executive Office Dept. of Treasury Contract for EM 2013). This occurred after a tumultuous period of public debate about how the city should resolve its financial crisis, the likes of which had not been seen in its long history. At the press conference announcing his appointment, Orr, a respected and experienced bankruptcy restructuring specialist, stated that his appointment would lead to “the Olympics of restructuring” (Davey 2013).

The state’s appointment of an emergency manager in Detroit sparked protests and condemnation from many residents who viewed it as an intrusion upon the local democratic process. This was in response to the practice that an unelected emergency manager displaces many of the roles previously designated to elected local officials. The emergency manager is the unelected combination of a city administrative official and city council, and possesses unprecedented authority to operate on behalf of the state. Because of this authority, serious questions about local democracy have been raised and should be explored further.

The emergency manager statutes of Michigan are complex policy issues, involving significant tension between the state and local governments. The statutes pit the values of local representative democracy against the values of government fiscal sustainability. Further controversy has resulted from the Michigan’s implementation of these statutes in predominately African American-majority municipalities, resulting in several protests over the disenfranchisement of a wide portion of African Americans in the state of Michigan.

In the modern administrative state described by public administration scholar Dwight Waldo, a central question is posed: “who should rule?” The dilemma stems from the concept that “democratic ideology and institutions grew up in association with a belief in an underlying harmony, a belief that things need not be managed but will run themselves” (Waldo 2007, 101). As the running of the federal, state and local governments became increasingly more difficult due to population growth, socioeconomic changes, and advances in commerce, technology and transportation, the idea of things running themselves no longer appeared feasible. As Waldo pointed out, the competing values of democracy and efficiency could coexist only as long as the politics-administration dichotomy was upheld. That dichotomy would be challenged, because as Waldo stated, “democracy is a way of life which must permeate the citizen’s work as well as his leisure hours” (14).

Competing forces are constantly found in public administration – Who should be in control of the decisions? How should that control be exercised? Whose interests are to be served, and which values should be placed at the forefront? In the United States, we value democracy and the ability to elect our local representatives; additionally, we value, and expect, fiscal responsibility at all levels of the federal system, including our local government. In the case of the Michigan emergency manager statutes, the value of democratic elective rights for residents in urban areas must be reconciled with the value of local government fiscal accountability.

This dissertation research study will explore and analyze an emerging phenomenon in the intergovernmental system of the United States - the complete state takeover of financially distressed urban areas in Michigan. This research aims to better

understand how the actions of public institutions, policy players and managers account for the placement of emergency managers in several local governments in Michigan, culminating in the state's takeover of Detroit.

Setting the stage for this central research question requires different research lenses to sufficiently generate plausible explanations and analysis. This shall be accomplished through a detailed literature review. Consequently, the purpose of this study is to conduct an exploratory case study of the emergency manager laws of Michigan. Upon a comprehensive review of relevant literature, a case study will be developed through the collection and analysis of publicly available documents, archival materials and media reports. The focus will be on uncovering the significant events leading to the complete state takeover of financially distressed local governments in Michigan, including an exploration as to how public policy players account for the management strategies of the emergency manager in the bankruptcy of Detroit. To provide another dimension, the experience of New York City's financial emergency of the 1970s will be used as a cross-case comparison. Additionally, the city of Flint's experience under an emergency manager will be explored, to highlight a "worst case scenario" as to the consequences that may occur when local elective government is removed.

Upon completion of the case study, a concluding discussion chapter will provide a theoretical inquiry of the emergency manager laws to address the research questions presented in this opening chapter. Incorporating the exploratory case study, new theory will be developed regarding the role of public administration in the emergency management of a distressed urban area. In the concluding section, recommendations will

be made for improvement to the policy that results in preservation of social equity during its implementation. This research design will explore an emerging phenomenon and advance the knowledge base for public administration by providing exploratory research, developing theory and providing direction for future research.

Research Questions

Case study research explores a description for the facts of the case; and this includes the key institutions and players involved, as well as the sequence of events within an established time period. In order to focus this research towards a set of useful questions, it is appropriate to summarize the proposed research questions.

Central Research Question:

1. How do the actions of public institutions and key policy players account for the placement of emergency managers in local governments in Michigan, culminating in the state takeover of Detroit?

Subsidiary Research Questions:

2. What are the intergovernmental implications of the complete state takeover of local governments in financial emergency?
3. How does the placement of an emergency manager in a financially distressed local government account for the larger socioeconomic causes for the local government's fiscal crisis?
4. How should future public administration research approach the emergency financial management of local governments?
5. In a local government fiscal emergency, who should rule?

Chapter Two: Literature Review

“The problems of administration are so large and complex, the issue of successful administration so crucial, that we cannot afford to leave unopened any windows that may let in light upon what we are doing” (Waldo 1956, 50).

Given the scope of the research questions, and in order to better understand the proposed exploratory case study, an appreciation of the historical context of the phenomenon to be studied is required. This literature review chapter examines key theoretical and policy literature relevant to the study. Due to the exploratory case study research design, the literature review for this dissertation will be diverse and detailed.

As this area of research is multi-disciplinary, the literature review will be subdivided into subsections. The literature review will include five sections: (1) Public administration foundations; (2) Qualitative and Case study research; (3) Federalism and intergovernmental relations; (4) Local government fiscal crisis; and (5) Detroit’s economic and administrative challenges. The literature review is an especially vital component of this dissertation research project because it will set the foundation for the case study research of Chapter Four and the concluding theoretical inquiry in Chapter Five.

Literature Review Outline

Section 1: Public Administration Foundations and Concepts

Section 2: General Literature on Qualitative Methods and Case Study Research

Section 3: Federalism and Intergovernmental Relations

- The Framers and Federal Government
- Federalism and Intergovernmental Relations
- Dual Federalism
- Cooperative Federalism
- Creative Federalism
- New Federalism
- Coercive Federalism
- State-Local Governmental Study
- Fragmented Federalism
- IGR Literature Summary

Section 4: Local Government Fiscal Crisis

- Causes of Local Government Fiscal Stress
- Predicting Fiscal Stress
- Cutback Management
- Municipal Bankruptcy
- Stockton California
- Harrisburg, Pennsylvania
- Central Falls, Rhode Island
- New York City

Section 5: Detroit's Economic and Administrative Challenges

- Background and History
- De-industrialization
- Detroit's Race Relations
- Detroit's Public Management

Chapter Two: Literature Review

Public Administration Foundations

Public administration is a rather diverse and composite field of study. Students examine the management of public resources, which is conducted by humans, who are complicated creatures to research and understand. Studies in public administration often require consideration of history, statistics economics, science, law, psychology and sociology, if a student is to better understand how public policy is developed and implemented by public organizations. A comprehensive overview of public administration concepts is beyond the scope of this paper; however, as this dissertation is in the field of public administration, it would be incomplete without at least a brief overview of some of the larger concepts of public administration that may guide portions of this dissertation research project.

The founding of American public administration is often associated with the civil service reform movement of the Progressive Era. Some scholars, however, have argued that Alexander Hamilton should be designated as the father of modern public administration. To gain a perspective of the founding father era of public management, Richard Green (2002) describes Alexander Hamilton's theory of public administration based upon four points: politics, organizational design, ethics, and law (Green, 542). Writing as Publius, in *The Federalist Papers*, Hamilton outlined new concepts of American public administration in the context of the debated constitution. Hamilton also developed the foundation of American public administration in action, while serving as George Washington's Secretary of the Treasury.

The Hamilton theory of public administration was based upon a republic, bent on commerce, developed from several European theories, and applied to the American institutions (Green, 543-544). This theme of “Americanizing” foreign institutions is also discussed in Woodrow’s classic essay, “The Study of Administration” (1887). In Wilson’s 1887 paper that helped launch the entire discipline of academic study, he explains that Europe was more advanced in the field of administration, and should the United States begin to employ the new science of administration, it will need to be tailored to the unique characteristics of America. The science must be “adapted, not to a simple and compact, but to a complex and multiform state, and made to fit highly decentralized forms of government” (Wilson 1887, 202).

Hamilton may be described as the founder of developing the administrative infrastructure essential to enable the United States to thrive, while scholar and future President of the United States Woodrow Wilson is often thought of as the founder of public administration as an academic discipline. Wilson observed the need for the study of administration as governing tasks became increasingly complex. The question in the first American century, as Wilson explained, was generally “who shall make law, and what shall law be?” As the country grew and became more complex:

“The other question, how law should be administered with enlightenment, with equity, with speed and without friction was put aside as practical detail, which clerks could arrange after doctors had agreed on the principles” (Wilson 1887, 198-199).

The question of how law should be administered properly was never fully addressed until the later part of the 19th century. As Wilson’s biographer A. Scott Berg would later write, “With a civil service system expanding as rapidly as the nation itself,

administrative science was becoming a viable branch of political science, a discipline in which Wilson had become expert” (Berg 2014, 108).

While Wilson wrote about the increasing need for the study of public administration, Leonard White would write the first textbook dedicated to explaining the study of public administration and its objectives. White defined public administration as “the execution of the public business; the goal of administrative activity the most expeditious, economical and complete achievement of public programs” (White 1926, 51). To build upon Wilson’s observation that a study of public administration is needed, White pinpointed the industrial revolution as a primary cause for the abandonment of the laissez-faire government philosophy of the past. New public concerns had emerged and old concerns became increasingly complex in scope and scale. To cope with the expanding need for administration, organizations turned to scientific management.

In developing principles of scientific management, Frederick Taylor (1912) warned of the transformative nature management would experience. These new obligations, Taylor writes, “are so unusual and so great that they are to the men used to managing under the old school almost inconceivable” (Taylor 1912, 36). The principles of scientific management developed by Taylor include information gathering of a scientific nature; selecting workers based on scientific factors; synthesizing science and workers together; and balancing the workload between management and workers (Taylor, 36-37). Along with the public’s fatigue from the municipal corruption of the late 19th and early 20th centuries, technological developments created a public eager to accept the disinterested objectivity of scientific management applied to address the issues in the social world (Adams 1992).

The emerging scientific study of administration was also seen in the studies of Max Weber. Weber's work on bureaucracy was among the starting points for future scientists to study the process of administration (Shafritz 2010, 11). In Germany, Max Weber identified the major features that characterized bureaucracies, which included the division of labor ordered by rules, a formal hierarchical structure, personnel hired on grounds of technical competence, and written documents, or "the files"(Weber 1946, 43-46). While Weber does not describe in detail the role that politics should play in the emerging field of administration, this topic was addressed in the Progressive Era.

Wilson contended that the field of administration was "a field of business; it is removed from the hurry and strife of politics" (Wilson 1887, 209-210). While introducing the politics-administration dichotomy, Frank Goodnow defined the primary function of government as the "expression of the will of the state and the execution of that will" (Goodnow 1900, 29). Unlike Wilson's proclamation that politics and administration are necessarily separate, Goodnow described the dilemma facing the interplay of politics and administration within the American governmental system of separation of powers. "Practical consideration," Goodnow wrote, "makes impossible the consideration of the function of politics apart from that of administration" (30).

Influenced by Taylor's "Principles of Scientific Management, Luther Gullick developed a theory of organization with a heavy influence on the division of labor. Gullick argued that, "work division, is the foundation of organization; indeed the reason for organization" (Gullick 1937, 79). Gullick's theory of organization involved consideration of an organization's division of work, the co-ordination of work and the organizational patterns. All of the components of Gullick's Theory of Organization

relate in some way to Taylor's scientific management principles. It is based on scientific measurement and management that the division of work is properly calibrated; it is also based on scientific interpretation of data that the level and detail of coordination is implemented to achieve an optimal level for the effect on efficiency.

In his famous work, *Administrative Behavior*, Herbert Simon dismantles the notion that the traditional orthodoxy view of public administration principles are actually proverbs, and that they contain many contradictory elements that need clarification in order for administrative study to advance forward (Simon 1946). The "principles" of public administration came under further attack by Robert Dahl, who outlined three major problems with the orthodox view of public administration: The impossibility of excluding normative values from public administration, the role of individual human behavior, and the role of social forces (Dahl 1947). Simon also pointed out "that it has not been commonly recognized that a theory of administration should be concerned with the processes of decision as well as with the processes of action" (Simon 1945, 1). As decision-making is among the foundations of any organization of administration, the problem, Simon explained, is that decision-makers do not have more than a "fragmentary knowledge of the conditions surrounding his action" (Simon 1945, 94), and consequently they cannot make decisions except with limited, or bounded rationality.

Dwight Waldo, a towering figure in the field of public administration and occasional academic sparring partner of Herbert Simon, put forth a philosophy that rejected the notion that public administration should live up to the standard of a business-like practice, based primarily on empirical and economical basis while rejecting political considerations. Waldo pointed out that administrative study is not the same as the "hard

sciences,” and that social science, such as the study of public administration, involves human beings. Because humans think and make value judgments, Waldo argued “that the established techniques of science are inapplicable to thinking and valuing human beings” (Waldo 1948, 181).

Writing in the 1970s, H. George Frederickson, a “Waldonian,” called for a “new public administration,” explaining that this concept should add social equity to the classic objectives and rationale of public administration (Frederickson 1971, 297). Frederickson sought to change administrative structures from within to enable them to provide sound management in the public sector, as well as positive change to promote equity for many demographics that had been treated subordinately by public administrative structures. The harmonizing of efficiency with social equity is an important concept that will be revisited in the recommendations of Chapter Five.

This section of the literature review has ever so briefly touched upon some of the foundations of the discipline of public administration, the discipline upon which this dissertation project proposes to make a contribution. This contribution will be through an exploratory case study. To better understand why an exploratory case study was chosen as the research tool for this particular phenomenon, the next section in the literature review will provide a brief overview of qualitative research methods, and why the case study is the preferred option for this particular area of interest.

Chapter Two Literature Review

Case Study Research

Developing a framework for the research inquiry is necessary to keep the study focused and orientated toward success. A research design is the plan that directs the research and is found at “the intersection of philosophy, strategies of inquiry and specific methods” (Creswell 2009, 5). Imbedded within research designs are guiding philosophical worldviews as well as philosophical modes of inquiry. Philosophical worldviews are defined by Creswell as “a general orientation about the world and the nature of research that a researcher holds” (6). The pragmatic philosophical worldview will encourage the research proposed for this dissertation. Pragmatism does not focus solely on the methodological choices, but instead emphasizes the research problem and area of interest that is being studied. As further described by Creswell:

“Individual researchers have a freedom of choice. In this way, researchers are free to choose the methods, techniques, and procedures of research that best meet their needs and purposes “Pragmatists opens the door to multiple methods, different worldviews, and different assumptions, as well as different forms of data collection and analysis” (Creswell 2009, 11).

The Creswell description of pragmatism accurately captures the spirit of research inquiry utilized by this dissertation project – a desire to understand a new public administration phenomenon utilizing any procedures that will generate the most comprehensive story and understanding.

Public administration involves the decisions individuals make; and these people have individual as well as collective values that guide them. The term “postnormal science” was described by Funtowicz and Ravetz (1992) to explain the complexity in the social sciences due to uncertainty, differing values and social complexity that results in

less objectivity. Public administration, like many social sciences, has been described as a post-normal science. As Riccucci explains, “the post-normal sciences are premised on uncertainties, values and social traditions, and anomalies. Thus, “a range of epistemic traditions is relevant for generating knowledge and theory building in public administration” (Riccucci 2010, 46). Public administration is also thought as a post-normal science because a research paradigm has not been concretely established in the field. Scholars have asserted that unlike the natural or “hard” sciences, public administration does not yet possess a paradigm that instructs its research inquires with the same level of rigidity (Waldo 1980; Rainey 1994; Riccucci 2010).

This proposed dissertation project will be carried out with primarily qualitative research methods centered in case study analysis. Qualitative research “involves language, images, and other forms of expressing meaning that researchers then interpret – research that does not involve numbers or quantification” (Remler and Van Ryzin 2011, 530). The exploratory case study method is proposed for this study. Stake (1995) argued that the “case study is not a methodological choice but a choice of what is to be studied” (Stake 1995, 134). Some research interests are better suited for qualitative case study research designs than others. As Lutton (2010) points out:

“Quantitative approaches are well suited for testing hypotheses and predicting which factors influence an outcome. Qualitative case studies are better suited for exploring poorly understood topics and understanding complex relationships” (Lutton 2010, 129).

The emergency manager laws in Michigan and their implementation in Detroit have historically been poorly understood. This remains the case at present time. The emergency manager laws represent an emerging issue, and therefore, an exploratory case

study is the optimal choice for a dissertation research project that will benefit the field of public administration.

The case study will be the method of choice to address the issue in this project; therefore it is important to define exactly what a case study is. Definitions of a case study are numerous, and vary depending on the approach. Stein's (1952) definition for the case study method focused on the decision-making process, in that a case study is:

“a narrative of the events that constitute or lead to a decision or group of related decisions by a public administrator or group of public administrators. Some account is given of the numerous personal, legal, institutional, political, economic and other factors that surround the process of decision but there is no attempt to assert absolute causal relationships” (1952, 12).

Yin (2009) differs from the emphasis on decision making and provides a two-part definition of the case study:

1. “A case study is an empirical inquiry that:
 - Investigates a contemporary phenomenon in depth and within its real-life context, especially when
 - the boundaries between phenomenon and context are not clearly evident.”
2. “The case study inquiry:
 - Copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result
 - Relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result
 - Benefits from the prior development of theoretical propositions to guide data collection and analysis.” (Yin 2009, 18).

Van Evera (1997) identified five different uses for conducting case study research in public administration: creating theory; testing previous creative theory; identify precursor conditions; test importance of precursor conditions; explain cases of central importance. Of Van Evera's five uses, the creation of theory and explaining cases of

central importance are the most applicable to this current research proposal. The Stein (1952) definition of case study appears to most closely align with the aims of this research proposal. The exploratory case study will follow the sequence of events that led to emergency managers appointed across local governments in Michigan culminating with the state takeover of Detroit. Likewise, the focus of this research proposal is not to affirm causal relationships, but to better understand the phenomenon that is taking place.

The proposed dissertation project study will generate theory through a variety of research approaches: interpretivism, empiricism, and rationalism. Interpretivism represents a philosophic tradition based on the interpretive nature of knowledge (Riccucci 2010, 66). This generally involves the examination of archival documents, texts, and written works, to develop the meaning behind them. Because this proposed case study will examine a multitude of public documents, legal documents, transcripts and media statements, interpretivism will be a philosophical tradition that is utilized to structure the research strategy.

The empiricism philosophic approach “supports the existence of reality and knowledge through experience” (Riccucci 2010, 77). While often identified with quantitative methods, qualitative methods, such as the proposed exploratory case study, also undertake an empirical inquiry to generate new knowledge and create theory about what has been learned. Because this proposed case study will acquire new knowledge and develop theory based upon these experiences, the empiricism philosophic approach will be also be utilized.

Rationalism is the philosophic view of acquiring knowledge through reason (Riccucci 2010, 72). Theoretical inquiries, such as those planned to follow the proposed

exploratory case study, use rationalism to generate new theory based upon reason.

Because this proposal aims to create new theory based upon the information uncovered through the exploratory case study, utilizing vantage points from the literature review, a rationalist philosophic point of view will also be utilized to develop new theory.

Validity

It has been noted that particularity, instead of generalizability is the trademark of qualitative research (Green & Caracelli 1997). As the goal of this research proposal is not to generalize findings to sites outside of this specific research study, external validity is not a primary concern. However, upon completion of the case study, a theoretical inquiry will provide some themes that may be applicable to other states that may develop stricter local intervention laws, and cities with socioeconomic conditions similar to that of Detroit. This approach will allow some degree of generality to be approached at the conclusion of the case study.

Construct validity, the idea that the research measures what it intends to measure, has a different relationship with qualitative research than quantitative research. The questions asked by qualitative research are different and have more to do with “validity of representation, understanding and interpretation” (Ritchie and Lewis 2003, 273). It has been pointed out that validity of research is dominated by the positivist research tradition that demonstrates quantitative research, whereas qualitative research will generally follow different philosophical research traditions (Yanow and Schwartz-Shea (2006).

Theory

A theory may be thought of in public administration research as “a logical description of how a particular corner or aspect of the world works” (Remler and Van Ryzin 2011, 26). In research approaches, theory may have a different position in the research design based upon whether an inductive or deductive approach is being utilized. Induction involves researchers undertaking a “systemic observation of the world” and then developing a logical explanation (or theory) to account for what has been observed. On the other hand, deduction is when the researcher “moves first toward the development of a logical explanation or theory and next gathers evidence to test the theory” (17).

Whether research is conducted inductively or deductively, either approach requires different skills and abilities to carry out successfully. Deduction requires “researcher’s independence or objectivity and ability to generalize findings” (Riccuci 2010, 45). Induction, on the other hand, seeks to “promote a greater understanding of the meanings that humans attach to events or phenomena. It places less emphasis on the ability to generalize...it allows for changes in research as the work progresses” (45). Therefore this exploratory case study will employ a greater measure inductive reasoning during the research process.

Utilizing the case study method will provide a more comprehensive treatment of the public administration phenomenon to be studied in this project – the emergency manager laws of Michigan. Among the cornerstones of the case study will be to understand the theory and concepts at play when a relationship between a state and local government is analyzed. Having described the usefulness of the exploratory case study research method, it is now time to deliver relevant academic and historical research that

will provide the overall framework for the case study and theoretical inquiry. The next section of the literature will provide an overview and relevant concepts of federalism and intergovernmental relationships that will provide a foundation for this case study.

Chapter Two Literature Review Federalism and Intergovernmental Relations

The Framers and Federal Government

Organized governments have existed for over four hundred years in the land area that now makes up the United States of America. Colonial governments historically set up frameworks for two-tiered systems due to their distance from the various “mother countries” (Stephens and Wikstrom 2007, 7). While this presents a type of early federalism, the most commonly thought of federal system of government was established during the Constitutional Convention of 1787 in Philadelphia.

There is an old story, often repeated in the telling of American history, that after the final day of deliberation during the Constitutional Convention, when Benjamin Franklin was asked whether the convention produced a monarchy or republic, Dr. Franklin replied, “A Republic, if you can keep it” (Farrand 1934). It is commonly understood that the United States of America is a republic. However, what does this mean? How is the republic form of government defined, and how does that relate to the federal form of government? To better understand the Founding Fathers’ vision of the republic that had been created in Philadelphia, it is sensible to consult the *Federalist Papers* written by James Madison, Alexander Hamilton and John Jay after the Constitutional Convention, in order to rally support for the new government prior to the ratification conferences the states would undertake.

Writing as *Publius* in *The Federalist* 39, James Madison defined a republic as “a government which derives all its powers directly from or indirectly from the great body of the people, and is administered by persons holding their offices during pleasure, for a

limited period, or during good behavior.” When considering why this particular form of government was needed for the United States, Madison wrote that “no other form would be reconcilable with the genius of the people of America.” He further points out that “if the plan of the convention, therefore, be found to depart from the republican character, its advocates must abandon it as no longer defensible” (*Federalist No. 39*).

While the founders viewed the new nation as a republic, was the United States government thought of a federal form of government? Martin Diamond (1974) argued that the Founders viewed the Constitution as a departure from the three primary types of government, which were the unitary/national, confederal, and federal forms. The unitary form of government places the central government in control, with the state subdivisions entirely dependent upon it. Conversely, the confederal form of government holds the opposite form, with the state subdivisions in control and the central government primarily dependent upon them.

The federal form of government, therefore, is a combination of the unitary and confederal, and occupies the middle tier. As Diamond pointed out, “A federal system combines states which confederally retain sovereignty within a certain sphere, with a central body that nationally possesses sovereignty within another sphere, the combination is thought to create a new and better thing to which is given the name federalism” (Diamond 1974, 44).

Diamond argued that the founders did not intend for the United States to be a purely federal form of government, but instead, they thought of it as a combination of national and federal government elements; essentially a new and innovative hybrid form of government. Diamond points to *The Federalist 39*, where Madison writes: “The

proposed Constitution, therefore, is in strictness, neither a national nor a federal Constitution, but a combination of both” (Federalist No. 39). Diamond also cites Tocqueville’s early observations on the new experiment taking place in the United States. Tocqueville observed that “this is no longer a federal government, but an incomplete national government, which is neither exactly national nor exactly federal; but the new word which ought to express this thing does not yet exist” (Tocqueville 1945, 159).

Federalism and Intergovernmental Relations

At the heart of this policy topic; the state takeover of fiscally troubled local governments, is an analysis of intergovernmental relations in its current state. Federalism may be defined as the “authority constitutionally apportioned between central and regional governments” (O’Toole 2007, 1). There is a distinction made between the term “federalism” and the term “intergovernmental relations.” The latter “is the more comprehensive term, including a full range of federal-state-local relations”(3). Intergovernmental relations in the United States have also been defined as “the interactions and interrelationships between levels and units of government in a complex multilayered federal system of government (Stephens and Wikstrom 2007, 1).

The term “intergovernmental relations” (IGR) is found in scholarship as early as the work of John Anderson, who defined the term to “designate an important body of activities or interactions occurring between governmental units of all types and levels within the federal system” (Anderson 1960, 3). It is the inclusion of the local government element that makes IGR more comprehensive and useful when conducting a case study such as the one undertaken by this dissertation project. Deil Wright, a noted scholar in

IGR scholarship, provides an even further definition of IGR and the difference with federalism:

“IGR encompasses more than is usually conveyed by the concept of federalism, where the emphasis is chiefly on national-state relationships with occasional attention to interstate relationships. IGR recognizes not only national-state and interstate relations, but also, national-local, state-local, national-state-local and interlocal relations. In short, IGR includes as proper objects of study all the permutations and combinations of the relations among the units of government in the American system” (Wright 1974, 2).

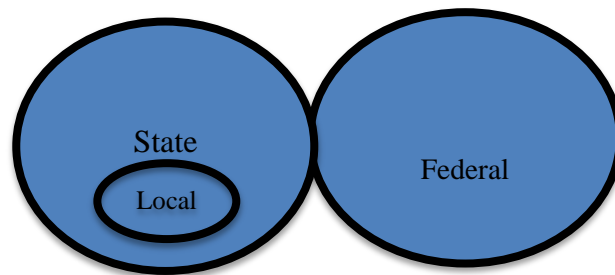
Based upon this understanding that IGR is the more comprehensive term, therefore it will be IGR, rather than the concept of federalism, that this dissertation project will analyze in relation to the forces at play when analyzing the emergency manager laws of Michigan. While IGR will be the lens upon which later analysis will take place, it is important to develop a brief overview of the various phases of federalism and IGR as found in academic literature.

Historically, IGR was thought of as a type of three layer cake, with each layer corresponding to a different level – Federal, state and local. Grodzins (1960) would refute this with the famous “marble cake” metaphor, arguing that the interactions of the levels of government are not quite so clearly defined, but are found “appearing in vertical and diagonal strands and unexpected whirls” (Grodzins 1960, 265). The metaphor of marble cake supplanted the traditional view of a dual-federalism, replacing clearly defined roles with a more concept of complex and chaotic interaction.

Deil Wright (1988, 72-85) presented three models for IGR in an effort to select the model that best reflects the U.S. system. The first model is the coordinate-authority model. This model is characterized by “sharp, distinct boundaries separate the national government and state governments” (72). The coordinate-authority model recalls the

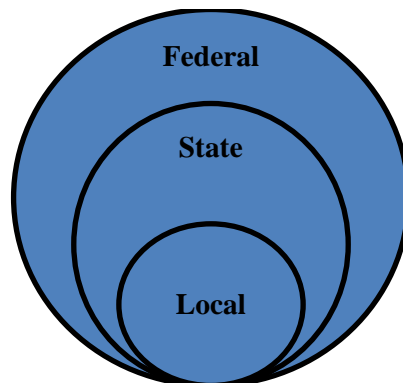
concept of Dual Federalism, with the focus on the two levels of government with each possessing separate and autonomous functions.

Figure 2.1 - Coordinate-Authority Model



The second model that Wright describes is the inclusive-authority model. This model visualizes the three levels of government as a hierarchy with decreasing authority, but within a single connected system. In this model, the federal government is supreme, and if this model were representative of the federal system “states and localities would be mere minions of the national government with insignificant or incidental impact on U.S. politics and public policy” (76).

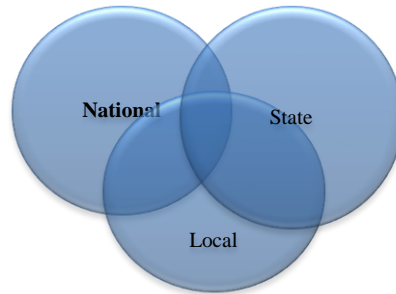
Figure 2.2 - Inclusive-Authority Model



The third model Wright presents is the Overlapping-Authority Model. Wright argues that this is the most representative model of the IGR system because it has substantial areas of governmental operations involving national, state, and local units

simultaneously; the levels have relatively small areas of full autonomy; and the level of power for any one level is limited. Comprehensively, these limits produce an authority pattern best for bargaining (82).

Figure 2.3 - Overlapping-Authority Model



IGR scholars, looking back at Wright’s overlapping-authority model, would note that it provided the theoretical foundations for moving away from the fixed views of IGR federalism (Agranoff and Radin 2014). There are a variety of theories and models outlining the various phases of federalism and IGR in the history of the United States. While a comprehensive treatment of the many schools of thought and debates on the terms and phases is beyond the scope of this section, an overview of three broad phases of federalism will provide a valuable framework for the case study.

Dual Federalism

“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people”
(Tenth Amendment to the United States Constitution)

Public administration scholars in the middle to late twentieth century began to look back in history to analyze the phases of intergovernmental relations in the United States. Reviewing the first half of the 19th century, the concept of Dual Federalism was

the prevalent way of understanding the interactions among the levels of government in the United States. To this effect, the “dominant view of the relationship between the nation and states was that of Dual Federalism, stipulating a discrete division of power and responsibilities between them” (Nathan 2008, 14). O’Toole described Dual Federalism as “each of the two levels of government operating independently within its separate jurisdiction without relying on the other for assistance or authorization (O’Toole 2007, 6).

The concept of Dual Federalism as a study in public administration was developed by Edward Corwin, who identified four primary components: (1) the national government only possesses enumerated powers; (2) the purposes it may promote under the constitution are limited; (3) the two levels of government, in their respective spheres, are equally sovereign; (4) the relationship between the two centers of government is not one of cooperation, but rather, of tension (Corwin 1950).

Dual Federalism is the first phase of federalism in the United States and was a result of the negotiations and debates that took place at the Constitutional Convention and ratification debates that would follow. Dual Federalism was the federal system of government that took place from 1789 through the 1930s. The federal and state governments occupied separate spheres of influence, and these spheres of influence derived from the Constitution’s implicit division of powers (Kincaid 1996).

The enumerated powers provided to the federal government in the Constitution as well as the language in the Tenth Amendment created the basic framework for the era of Dual Federalism. Based upon the enumerated powers in the Constitution, the idea of Dual

Federalism was confirmed and clarified by James Madison in *Federalist 51*, when he wrote:

“In the compound republic of America, the power surrendered by the people is first divided between two distinct governments, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself.” (*Federalist 51*).

Early in the American republic’s existence, the Supreme Court upheld the Dual Federalism model with such decisions as *Chisholm v. Georgia of 1793*, where the Federal government of the United States was argued to be sovereign to the powers of government that were surrendered to it, while the States are sovereign to the powers reserved (Zimmerman 2001).

In the Supreme Court’s *Gibbons v. Ogden 1824* decision, despite the favorability toward federal power, the Marshall Court also preserved “a residual enclave of state authority,” this decision “recognized both a national, interstate economy and a local intrastate economy. The former was a federal province while the latter was reserved to the States” (Young 2001, 146).

Fiscal transfers from the states were limited during the Dual Federalism era. During this time there was little involvement by the federal government in state matters that involved what we would now classify as a grant-in-aid or similar financial instrument (Hale and Palley 1981). This period was one of states’ rights control regarding internal improvements. Any approximation of grant activity in the form of transfers to the state was limited to land grants from the Northwest Ordinance of 1787. However, such federal grants were allocated infrequently and were generally not tied to any specific federal government terms and condition (7).

During the Dual Federalism era, the Morrill Act of 1862 granted public land to each state for public universities. The Morrill Act established some of the basic foundations for intergovernmental grants, especially provisions which “resources were provided in exchange for acceptance of certain minimum standards for a specific purpose” (ACIR 1977, 15). Nonetheless, this was a limited grant and did not extend into fiscal federalism that would mark later eras of IGR.

The Court’s ruling enforcing the concept of Dual Federalism includes Chief Justice Taney’s assertion in 1859 that “powers of the general government, and of the States, although both exist and are exercised within the same territorial limits, are very separate and distinct sovereignties acting separately and independently of each other, within their respective spheres” (Zimmerman 2001, 17). Dual federalism would persist even after the conclusion of the Civil War.

While the Union’s victory in the Civil War represented a victory for the federal government, Kincaid (1996) points out that President Abraham Lincoln would view the great victory as one of the Union over secession, not necessarily a total victory of the federal government over the states. Furthermore, Congress’s refusal to enforce the individual rights granted by the Fourteenth Amendment, the Supreme Court decisions in *Texas v. White* (1869), as well as *Plessy v. Ferguson* (1896) upheld Dual Federalism, and the unfortunate racial discrimination that accompanied this accommodation, well after the Civil War; constituting much of why many view the idea of Dual Federalism somewhat negatively today (34).

There is much dispute among scholars as to when the era of Dual Federalism ended and the era of “Cooperative Federalism” began. Scheiber (1979) organized the era

of Dual Federalism into distinct eras. The era from 1790 to 1861 was defined as dual federalism marked by “rivalistic state mercantilism.” This first era conforms to the judicial model of dual federalism that was supported by the early landmark decisions by the Supreme Court, which pushed for a dualistic model between the federal and state governments that discouraged policy innovation from the federal government and was enabled by the decentralized nature of the economy at the time. The second era from 1861 to 1890 was explained as an era of “transitional centralization” and was an era when an expansion of the responsibilities of the federal government resulted in a significant centralization of power, including regulation of the railroads and the early stages of general business regulation. Scheiber’s third stage of federalism took place from 1890 through 1933 and accelerated the centralization of power towards the Federal government, due to increased regulation, the fighting of the First World War and the early stages of grants-in-aid.

However, Staten (1993) argued that the turn of the century administration of Theodore Roosevelt was more nuanced and should not be considered as purely that of dual federalism. Instead, Staten argues that was more transitory of a transitory period in federalism due to the problems brought about by industrialization and modernization that required a more cooperative federalism model in order to solve the problems. The federal grant programs that took place at the dawn of the 20th century were limited to providing assistance and generally concentrated on areas that commanded strong political support, such as agriculture and road construction, and correspondingly were directed toward the states rather than the local governments (O’Toole 2007, 12).

Cooperative Federalism

Dual federalism gave way to cooperative federalism when the former could not face the challenges of modernization. Reformers called for government response to the externalities of the new urban-industrial era, and demanded the Federal government take on a stronger role to manage the new economy (Kincaid 1996, 34-35). Cooperative Federalism took place from roughly the 1930s through the mid-1960s. The era and phase of Cooperative Federalism may be thought of as “the desirability and need of the various levels of government – federal, state, and local – of working together to conform and alleviate domestic problems, utilizing a range of grant programs, technical assistance, mutual aid, and a variety of other mechanisms to realize shared policy goals” (Stephens and Wikstrom 2007, 109).

In 1950 Edward Corwin proclaimed, and perhaps lamented, the death of dual federalism, and wondered whether the states of the federal system “may be saved for any useful purpose” (Corwin 1950, 1-2). Additionally, Corwin provided a technical definition for the emerging era of cooperative federalism by describing it as an era where the various units of government “are regarded as mutually complementary parts of a single governmental mechanism, all of whose powers are intended to realize the current purposes of government according to their applicability at hand” (Corwin 1950, 19).

Kincaid (1996) points out that the emergence of local governmental units as a third partner was one characteristic of Cooperative Federalism. The addition of a direct line from the Federal government to local governments helped distinguish the Cooperative Federalism era from the previous era of Dual Federalism as well as the approaching era of Coercive Federalism. Suddenly local governments were in the game,

and could receive direct assistance from the Federal government, and had a larger voice in policy conversations.

While the inclusion of local governments in the federalist system was an important development, perhaps the most critical aspect of cooperative federalism was the power of the fiscal transfers the Federal government provided the state and local governments that increased significantly (Kincaid 1996; Wright 1988). Although placing the cooperative federalism era in a more narrow timeframe than other IGR scholars (through only 1950), Deil Wright explained that the increased collaboration by the federal, state and local governments was found in such areas as national policy planning, tax credits, and categorical grants-in-aid; with “the prime IGR mechanism being the substantial and significant fiscal links that were firmly established” (Wright 1974, 7).

One major driving factor of this expansion was the passage of the Sixteenth Amendment in 1913, granting the federal government power to levy income tax. The subsequent increase in federal revenues allowed the federal government to expand its role in directing intergovernmental matters. Tax collections accounted for 60 percent of national revenue, and enabled increased sharing of revenue with states and local governments which had far less elastic taxes (Hale and Palley 1984, 8). While there was a significant transitional phase from dual federalism to cooperative federalism of the rapidly modernizing mid-20th century, the IGR paradigm shift was nonetheless quite significant when compared to the more simplistic Dual Federalism models.

Creative Federalism

The era of Cooperative Federalism transformed into what Lyndon Johnson would call “Creative Federalism.” Walker (1981) explained the differences between the two phases:

“The theory and practice of Creative Federalism was markedly in contrast with the practice of its Cooperative Federalism predecessor. It differed in its range of new grant programs, in its diversity of participating state and especially local units and nonprofit agencies, in its expanding federal outlays, and in its urban and city emphasis” (Walker 1981, 104).

Creative Federalism greatly expanded the amount of federal aid given to states and local governments. In 1960 the states and local governments received \$7 billion in federal aid. By 1967, this amount would increase to over \$15 billion, and by 1975 It would be nearly \$50 billion; well over triple the amount from 1960 (O’Toole 2007, 10). The nature of this federal aid was also different. Many of the new grants to state and local governments were in the form of categorical or project grants. Additionally, many of the new funds were provided to local governments, resulting in the local governments viewing the federal government as a partner, at times, more so than their own state government (11).

Creative Federalism may be thought of as a more robust version of Cooperative Federalism that included more outreach to state and local government officials. In a memo to his cabinet, Johnson explained what he considered the framework for Creative Federalism:

“The basis of creative federalism is cooperation. If Federal assistance programs to State and local governments are to achieve their goals, more is needed than money alone. Effective organization, management and administration are required at each level of government. These programs must be carried out jointly; therefore, they should be worked out and planned in a cooperative spirit with those chief officials of State, county and local governments who are answerable to their citizens.

To the fullest practical extent I want you to take steps to afford representative of the chief executives of State and local government the opportunity to advise and consult in the development and execution of programs which directly affect the conduct of State and local affairs” (Johnson 1966, Memo 606).

While the era of Creative Federalism involved more funding and partnership, the categorical and project grants did come with more strings attached and resulted in many more federal programs. This proved problematic if economic conditions changed for local governments and they struggled to maintain the level of effort or matching funds needed in order to continue to receive federal programs. These were areas that a new IGR phase, “New Federalism,” proposed by Nixon would seek to address.

New Federalism

The “New Federalism” proposed by President Richard Nixon in the late 1960s and early 1970s may be seen as a reaction to Lyndon Johnson’s Great Society and the increased involvement federal agencies previously had in regards to specific categorical grants with a large degree of federal oversight (Stephens and Wikstrom 2011, 38). The New Federalism of Nixon intended to return power to the states and local governments in the form of general revenue sharing, which set up a system to transfer over \$30 billion to state and local governments from 1972 through 1976 (Public Law 92-512 of 1972).

In an address to the nation outlining his policy on domestic programs, Nixon spoke about his New Federalism:

“For a third of a century, power and responsibility have flowed toward Washington, and Washington has taken for its own the best sources of revenue. We intend to reverse this tide, and to turn back to the States a greater measure of responsibility--not as a way of avoiding problems, but as a better way of solving problems.

Along with this would go a share of Federal revenues. I shall propose to the Congress next week that a set portion of the revenues from Federal income taxes be remitted directly to the States, with a minimum of Federal restrictions on how those dollars are to

be used, and with a requirement that a percentage of them be channeled through for the use of local governments.

The funds provided under this program will not be great in the first year. But the principle will have been established, and the amounts will increase as our budgetary situation improves. This start on revenue sharing is a step toward what I call the New Federalism. It is a gesture of faith in America's State and local governments and in the principle of democratic self-government.”
(Nixon 1969).

Susskind (1974) outlined three assumptions that underscore Nixon’s New federalism philosophy and policy. First, that state and local governments were constrained by the federal government’s preemption of their most productive sources of tax revenue. Second, that states and local governments were more qualified to address their needs than the federal government. And third, that the federal grant-in-aid programs had been serving a “self-indulgent bureaucracy (Susskind 1974, 35-37).

Based upon these underlying principles of New Federalism, it is useful to understand the overview that Conlan (1998) provides regarding the four strategic points of Nixon’s New Federalism: (1) Reforms of management processes to improve program efficiency and coordination; (2) consolidation of several federal grant programs into smaller block grants; (3) an expansion of the flexibility for states when using federal funds; and (4) the federal government would take on a larger role in areas where it was believed the federal government was the more efficient level of government to address the program and problem (Conlan 1998 3-4).

President Reagan also proposed the idea of New Federalism but his administration’s version would differ from Nixon’s. In the Reagan years, the emphasis was placed on cutting spending and reducing federal involvement in the program areas (Conlan 1998 4-5). The consolidation was significant; for example, in 1981 Public Law

97-35 was passed by Congress as an omnibus appropriation and consolidated seventy-nine Federal grant programs into only nine. These funds were channeled to the states, rather than local governments, and reduced funding by 25% (Walker, Richter and Colella 1982).

Coercive Federalism

Since the 1960s, more coercive models of federalism have also coincided with the Creative Federalism and New Federalism movements. As Conlan and Posner (2008) have observed:

“One of the most profound changes in American federalism has been the changing mix of policy instruments employed in federal-state-local relations, moving the system away from an almost total reliance on grants and incentives and toward instruments that impose sanctions on, preempt, or co-opt state and local authority” (Conlan and Posner 2008, 33).

Coercive Federalism was described by Kincaid as a result of considerations of national public policy “shaped by concerns about national and regional externalities and individual rights” (Kincaid 1996, 29). A primary characteristic of the Coercive Federalism is that of the unfunded mandate. The U.S. Advisory Council on Intergovernmental Relations (ACIR) explained that “in general, mandates arise from statutes, constitutional provisions, court decisions and administrative regulations or orders that demand action from subordinate governments under pain of civil or criminal sanctions.” The ACIR points out that another definition includes the financial element:

“Others view mandates from a broad financial perspective – considering the aggregate financial impact induced by a superior government. By this definition, mandates are interpreted as covering a wide array of governmentally induced costs” (ACIR 1990, 2).

As Conlan points out, from the 1960s to 1990s, there was an enormous increase in federal mandates. More than 60 new mandates were enacted, whereas previously only two mandates existed before 1960 (Conlan 2008, 34). The ACIR outlined the areas were

mandates, or federally induced costs are given to State and local governments from the Federal government by way of policy or action. These mandates include:

- Direct orders that mandate the State or local government perform an activity for which there is little or no federal funding.
- Federal regulations that allow state or local government enforcement if the state or local standards are equal to or higher than the federal standard.
- Prohibitions of state or local actions that could save state and local costs.
- Tax policies that make it more difficult or expensive for state and local governments to raise revenues, borrow funds, fund public-private partnerships, and privatize public functions.
- Court decisions or administrative regulations that impose an implied constitutional or statutory obligation for state and local governments to do or not do something.
- Regulatory delays and non-enforcement.
- Laws that expose state and local governments to liability lawsuits.

(ACIR 1994 v)

Coercive Federalism and mandates are not exclusive to the federal government toward the state and local governments. States may place coercive mandates on the local government as well. The ACIR provided several explanations for the rise in state mandates on local governments in the latter half of the 20th century, including: the professionalization and increased staffing of state governor's offices and legislature; an increase in interest groups involved in state policies; an increase in citizen's expectations for service delivery; a need to protect individual rights; and genuine deficiencies in the performance of local governments on a variety of policy issues (ACIR 1990, 3-5).

Based upon the federal policy areas listed above, the frustration over "unfunded mandates" became a rallying cry for state and local actors in the early to mid-1990s. This resulted in the Unfunded Mandates Reform Act (UMRA) of 1995, which aimed to relieve

the burden of unfunded mandates on state and local governments. Posner summarizes the impact of UMRA:

“UMRA established a new regime for Congress and the Executive as it considers legislation defined as unfunded mandates by the law. It strengthened requirements for CBO to estimate state and local cost and private sector impacts of legislation reported by committees, and it provided a point of order for those intergovernmental mandates exceeding a defined cost threshold or lacking a CBO estimate....As such, it was not an impenetrable barrier, but more of a “speed bump” that could be promote accountability which could potentially embarrass mandate proponents and rally opponents” (Posner 2007, 402).

Kincaid (1996) explained the irony of how the trends in Coercive Federalism are formed. He argued that Cooperative Federalism essentially led to Coercive Federalism because it removed the constitutional and political obstacles to federal involvement and created greater opportunities for national policy results. The idea or era of Coercive Federalism has not been traced along political party lines. The trends toward an increasingly coercive federal system have not been linked to either Democratic or Republic control of the white house or Congress (Posner 1998).

Trends of Coercive Federalism have dominated the 1990s and much of the early 21st century when looking at IGR in the United States. Posner points out that despite the indication that the presidency of George W. Bush might be a return to decentralization, in fact a more coercive direction took place. Examples include education, with No Child Left Behind mandates; welfare reauthorization, tax policy and homeland security provisions. (Posner 2007)

State-Local Government Study

Surprisingly, little attention is paid to intergovernmental affairs in the United States. This is despite the fact that there are few policy areas that do not impact multiple levels of government. Why is such little attention paid to such a complex area of study?

One possible reason for this lack of interest is that the concept of federalism is so deeply ingrained in the American way of governing, that analyzing intergovernmental affairs as a specific area of study seems unnatural, and is only done occasionally after a policy has been implemented (Walters 2005). In the study of American intergovernmental relations, it has been noted that there is a “blind spot” regarding state – local relations:

“Relatively few scholars know much about the constitutional, political, and fiscal ties that bind states and localities, and even fewer have much information about the complex interactions between the state and local governments engaged in the delivery of public goods and services. Research continues to suffer from this blind spot on state-local relations and, of course, so does the teaching of subnational politics” (Hanson 1998, 3).

Therefore, in an attempt to correct our vision, it is useful to revisit the historic foundations of state-local relations within our federal system. Due to the fact that the primary issue of this case study is between the relationship between the state (of Michigan) and local governments experiencing fiscal stress, it is important to develop a framework to better understand the state-local IGR dynamic. One of the first questions a policy analyst may address in the literature review is whether or not the state takeover of a local government is constitutional and grounded in historical precedent.

It may surprise casual observers of American political events to learn that local governments are not mentioned in any shape or form in the United States Constitution. Elazar (1962) explained that it is the states that provide the basis for the existence of local governments: “the State government is the source and central authority for all the local governments within boundaries” (24). The states formally provide this authority through the state constitution which, in turn, is made possible by state authority in the federal constitution. When it comes to state-local relations, state constitutions provide for local governments which “derive their authority from the state rather than the populace; the

legal setting of state-local relations is framed by state policies” (Stephens and Wikstrom 2007, 188). The basis for the scholarly interpretations rests in the framework developed of the United States Constitution and subsequent judicial interpretation, perhaps most notably a case that develop “Dillon’s Rule.”

Since local governments are not mentioned, the Constitution also does not advise the form of authority that should be possessed by local governments. Dillon’s Rule is perhaps the most prevalent interpretation of statute, but earlier courts had addressed the issue and consistently ruled in favor of state control of local governmental matters (Grumm and Murphy 1974). The Massachusetts Supreme Court ruled in 1816 that towns are “creatures of the legislation” and may exercise “only the powers expressly granted to them” (*Stetson v. Kemp* 1816).

Dillon’s Rule was the result of the decision in *City of Clinton v. Cedar Rapids & Missouri River Railroad* (1868). In the decision, Judge John Forest Dillon outlined an interpretation of the relationship state governments have with local governments:

“Municipal corporations owe their origin to, and derive their powers and rights wholly from, the legislature. It breathes into them the breath of life, without which they cannot exist. As it creates, so it may destroy. If it may destroy, it may abridge and control. We know of no limitation on this right so far as the corporations themselves are concerned. They are so to phrase it, the mere tenants at will of the legislature” (*City of Clinton v. Cedar Rapids & Missouri River Railroad* 1868)

Dillon would expand upon the theory behind his rulings in Iowa with an 1873 treatise, *Commentaries on the Law of Municipal Corporations* that would further outline his interpretation of the relationship between states and local governments.

Dillon’s theory on state supremacy over local government did not go unchallenged. Around the same time of Dillon’s ruling in Iowa, a competing legal argument was made in favor of retention of local government autonomy. The framework

that would become the “Cooley Doctrine” stems from Michigan Supreme Court Justice Thomas M. Cooley’s opinion in *People v. Hurlburt* (1871). In contrast to Dillon, Cooley declared that “local government is a matter of absolute right; and the state cannot take it away” (*People v Hurlburt* 1871).

The Cooley Doctrine argued that local governments possess the intrinsic right to self-government. Cooley believed that limitations on state supremacy occurred as a matter of law and principle. Cooley had previously outlined this argument in the inherent right for local governments to govern their own affairs in his *Treatise on Constitution Limitations* (1871). In his treatise, Cooley theorized that the people had delegated only a portion of their sovereignty to the state governments, while the remainder stayed with them in the form of a right to local self-government.

Another defense of local self-government came from Eugene McQuillin. In his treatise, *The Law of Municipal Corporations*, McQuillin outlined the history of municipal corporations and identified the right to local self-government to be a central theme. Like Cooley, McQuillin believe that local governments had an inherent right to self-government: “The right of local self-government, as an undoubted right of the people, is regarded as an inseparable incident to our republic form of government, and, therefore, all our constitutions assume its continuance” (McQuillin 1921, 558).

Amasa Eaton, a legal scholar focusing on municipal law, wrote in the *Harvard Law Review* a series of articles to demonstrate the right to local government. Eaton cited Cooley’s rulings in Michigan. Writing about the ruling from the Cooley court in Michigan:

“Let us rather put our proposition in this form: The state may mold local institutions according to its views of policy or expediency, either by general laws, or, at the request

of the affected locality, by special act; but local government is matter of absolute right; and the state cannot take it away” (Eaton 1900, 20).

Many states, in response to the arguments made in the Cooley Doctrine, began enacting constitutional amendments to defend local government autonomy. The drive for home rule began when Missouri adopted a constitutional home rule provision in 1875. Shortly thereafter, California (1879), Washington (1889), Minnesota (1896), Colorado (1902), Virginia (1902), Oregon (1906), Oklahoma (1907), Michigan (1908), Arizona (1912), Ohio (1912), Nebraska (1912), and Texas (1912) also established state constitutional authority for local government charters to be ratified by voters or the city council (Krane, Rigos, and Hill 2001).

There is often some confusion over the home rule concept. It has been noted that there is “perhaps no term in the literature of political science or law which is more susceptible to misconception and variety of meaning than ‘home rule’” (Chicago Home Rule Commission 1954). Some of this confusion is due to the term’s role as both a political motto as well as a legal doctrine (Sandalow 1964). To clarify, home rule adoption generally involves two parts: (1) the power of local government to manage local affairs; and, (2) the capacity of the local government to avoid state interference (Timmons 1993).

Richardson, Gough and Puentes (2003) conducted a study to determine which states have adopted Dillon’s rule to act as the statutory restriction on local governments and found that 39 states (including Michigan); but with some major caveats:

“However, in many cases, the legal treatises and foremost state authorities contain outdated, incomplete, or incorrect information. In some cases, state appellate court decisions suggest confusion on the part of state court justices on Dillon's Rule. The conclusions contained in this paper, therefore, represent the best data yet made available on Dillon's Rule. In some cases, legal judgment was exercised to classify particular states

in which the resolution of this issue was less than clear” (Richardson, Gough and Puentes 2003, 18).

Richardson Gough and Puentes found that of the 39 states that use Dillon’s Rule, 31 apply the rule to all municipalities; 8 appear to use the rule for only certain municipalities; and 10 states do not use Dillon’s Rule at all. The states using Dillon’s Rule were found scattered throughout the regions of the U.S. (18).

Academically and legally, history has favored the Dillon Rule and arguments over the Cooley-Eaton-McQuillin thesis (Frug 2001, 49). Dillon’s Rule and Cooley’s Doctrine held opposing views as to the level of self-government local governments should exercise. Both judges outlined their positions in their court cases in Iowa and Michigan, as well as articulate their points in the publication of treatises. The United States Supreme Court upheld Dillon’s Rule in *Atkins v. Kansas* (1903); *Hunter v Pittsburgh* (1907); and would further rule against the inherent right to local self-government in *Trenton v. New Jersey* (1923). Ultimately, the Cooley Doctrine and the inherent right to stronger local government control faded from prominence, with the exception of some rulings during the Burger court of the 1970s that retained some self-governance for local governments (Gelfand 1980). Overall, Dillon’s Rule and the idea of local governments serving as “creatures of the state” became the preeminent viewpoint for state-local relations.

While local governments are not mentioned in the Constitution, and Dillon’s Rule would affirm the state’s dominance in the state-local relationship, local governments are inherently the closest form of government to the people. Derthick (2001) explains that state governments would take on an expanded role in the late 19th century terms of

supervision, and eventually performance of local functions. However, previously, local governments dominated:

Local governments... built and maintained roads, maintained public decency and order, provided relief to the poor, taught children and raised taxes. In short, they did the things that connected people to the polity on a daily basis. The bedrock of American domestic government for a very long time was local. (Derthick 2001, 88).

The Tenth Amendment, traditionally thought of as the guardian of state power, may be looked upon for providing local government autonomy as well. In cases concerning the Tenth Amendment, especially during a period of new federalism in the 1990s, the Supreme Court had often ruled that the Tenth Amendment “reserves a zone of activity to the states for their exclusive control” (Chemerinsky 1997, 227), yet the Court remained rather silent to the amendment’s reference “or to the people” at the end of the brief text of the Tenth Amendment. Placing such a narrow focus on the dual federalism between the federal and state governments “ignores the elephant in the room” as Jake Sullivan (2003) explained, and the phrase, “or to the people” should not be thought as “merely surplusage” but rather, that “the final clause of the Bill of Rights tells us something about the structure of our republican government” (Sullivan 2003, 1937). Sullivan argued that inclusion of the phrase “or to the people” in The Tenth Amendment, based on the historical role of local government in the United States and the Tenth Amendment’s creation, equates to a constitutional protection for local government autonomy:

“as the provision implicitly authorizes the people to express their will through local communities, it consequently demands that they freely choose the organization of their town or city government. In this way, the Tenth Amendment grants the right of local self-determination” (1938).

While local governments are created and administered by the state governments, they may derive the formal authority from charters granted by the state. Similar to a federal or state constitution, charters represent the written laws of the local government. Charters (the word is derived from the Magna Carta of England in 1215) generally outline the government's boundaries, its structure of governance, revenue structure and other provisions that apply within the community. The "home rule" chartering system is defined by Graves as "The power of local government."

"Communities have the right to select their own form of governmental organization and either draft their own charter or select one to their liking" It may be adopted by legislative act, or by a constitutional provision which become effective only upon legislative implementation (Graves 1964, 700)

Home rule has been compared to as "mini-Tenth Amendments" that provide barriers around local matters; however few state court cases have held state legislatures as unable to intervene on local control matters. Home rule also have a function for power granting, as local governments are creatures of the states, "no powers arise simply from the fact that they are governments" (Barron 2001, 392)

In theory, home rule increases the level of independence the local governments have to govern themselves, although such charters are subject to approval or sanction from the state. Some IGR scholars have utilized Dillon's rule and/or home rule as a starting point to score local governmental unit's relative independence from the state (Weeks and Hardy (1984); Krane, Rigos and Hill (2001). However, other scholars reject utilizing the concept of Dillon's Rule and the designation of home rule labels as a means of determining the autonomy of a local governmental unit (Bluestein 2006; Richardson, 2003, 2011).

As Richardson points out, whether or not a state undergoes a home rule chartering system is not necessarily an indicator for local government autonomy. In an analysis of Dillon's rule vs. home rule states, Richardson (2011) found that a more comprehensive investigation of state constitution, state statutes, and court decisions provide understandings into the autonomy of local government. Richardson also found that the results were limited by variables such as political environment and fiscal constraints. To better understand the distinction between Dillon's Rule and home rule, it has been explained that Dillon's Rule is a statutory construction, while home rule may refer to the degree of the delegation of authority to the local government from the state (Bluestein 2006).

In conclusion, Dillon's Rule is a rule of statutory limitation combined with subsequent judicial interpretation, while home rule lacks a simple explanation. Richardson concludes that home rule and Dillon's Rule signify different ideas, each of which relates to local governmental autonomy, but in indirect ways. Dillon's Rule exerts limited influence on local government autonomy. The complicated nature of intergovernmental relations within the Federal system of governments results in difficulty in applying theoretical concepts to reality without considering the nuances of the complex intergovernmental relationships in the United States.

The Role of the Courts

The role of the courts and scope of their power in reviewing legislation and the actions of public administrators has been a source debate among researchers in the field of public administration. Courts have often been viewed or criticized for interfering with

administration. While the Supreme Court has the authority to review the legality and constitutionality of the Executive and Legislative branches activities, the extent of the judicial review and its consequences for administration have often been contentious matters (Hildreth and Miller and Rabin 2007, 704). Researchers have been especially concerned as to how the courts are able to make policy within their decisions, which in turn may have a great impact on administration of government (Barclay and Birkland 1998).

Court cases where the judge(s) have ordered and supervised administrative practice often raise concerns because this involves a pressure between the issues of constitutional rights and government practices. Examples of areas that researchers have looked into include the active judicial supervision that sought to remedy discrimination in schools or prisons schools that finds once implemented, judicially mandated federal court supervision of public institutions is not easily terminated (Wise and O'Leary 2003; Rosenbloom and O'Leary 1997).

There have been various ways to categorize how courts approach the review of legislation, regulation and administrative action. The contemporary view is to consider the relationship as a partnership between the administration and the courts; which at times has been a difficult partnership involving various levels of respect from the courts to the administrative interpretation of statutes and corresponding administrative processes. Rosenbloom (2000) viewed the relationship between the courts and legislature as partners in establishing values and goals. In regards to public administration, the courts, such as the case of a court-appointed receiver, may play a supervisory role over public administrations in the partnership that is formed (Bazelon 1976). As Rosenbloom

and O’Leary explain, the judicial supervision over public administration becomes complete, “when, in order to protect the newly established rights of individuals, the courts take over direction of the actual operation of a governmental institution or agency, such as a prison or school system” (Rosembloom and O’Leary 1996, 304).

Much of the literature on the role of the judiciary in public administration concerns administrative or regulatory law and the courts getting involved with schools and prisons to protect rights or enforce orders. There is less literature on the partnership between a judge and receiver during the complete takeover of large urban cities, most likely due to the relatively few cases to study in order to generate a concrete theory. This area will likely become a source of greater emphasis for future research, especially related to judicial involvement of the public administration of local government during a Chapter 9 bankruptcy filing or form of receivership.

Fragmented Federalism

While the previous sections have briefly traced federalism and IGR phases found in the academic literature, it is useful to understand the most current environment in which IGR is taking place. Intergovernmental relations in the United States remain complex – in the 2010 census, there were a total of 89,476 governmental units in the U.S., including 19,492 municipal governments and 16,519 townships (U.S. Census 2010). A review of the most recent intergovernmental relations assessments finds a further chaotic state of federalism in the United States than has ever seen before.

In the *Publius* Annual Review of American Federalism of 2011-2012, it was observed that a type of “bottom-up federalism” was the result of trends in economic,

political and judicial events, which caused states to deal with fiscal and social problems without federal assistance. (Gamkhar and Pickerill 2012). In the 2012-2013 Review Bowling and Pickerill (2013) summarized that the state of contemporary federalism eludes all previous definitions that attempted to simplify the system into basic models. The authors stated: “Policies, when agreement can be reached, are created by factions. Implementation occurs in fits and starts - fragments pieced together across and within conflicted institutions” (Bowling and Pickerill 2013, 316).

When the leading academic publication relating to IGR and federalism indicate that the current state of IGR is indescribable, it may have the potential to frustrate a public administration scholar trying to draw connections from interesting cases such as the emergency manager laws in Michigan as applied to Detroit. However, it may in fact be due to this confusion and chaotic nature of IGR that allows such phenomenon to take place in the vacuum created by such complexity. This trend of fragmentation and bottom-up federalism continued in Bowling and Pickerill’s 2014 Review, as they described that the state of federalism remains fragmented (Bowling and Pickerill 2014, 392). The conditions for state initiated bottom-up activism were addressed by Bowling and Pickerill. They explain that three conditions will exist for a bottom-up activism that is more ideologically extreme in nature: (1) Polarization and legislative gridlock at the federal level; (2) Polarization and unified government at the state levels; and (3) Strong safeguards of federalism for states and local governments (393).

This most recent notion of “fragmented federalism” concludes a great deal of study over the previous decades in which scholars have noted the increasingly complex nature of IGR. Some scholars have gone as far to say that the concept of federalism is

“bankrupt” and cannot be easily defined (Reagan and Sanzone 1981). Leach (1968)

argued that federalism, as the framers understood it, has never been made clear:

“Precisely what “federalists mean is not now and has never been clear. We can only be sure that the framers of the Constitution regarded it as one of the several ways to limit the governing in the United States....Federalism is thus something which is able to respond to changing needs and circumstances and is not bound by the tenets of a particular political theory” (Leach 1968, 9).

IGR Literature Summary

In the 1950’s, President Dwight Eisenhower called for a commission to study intergovernmental relations when he determined that the federal system of government had become too complicated and needed to be studied and controlled. The Kestnbaum Commission, a temporary commission on intergovernmental relations, was formed, and recommended that a permanent commission was required that would to confront and provide guidance on a broad range of questions affecting the federal state and local governments. The resulting commission, The Advisory Commission on Intergovernmental Relations (ACIR) was formed in 1959.

During its life, until its closure in 1996, the ACIR published 130 policy reports, 194 informational reports and conducted 23 public opinion polls on issues relating to intergovernmental relations (McDowell 1997, 113). The ACIR was terminated in 1996 due to the tough fiscal climate of the mid 1990’s amidst the reinventing government era, and the need for budget cuts (121). No other agency or commission has since taken on the role that the ACIR took in studying IGR. The elimination of the ACIR contributed to a significant deficit in the United States’ understanding of IGR, especially in an era when IGR became increasingly complex.

The United States has over half a million elected officials in over 88,000 local governmental units which are distributed across 50 states, the District of Columbia, 2 commonwealths and 4 territories, all with overlapping duties and collective responsibilities (Stephens and Wikstrom 2007, 6). With the incredible scope and complexity of governmental activity at all levels, it has been pointed out that it is unfortunate that the capacity to evaluate and observe intergovernmental relations has been hindered at the exact time when we require a greater level of understanding as to the complicated and numerous intergovernmental relationships (Conlan 2008, 4).

In this section of the literature review, we have briefly traced the history of intergovernmental relations and federalism in the United States and identified several key concepts that will be relevant in the theoretical analysis of the case study studied here. While certain theoretical perspectives and themes have emerged, this research paper takes the perspective of IGR is a complex concept in United States public administration. One important consideration is that the situation in Michigan with the placement of emergency managers in local governments is an outlier from the models, concepts or phases of IGR and federalism that were previously discussed. This uncharted territory is what makes this case study such a unique phenomenon and of particular interest to students of public administration and its relationship to IGR.

While this section has reviewed various models of IGR and explored a sample of the various phases of federalism in the United States, there is an important element to federal-state-local governmental relations that has not yet been discussed, and will be addressed in the next literature section - the increasing occurrence of local government fiscal crisis. Fiscal stress has taken place in many large urban cities during the latter half

of the 20th century and continued on in the aftermath of The Great Recession of 2007-2008. As we will see in the next section, the local government fiscal crises have exacerbated the already complex nature of intergovernmental relations. Analyzing the academic literature of local government fiscal crises will also be an important part of the analysis in that it will provide a context for comparing and contrasting the actions that have taken place.

Chapter Two Literature Review

Local Government Fiscal Stress

Charles Levine, a prominent scholar in the area of fiscal decline and cutback management, cautioned that “growth and decline are issues of a grand scale usually tackled by only the most brave or foolhardy of macro social theorists” (Levine 1980, 23). With Levine’s caution in mind, the following section will provide a brief overview of the local government fiscal stress that has gripped many local governments.

One important question when considering fiscal stress is exactly how that term should be defined. David Stanley, writing in 1980 about the cities in trouble, asked a simple question; what is trouble? Stanley defined “trouble, as “a fiscal situation so unfavorable as to impact borrowing ability, require reduction of municipal services, pose a threat to public health and safety, and thus diminish the quality of urban life” (95). Stanley further divided the city trouble into two main types: First, fiscal crisis, “in which the city has neither cash nor credit to meet near-term expenses such as payroll and supplies;” and second, “long-term decline, in which the city’s economy, social conditions and general enjoyment of life are slowly deteriorating” (Stanley 1980, 95).

While headlines of local governments collapsing into fiscal stress suggest that the phenomenon is a modern development, significant state intervention in local government fiscal affairs has taken place since the 19th century. In order to understand the history of local government fiscal crisis, it is helpful to understand the phases upon they have unfolded. According to the *Handbook of Local Government Fiscal Health*, there have been four eras of local government fiscal decline. These phases are outlined as: (1) municipal bond defaults of the 19th century; (2) the Great Depression; (3) the fiscal crisis

of larger cities in the 1970s and 1980s; and (4) the fiscal crises associated with the Great Recession. When considered together, “these historical events have shaped practitioners’ and academics’ understanding of how to define, predict and deal with fiscal health and stress” (Levine, Justice and Scorsone 2013, 47-50).

According to the ACIR, Mobile, Alabama was the first local government to default on its debt in 1838. In the two decades prior to the civil war, 19 defaults took place, primarily due to bank failures. Two distinct phases of local government debt default followed the economic crises in 1873 and 1893, and coincided with overly ambitious projections of railroad revenue growth and the “boom philosophy” of economic development that was prevalent at the time. As the number of defaults increased, representing nearly 25% of all indebtedness situations, the states began implementing limits on the borrowing ability of their local governments (ACIR 1973, 9-11). The limits on local government’s ability to borrow resulted in additional control of local government indebtedness, but also to spur the innovation of ways to circumvent the state-imposed limits. This included the creation of public authorities and other entities that could be kept off the balance sheet (Sbragia 1996).

In the 1870s, a few states imposed oversight boards or receiverships in cases of municipal default. The first such system that has been found in the literature involves Missouri in the mid-1870s. Missouri allowed creditors the option of accepting “compromise bonds.” If those bonds went unpaid they were to be redeemed through the appointment of an official with the power to assess and collect taxes necessary to pay the outstanding judgements. Tennessee likely appointed the first formal municipal receivership. The result was the disincorporation of Memphis and a transition into an

entity called the “taxing district of Shelby County.” In 1879, the Governor, Albert S. Marks, appointed a receiver as allowed under the Receivers Act of 1877 who was authorized to assume power and put the city’s financial affairs in order (McDonnel and Picker 1993, 36; Hillhouse 1938, 320; Weikart 2013, 390).

New Hampshire was also among the first states to take over the entire operations of a local government, when the city of Manchester was taken over in 1921 by a state financial control board (FCB) (Harvard Law Review 1997; Weikart 2013; Hren et al, 1998). Weikart describes FCBs as generally state-created agencies established by a legislative statute to oversee the improvement of the financial condition of a local government due to desperate fiscal conditions. FCB board members generally consisted of both public managers and private citizens who possess expertise in the fields of finance and accounting. The focus of FCBs is generally applied to the restructuring of debt to restore the local government’s credit standing, as well as financial reform to reduce the risk of fiscal insolvency in the future. FCBs often mandate cuts to local government services to balance budgets (Weikart 391). Examples of types of FCBs include the consent agreements that took place under the emergency manager statutes of Michigan (although without a private-sector presence), usually as a last step before an emergency manager is appointed; and more specifically, the case of New York City’s fiscal crisis in the 1970s.

The Great Depression that the United States experienced in the late 1920s and 1930s resulted in a wave of local government fiscal stress. The ACIR outlined the environmental factors attributable to the Great Depression that lead to widespread local government fiscal crisis. These include: (1) significant decrease in taxable income; (2)

bank failures; (3) increased demand for local government services for relief; and (4) rapid decreases in revenue from tax collection. In addition to the environmental factors forced upon local governments in the 1920s and 1930s, the local governments themselves made the problem worse with some practices. These practices include ignoring the overdevelopment of real estate, allowing deficits to accumulate for years and using short-term debt to fix significantly large operating deficits (ACIR 1973, 28). In the midst of the Great Depression and subsequent years, states dramatically increased the level of their control and intervention after multiple local units went bankrupt (Berman 1995). State intervention and increased control measures during local government crises is not a new phenomenon, but instead has a rather extensive historical precedent.

The 1970s and 1980s brought forth another wave of local government fiscal stress. The causes are complex and highly debated. Pammer (1990) grouped the various explanations into categories, such as population migration and the loss of tax base, urban political culture and public sector unions, the self-interest of public administrators in the budget process, and management problems inherent in local governments. Some or all of these elements may be found in the local government crises that took place in the 1970s. As part of the background and literature review portion, as well as the cross-case synthesis phase of the case study (see Chapter Three, Methodology and Chapter Four, Part Three), New York City will serve as the example of 1970s local government fiscal stress and the measures taken to address the financial emergency.

The Great Recession of 2008-2009 has brought forth another phase of local government fiscal stress. Assessing the latest phase of local government fiscal stress, Justice, Levine and Scorsone explain that:

“All that is old is new again: the current round of fiscal problems are varied but familiar in their mix of forms and causes.” Heavy debt accumulations, fallout from the exuberance of rapid growth and economic boosterism, persistent fiscal strain resulting from more rapid growth (or less rapid decline) of spending demands than available willingness or ability to pay, external shocks or cycles (intergovernmental as well as economic) and political and managerial behaviors all appear still to be important shapers of fiscal health. (Justice, Levine and Scorsone 2013, 50).

In the years after the Great Recession, by 2010, national trends found that states were receiving increasingly less revenue from states. The National League of Cities 2010 survey highlighting the financial situation for local government units in the United States, asked local financial officers questions about the emerging conditions they are currently faced with. The survey respondents answered that reductions in general aid (50%), decreases in state-shared revenues (49%), diminished reimbursement programs (32%), reductions in funding for activities and services that the local governments supply for the state governments (22%) and transfer of program responsibility from the state to the local government (17%), all contribute to the hardship and difficulty that local governments face (National League of Cities 2010).

Aside from the changing and more challenging environment local governments face in their relation to state governments, local government units face their own daunting challenges. Just under half (46%) of local respondents indicated that the housing market was now worse, with 65% answering that it is a major (19%) or moderate (46%) problem. Consequently, over 80% of respondents answered that the commercial property market is also a major (31%) or moderate (51%) problem for their local government.

By 2014, the financial picture in cities had improved somewhat, due to a recovering economy. Finance officers across the United States reported that fiscal conditions were improving as the impacts of the Great Recession continued to slowly

recede. In the 2014 National League of Cities survey, more city finance officers reported a status of improved conditions in the history of the survey. The majority of cities were increasing, rather than decreasing municipal workforce. 80% of city finance officers reported improved conditions in their local government's financial outlook versus the previous year. Property tax revenue was projected to increase at a rate of 1.6%, marking the first time in over five years positive growth was projected. Also, in line with the improving economy, sales tax and income tax revenues also continued to post increases. However, despite the good news brought forth by a recovering economy, long-term challenges lie ahead. Respondents cited infrastructure needs health benefit costs and pension costs as factors that will weigh most negatively on city budgets for years to come (National League of Cities 2014).

Causes of Local Government Fiscal Stress

There are several causes of local government fiscal stress. However, for large American cities, one of the largest historical factors for fiscal decline was that people moved from city centers toward the suburbs in large waves after World War II. Nechyba and Walsh (2004) outlined the changing landscape of America and the move toward the suburbs. Analyzing census data, they found that in 1790, only 5% of the population lived in urban areas. By 1950, over half of Americans lived in urban areas. Between 1950 and 1990 the United States experienced a tremendous change in where this "urban" population was concentrated. In 1950, approximately 65% of the urbanized population lived in central cities, with the remaining 35% living in suburbs. By 1990, those numbers were reversed, with the central city population reduced to only 35% and the suburbs now claiming 65% of urbanized population (Nechyba and Walsh 2004, 178-182).

By 1970, more Americans lived in the suburbs than central cities or rural areas. By 2000, more Americans lived in suburbs than central cities and rural areas combined (Hayden 2004, 10). At the dawn of the 21st century, the United States had become an overwhelmingly suburban nation. There are several reasons for this, and these reasons have had a profound impact on local government's fiscal health, especially large cities such as Detroit with a concentrated urban population.

Banfield (1974) summarized three basic forces that determined whether an urban area would experience growth or decline. The first force is demographic: when a city's population increases, it must expand in some direction, possibly upward, but generally outward. The second force is technology, because it is possible to transport people outward by train and automobile, but not upward or downward, then the city will in fact expand outward. The third force is economic; if wealth is distributed so that some people have the opportunity to live farther, and can afford the time and money the longer commute will bring forth, then they will venture further out (Banfield 1974, 24).

Technological innovation in transportation and communication has always been at the forefront of population changes. Just before the dawn of the 20th century, Kingsbury (1895) was alarmed at how technology could change the makeup of cities, including the emergence of the trolley, the bicycle, and the telephone, which he claimed would add from five to fifteen miles to the radius of every large town (Kingsbury 1895). Academic inquiry to understand this development was examined in Harlan Douglass' (1925) research describing the evolving trend of subordination. He characterized the emerging movement:

"It straddles the arbitrary line which statistics draw between the urban and rural spheres, but in reality it is the push of the city outward. It makes physical compromise with

country ways but few compromises of spirit. It is the city trying to escape the consequences of being a city while still remaining a city. It is urban society trying to eat its cake and keep it, too” (Douglass 1925, 5).

Moving on from the era of bicycles and trolleys, the automobile would have a profound effect on population changes. Writing for the National Resources Committee in 1937, William F. Ogburn wrote that “the invention of the automobile has had more influence on society than the combined exploits of Napoleon, Genghis Khan, and Julius Caesar” (Ogburn 1937, 4). Suburbanization scholar Kenneth Jackson would state that the automobile “so vastly changed the equation that cities began to come apart economically and functionally even as they had earlier come part legally with the breakdown of annexation.” Jackson would go further, stating that “the automobile had a greater spatial and social impact on cities than any technological innovation since the development of the wheel” (Jackson 1985, 88).

In many ways, the eventual innovation and dominance of Detroit in the automotive industry would spur demographic shifts that would create fiscal difficulties for large urban cities. Ironically, Detroit’s innovation in the automotive industry was a contributing factor for the population shifts it was unprepared for, and that would ultimately lead to its fiscal demise. The automobile was a key component of the trend toward suburbanization. As urban management scholars Ross and Levine commented:

“The automobile revolutionized urban form, as suburbanites no longer needed to live in close proximity to streetcar and railway lines. New suburban housing spread to fill in the spaces between the ‘fingers’ or spokes of the streetcar and rail systems. With the automobile, commuters could also live at considerable distance from the central city. Industrial and commercial enterprise followed the shift to suburbia. Manufacturers, seeking the space for assembly line production were attracted to the relatively low price of undeveloped suburban land. The rise of the trucking industry soon led to an exodus of warehousing and distribution activities out of the central city.

Beginning in the 1970s, advances in cargo containerization further accelerated the suburbanization of warehousing and distribution, as narrow, congested city streets and

old central-city warehouse with their small loading docks could not handle the new shipping technologies” (Ross and Levine 2012, 29).

Aside from technological advancements, the federal government had policies that encouraged movement away from cities and toward the suburbs. Scholars have pointed out that FHA housing loans for new suburban homes; and the construction of the federal highway system created a strong economic development connection and agenda towards suburban expansion (Jackson 1988; Hayden 2004; Campbell and Shalala 1970). The federal government advocated for population migration from city centers toward single family homes in the suburbs. When coupled with the advances in technology, especially the automobile and communication systems, the result was a rapid expansion into suburban development that was encouraged by the federal government, but without a comprehensive strategy to address the negative effects of such a large scale transformation.

Many academic studies place the greatest emphasis on technological transportation improvements that made commuting easier, including the rise of the automobile culture and highway and road building, which reduced commuting time and cost (Alonso 1964; Mills 1967; Muth 1969; LeRoy and Sonstelie, 1983; Baum-Snow 2007; Kopeccky and Suen, 2010). However, other studies have focused more on residents - especially white middle and upper class residents - leaving cities to escape rising crime rates, declining schools, blight, fiscal mismanagement, and an increased presence of racial minorities and the poor (Bradford and Kelejian 1973; Frey 1979; Marshall 1979; Grubb 1982; Mills and Price 1984; Cullen and Levitt 1999).

While these academic theories and models either exclude or reach mixed conclusions regarding the role of racial diversity, other academic researchers and

historians place more emphasize on the connection between racial diversity and white flight toward the suburbs (Jackson 1985; Massey; 1990; Sugrue 2005; Meyer 1999). Further discussion about the phenomenon of white flight and the impact it had on Detroit will be discussed in the Detroit-specific section of the literature review.

The political climate and local governmental structure also have been studied as causes for predicting overspending and fiscal stress. In a case study of New York and Chicago in the 1970s, it was found that strong party organization and control enabled Chicago to avoid giving in to demands of special interests in the form of additional spending, unlike the case of New York City (Fuchs 1992). Schefter (1985) observed that coalitions that were politically weak and pieced together would often need to put supporters on the payroll and fund projects favored by business community allies.

Schefter (1985) also identified three circumstances that encourage cities to increase their expenditures at an alarming rate that may lead to fiscal crisis: (1) a group has recently gained political power and begins to assert claims upon the government for greater public benefits; (2) the government responds to these claims because they are allied, or cannot withhold opposition; and (3) the government is too politically weak to finance these new claims by reducing the flow of benefits to other groups or raising taxes.

Aside from the political climate, the organizational structure of a governmental unit may have some effect on whether or not it overspends. Persson, Roland and Tabellini (1997; 1998; 2000) found that overspending is more probable in parliamentary systems of government than in presidential systems, due to a lower threshold for separation of powers. Focusing on local governments, the political dynamic of increased spending to appease constituents may also stem from how a local government is structured;

specifically how the elective legislative body is structured. Some academic studies have found that more legislators involved in the city council leads to a larger amount of city spending per resident (Baqir 2002; Inman 1995).

Local governments are often restricted in what forces they have control over when a fiscal crisis strikes. Ross and Levine, studied the actions of the key actors involved, rather than the public office itself. They brought a focus on the impact that globalization has on the management of urban cities; with the conclusion that global forces restrict some of the impact local leaders may have over their localities (Ross and Levine 2011). This is an important consideration and will be further discussed when we focus on the situation of Detroit and its historic vulnerability to the forces of globalization.

Local governments are historically reliant on property taxes for revenue. Therefore, a significant impact on property tax collection will adversely affect a city's financial situation. According to the U.S. Census 2012 reporting, taxes account for 49% of general revenue for state governments and 40% of general revenue for local governments. Of local government general revenue generated through taxes, property taxes are far and away the primary revenue producer, accounting for 73.6% of local government revenue in the United States (U.S. Census Bureau, Annual State and Local Government Finances, 2012).

The weakened housing market that resulted from the Great Recession took a tremendous toll on local governments, and those effects were long-lasting. A 2013 Pew Trust study explains that local governments were among the last to emerge from the economic devastation of the Great Recession due to the lag time between the drop in home values and the decline in property tax revenue. At the same time, states were

cutting aid to local government to address their own budget shortfall issues. It was these two factors, which account for over half of local government revenue that dropped simultaneously for the first time since 1980 (Pew Research Trust 2013). Additional studies following the housing market collapse in 2007-2008 found that dramatic declines in housing prices did not correlate with immediate decline in tax revenues, due to the lag time between declining housing conditions and property tax assessments (Lutz, Molloy and Sham 2010; Doerner and Ihlanfeldt 2014).

Local Government Fiscal Stress - Predicting and Intervening

Cahill and James (1992) described three types of state power over local government's financial condition: (1) power by a state agency to displace local government decision-making; (2) power over a wide range of concerned parties assigned to roles; and (3) advisory power. Historically, state governments are troubled by local government fiscal problems because a fiscally poor performing local government may have a negative impact on state bond ratings and because the states distribute revenue to local governments and require accountability (Kloha, Weissert, and Kleine 2005, 314). Research of New York City's narrow avoidance of municipal bankruptcy in the 1970s revealed that bond ratings for the surrounding area were negatively impacted by the city's financial woes (Gramlich 1976; Kidwell and Trzcinka 1982). The effect that municipal crises have on the bond market is often referred to as "contagion." As summarized by Pericoli, Marcello and Sbracia (2003) contagion is the disruption in one section of a market that overflows into another.

In addition to the risk of contagion, there is also a potential for "headline risk." Headline risk occurs when the mere mention of potential bankruptcy points to a

perceived breakdown of leadership, at both local and state level, that may negatively impact the credit ratings for the state and surrounding local governments (Bateson and Scorsone 2012). Headline risk is similar to the panic that takes place in the stock market when the difficulties of a few large companies are perceived to be indicators or issues for an economic sector or even the entire national economy.

A 1973 report published by the ACIR examined the fiscal health of cities and identified six indicators of fiscal stress: (1) An imbalance in the operating fund; (2) patterns of expenditures exceeding revenues over several years; (3) operating liabilities that currently exceed assets; (4) short-term operational loans that are outstanding at year's end and borrowing cash from restricted funds; (5) an increasing rate of property tax delinquency; and (6) significant decreases in assessed values (ACIR 1973).

In the 21st century, local government fiscal crisis is a constant threat. Based upon a survey administered to members of the National Association of State Auditors, Comptrollers and Treasurers in 2002, 26 of the 50 states reported that one or more local governments had recently experienced a fiscal crisis, and ten states had developed formalized definitions as to what constituted a fiscal crisis (Honadle 2003). To cope with the increasing fiscal stress placed upon municipalities, some states have taken steps to measure or predict financial crisis. Due to negative consequences such as contagion and headline risk that may spread to other communities, states have additional incentive to intervene in local government fiscal crises.

Kloha Weissert, and Kleine (2005) found that 15 states measure local governments fiscal condition in some manner; first by measuring whether a fiscal distress situation is currently occurring, and second by predicting if a distress situation will occur.

Coe (2008) examined nine states that predicted fiscal distress and identified three best practices. First, states should predict fiscal crisis rather than to wait for it to happen. Second, after detecting a potential fiscal crisis situation, states should assist local governments to prevent the situation from developing into a full crisis. And third, if a situation reaches crisis levels, states should have the power to require local governments to take corrective action, not simply request it (Coe 2008, 760).

More recently, a 2013 Pew Research Trust study discovered that 19 states had enacted statutes that allowed the state government to designate a local government fiscal stress situation; 25 states have bankruptcy authorization and 20 have an intervention program (Pew Research Trust 2013).

Cutback Management

Government growth was the norm following the booming post-World War II years. However, around the mid-to late 1970s, academics became concerned with what lay ahead. Boulding (1975) examined the future of education funding, and referred to an upcoming “management of decline.” Writing in the late 1970’s, Levine would warn about the coming era of tough decisions that would affect public organizations:

“So great is our enthusiasm for growth that even when an Organizational decline seems inevitable and irreversible it is nearly impossible to get selected officials, public managers, citizens or management theorists to confront cutbacks and decremental planning situations as anything more than temporary slowdowns” (Levine 1978, 317).

Lewis (1984) examined changes in patterns of revenue and expenditure patterns of six fiscally healthy and six fiscally troubled local governments between 1964 and 1979. He found that outside of capital spending changes, revenue patterns are not significantly related to changes in expenditure patterns. The underlining theory being that

cutback strategies use the same strategies as those under budget expansion; incrementalism, or in this case, decrementalism, still predominates the decision process of public organizations.

Allen Schick (1983) also explored the trend of decrementalism budgeting. He wrote that the previous era of incremental budgeting was facing a tipping point when budgets would begin to feel constraint, followed by a period of decline. Schick questioned whether decremental budgeting was simply incremental budgeting in reverse. He concluded that decremental budgeting was more complex and would result in a new era of conflict between agencies and stakeholders and would likely to be far more unstable than before. Schick argued that a theory was needed to help public administrators navigate the difficult new terrain they encountered, as well as a guide for when cutback strategies should be used.

Plant and White (1982) analyzed the political considerations involved with cutback budgeting and identified five strategies that are involved in cutback budgeting: (1) initiate across the board cuts; (2) improve productivity; (3) eliminate vulnerable programs and activities; (4) privatization; and (5) link resources to the goals. Plant and White also provided two strategies to develop political alliance and navigate the challenging cutback management environment. The first involves developing support among the technical financial experts, both within the governmental unit and within the external private business community. The second alliance strategy calls for a concentration on citizen support and to identify which programs have widespread public support (Plant and White 1982, 66).

Berne and Stiefel (1993) also studied the effect of education cuts in New York City. They concluded that short-term decisions in cutback management, such as salary cuts, would often have only short-term impacts. However, when the cuts were targeted on capital expenditures, maintenance expenditures and total numbers of positions, the impacts were longer-term. This study found that public managers in decision-making roles in a cutback management environment may want to be careful when addressing short-term budget issues; and moreover, be mindful of the possible negative consequences short-term thinking has on long-term viability. The results of Berne and Stiefel's research synthesize with Plant and White's emphasis on political strategy for effective organizational cutback management. A key takeaway from these studies is that local government officials should stay away from the traps of short-term impacts at the expense of long-term solutions; pitfalls that may jeopardize the political alliances needed in cutback management.

Schefter (1980) explains that retrenchment is a result of fiscal crisis where a local government eliminated nonessential public expenditures. Schefter describes two "fundamental routes in which this may take place: The first, "the path of political organization and internally imposed discipline, preserves at least the forms of democracy. The other, the path of political contraction and externally imposed discipline, does not" (Schefter 1980, 92).

In the modern era, it seems as though we are inundated with news about state and local government budget shortfalls and impending crises. Osborne and Hutchinson (2004), referred to this new era as one of perpetual fiscal crisis and coping with turbulent environments. Assessing the literature of cutback management and fiscal stress,

Scorsone and Plerhoples (2010) concluded that there is a dichotomy between the research regarding tax strategies and that of budget cutting that limits the effectiveness of any analysis. The authors, after reviewing cutback management literature from the 1970's and 1980's, advised public managers to be more introspective, look into an organization's reason for existence, as well as placing a greater emphasis on engaging external and internal stakeholders during the process.

Municipal Bankruptcy in the United States

The most extreme form of fiscal crisis is the threat of a municipal bankruptcy. A comprehensive overview of municipal bankruptcy law in the United States is beyond the scope of this section, and dissertation; however, a brief overview will provide context for the future analysis of decision-making in the serious step in whether or not a municipality files for bankruptcy. In a way, the option of municipal bankruptcy paved the way for increased state intervention in local government fiscal emergencies. The Tenth Amendment to the Constitution states that:

“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”

Because of the Tenth Amendment, the federal government plays a relatively small role in monitoring the fiscal health of local governments. The Supreme Court ruled in *East St. Louis v. ex Rel Zebley* that this prevented the federal government or court from interfering with local governmental decisions about spending (Weikart 2013, 388). It was not until the 1930s that the United States began to address the possibility of some level of federal involvement via the court system and municipal bankruptcy. As McConnell and Picker examined municipal bankruptcy in the University of Chicago Law Review:

“Prior to 1933, there was neither state nor federal municipal bankruptcy legislation. Indeed, it appeared, for a time, that the Constitution prevented either level of government from touching the subject. For the federal government to do so would intrude into the internal governance of states and their political subdivisions and thus violate state sovereignty. For the state government to do so would impair the obligation of contracts (something the federal government may do but the states may not)” (McConnel and Picker 1993, 425).

In 1934, Congress passed the first municipal bankruptcy law due to the widespread issues local governments faced meeting their obligations during the Great Depression - Public Law No. 251, 48 Stat. 798. 1934. The Supreme Court ruled the 1934 Act unconstitutional due to an improper interference with the sovereignty of the states in *Ashton v. Cameron County Water Improvement Dist* 1936. Congress tried again in 1937 with a revised Municipal Bankruptcy Act, Pub. Law No. 302, 50 Stat. 653. 1937, and this time it was upheld by the Supreme Court via *United States v. Bekins* 1938. In 1942, the Supreme Court case of *Faitoute Iron and Steel Co. v. Asbury Park* upheld the authority of states to compel unwilling creditors to join in a plan of adjustment of municipal debts.

A key difference between Chapter 9 and Chapter 11 bankruptcy is due to the federalism inherent in the United States. As Weikart explained, “because of the nature of our federal system, the federal law covers municipal bankruptcy with this caveat – state autonomy results in a narrow federal scope of municipal bankruptcy law as compared to private bankruptcy” (Weikart 2013, 389).

The most extreme form of fiscal stress local governments face, is the prospect of filing for a proceeding of municipal debt adjustment under Chapter 9 of the Bankruptcy Code - 11 U.S.C. § 901. In 1976, Public Law 94-260 revised the bankruptcy code; among the most important changes was removal of the requirement to obtain consent from 51%

of the creditors, which was the provision that kept New York from using bankruptcy as an option the year before, during that city's historic financial crisis.

Under Chapter 9 of the Bankruptcy Code, the local government must meet five criteria to file for bankruptcy: (1) the municipality must have specific authority to file for Chapter 9 bankruptcy under state law; (2) the municipality must be insolvent; (3) the municipality must prove that it wishes to adopt a plan to adjust its debt; (4) the municipality must fulfill conditions to show that it has gained, or tried to obtain an agreement with its creditors, or that it's not feasible to negotiate; and (5) the municipality must be able to show that it filed for bankruptcy in good faith (Dabney et al 2012).

The general purpose of Chapter 9 bankruptcy is to provide municipal governments in financial crisis with protection from creditors while it develops and negotiates a plan for adjusting its debts. The reorganization of municipal debts may be achieved by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining new loans. Chapter 9 bankruptcy is significantly different from Chapter 11 bankruptcy because there is no provision in the statute for municipal asset liquidation and subsequent distribution to the creditors. A federal court mandated liquidation of municipal assets would likely violate the Tenth Amendment to the Constitution and impede the states of sovereignty over their internal affairs.

Chapter 9 bankruptcy proceedings are generally not as active as in corporate reorganizations under chapter 11. The functions of the bankruptcy court in chapter 9 cases are mostly limited to determining eligibility and approving the bankruptcy petition, confirmation of a plan for debt adjustment, and ensuring the implementation of the debt adjustment plan. However, "municipalities may consent to have the court exercise

jurisdiction in many of the traditional areas of court oversight in bankruptcy, in order to obtain the protection of court orders and eliminate the need for multiple forums to decide issues” (United States Courts – Chapter 9, Bankruptcy Basics).

While the city of Detroit’s 2013 filing for bankruptcy was the largest in the history of the United States, local governments filing for bankruptcy are overall quite rare. One recent analysis found that since 2008, only 0.06 percent of general purpose local governmental units have filed for bankruptcy – roughly one for every 2,710 (Maciag 2013). A 2013 Pew Research Trust study found that of the 55,000 municipal governments that sell bonds, less than ten file for bankruptcy each year. Bankruptcy among local governmental units is quite rare. The Pew study points out that most bankruptcies generally have a single cause that stands out: a bad investment decision such as Orange County, California; a failed infrastructure project such as Jefferson County, Alabama and Harrisburg, Pennsylvania; an expensive legal decision as was found in Mammoth Caves, CA; or astronomical rising pension costs such as found in Central Falls, RI (Pew Research Trust 2013, 7).

Recent Cases of Local Government Fiscal Crisis

The following four cases represent examples of recent local governments in a fiscal crisis.

Stockton, California

Until Detroit filed for bankruptcy in 2013, Stockton, California held the record as the largest populated city to file for Chapter 9 municipal bankruptcy. According to a non-partisan think tank, California Common Sense, there were three causes of the Stockton fiscal collapse and eventual bankruptcy filing. First, a devastating collapse in the housing

and financial markets decimated the property tax base. Second, the city signed very generous employment agreements that dramatically increased expenditures during the mid-2000s, which would turn out to be the worst possible time – right before the financial and housing market collapse - by 2012 Stockton’s unfunded pension liability was \$413 million and climbing. And third, an equally poorly-timed bond offering that took place right before the financial market crash (Evans, Kosenko and Polyako 2012). Housing prices fell dramatically in Stockton, which decimated the property tax collected.

The City of Stockton has a council-manager form of government, in which one of the council members is elected as a mayor. The mayor appoints a city manager who the city council has to formally approve. The Council possesses the majority of the power within the city governmental structure and as the Stockton City Charter states, “The City Council shall be the governing body of the municipality. All powers of the City shall be vested in the Council” (Stockton City Charter 2015). The State of California took a relatively hands-off approach to Stockton’s fiscal crisis. There was no large-scale intervention by the state and Stockton was generally left to find a solution on its own. Ultimately, The Stockton City Council voted by a 6-1 margin to file for bankruptcy in June 2012, which called for the city manager and attorney to prepare the paperwork for a Chapter 9 filing. Unlike Detroit’s bankruptcy filing, there was no real state involvement or removal of local democratic control in the city of Stockton.

Harrisburg, Pennsylvania

The major fiscal problems in Harrisburg, Pennsylvania can generally be traced back to an incinerator that was built in 1972. Although the original cost of the incinerator was under \$15 million, it would ultimately require multiple repairs and several rounds of

refinancing that would eventually leave Harrisburg with \$94 million in debt by the time the Federal government shut it down in 2003 due to air pollution issues (Cooper 2010).

Buntin (2010) provides a vivid account of the ordeal. Local environmental advocates wanted the incinerator to remain closed for health reasons; however, due to the outstanding debt that had ballooned to over \$100 million, the city of Harrisburg's elected leaders decided to forge ahead and issue \$120 million in new debt to retrofit and expand the facility in order to generate new revenues to make up the money that was lost over the last 40 years of incinerator issues. Essentially, the city doubled down on an already poor decision, in order to hopefully make up for the previous mistakes. The contract to retrofit two of the boiler units and build a third was awarded to a company named Barlow Projects, Inc., which offered to build the new facility for one-third less than any other offer. It turned out that there was a reason for this, as the company had never completed such a large project and would soon be overwhelmed. There were repeated cost overruns and missed deadlines by the contracting company. The project ended with the mayor of Harrisburg, Steve Reed, firing the contractor after a hostile meeting (Lucinew 2011). By that point the incinerator project was nearly \$300 million dollars in debt, an incredible sum for a city as small as Harrisburg – the capital has a population of fewer than 50,000.

The Harrisburg city council, by a 4-3 vote, directed the city attorney to file for Chapter 9 bankruptcy in 2012 in order to obtain relief from the massive municipal debt that resulted from the multiple failed incinerator projects. However state officials and the mayor opposed the filing, arguing that the Harrisburg City Council did not have the authority to do so. The U.S. Bankruptcy Court in Harrisburg agreed, stating that the city did not follow the state's procedures for filing bankruptcy. The state was then placed

under receivership after being designated as a distressed municipality under what is known as Act 47, Public Law 246, No. 47, formally known as the Municipalities Financial Recovery Act.

While several cities in Pennsylvania have been designated as “distressed,” under Act 47 at the time, Harrisburg was the only city that has been placed under receivership, which was authorized by section 702 of Act 47. Under Act 47 the Receiver cannot personally levy taxes, or modify debt, but they can petition the Court to force the elected local officials to comply with the recovery plan until it approved in court. The Harrisburg City Council sued the state of Pennsylvania in Federal court, with the claim that the receivership under Act 47 violated their civil rights. As of early 2015 there were 19 municipalities declared distressed that had to develop Recovery Plans as required by Act 47; however the only city to fall under state receivership was Harrisburg (Pennsylvania Department of Community and Economic Development website 2015).

Central Falls, Rhode Island

Due to rapidly increasing pension costs, the city of Central Falls, Rhode Island found itself in the a fiscal crisis by 2009. In 2010 the scope of the city’s crisis was laid out in Rhode Island Superior Court Case of *Pfeiffer v. Morneau*. In 2010, Central Falls total net assets were -\$16,866,819 and an operating budget of approximately \$18 million. The projected shortfalls were \$3 million for 2010 and \$5 million in 2011. The accrued pension fund liability was \$35 million in contrast to just \$4 million in assets. In fact, the city did not even make a contribution to the pension fund in 2009, even though they were required by law to make a \$2.7 million dollar contribution that year. Even if the city increased the property tax to the maximum that Rhode Island state law would allow, it

would only generate a projected \$500,000 in additional revenue. With no other course of action, the city sent a request to the Rhode Island General Assembly to allow them to file for Chapter 9 bankruptcy to adjust the municipal debt.

On July 16, 2010, the Rhode Island Department of Revenue appointed Mark Pfeiffer as receiver for the city. Three days later, the new receiver Pfeiffer wrote a letter to the Mayor of Central Falls, Charles Moreau informing the mayor that he had been appointed receiver and would essentially be removing him from office. To this effect, Pfeiffer would write:

“R.I. Gen. Laws 45-9-7 provides the receiver with ‘the right to exercise the powers of the elected officials’ of a municipality and that the ‘powers of the receiver shall be superior to and supersede the powers of the elected officials’. That statute further provides that the elected officials of the city or town ‘shall serve in an advisory capacity of the receiver’.

Effective immediately, I have assumed the duties and functions of the Office of Mayor. As a result of my role, your responsibility will be limited to serving in an advisory capacity, on such occasions as my office may seek input from you. Accordingly, pursuant to R.I. Gen Laws 45-9-6 (g) your compensation will be reduced to \$1,000 bi-weekly effective today”
(*Pfeiffer v. Moreau* 2010, 6).

Central Falls emerged from bankruptcy in September 2012, after a debt-adjustment plan was approved by Judge Frank J. Bailey. The plan ensure that bondholders were repaid in full by raising taxes on residents and making large cuts to employee pensions and other benefits (Bidgood 2012).

New York City

Before Stockton and Harrisburg and Detroit there was New York City. Prior to Detroit, the largest example of a municipal government in fiscal crisis was New York City in the mid-1970s. Running massive deficits and unable to meet its obligations, New

York City would fall under partial state control under a state Financial Emergency Act. This special state legislature legislation was part of a plan to provide over \$2 billion to the troubled city to meet its cash requirements and provide time for a restructuring plan to take place. The key element in the plan was the Emergency Financial Control Board which was dominated by state appointees who were tasked with overseeing the city's finances (Congressional Budget Office 1976).

New York City's financial trouble was not a new phenomenon of the 1970s. On three occasions in New York City's history, 1871, 1933 and 1975, the increase in spending to keep political constituencies happy led to fiscal crisis, which enabled banks owning the city's debt to insist that municipal expenditures be drastically reduced as part of a bailout plan (Schefter 1985). Shalala and Bellamy (1976) outlined four basic causes for New York's fiscal crisis in 1975: (1) Changing demographics and economic characteristics; (2) national economic difficulties; (3) state and federal government actions; (4) inaction and weakness in the political system (1119).

The case of New York City's fiscal crisis in the 1970s will be discussed in further detail to provide comparison to Detroit's fiscal crisis in Chapter Four, Part Three.

Local Government Fiscal Stress Summary

In this section we have briefly discussed some of the trends of fiscal stress as found in the literature. Some recent examples of cities in financial crisis were highlighted. Local governmental fiscal stress continues to be an issue in the United States. In the next section, the challenges the City of Detroit has faced will be highlighted. Researching the root causes of Detroit's fiscal decline will enable a better

understanding as to how the city was placed on a path toward fiscal stress, which resulted in the appointment of an emergency manager whose arrival would temporarily suspend democracy in the city. As Detroit is by far the most prominent example of the state takeover and placement of an emergency manger, the city's path toward financial crisis will be provided further detail in Chapter Four, Part Two. .

Chapter Two Literature Review

Detroit's Economic and Administrative Challenges

“If ever a city stood as a symbol of the dynamic U.S. economy, it was Detroit. It was not pretty. It was, in fact, a combination of the grey and the garish: its downtown area was a warren of dingy, twisting streets; the used-car lots along Livernois Avenue raised an aurora of neon.

But Detroit cared less about how it looked than about what it did—and it did plenty. In two world wars, it served as an arsenal of democracy. In the auto boom after World War II Detroit put the U.S. on wheels as it had never been before. Prosperity seemed bound to go on forever—but it didn't, and Detroit is now in trouble” (*Time Magazine* 1961).

As the headline of Time Magazine declared in 1961, Detroit had been perceived to be in decline for quite some time. The factors leading to Detroit's fiscal decline are complex as is the case with the financial decline of any major city. A comprehensive treatment of Detroit's decline is beyond the scope of this section; however, it is important that a foundation is outlined for a better understanding of the environment in which the emergency financial laws were created is provided. As will be demonstrated in this section, and to a degree in Chapter Four, many of the factors that led to Detroit's fiscal decline involve forces that are generally beyond the scope of local government officials to deal with.

Background

The land area that would become the city of Detroit was born as a trading post, due to economic opportunity and global demand. Beaver fur hats made a stylish appearance among high Parisian society in the 1570s, and with the European continent's native beavers nearly extinct, the numerous rivers in the “New World,” which were abundant with beavers, became a potentially lucrative investment for enterprising European businessmen (Bunker 2010). The area that would become the city of Detroit

was settled in 1701 by French explorer Antoine de la Mothe Cadillac after he secured a grant from Louis XIV to develop a fur trading fort that would serve a dual purpose of keeping an eye on the British, France's long-time enemy. The name, "Detroit" means "the strait," and the strategic significance of the location and access to the many waterways was a key selling point that Cadillac provided to Louis XIV (Burton 1922). And so, the French settlement of Detroit was a result of global demand of beaver furs and the rivalry with the British.

After the French and Indian War ended with the Treaty of Paris in 1763, the British were given control of the French territory east of the Mississippi including the future state of Michigan and its largest city, Detroit. Following the American colonies' victory in the Revolutionary War, the frontier territory of Detroit and Michigan would become part of the new United States of America in 1783. The Detroit area remained a mostly remote frontier outpost for trade until advancements in transportation technology provided the area with a larger role to play. Completion of the Erie Canal in 1825 connected Detroit to the eastern seaboard and "gave the Detroit trade a new impetus" (Burton 1922, 501).

Michigan became a state in 1837 and the state's agricultural and timber industries would include an increasing number of industrial manufacturing jobs, especially in Detroit. The city of Detroit's famous historian, Clarence Burton, described Detroit's destiny as a manufacturing hub:

"Nature ordained that Detroit should be a great manufacturing city. Its situation on the strait connecting the upper and lower lakes, assuring easy access to the raw materials from forest, soil and mine, its location at the gateway through which east and west passenger and freight traffic would naturally go; the infusion into its population of the best blood of New England, New York and Ontario – these elements all combined to forecast for the place a secure industrial position" (Barrow 1922, 529).

The reliance on manufacturing in Detroit predates the rise of the automobile. In the latter half of the 19th century Detroit had become a leading producer of items made of iron, brass and other metals. By 1900, Detroit's six large cast-iron stove companies represented over 10% of the entire United States stove and furnace production (Gavrilovich and McGraw 2006, 164).

The automotive industry was not originally focused around Detroit. From 1895-1900 there were 69 entrants in the emerging automotive industry; none of which were located in Detroit (Smith 1968). The Packard Automotive Company moved from Ohio in 1900, and Old Motor Company opened in 1901. Ford would be established in 1903. General Motors established in 1908, which combined Buick, Olds and Cadillac components. By 1913 the number of automotive firms in Detroit reached 41. The number of U.S. automotive firms peaked at 272 in 1909, which included major companies in located in Ohio and New England (Smith 1968; Klepper 2007).

Detroit firms began to pull away from the rest of the country during the 1910s. By 1915, 13 of the United States' 15 largest automotive brands were based in Detroit. Detroit firms invested heavily in research and development, distancing their products from the rest of the nation. Chrysler entered the market in 1924 and solidified what would be known as "The Big Three" along with Ford and General Motors. The American automotive industry evolved into domination by the Big Three firms. After a "prolonged shakeout" the national automobile industry would become more heavily clustered around Detroit due to heterogeneous automotive firm capabilities and increasing returns associated with research and development (Klepper 2007).

By 1930, Detroit accounted for over 80% of automobile production in the United States. In addition, the automotive industry had become the United States' largest economic sector by 1929 (Davis 1988). With the largest concentration of the nation's largest industry, Detroit was primed for decades of exponential growth. By 1920 Detroit would become the fourth largest city in the United States, behind only New York, Chicago and Philadelphia. The city became a center of great wealth, a global power that would have been unimaginable a half century earlier.

The automotive manufacturing capacity of Detroit would play a prominent role during World War II. Nicknamed "The Arsenal of Democracy" by FDR, Detroit would account for over 20 percent of the United States defense production during the war. Switching from automobile to wartime production, Detroit's auto industry companies provided 12.5 billion rounds of small arms ammunition, 245 million shells; 6 million guns, 2.6 million military trucks, 50,000 tanks and 27,000 aircraft (Lankton 1991, 42).

Deindustrialization

Detroit reached the height of its growth in the 1940s and early post-World War II years. The mid-1950s began a decades-long decline due to many factors. Detroit had achieved such towering success as a result of its position as the global leader in automotive manufacturing that proposals to discuss alternatives and plans for the future were considered as a threat and went against the faith in the industry that made the city great (Glaeser 2011). In some ways Detroit was a victim of its automotive manufacturing success. An industry that started with budding entrepreneurs and a spirit of competition, evolved into an industry that stifled competition and innovation. As Edward Glaeser explained:

“The irony and ultimately the tragedy of Detroit is that its small, dynamic firms and independent suppliers gave rise to gigantic, wholly integrated car companies, which then became synonymous with stagnation. Ford figured out that massive scale could make his cars cheap, but supersize, self-contained factories were antiethical to the urban virtues of competition and connection. Ford figured out how to make assembly lines that could use the talents of poorly educated Americans, but making Detroit less skilled hurt it economically in the long run” (Glaeser 2011, 96).

Thomas Sugrue, one of the leading scholars of Detroit’s decline, explained the transformation that began to take place in the 1950s from a long-term perspective. Sugrue explains that throughout the 19th and early 20th centuries, United States industry was patterned toward centralization due to limitations in transportation technology and raw material availability. However, Sugrue points out that by the 1950s advances in communication and transportation, as well as increased regional and global competition lead to an expansion of industry into more low-wage states in the South. Cities in the industrial “Rust Belt” lost hundreds of thousands of industrial manufacturing jobs, as companies moved out of center-cities. Workers were increasingly replaced with automated technology and more plants were constructed in suburban and semirural areas (Sugrue 2005, 128).

After the incredible manufacturing that took place during World War II, shifting national defense policy had an impact on the deindustrialization of Detroit and other Rust Belt cities. More manufacturing activity moved to the suburbs due to a national defense policy that called for the distribution of defense manufacturing to satellite cities in order to protect against potential nuclear attack. Additionally, the growing political power of Sun Belt states and southern politicians ensured that more federal defense programs would be developed in the south and west, replacing earlier Midwestern and Eastern locations (Hill and Thomas 1990, 16-18; Sugrue 2005; 140-141).

The construction of the Federal highway system along with Federal housing policy created a strong economic development sector to suburban expansion (Jackson 1988; Hayden 2004; Campbell and Shalala 1970). The FHA insured loans for homes in the new suburbs, while “redlining” older and poorer areas in the central city. At the same time, a new federal freeway system provided a boost for city residents and businesses to flock toward the suburbs. As Hill and Thomas summarize:

“The freeway system provided a funnel for suburban immigration. Manufacturing plants relocated to suburban industrial corridors. Commercial establishments flocked to suburban shopping malls. Warehouse facilities left lofts at points of central-city railway convergence for single-story buildings at points of suburban interstate freeway convergence. And as the auto industry continued to decentralize, some central-city neighborhoods became blue-collar dormitories for workers commuting to suburban plants” (Hill and Thomas 1990, 17).

Detroit’s economy had historically been tied to large-scale automotive manufacturing but the city never diversified to include other sectors, such as New York City developing a robust financial and service sector, Chicago a financial sector, and even more recently Pittsburgh a technology and medical services and research sector. Ironically, the Detroit’s mastery of building automobiles enabled the population shifts that would ultimately help destroy its fiscal health. As Ross and Levine explained:

“The automobile revolutionized urban form, as suburbanites no longer needed to live in close proximity to streetcar and railway lines....Manufacturers, seeking the space for assembly line production were attracted to the relatively low price of undeveloped suburban land. The rise of the trucking industry soon led to an exodus of warehousing and distribution activities out of the central city” (Ross and Levine 2011).

The 1960s were a decade of deindustrialization and job migration away from Detroit. From 1960 to 1970, Detroit lost an astounding 18% of its jobs, beating out Buffalo (15%); St. Louis 14.2%; and Cleveland (12.9%) for the unfortunate distinction for greatest job migration (Sacks 1975, 4). Detroit lost on average 5 percent of its jobs each year between 1972 and 1992. In 1982, Detroit had half as many manufacturing jobs

as it did in 1982, and half of those jobs would be gone by 1992. By 2007, there were 80 percent fewer manufacturing companies in Detroit than there had been in 1972 (Citizens Research Council 2013, No. 382). Manufacturing jobs simply disappeared from the city of Detroit.

Race Relations in Detroit

A recent biographical account of the evolution of the city of Detroit pointed out that it's impossible to discuss the history of Detroit without discussing role that racial relations, "which has influenced the city's evolution as much as the city's shifting economic fortunes" (Martelle 2012, 35). While Detroit has vibrant population subsets of various racial and ethnic groups, the primary historical dynamic in regards to racial relations has always been the tension between the predominantly white suburban population who had fled the city in the 1960s – 1980s, and the predominately African American city population which remained within the city limits.

While studies have shown that segregation remains high in much of the country (Iceland 2009; Logan and Stults 2011), academic analysis of 2010 census data has shown that many communities have continued to become more racially and ethnically diverse over the last 30 years. Large increases in Hispanic and Asian populations have contributed to this diversity, with the most diverse communities in the United States disproportionately located in western, southern, and coastal metropolitan areas (Iceland 2012). Based upon an analysis of 2010 U.S. Census data, researchers at Brown University discovered that metro-Detroit was the most segregated and racially isolated city in the nation when it comes to black-white population comparison (Logan and Stults 2011). While the analysis used advanced spatial population statistics to calculate the level

of segregation in major population areas, a brief look at descriptive statistics in the city of Detroit provides a glaring example of the segregation and migration the city has seen over the last 100 years. In the following chart, the statistics illustrate the transformation of the city of Detroit:

Year	Total Population	African American Population	% African American	White Population	% White
1910	465,766	5,741	1.2	459,926	98.8
1920	993,675	40,838	4.1	952,065	95.8
1930	1,568,662	120,066	7.7	1,446,656	92.2
1940	1,623,452	149,119	9.2	1,472,662	90.7
1950	1,849,568	300,506	16.2	1,545,847	83.6
1960	1,670,144	482,229	28.9	1,182,970	70.8
1970	1,511,482	660,428	44.5	838,877	55.5
1980	1,203,339	758,939	63%	413,730	34.4
1990	1,027,974	777,916	76%	222,316	21.6
2000	951,270	775,772	81.6	116,599	12.3
2010	713,777	590,226	82.7	75,758	10.6

Source: U.S. Census Historical Data 1910)

Viewing a table of Detroit’s population over the last 100 years, the social phenomenon of “white flight” becomes apparent. Incredibly, for each decade over the last 100 years, the number of white residents in the city of Detroit has decreased while the number of African American residents has increased. In 1950, Detroit recorded its highest population total and was the fourth largest city in the nation with nearly 1.85 million residents. At the time, over 1.5 million (83.6%) white residents lived in the city. 20 years later, the number would fall to 838,877 (55.5%). After the 1967 riots, and coinciding with the election of the city’s first African American mayor in 1974, the period from 1970 to 1980, a ten year span, recorded the largest white flight movement as overall, 400,000 white residents left.

To put this migration in perspective, the 400,000 white residents that left is roughly the 2010 population for the entire city of Miami, Florida. It is rather remarkable to imagine one of the largest cities in the nation having 400,000 members of one racial group vacate the city in the span of only 10 years. From 1950 to 2010, the demographics make a 180 degree turn. A roughly 83% – 10% split in racial divide was completely reversed. The population trends over the last century reflect the troubling history of inequality and structural racism that marked Detroit during the 20th century, which will briefly be described here.

Popular accounts of Detroit's decline, such as Ze'ev Chafets' book *Devils Night* (1990) placed the majority of the blame at inner-city violence, culminating in the 1967 riots causing whites to flee to the suburbs as black leaders would take over the public administration of Detroit (Chafets 1990, 22). However, most contemporary historians have traced Detroit's decline further back. Summarizing the scholarship of Detroit's decline, Kevin Boyle's work in the *Michigan Historical Review* (2001) indicates that historians and scholars have since moved in another direction – tracing the decline of Detroit to the post-war policies and the institutions controlled by whites. Boyle explains: "The popular story serves an obvious political purpose: black rioters and bad luck caused the city's decline; whites bear no responsibility for its problems. Historians accounts of postwar Detroit have moved in precisely the opposite direction, insisting that the roots of Motown's continuing crisis must be traced not to the terrible events of 1967 but to white Detroiters and the institutions they controlled" (Boyle 2001, 109-27).

Mayor Coleman A. Young was elected as the first African American mayor of the city in 1974. He would summarize the experience in the 1970s:

"They are basically the same problems that beset every American city, except that they are magnified by the fact that modern Detroit was built around the auto industry, which has been losing blood for two decades and the accompanying reality that white flight,

industrial and social, has left Detroit with the damnedest demographics in America” (Young and Wheeler 1994, 204).

Three infamous dates mark the major flashpoints in Detroit’s race relations: 1863, 1943 and 1967. These dates represent the three occasions when United States armed forces had to intervene to suppress violent racial riots in the city. Images of tanks and armored personnel vehicles driving through the streets of Detroit captivated the rest of the nation in 1967, when the city was perhaps more reminiscent of a war zone in Vietnam rather than a domestic discord. While these flashpoints of violence mark the most shocking racial events, the massive migration of white residents in the 1970s through 1990s tells an equally unfortunate story of race relations in the city.

When Michigan was admitted into the Union in 1837 as the nation’s 26th state, slavery was abolished, and a small African American population had previously settled in the city in the early 1800s. The African American neighborhood was brutally victimized during violent race riots in 1863 that involved white mobs targeting African Americans in relation for an alleged rape of a young white girl. The white mob would conduct an “inhuman and indiscriminate attack” that culminated in burning the African American tenements in the area, and only subsided when federal troops were called in to maintain order (Roberts 1884). Despite its location in the extreme North of the country, and serving as a final stop along the Underground Railroad to Canada, the city of Detroit was still operating within the prejudicial racial culture that predominated much of 19th century America.

The innovation of automobile manufacturing during the dawn of the 20th century catapulted Detroit into a new role as a prominent national and international city. The

need for workers to toil on new assembly lines coincided with “The Great Migration” of African Americans wishing to escape Jim Crow laws in the South for better lives elsewhere. In the introduction to, *The Warmth of Other Suns*, Wilkerson summarizes the dramatic the story of individuals seeking a better life:

The configuration of cities as we know them, the social geography of black and white neighborhoods, the spread of the housing projects as well as the rise of a well-scrubbed black middle class, along with the alternating waves of white flight and suburbanization – all of these grew, directly or indirectly from the response of everyone touched by the Great Migration
(Wilkerson 2010, 10)

The Great Migration ensured that the elements of inequality and racial tension in Detroit would remain in place. An entrenched white majority still overwhelmingly possessed the dominant racial prejudices of the era; was combined with a rapid influx of African Americans eager to escape the Jim Crow South, only to find that the city, while perhaps an improvement, would still present large obstacles toward equality and prosperity. The migration of African Americans from the South occurred during a remarkable economic expansion, which only heightened the tensions brought forth by competition for housing and economic opportunities between the entrenched white majority and the rapidly increasing African American population eager for their share of the American dream.

There certainly was opportunity to be had in Detroit for African American workers, and often the automobile industry was connected to the local politics in the black community. By 1926, in the “golden age of the auto industry,” the Ford Motor Company alone had 100,000 employees, of which 10% were African American (Kennedy 1941, 155). Henry Ford’s reputation for hiring African American workers was assisted by his use of black churches and their ministers as recruiters for his automotive

plants. With Ford's sponsorship, black ministers would become major power brokers in Detroit's black community. Ford elevated their standing in the community while simultaneously insulating against unions and any perceived communist politics. Ford feared the threat of communism and Jewish radicals and wanted to insulate black workers from their influences. The coalition between Ford and the black ministers was the beginning of clientage politics in Detroit, and this type of political arrangement inhibited the development of an independent black leadership (Rich 1989, 44-45). As Wilbur Rich described,

"The politics of the twenties was a style of clientage politics in which black ministers acted as brokers for the Protestant Republican class that dominated city politics. In this particular political universe, Henry Ford was the star; black ministers revolved around him" (57).

Tensions over a lack of adequate housing and jobs would reach a boiling point in 1943. The 1943 summer riots, although less known than the more famous 1967 riot, was among the worst in the 20th century, in which 34 people, 26 who were African American, were killed and 433 wounded (Capeci and Wilkerson 1990). The violence began with fights between whites and blacks on Bell Isle, a popular island park owned by the city. The tensions, however, were long running and stemmed from a lack of housing and job opportunities for African Americans in Detroit. The white majority wanted to reinforce the "racial status quo" as competition for housing and employment increased during a booming World War II economy, but failed to meet expectations (Capeci and Wilkerson 1990). The riot would only end once FDR sent in Federal troops to control the city until tensions subsided.

Among the most detailed analysis of the racial tensions in Detroit during 1940s and 1950s, Thomas Sugrue (2005) provided a comprehensive study for the racial

problems that led to Detroit's decline. Sugrue traced the cause of modern urban poverty to the racial violence, workplace and housing discrimination, and political decisions of the immediate post World War II era - much earlier than many other researchers had previously identified. Sugrue explained the process of housing discrimination for African Americans:

They were confined to the city's oldest housing stock, in most need of ongoing maintenance, repair and rehabilitation. But they could not get loans to improve their properties. As a result their houses deteriorated....Moreover the decaying neighborhoods offered seemingly convincing evidence to white homeowners that blacks were feckless and irresponsible and fueled fears that blacks would ruin any white neighborhood they moved into. (Sugrue 2005, 36).

In contrast to the school of thought that pinned the cause of Detroit's decline on the high levels of crime and mismanagement of the city by African American leaders, scholars have also found that federal housing development policy systemically provided incentives for whites to flee Detroit for the suburbs (Darden1987). At the same time, suburban leaders, intent on protecting their white communities, would develop policies that would prevent blacks from taking advantage of the same opportunities (Good 1989).

Detroit in the 1960s

By 1961, one national magazine declared that Detroit was known for three things: "automobiles, bad race relations and civic sloth" (*Time* 1961). However, the 1960s are a surprisingly more nuanced decade in the history of Detroit's racial relations. Before white flight completely hollowed out the Detroit tax base, there was a brief moment of time when Detroit showed some promise in addressing racial problems.

White liberal leaders took control of city government functions in the early to mid-1960s, and made some efforts to lessen racial tensions. Jerome Cavanaugh, a liberal

Democrat was elected mayor in 1961, defeated Louis Miriani, who to this date, has been the last Republican mayor of Detroit. Cavanagh brought many African Americans into city hall, most notably Alfred Pelham as Comptroller, the highest office ever held by an African American in Detroit at the time. Cavanaugh appointed George Edwards Jr., who had the reputation for racial reform as police commissioner to reform the department's perception of racial stereotyping. Cavanagh directed the Commission on Community Relations to study racial issues and develop solutions, especially in regards to city employment positions. Additionally, the Cavanagh administration achieved success in lobbying the federal government for funding for national programs to address the growing challenges of the city, receiving over \$230 million between 1962 and 1967 (Fine 1989, 18-19).

Under the Cavanagh administration Detroit began to achieve a reputation for improving racial relations. In 1965 *Time* magazine declared that "Despite its long history of rancorous race relations, Detroit in recent years has been one of the few big Northern cities to escape large-scale Negro rioting" (*Time* 1965). In the same year, *Fortune Magazine* reported on Detroit's progress in race relations and showered the city, and its young mayor with praise:

"Of all the accomplishments in the recent history of the city, the most significant is the progress Detroit has made in race relations. The grim specter of the 1943 riots never quite fades from the minds of the city leaders. As much as anything else, that specter has enabled the power structure to overcome tenacious prejudice and give the Negro community a role in the consensus probably unparalleled in any major American city.

Negroes are sufficiently well organized socially and politically to have elected a member of the Detroit common council in a city-wide election. They have also elected three local judges, ten state legislators, and two congressmen" (as quoted in Dillard 2007, 219).

Despite, the major reforms that took place, in the summer of 1967, the most destructive racial riot in United States history would take place in Detroit. This brings forth two key questions: First, did the liberals of the 1960s inherit problems of such magnitude that they simply could not be overcome? And second, were the liberals efforts fundamentally flawed? (Boyle 2001, 115). While the reforms were effective in parts, police-community relations remained a major point of racial contention, despite the increase in communication. Sidney Fine identified police-community relations as the single most important factor facing Detroit in the 1960s (Fine 1989, 95). Regarding Detroit's reputation as a model city for race relations prior to the riot, Fine adds that the national reputation was likely due to a misunderstanding of real attitudes and real conditions: "There was insufficient understanding outside Detroit or, probably, even among the city's white leaders of the degree of disaffection among blacks with regard to police behavior any more than with regard to housing, education, employment, and other matters (125).

The riots of 1967 would mark the culmination of many social forces that resulted from the discrimination of the preceding decades. 43 Detroiters were killed, 1,100 injured and an astounding 7,000 were arrested. As the New York Times would commemorate on 30th anniversary of five days of violence:

"There were nearly four dozen riots and more than 100 smaller cases of civil unrest in the United States in 1967, but Detroit's riots were the deadliest. A Presidential commission later attributed most of the 43 deaths to police officers and National Guardsmen who, in the commission's view, had gone out of control" (Meredith 1997).

The 1967 riots, the cataclysmic event for racial relations in Detroit in the 1960s, has been debated by historians and scholars in terms of its impact as a protest statement. Some scholars have argued that the riot was a rebellion and rejection of all of the reform

policies and would create fertile ground for black activists to take back control of Detroit's economy and community (Georgakas and Surkin, 1975; Thompson 2001). However, other scholars and historians reject the notion that the riot was formed as an organized protest, but was rather a more spontaneous and was brought forward by the history of poor racial relations and lack of opportunity. As Sidney Fine, who wrote perhaps the most detailed accounts of the 1967 riots explained, "those who thought the Detroit riot had a political dimension, that it was aimed at restructuring political power since other means had failed, were reading too much into the event" (Fine 1989, 359). In contrast to the arguments that the riots provided fertile ground for black communities and radicals to take control of the local economy and political positions, historians and scholars have argued that the riots made things precipitously worse for Detroit. The next few years witnessed increased racial tension, with a poorly-funded school system, intensified reactionary tactics from the police force, and a dramatic increase in the white flight (Fine 1989; Thomas 1977; Mirel 1993).

While it is difficult to adequately discuss the history of Detroit without addressing race relations and demographic changes, likewise any discussion would be incomplete without understanding Detroit's most prominent politician of the 20th century, Mayor Coleman A. Young. Detroit elected its first African American mayor in 1974, when Coleman A. Young narrowly defeated Police Commissioner John Nichols. Young's election became a lightning rod for Detroit-suburban relations as well as an even greater flashpoint for increased white flight. While Young's policies and actions over 20 years as Detroit mayor may be debated extensively, Young took over during the apex of

demographic changes and collapse of the auto industry. In his autobiography, Young would reflect upon his feelings on the eve of a historic election in 1974:

“I was in the right place at the right time, and that my fortune was a direct result of my city’s misfortune – of the same fear and loathing that had caused all of my problems and Detroit’s problems in the first place. I was taking over the administration of Detroit because the white people didn’t want the damn thing anymore. (Young and Wheeler 1994, 200).

As Wilbur Rich would recall in his detailed case study of the first decade of Young’s administration:

“The First Black Mayor of Detroit had inherited a politically rich city but an economically poor one. In his first four years of office, he would have a fiscal crisis in 1975, a near riot, a police confrontation over layoffs and residency rules, and the threat to close Chrysler’s Jefferson Avenue plant” (Rich 1989, 106).

By 1980, white Detroiters had abandoned city in large numbers. Census data shows that between 1970 and 1980, more than 400,000 white Detroit residents left for the surrounding suburbs. The history of race relations in the city of Detroit is marked by segregation. Whether it is from the relegation of African Americans to the poorest sections of the city in the 1940s and 1950s, or the migration of whites in the 1970s and 1980, racial tension has made a constant presence in the city’s history.

Highlighting the flashpoints of white flight and racial violence certainly does not include many instances when the city and suburbs have successfully collaborated or the numerous citizens of all racial backgrounds who work together to promote a better future for the city that they love. However, Detroit is statistically the most segregated white-black area in the country, and has undergone the largest instance of “white flight” the nation has ever seen. These are important considerations, and must be factored in when a policy and its implementation is analyzed.

Understanding the historically troubling race relations, segregation and population migration to and from the city helps provide a more in-depth understanding of the objections some residents have had to the policy of emergency management in Detroit. Through the vantage point of Detroit's historic race relations, it is easier to understand the potential barriers to implementation and social equity. Exclusionary policies have a troubling history in the city of Detroit. During the 1920s – 1950s, African Americans were confined to some of the worst neighborhoods in the city, with prejudicial barriers, both institutionalized by government and informally put in place by community actions to prohibit mobility toward better neighborhoods. The unfortunate racial legacy of Detroit is one of exclusion toward the African American population, either within the city or from moving away from the city. Therefore, it stands to reason that the state takeover of local government functions should be treated with greater caution in a city with such a complicated history of segregation and racial discord.

Detroit's Public Management

De-industrialization, automation, global and regional competition and institutionalized racism reflected in federal, state and city policy had much to do with Detroit's decline since 1950. It is uncertain if any city leader could have prevented the decline, when faced with such challenges. However, city, state, and suburban leader's actions, or inactions, at best did not address the long-term challenges, and at worse, made them more difficult. Much has been written about Detroit's economic decline since the post-World War II prosperity. While a complete treatment of Detroit's missed opportunities for corrective action the past half century is beyond the scope of this

section, it is useful to provide some background for the potential missed opportunities for city leaders.

Detroit has historically operated in a strong mayor form of government. The mayor, like the city council, is elected separately in an election every four years by the people of Detroit.

There are two primary sources of information that describe Detroit's financial operations - the annual fiscal year budget and the comprehensive annual financial report (CAFR).

The annual budget is a planning document adopted before the beginning of the fiscal year, is based on the city's departmental organizational structure, and contains projections of revenues and expenditures for city department. On the other hand, the CAFR is a financial report of *actual* revenues and expenditures which is required to be completed under Michigan law. The CAFR is required to be completed and published within six months of the end of the fiscal year. The budget as a planning document is based on departments; the CAFR report of the actual revenues and expenses is based on funds. Additionally, some departments have sub-divisions that utilize different funds and some funds are comprised of numerous departments. Therefore, it may often be difficult to reconcile one document with the other (Citizens Research Council 2012, Memo 1112).

This difficulty is compounded when a city struggles with its accounting and faces annual deficits. In his initial report assessing the city's condition, Emergency Financial Manager Kevyn Orr summarized the state of city management:

"The City's operations have become dysfunctional and wasteful after years of budgetary restrictions, mismanagement, crippling operational practices and, in some cases, indifference or corruption. Outdated policies, work practices, procedures and systems must be improved consistent with best practices of 21st century government."
(Orr - City of Detroit Financial and Operating Plan, 2013).

Michigan law requires that local governments balance their budgets under Public Act 2 of 1968, as amended, through Public Act 493 of 2000. While Detroit had submitted “technically” balanced budgets when enacted based on the estimates of revenues and expenditures, in reality, the city of Detroit had been developing massive operating deficits due to the continued practice of major overestimation of revenues and the discrepancy between a budget plan versus what actually occurs (Citizens Research Council of Michigan 2012, Memo 1112).

The CAFR reports the actual financial result of the fiscal year activities – whether there is a surplus or deficit in each fund. If there is a projected deficit, state law requires that the local government develop a plan for its elimination which is then submitted to the State Department of Treasury. At the end of fiscal year 2011, the city of Detroit ended with a deficit of over \$196 million and projections of cash flow issued in the fall of 2011 showed that the city was estimated to exhaust the cash of the General Fund in April of 2012 (Citizens Research Council of Michigan 2012, 1112).

A recent analysis of the City of Detroit’s descent into insolvency, based upon the newly reviewed documents and financial data, was a 2013 report by *Detroit Free Press* staff writers Nathan Bomey and John Gallagher with the Detroit Free Press. Bomey and Gallagher shed new light on the historical mismanagement of the city since the 1950s. The comprehensive *Free Press* study found that since the 1950s, Detroit leaders have had many chances to address the major issues but failed to take decisive action. Furthermore, the research challenges the perception that Mayor Coleman Young, who has often taken much blame for Detroit’s decline in some, mostly suburban quarters, was in fact to blame

for the bulk of Detroit's financial woes, and in fact may have been its most fiscally conservative mayor.

When Detroit first started facing fiscal issues, city officials often used taxation to solve the declining revenue trends. The first income tax of 1% for residents and 0.5% for non-residents was levied in 1962 during the Cavanaugh administration to successfully address a \$19 million dollar deficit. The income tax would be raised to 2% by 1969, and as of 2015 was 2.4%. An additional utility tax was added in 1971, and a casino revenue tax was added in 1999. Despite such diverse sources of revenue, adjusted for inflation, revenue had decreased by 40% from 1962 to 2012. While there were many factors that led to Detroit's population decline, higher taxes on a City with a low per capita median income likely did not help stem the flow of residents and business to the suburbs. In 2012, Detroit did not receive as much total revenue as it did from property taxes alone in 1963 (Bomey and Gallagher 2013).

Reviewing state income and property tax rates for the State of Michigan, Detroit ranks highest in each category. Only 22 cities in the state Michigan levy income taxes. Of those 22, 18 levy only a 1% rate for income tax. Detroit has the highest income tax at 2.4%. Only one other local government levies a 2% income tax – Hamtramck – which is a municipality that is completely surrounded by Detroit city, and has faced large financial difficulties of its own. Additionally, Detroit has the highest property tax in Michigan, at \$6,700 per \$100,000 in state equalized value. (Bomey and Gallagher 2013).

In comparison with all U.S. cities, Detroit was ranked 9th worst in 2012 of overall tax burden. However, the ranking would likely be higher if not for Detroit's incredibly low real estate property values (Frohlich and Hess 2014). When factoring in property

taxes alone, one study determined that Detroit had the very highest in the state of Michigan as well as highest among major city in the United States when it comes to residential and commercial property tax rates (Lincoln Institute 50 State Property Tax Comparison Study 2013). The high tax rates in Detroit form a vicious cycle for population decline – residents move out, so taxes were raised to replace revenue; the high taxes prevent potential residents from moving to Detroit and lead to more residents moving out of the city.

While city leaders have instituted high taxes to address the declining revenues, further compounding the tax issue is the historic inability Detroit has had in collecting taxes. A 2013 *Detroit News* research project found that half (47%) of Detroit's 305,000 property owners did not pay their property taxes, resulting in \$245 million in uncollected revenue. The situation has reached the point that Wayne County Department of Treasury, which collects property taxes for the city of Detroit, had simply ignored 40,000 delinquent Detroit properties that should have been seized in 2012. Resident apathy was found to be the primary cause. Many Detroiters simply felt that they did not receive the level of services that would be acceptable of paying their income taxes (MacDonald and Wilkinson 2013).

Recent analysis has found that Detroit did not reduce workforce in relation to dramatic decline in population that has taken place. While the total assessed value of Detroit property declined 77% over the past 50 years, the city has only cut the workforce by 28%. It was not until recent years and likely when it was much too late, that the city made dramatic cuts and reduced the workforce by half. Throughout the years, Detroit

constantly failed to utilize efficiencies that were found in new technologies in relation to those found in the economy as a whole (Bomey and Gallagher 2013).

In conjunction with retaining high number of municipal employees, legacy costs for retirees increased dramatically. In 1960, Detroit had 26,386 employees and 10,629 retirees. By 2012 the ratio nearly flipped completely - in 2012 Detroit only had 10,525 employees that support 21,113 retirees (Bomey and Gallagher 2013). While the state of Michigan and private companies were increasingly transitioning to less expensive employee benefit plans, Detroit retained a relatively expensive retirement system. During the time period of 2000 to 2012, the city's spending on health care soared 46% while general fund revenue fell 20%. City leaders allowed legacy costs — the tab for retiree pensions and health care — to spiral out of control even as the State of Michigan and private industry were necessarily pushing workers into less costly plans. This placed major stress on the budget and diverted money from services such as streetlights and public safety. Detroit's spending on retiree health care soared 46% from 2000 to 2012; at the same time, the city's general fund revenue fell by over 20% (Bomey and Gallagher 2013).

From 1985 until 2008, Detroit pension officials awarded over \$1 billion in bonuses from the city's two pension funds to retirees. This money was generally in the form of "13th checks" – an additional check paid to retirees when the stock market was doing well. The money was paid off to retirees, and in some cases, current employees, instead of reinvesting in the pension system to prepare for future market downturns. Affidavits filed during the bankruptcy process revealed that the pension boards gave out \$756 million in excess pension earnings to active city employees, \$195 million to

retirees, and sent \$445 million back to the city (Bomey 2013). The awarded funds could have been utilized to shore up the pension funds and possibly assisted in preventing or delaying a bankruptcy filing. Recent analysis shows that if that money had been saved, it would have been worth more about \$2 billion in 2013 (Bomey and Gallagher 2013).

To address the rapidly increasing pension costs, in 2005, Detroit Mayor Kwame Kilpatrick signed off on a complex Wall Street deal and borrowed \$1.44 billion to restructure the ballooning pension fund debt. Detroit sold pension obligation certificates of participation and put the money into its pension funds, making them nearly 100% funded. Separately, the city also bought so-called swaps, or derivatives, a complex Wall Street financial deal to permanently lock in steady interest rates in the range of 6%, a comparatively good rate at the time. Detroit made a risky Wall Street bet and lost - interest rates soon plummeted, the city was on the hook and the its credit was severely downgraded. The gamble to shore up the pension funds with risky and complex Wall Street deal backfired in an incredible fashion:

“At issue is a 2005 deal engineered by then-Detroit Mayor Kwame Kilpatrick, UBS and Merrill Lynch-backed SBS Financial Products. The city borrowed \$1.44 billion in variable-rate debt to eliminate its unfunded pension liabilities. It was the financial equivalent of a Hail Mary pass that was not only intercepted, but returned for a touchdown”(Bomey 2013)

That deal, which could cost up to \$2.8 billion over the next 22 years, represented nearly one-fifth of the city’s overall debt (Bomey and Gallagher 2013; Bomey 2013).

The solutions to Detroit’s fiscal crisis prove delusive. Overall, the tax rate for Detroit ranks among the highest in the state of Michigan and compares unfavorably with other cities across the United States. While enhanced collection techniques may provide some help, Detroit’s ability to address the fiscal problems through additional tax

increases would be nearly impossible to achieve (Citizens Research Council 2013, No. 382). Out of necessity, addressing the city's fiscal crisis would need to focus on program and service cuts and realignment of operations, rather than tax increases on a struggling tax base. The city was simply maxed out on the amount of tax revenue it can generate. In its wake, a vicious cycle ensues: Hardship requires more services, while at the same time, the fiscal emergency requires cuts to those needed services.

As a result of many factors tracing back over 60 years, Detroit has lost population at historic levels. This resulted in a vicious cycle whereby the more people leave, the harder it is for the city to provide services and become fiscally sound, which in turns leads to more people leaving. After the 2010 census figures were released, Detroit's population dropped to 713,777, the lowest since 1910. This resulted in the largest population decrease in any United States city, not including New Orleans after Hurricane Katrina (Seelye 2012). Detroit is a large city in geography, with nearly 140 square miles, and is a city that was built for a population over twice the current level. In 1940, Detroit was the fourth largest city in the U.S., behind New York City, Chicago and Philadelphia, with a population of 1,623,452 (U.S. Census Bureau: Population of the 100 Largest Urban Places: 1940). According to the U.S. Census Bureau, in 1950, the city had nearly 2 million residents. A city that has 40% of the residents it was designed to accommodate faces significant challenges, especially when it comes to service delivery. As Detroit mayor Dave Bing highlighted in a speech regarding service delivery:

"We don't have enough resources on the human side or the financial side to continue to support every neighborhood in the city of Detroit," he said. "Some neighborhoods -- it's not that we just want to leave them out there -- but I have to be honest with people, we don't have the funding to be able to support everybody. So I've got to be smart about how I invest the money so we can get maximum return on the investment" (Oosting 2011).

The focus of this dissertation project is not to comprehensively trace the challenges in Detroit that lead to a financial emergency. Instead, this research project will conduct an exploratory case study of the emergency management statutes of Michigan, with Detroit being the most prominent example, and the largest modern state takeover of a city in modern American history. However, it is important to provide an introduction to the multitude of factors that pushed Detroit's into fiscal decline in order to understand the challenges that city officials faced. These topics will be addressed further in Chapter Four and Chapter Five. In the next chapter, the methodology for the exploratory case study will be explained.

Chapter Three: Methodology

This dissertation research proposal intends to conduct an exploratory case study of the emergency financial management statutes of Michigan, with a particular focus on their implementation in Detroit. The purpose of the case study is to better understand a new phenomenon existing in the world of public administration - the largest modern state takeover of a city in modern American history, which resulted in the largest municipal bankruptcy in American history. Upon completion of the exploratory case study, a theoretical inquiry will be conducted to answer the research questions outlined in Chapter One. The result will be a contribution to the study of public administration as it applies to the state takeover and financial management of a fiscally distressed local government.

This exploratory case study and theoretical inquiry may lead to further studies that will move closer toward examining relationships within the emerging area of emergency financial management of local governments. The proposed study will be guided by a pragmatic worldview and the specific research approaches will follow interpretivism, empiricism, and rationalism philosophic research approaches.

Exploratory Case Study

The exploratory case study will be structured in four phases: (1) A chronological analysis of the emergency financial manager statutes of Michigan, as well a summary of their implementation in local governments across the state. (2) A chronological analysis of Detroit's selection for an emergency financial manager that will outline the decisions made by organizations and key public figures for their policy formulation and

implementation. (3) A cross-case synthesis using the experience of New York City's financial crisis of the 1970s for comparison. (4) The experience of the city of Flint; the emergency manager's actions relating to the water system will be analyzed, to provide a "worst case scenario" of what may happen when control is taken away from locally elected government.

Theoretical Inquiry

In the concluding chapter, a theoretical inquiry will be undertaken to answer the research questions posed in Chapter One. The findings of the case study will be analyzed through an intergovernmental lens, as well as through the socioeconomic issues that contribute to a city's financial decline. Additionally, recommendations will be made for improving the implementation of the emergency manager statutes with a concern toward preserving social equity.

To maintain the focus of the study and to ensure the new phenomenon of emergency financial management implemented in Detroit is captured accurately, various case study strategies are employed to ensure triangulation and develop a rich and complete case study. To describe the methodology utilized by this research proposal, three points of clarification will be made: (1) An explanation as to what counted for evidence or data in relation to the central research question; (2) An outline of the steps, procedures or processes used to collect that data or evidence; and (3) An explanation of the modes of analysis that were used to generate plausible explanations from the collected data and evidence.

1. What counts for data/evidence?

In the first part of the exploratory case study, a chronological time-series exploring the timeline of Michigan's emergency manager laws and their implementation, involved a collection of evidence that focused on legislative statute texts, legislative procedural markups, statute analysis documents and committee reports. It was important to explore which stakeholders supported, and opposed, the emergency manager laws. Media interviews with legislators, governors and opponents of the legislation were collected as evidence because it provided further context for the exploratory research. Briefings by think tanks, advisory boards, public interest organizations and citizen groups provided further evidence into the exploration of the emergency manager statutes of Michigan and their implementation.

In the second part of the case study, focusing on the timeline of Detroit's selection for an emergency manager, court testimony and publicly available documents released by state and local government institutions documented key events. Additionally, since the appointment of emergency manager Kevyn Orr, bankruptcy proceedings resulted in a tremendous amount of publicly available information that provides insight into the decisions made early in the Detroit emergency financial management process, this was analyzed for evidence. The state of Michigan and the emergency manager's office in Detroit released numerous reports outlining findings and decisions made by the emergency manager. These reports provided further evidence in the exploration of the events that took place as Detroit was selected for state takeover.

The third part of the case study, New York City's financial decline in the 1970s, utilized primarily academic literature and other research that traced the events. The fourth

part of the case study, Flint's experience under emergency management utilized similar collection techniques as parts one and two, with a greater emphasis on media accounts.

2. What procedures or processes will be followed to collect the data or evidence?

In the first phase of case study, the four emergency financial manager statutes that have been passed since 1988 were explored. Evidence was collected by researching the text of the statutes, exploring legislative committee reports, as well as policy papers written for, and against, the legislation. This information is available in the Michigan state legislature's online repository or was also found in various public library archives. Archival news reports surrounding each of the four statutes were collected by visiting local libraries with media databases, as well as advanced internet searches. Descriptive statistics of the cities selected for an emergency were obtained via state public financial information, as well as U.S. Census data. Legal challenges were examined, as well as media interviews with state legislatures, the Governor's Office, Detroit Mayor's Office, and the emergency managers themselves. These interviews were readily available in print and video form through advanced searches conducted via the internet as well as archival media reports in Detroit-area libraries.

The second part of the case study, focusing on the chronology of Detroit's selection for an emergency manager, involved the collection of media documents and publicly available financial statements and reports. Michigan media outlets covered the events of Detroit's selection for an emergency manager, and subsequent declaration of bankruptcy, resulting in a multitude of news reports outlining several key events and

decisions that have been made. The Emergency Manager's office released several reports outlining the decisions that have been made leading up to the declaration of bankruptcy, and these are publicly available. After Detroit bankruptcy proceedings, a significant amount of testimony was released regarding the governor's selection of Detroit for an emergency manager, as well as the emergency manager's decisions leading to the bankruptcy filing. This information is available for collection via local media reports. Financial statements, think tank and nonpartisan policy analyst research papers were collected from the various stakeholder sites to further explore the chronology of Detroit's selection for an emergency manager, and subsequent actions that led to a bankruptcy declaration.

The third part of the case study, New York's financial decline in the 1970s utilized primarily academic literature and other research that traced the events. The fourth part of the case study, Flint's experience under emergency management utilized similar collection techniques indicated for case study parts one and two with an emphasis on online and library media accounts and research studies.

What modes of analysis will be used to make meaning and generate plausible explanations from the collected data and evidence?

According to Yin (1999, 130) case study analysis consists of underlying analytical strategies, which supports the mode of analysis that is utilized. This exploratory case study utilizes the general analytical strategy of relying on theoretical propositions. The theoretical proposition for this exploratory case study is that the phenomenon taking place in Michigan, with control given to a state-appointed emergency manager, is a unique phenomenon found in intergovernmental relations in the United States, and should

be explored in order to understand what is taking place and develop theory that is relevant to the field of public administration. This general theoretical proposition - that the phenomenon is new, unique and requires exploration - is the strategic framework that will guide the analysis of evidence.

Within this broad analytical strategies are two primary modes of analysis that will be undertaken after the evidence is collected: (1) Chronological time-series analytical framework; and (2) the cross-case synthesis analysis.

Chronological time-series analysis

The chronological time-series framework will describe the chronology of key events that took place within each phase of the case study. As previously outlined, the first phase is an exploration into the chronology of the subsequent emergency manager statutes to understand how the emergency manager laws arrived in Michigan; inclusive of the decisions made by organizations and key public figures for their policy formulation and implementation. The second phase of the case study provides a chronology of the events leading up to Detroit's selection for an emergency manager, inclusive of the decisions made by public institutions and key players. Analyzing the evidence collected within a chronological framework is ideal for the exploratory nature of this case study, resulting in a summary of decision points that will be synthesized with cross-case analysis to generate theory. The chronological analysis forms the background for the subsequent cross-case synthesis and analysis.

Cross-case synthesis

The cross-case synthesis analysis compared and contrasted the information found in the Detroit fiscal crisis, with another historic local government fiscal crisis in the United States - New York City in the 1970s. The chronological analysis was compared and contrasted with characteristics of New York City's government fiscal crises. This synthesis provided the ability to better analyze the Michigan statutes and their implementation with further perspective. Utilizing these dual analytical tools enabled the study to triangulate towards a richer description of the phenomenon while also enabling the generation of new theory for emergency management in fiscally distressed urban cities. Additionally, the case of Flint, Michigan was analyzed to provide an extreme example of the potential ramifications of removal of local democratic control – essentially a “worst case scenario” of what may happen when local government control is removed.

The chronological analytical view and cross-case synthesis modes combined to create a fuller description and explanation for the phenomenon of emergency financial manage in a major city experiencing fiscal stress. The two levels of analysis triangulated the research towards a complete exploratory case study that lead to a theoretical inquiry and generated new theory in the field.

Theoretical Inquiry

The proposed research was carried out inductively. Induction seeks to” promote a greater understanding of the meanings that humans attach to events or phenomena. It places less emphasis on the ability to generalize...it allows for changes in research as the work progresses” (Riccucci 2011, 45). The two levels of analysis of the exploratory case

study resulted in a concluding theoretical inquiry. The emergency manager statutes of Michigan and their implementation were examined and theory developed through two overall vantage points: (1) the lens of federalism and intergovernmental relations in the United States.; and (2) the lens of local government fiscal crisis and larger socioeconomic issues contributing to Detroit's decline. The vantage points were used when addressing the research questions listed in Chapter One. In the concluding section, after addressing the research questions through these vantage points, a normative discourse will be conducted to provide recommendations for the implementation of the policy to preserve social equity.

As stated previously, the underlying proposition for this proposal is that the situation in Michigan is a unique and emerging phenomenon, and requires exploration and theoretical inquiry to better explain the state take over and emergency financial administration of a distressed urban area. Overall, the methodology for this exploratory case study proposed to explore an emerging phenomenon and advance the knowledge base for public administration by providing evidence in critical exploratory research, developing theory and providing direction for future research. A methodological summary is provided on the following page to better visualize the approach.

Methodology Summary

Theoretical proposition – This case represents a new phenomenon in intergovernmental relations that must be explored and analyzed, and will generate preliminary theories for future research to further testing.

Chapter 4: Results

Exploratory Case Study

Phase 1: Chronological time-series

- An exploration into the chronology of Michigan’s emergency manager statutes and their implementation.
- An exploration into the chronology of Detroit’s selection for an emergency manager and subsequent events that lead to the largest municipal bankruptcy in U.S. history.

Phase 2: Cross-case synthesis

- New York City Fiscal Crisis of the 1970s – A comparison to the second largest local government fiscal crisis in the United States.
- Flint Emergency Management and Water Crisis – An example of the “worst case scenario” that may take place when local democracy is removed from a government in fiscal crisis.

Chapter 5: Discussion

Theoretical Inquiry

- Answers to the proposed research questions.
- Recommendations for improving social equity in the emergency manager statutes.

Chapter Four: Results

State intervention in local government financial matters has taken place in various forms since the mid-19th century; however the scope involved in the state of Michigan is unprecedented. State takeover of financially stressed local governments represent an emerging subfield in public administration. Therefore, an exploratory case study of the emergency statute laws in Michigan will be beneficial. This exploratory case study is structured into four parts: (1) a chronological time-series analysis of Michigan's emergency financial manager statutes and their implementation; (2) a chronological time-series analysis of Detroit's selection for an emergency manager and subsequent activities that led to the largest municipal bankruptcy filing in U.S. history; (3) a cross case analysis with New York City's financial crisis; and (4) an examination of the city of Flint's emergency manager experience, specifically in relation to the drinking water tragedy that unfolded in 2014 – 2015. Upon completion of the case study, answers to the proposed research questions will be answered in the concluding chapter.

Chapter Four: Results

Part One: The Emergency Manager Statutes of Michigan

“It’s lonely running a city by yourself. You look at everyone and wonder if they can help you, or if you need to get rid of them” –Emergency Manager Louis Schimmel (Collins 2001).

Michigan is not the first state to intervene in a local government financial crisis, nor is it the first state to suspend some form of localized democracy to enforce fiscal discipline on a local government. However, Michigan does represent the farthest reaching state intervention into a local government’s financial administration in United States history. Furthermore, there is no true precedent for what took place in Michigan from 2013-2014, when the state appointed an unelected emergency manager, who ultimately had the power to declare bankruptcy. The experience in Detroit represented a significant example, but one that has taken place repeatedly in other Michigan localities, where emergency managers have been appointed in financially distressed cities with sweeping powers to dissolve contracts, fire city staff, and even declare bankruptcy. In this first part of the case study, the emergency manager statutes in Michigan will be traced, as well as their implementation.

Collectively, there have been four successive state-wide emergency financial manager laws in the state of Michigan. Despite the relatively new controversy surrounding emergency manager laws in Michigan, there has been some version of the law since 1988, although with significantly less authority attached to it. The fiscal crisis that took place during the 1980s in the city of Ecorse set in motion a chain of events that led to the future emergency manager statutes in Michigan. The Ecorse experience

resulted in the Michigan legislature passing a law to address the perceived need for oversight of financial management in distressed cities. Prior to 1988, and the passage of Public Act 101, Michigan state officials lacked a structure for intervening in local governments experiencing a fiscal crisis; “local fiscal emergencies were handled on an ad-hoc basis by the state and the courts” (CRC 1990, 1).

Ecorse Receivership 1986

Before Detroit was placed under an emergency manager and declared bankruptcy, before any of the Michigan emergency manager laws were on the books, the city of Ecorse experienced a significant fiscal crisis in the 1980s. This was the catalyst event for state intervention in local government financial crisis in Michigan. On December 3, 1986, the city of Ecorse became the first city in Michigan’s history to be placed under state receivership, under court order by Wayne County Circuit Court Judge Richard Dunn. Louis Schimmel, who at the time was the Executive Director of the Municipal Advisory Council of Michigan, was appointed as receiver and given power to renegotiate city labor contracts, control city finances, and supervise and eliminate city employees. According to newspaper accounts of the time, elected mayor Harry White, as one might expect, was not at all happy with the Judge’s order (*Toledo Blade* 1986).

The receivership in Ecorse took place before any of subsequent emergency manager laws had been passed in Michigan, but the events surrounding Ecorse contributed to a push for legislation in order to prevent other Michigan cities from facing the same situation as Ecorse. Because the financial collapse of Ecorse was the event that

triggered Michigan's emergency manager laws, it is useful to provide a brief overview of Ecorse, the origin of Michigan's state takeover policy.

The story of Ecorse's financial decline is chronicled in Paul Seidenstat's *Contracting Out Government Services* (1999). Ecorse is a relatively small industrial city in the "downriver" area of Detroit – an industrial region just south of Detroit, and the Detroit River. The tax base was fairly well established in the 1950s and 1960s, with large-scale manufacturing employers such as automotive supplier Dana Corporation and Great Lakes Steel employed thousands of the city's residents. By the 1980s, Great Lakes Steel dramatically reduced its workforce and Dana Corp relocated its plant entirely. Ecorse's population declined from nearly 18,000 in the 1970s to 12,000 by 1986.

Like many industrial towns in the Midwest, Ecorse was facing fiscal stress. However, in response to a declining population and decreasing revenue, the city did not cut services, but instead increased taxes to maintain the level of service. In Michigan, property tax is cited according to millage rate. A millage rate is the amount per \$1,000 that is used to calculate taxes on property and is multiplied by the total taxable value of the property to determine the amount of property taxes due. In 1975, the property tax rate for Ecorse was 53.71 mills, and was only slightly above the state average millage rate in 1975. By 1985, despite a declining population, the millage rate was raised to 73.07, nearly 25% higher than the state average of 54.47. Despite the increase in property tax rates, revenue was still rapidly declining due to larger economic forces – especially the deindustrialization of the city and corresponding loss of population. The loss of jobs and population decimated the tax base. Property values and per capita income fell sharply in

Ecorse through the 1980s. The state equalized value of property in Ecorse declined from \$235 million in 1980 to only \$165 million in 1986 (Seidenstat 1999, 153)

From 1982 through 1986, the city of Ecorse was unable to make payment to various vendors and accounts, including utility companies, police and fire department payroll and pension boards. Lawsuits and petitions were filed, and the case fell to Judge Dunn in the Wayne County Circuit Court. Judge Dunn ordered Ecorse to post a judgement bond in 1985 to pay off debt and balance its budget. The city was able to sell bonds for \$4 million, but still ran a \$4.5 million deficit. When the city failed to adopt a budget in the 1986-87 fiscal year, Judge Dunn ruled that the city was in violation of Michigan's Uniform Budgeting and Accounting Act (PA 621 of 1978) which required cities to adopt a balanced budget. When city officials did not comply with the Judge Dunn's ruling to adopt a budget, the court appointed Louis Schimmel as the first receiver in Michigan history (152-153).

Schimmel, a local government finance expert and director of the Municipal Advisory Council of Michigan, was provided with the authority to act with unprecedented power.

Robert Daddow (1993) an analyst with The Mackinac Center for Public Policy, a free market think tank based in Midland, Michigan that focuses on Michigan financial policy, undertook a case study of the Ecorse Receivership. According to Daddow, Schimmel's power and authority as receiver was not clearly defined upon assumption of the position. Once Schimmel was appointed as receiver in December of 1986, meetings were held with various Ecorse city departments in an effort to understand the underlying causes of the fiscal emergency. From there, Schimmel undertook a plan of reduction of city services,

renegotiating contracts, laying off city employees and privatization a large share of the city's services.

The appointment drew some national news coverage at the time. A 1989 *LA Times* feature chronicled the actions taken by Schimmel and helped capture the mood of the city. Forty of the city's political appointees were removed, who, according to Schimmel, "weren't doing anything." The jobs were either eliminated or consolidated with other positions. The city's Department of Public Works was removed altogether. Its employees were fired, and assets, including heavy equipment and property, were sold. In its place, Schimmel privatized the public works services to a contractor. City services were removed and private contractors were inserted for other city services, including street sweeping, water and sewer system maintenance, tree trimming and road repairs. The city's workforce was reduced by 60%. According to the *LA Times* feature; the privatization efforts saved the city of Ecorse over \$1 million a year; Seidenstat puts the cost savings at \$926,798 (Green 1989; Seidenstat 1992, 161).

Discussing his position as receiver for the city of Ecorse emergency manager, Schimmel told the *LA Times*:

"There is something wrong . . . when you have one guy come in who's almost like a dictator and take home rule away from people. You can justify it . . . when somebody is flagrantly abusing the system, which is what was going on here."

From the perspective of local elected officials, Mayor Larry Salisbury, who had been elected after Schimmel was appointed receiver, described who really ran the city:

"The receiver is the absolute chief executive officer," The council, by court order, yielded all the power vested in them. The receiver doesn't have to discuss what he's going to do with anybody. But he's a polite enough person that he does" (Green 1989).

According to Seidenstat, Schimmel had four primary objectives that were completed during his tenure as receiver of Ecorse: (1) straighten out a chaotic system of financial record keeping; (2) settle all pending labor grievances and litigation; (3) eliminate unnecessary personnel and services; and (4) privatize nearly all necessary services and contract them out.

Not everybody was happy with this privatization and cost cutting experiment.

James W. Parker Sr., an Ecorse city councilman told reporters:

"Look man, I can't go along with nothing he's trying to do. The man came into this town to destroy Ecorse, and he's doing a damn good job." Standard and Poor's municipal finance expert, Hyman C. Grossman described the receivership and subsequent measures undertaken by Schimmel as "draconian" (Green 1989).

Ecorse's elected politicians and employee unions were angered by the actions.

Some community members criticized the \$100,000 salary Schimmel collected, which would be \$217,000 in 2015 dollars. A prevalent critique was that Schimmel was not elected by the people of Ecorse, and should not have had the power to make such dramatic decisions for the community. However, Seidenstat points out that Judge Dunn and his successor, were elected positions, so there was at least *some* degree of electorate accountability to the receivership course of action (Seidenstat 1999, 160)

In 1990 after more than three years of receivership and suspended local democracy, the city of Ecorse posted a budget surplus and the receivership subsequently ended, although the city was dramatically transformed and privatized. The financial crisis experienced by the city of Ecorse was a catalyst for legislation to address future financial crises in the state of Michigan. In Ecorse, state officials found themselves without a mechanism to control, prevent or repair a situation that had quickly escalated to

municipal default status. In the absence of statute, the local government fiscal crisis required the intervention of the circuit court judge.

The situation in Ecorse was the first example of a court-appointed receiver to be found in Michigan history and among the first in U.S. history. The emergency manager statutes, which also may be thought of as state intervention laws and would be generally titled with variations of “local government fiscal sustainability” were a direct result of the actions that took place in Ecorse. The actions taken by Mr. Schimmel during the receivership in Ecorse would form a playbook for future emergency managers operating under statutes that were passed as a reaction to the Ecorse financial crisis.

As Ecorse exited receivership, Schimmel reflected upon his time with unprecedented local government power in Ecorse:

"I'm glad I did it once. I think I've blazed a trail for others to follow." But, he added, "I don't think when a municipality gets in the kind of shape that Ecorse was in, to send someone like me in to bail it out does any good because now, when I leave, it is just going to fall apart again" (Green 1989).

Schimmel's warning would prophetic; nearly a decade after he departed, the city would once again fall into debt. Under a future state law, the city would be appointed an emergency manager again in 2009. Schimmel himself would go on to become an emergency manager of two other Michigan cities – Hamtramck and Pontiac under later versions of Michigan law.

Public Act 101 of 1988

Michigan's first emergency manager statute was Public Act 101 of 1988. This legislation was passed as a reaction to the financial crisis in Ecorse that led to a court appointed receiver. The ambiguity of that situation resulted in a political opportunity to

address a perceived need. Public Act 101 of 1988 (PA 101) became effective on April 11, 1988, after being signed by Michigan's Democratic Governor James Blanchard.

PA 101 was enacted around the same time that Schimmel was completing his privatization efforts as the court appointed receiver of Ecorse. A detailed analysis of the statute at the time of passage came from the Citizens Research Council (CRC) of Michigan. The CRC is a nonpartisan, non-profit public affairs research organization, founded in 1916, that aims to provide, unbiased, information on issues concerning Michigan's state and local government finance. The CRC described PA 101 as "the culmination of efforts begun in the 1970s to define the local financial conditions that should trigger state intervention, and the form that response should take. Those efforts in Michigan were reinforced by the severe fiscal crises in New York City and Cleveland that took place in the 1970s and 1980s (Citizens Research Council 1988, 3). PA 101 provided a statewide structure to identify and respond to severe financial crisis in local governments.

PA 101 of 1988 applied to any city, village, township, county, authority established by law, or public utility owned by a city, village, township, or county. PA 101 held the State Treasurer accountable for responding to initial requests and conditions for state involvement. The situations identified would define the local financial problems which allow for state intervention.

Request for Review

PA 101 set forth certain conditions that would trigger a preliminary review by the Michigan State Treasury that may potentially lead to a more comprehensive review, and eventually, the appointment of an emergency manager. The preliminary review would

determine whether a local government financial emergency existed. They different routes to prompt a review included:

1. Written request by the governing body; chief administrative officer or a major creditor.
2. Petition by 10% of the electors who voted in the last election for governor;
3. Petition by 10% of the beneficiaries of the pension fund that pension funding is deficient.
4. Notification that employees have not received pay, and paychecks are at least 7 days late.
5. A notice of default in a bond payment.
6. A resolution from the Michigan State Senate or House or representatives.
7. A violation of Michigan state law that pertains to local government finance. This includes the municipal finance act, emergency municipal local act, uniform budgeting and accounting act, or the state revenue sharing act.
8. Failure to provide an acceptable annual financial report or audit to the State Treasurer
9. Request by a taxing jurisdiction upon which the local government in question is delinquent in distributing tax revenue.
10. A court order of an additional tax levy without prior approval of the governing body.

Based upon these criteria, it is clear that there were many different potential avenues to trigger a preliminary review by the Office of the State Treasurer. The preliminary review under PA 101 required that the State Treasurer establish meetings with the local government unit and obtain information to verify the situations. The State Treasurer then had 30 days to inform the governor whether it was determined that a serious financial situation exists.

Appointment of Review Team

If the preliminary review determined a serious financial situation existed in the local government of question, the Governor was required to appoint a review team that would perform a more comprehensive review. The review team consisted of the State Treasurer; Auditor General; an individual appointed by the Senate Majority Leader; an individual appointed by the Speaker of the House of Representatives; and other state officials with relative experience, most likely consisting of Michigan treasury department members. The review team was required to conduct a full investigation, but also had the option of negotiating and entering into a consent agreement with the local government, which consisted of a long-term financial plan to address the issues uncovered during the review. In other words, the state and local government could negotiate a plan to address the issues while the review was taking place.

Within 60 days of the preliminary review, the review team had to report out the findings. There were only three recommendations the review team could provide to the Governor:

1. A serious financial condition does not exist.
2. A serious financial condition was found, but a consent agreement was adopted to resolve the problem.
3. A financial emergency currently exists in the local government and no consent agreement was agreed upon.

Governor's Action

Once the review team submits their report including the recommendations, the Governor had 30 days to make a choice among the three options:

1. A determination that there is not a financial emergency
2. There is a financial emergency and the negotiated consent agreement is sufficient to resolve the financial emergency.
3. There is a financial emergency taking place in the local government, and no plan or consent agreement in place to address it.

If the Governor determines there was a financial emergency, he or she was required to provide the local government with 10 days to request a hearing. Once the hearing was complete, the Governor would either confirm or withdraw the determination. Additionally, if a consent agreement was put in place during the full review, and the State Treasury office informed the Governor that the local government is not adhering to the terms of the review, then a local government financial emergency may also be declared.

Local Government Appeal Option11111111

Under PA 101 of 1988, the local government had the option to appeal to the local Circuit Court. The court may disallow the determination of a local government financial emergency if it is not supported by substantial evidence, or if the court determines that the review was not conducted fairly. The appeal option was provided to ensure that the courts could intervene if politically motivated acts were taking place under the law (Citizens Research Council 1988, 5).

Emergency Financial Manager

Once the appeal process is complete, the Governor had to assign responsibility to the Local Emergency Financial Assistance Loan Board, which was previously created under Public Act 243 of 1980. The board was then charged with appointing an emergency financial manager¹ that would report to the board. The emergency financial manager (EFM) was to have experience in the realm of local government financial management, and must not have been an elected or appointed official in the jurisdiction within the last five years. The EFM was entitled to compensation, paid by the local government, and had the ability to hire staff or contractors.

¹ Subsequent statutes would refer to emergency manager, instead of emergency financial managers.

The EFM was tasked with creating a financial plan for managing the local government's operations that would ensure fiscal sustainability. This plan was to include an assessment of the conditions that lead to the financial emergency, along with accompanying corrective actions to remedy the problems found. The EFM had the power to exercise budgetary control, approve or disapprove appropriations, consolidate departments, sell assets, renegotiate existing labor contracts or contract with other local governments to provide services. The contract powers under PA 101 of 1988 provided the EFM with authority to renegotiate, but not authority to break the contracts in place. In many regards, the powers of the EFM under PA 101 of 1988 corresponded to those exercised by Schimmell during the receivership of Ecorse that took place shortly before the act was passed, and most likely had a significant impact on the statute. The EFM was not authorized to raise taxes in the local government unit, without a vote from the residents.

In the event the EFM could not develop a plan to resolve the local government's financial emergency, the EFM was required to notify the Local Financial Assistance Loan Board, which would then authorize the local government to file for bankruptcy under Chapter 9 of the United States bankruptcy code. Chapter 9 bankruptcy requires that the local government be authorized by state statute to file for bankruptcy. As we previously discussed, states address the possibility of Chapter 9 differently – some states prohibit any such filing, others only under the most extreme conditions, while others have more relaxed requirements for Chapter 9 bankruptcy filing.

PA 101 of 1988 was the first emergency manager statute in Michigan, it was later repealed by PA 72 of 1990, then PA 4 of 2011 and finally PA 436 of 2012. Information

for PA 101 of 1988 is much less readily available -the statute was short lived, and an emergency financial manager was never appointed under the law in its brief lifespan. Two reviews were conducted in Royal Oak Township and River Rouge and both led to consent agreements from which very little information could be found. PA 101 of 1988, did not contain as formal a review structure as future laws would. Additionally, the statute did not apply to school districts. In 1990, a new law was developed, Public Act 72 of 1990, which repealed PA 101 of 1988. More so than PA 1988, this law forms the basis for the more controversial statutes that would follow - PA 4 of 2011 and PA 436 of 2012 which resulted in statewide protests and national news headlines. In the next section, we will discuss the structure of PA 72 of 1990, and how it was implemented.

Public Act 72 of 1990

An account is found in the Metro Times that briefly discusses the possible influence that Louis Schimmel, the first receiver in Michigan history, may have had on the formation of PA 72 of 1990:

“More than a decade ago, Louis Schimmel sat in an office, hard at work as the court-ordered receiver of Ecorse, slashing costs, dissolving the unions, streamlining services. An up-and-coming senator walked through the door with his entourage to ask questions.

‘This is great,’ Schimmel remembers the senator saying of his work as receiver from 1986 to 1990, when he erased Ecorse’s \$6 million debt. The courts had put Ecorse into receivership, and a judge appointed Schimmel receiver. ‘We should have the ability to do this on the state level,’ Schimmel says the senator remarked.

The senator went on to draft a measure that eventually became statute in 1990. The law allows the state to declare a city in a state of emergency and to appoint a financial manager, such as Schimmel, to balance its books.

The senator was John Engler. Since then, Engler and Schimmel have worked together” (Collins 2001)

In 1990, Public Act 72, titled The Local Government Fiscal Responsibility Act, was signed into law by, once again, Democratic Governor Jim Blanchard. It strengthened

some provisions of the previous PA 101 of 1988, and extended the powers to school districts which were previously not covered. PA 72 called for the state appointed review board to examine any Michigan local government that was found to be financially deficient based upon a number criteria. In this section, PA 72 of 1990 will be examined, as well as its implementation in Michigan local governments facing fiscal stress. Information regarding the PA 72 statute is more available than the earlier PA 101 statute, because it remained in effect for 21 years, unlike the reactionary PA 101 of 1988 statute that was only in existence for little over a year and was not fully utilized. PA 72 would be amended numerous times over the two decades it was in effect. The following represents a brief analysis of the key sections of the statute.

Preliminary Review

As with PA 101 of 1988, under PA72 of 1990 the State Treasurer was tasked with conducting a preliminary review based upon a multitude of conditions. Any one of these conditions could take place. The diversity of conditions that can trigger a preliminary review meant that various stakeholders could prompt a review. Under the law, a preliminary review would take place if any of the following conditions occurred:

1. The local government elective body or chief administrative officer requested a preliminary review. This request had to be in writing and outline the conditions that made the review necessary.
2. The State Treasurer received a written request from a creditor that had been debt which was unpaid for 6 months in the amount of over \$10,000 or represents over 1% of the general operating budget for the local government. The creditor was required to give the local government a 30 day written notice that they intended to exercise this provision.
3. The State Treasurer received a petition signed by 10% of registered electors in the jurisdiction containing specific allegations of the local government emergency and requesting a review. However, the electors were not allowed to file this petition within 60 days before a local government election.

4. At least 10% of the beneficiaries of a local government pension fund stated that the pension had not been funded as required by Michigan state law. In lieu of the 10% requirement, an actuary or trustee of the pension fund could also make the request.
5. Employees of the local government notified the State Treasurer that they have not been paid in at least 7 days after the scheduled pay day.
6. The State Treasurer received notification from a bondholder that there was a default in a bond payment.
7. The State Treasurer received a resolution from the Michigan Senate of House of Representatives that requested a preliminary review for the local government.
8. The local government violated any of a number of state laws pertaining to the finance of local governments. These included: Revenue Bond Act; the Municipal Finance Act; any law pertaining to issuing bonds or notes; the Emergency Municipal Loan Act of 1980; the Uniform Budgeting and Accounting Act; or the Glenn Steil State Revenue Sharing Act of 1971.
9. The local government was delinquent in distributing tax revenues that it collects for another jurisdiction, and that jurisdiction requested the preliminary review.
10. A court ordered a tax levy without the local government's approval.

If any of these conditions initiated a preliminary review, the State Treasurer was required to meet with the local government and conduct the preliminary review to determine whether or not a serious financial situation existed. What constituted as a “serious financial condition” was not defined in statute, and it appears the State Treasurer had some discretion in this designation. After the preliminary review was conducted, the State Treasurer had 30 days to notify the governor that a serious financial problem existed.

PA 72 Review Team

After the preliminary review, Under PA 72 the Governor would appoint a review team that would travel to the local government and conduct a more comprehensive review. The review team would consist of the State Treasurer, the auditor general, a nominee of the Senate Majority Leader, a nominee of the Speaker of the House of Representatives, and other state officials or “individuals with relevant experience” most likely state treasury staff or consultants that were hired.

The review team would conduct a local financial management review if any of the following conditions took place:

1. The governing body of the local government passed a resolution that requests assistance under PA 72. The resolution was required to list the financial conditions that necessitated the request. The resolution was required to pass the regular process required for passing an ordinance.
2. The governor was informed by the state treasure that a preliminary review took place and determined that the criteria (listed in previous section) demonstrates that a serious financial situation is taking place in the local government in question.
3. A review team was in place under PA 101 of 1988, they would continue under PA 72 of 1990.

Under PA 72 of 1990, the review team did not necessarily have to wait until a preliminary review was requested based upon the numerous trigger events outlined. The local government could request the full review to begin. Under PA72, the appointed review team had the authority to:

1. Review the books and records of the local government;
2. Use the services of other state agencies and employees;
3. Sign a consent agreement with the chief administrative officer of the local government, which would have to be approved by resolution by the local government’s governing body. The consent agreement had to address the long-term financial recovery of the local government. In addition, if a consent

agreement was signed, the local government had to provide periodic reports to the State Treasurer communicating the status of the implementation of the plan.

The review team was required to submit a report to the governor advising of the financial condition of the local government. Specifically, the review team was to investigate if any of the following conditions took place in the local government in question:

1. A default in the payment of bonds or notes;
2. Failure of withholding state taxes on the income of employees or failure to transfer taxes collected by the local government as an agent for another governmental unit;
3. Failure to make a contribution required by a pension plan;
4. If the total amount of accounts payable exceeded 10% of total expenditures in a fiscal year;
5. The local government was unable to eliminate an existing deficit within the 2-year period that preceded the end of fiscal year;
6. A projection of the deficit in the general fund was in excess of 10% of general fund budgeted revenues.

The review team had 60 days to report the findings from the review, unless the Governor specifically requested a shorter timeframe. Extensions could be granted as well. Copies of the report were to be sent to the chief administrative officer and the governing body of the local government, as well as the Speaker of the Michigan House of Representative and Senate Majority Leader. The review team was required to reach one of three major conclusions in the report:

1. A serious financial problem did not exist in the local government.
2. A serious financial problem was found to exist; however, a consent agreement was reached that would address the issues that were found.
3. A serious financial problem was found to exist and no consent agreement was reached to address the issues.

Governor's Actions under PA 72

Once the report was issued, the Governor had 30 days to make one of three major determinations:

1. There was no serious financial problem in the local government.
2. There was a serious financial problem in the local government, but a consent agreement had been adopted.
3. There was a serious financial problem in the local government and no consent agreement had been adopted. Therefore, a financial emergency existed in the local government.

If the third option is selected – a financial emergency was declared – then the Governor was required to provide a written notice to the local government (to the governing body and chief administrative officer). The written notice was to include the facts that the determination was based upon and inform the local government that it had 10 days to request a hearing given by the Governor regarding the determination. Following the hearing, the Governor had to revoke or confirm the determination that a local government financial emergency exists and provide a written report regarding the findings of fact. If the local government did not follow through on provisions in any consent agreement, then the Governor was able to declare a financial emergency exists.

Appeal Option under PA 72

Under PA 72, the local government had the option of appealing the determination made by the Governor. This appeal was to be made to the Circuit Court for the county in which the local government was located, or to the Circuit Court of Ingham County, which is the court in which Lansing, the state capitol is located. Whichever court the appeal is filed with, under PA 72 of 1990 the court was able to revoke the Governor's determination only if it finds that the determination was:

1. "Not supported by competent, material, and substantial evidence on the whole recorded."
2. "Arbitrary, capricious, or clearly an abuse or unwarranted exercise of discretion."

The Emergency Financial Manager Appointment

If the Governor determined that a financial emergency existed, under PA 72, the Governor then had to assign responsibility for managing the financial emergency to the Local Government Financial Assistance Loan Board. This board was created under Act 233 of 1980, the Emergency Municipal Loan Act. The board would be considered "ex officio" and consists of the State Treasurer, the Director of the Department of Licensing and Regulatory Affairs, the Director of the Department of Technology, Management and Budget. The board's authorizing statute states that it is to operate independent of the state treasury department. It is this board that was tasked with appointing the emergency financial manager; although it is likely the Governor may have had input in high profile selections.

The EFMs were to be chosen based upon their expertise and competence in the area of local government financial management. The statute stated that the EFM could not have been an elected member of the local government for at least 5 years, and was not required to be a resident of the local government unit. The EFM served at the pleasure of the Local Emergency Financial Assistance Loan Board. Compensation and reimbursement of expenses were to be paid by the local government and was to be approved by the board. The EFM could hire staff or professional consultants, subject to approval by the board, and those costs would also be paid by the local government in which they were appointed.

EFM's Written Financial Plan

Once appointed, the EFM's first deliverable was to complete a written financial plan for the local government to address the financial emergency. The financial plan was to address two key issues:

1. The operating plan for the local government with the resources available according to the EFM's revenue estimate.
2. The full payment of scheduled debt service requirements on all bonds and notes of the local government, as well as any other uncontested legal obligations.

The financial plan was to be made public, but did not require public approval. The plan could be modified if revenue estimates required modification. Essentially, the financial and operating plan is the diagnosis of the problems the local government has faced and an assessment as to their severity. The plan generally includes the preliminary recommendations for improvement, which are then followed up by the emergency financial manager's orders, issued under the authority of PA 72, and highlighted in the next section.

EFM Powers

Under PA 72 of 1990, The EFM could undertake several actions:

1. Analyze the factors that lead to the financial emergency and recommend corrective action steps.
2. Amend, revise, approve or disapprove the budget of the local government. This included limiting the amount appropriated or expended while acting as EFM.
3. Require, approve, revise or disapprove a plan for payment of all outstanding debt obligations for the local government.
4. Require special reports to be sent by the local government's finance office.

5. Conduct an examination of all records and accounts, including the production of any records necessary to provide analysis of the financial situation of the local government.
6. The authority to approve or disapprove any appropriation, contract, expenditure, or loan, the creation of new positions, or the filling of vacant positions.
7. Review the local government payroll, or other claims against the local government before payment.
8. Exercise the authority on behalf of the local government to renegotiate existing labor contracts, act as agent of the local government during bargaining, and approve any contract or agreement.
9. Consolidate departments of the local government; or transfer functions from one department to another.
10. Appoint, remove or supervise any heads of department that are not elected officials.
11. Unless restricted by the local government charter, sell local government assets, as needed.
12. Apply for a loan from the state, subject to the procedures in the Emergency Municipal Loan act of 1980. This loan could also be used to pay for some of the expenses of the EFM.
13. Approve or disapprove of the issuance of obligations of the local government, subject to state law and restrictions.
14. Enter into agreements with other local governments to provide services.
15. Exercise authority as the chief administrative officer and local governing body concerning the adoption, amendment, and enforcement of ordinances or resolutions that affect the financial condition of the local government.
16. Reduce or eliminate the salary of the chief administrative officer and/or members of the local governing body; however, the EFM was not permitted to impair vested retirement benefits.
17. Determine whether criminal conduct contributed to the financial crisis in the local government, and if so, submit a report to the local prosecuting attorney for investigation.

EFM's Report of Activities

The EFM was required to post a report to the local government's website every 6 months (which reflected a later amendment to the statute coinciding with the rise of the internet), with copies to the Governor and both houses of the state legislature. The report must contain:

1. A description of all expenditures approved or disapproved that were in excess of \$10,000.
2. A list of each contract the EFM approved, over \$10,000.
3. Descriptions of any positions created or eliminated by the EFM.

Chapter 9 Bankruptcy Option

Under PA 72, the EFM was given the power to authorize the local government to file for bankruptcy under Chapter 9 of title 11 of the United States Code (11 U.S.C 101 to 1330), unless the Emergency Financial Assistance Loan Board disapproves of this the action. This section in the statute (Section 22) was important because Chapter 9 of the bankruptcy laws requires the state have a statute that authorizes local governments to file for bankruptcy, if that course of action is chosen. The EFM was required to submit written notification to the Financial Assistance Loan Board that stated there was no feasible financial plan to resolve the financial emergency, or that the financial plan was unable to be implemented in a timely manner. The board then had up to 60 days to disapprove of the decision to file for bankruptcy.

Taxes

As was the case under PA 101 of 1988, under PA 72 of 1990 the EFM had no authority to unilaterally raise taxes without approval at an election of the majority of voters in the jurisdiction of the local government.

School Districts

Unlike PA 101 of 1988, PA 72 of 1990 also applied to school districts in Michigan. However, this case study is focused on local governments other than school districts, and an analysis will not be provided for the many school districts in Michigan that have fallen into financial emergencies, and subsequently appointed emergency manager.

Summary of PA72

The Local Government Fiscal Responsibility Act, PA 72 of 1990, called for the State Treasurer to conduct a review of a local government's financial situation upon request from local officials, state legislators or even residents. Once an initial review is conducted, the State Treasurer's office would issue a report to the Governor. If the Governor determined that an emergency financial situation existed, he or she would then select a financial review team to undertake a more comprehensive review of the local financial situation. The financial review team was to examine such issues as the local government's ability to compensate creditors, meet payroll obligations and continue to fund employee pension funds.

Upon completion of the review, the financial review team was required to determine one of three options: (1) An emergency financial situation is not found to be occurring in the local government unit; (2) An emergency financial situation is found, but

a consent agreement plan was negotiated during the review and was adopted to address the emergency; or (3) An emergency financial situation is found and no current plan was in place to address the problem. If the third option is reached, the Governor was to appoint an Emergency Financial Manager to the local government unit to address the emergency.

An EFM appointed, under PA 72, had a variety of options to address the fiscal crisis. These powers were considerable in scope. The EFM had the authority to remove current city officials, as well as appoint new officials to assist toward the development and implementation of a financing plan. The EFM could modify the budget of the local unit of government, disallow certain obligations, reduce or eliminate pay for the mayor or elected city legislator. The EFM could sell off locality owned assets, unless the local government's charter prohibited it, and this represented an important protection for the local government. The EFM was also authorized to initiate Chapter 9 Municipal bankruptcy proceedings, subject to state board approval. Compared to the future versions of the emergency financial laws, PA 72 Emergency Financial Manager's had two distinct limitations: First, labor contracts could not be voided, but only renegotiated; and second, the powers of the EFM were restricted by the municipalities' local charters (for example, the selling of certain city-owned assets could be forbidden by charter). In other words, the local charter still took precedence over the actions of the EFM.

Implementation of PA 72

PA 72 of 1990 became effective in May of 1990, and minor amendments were made over the next two decades. There did not appear to be a great deal of controversy over the statute. After it became effective in 1990, the law was not implemented for over

10 years. It is interesting to note that for over ten years, from 1990 – 2000, no EFM's were appointed, or consent agreements signed under PA 72. This is likely due to the relatively strong economy in the United States, and Michigan during the 1990s, as well as probable caution exercised in due to appointing an EFM to a local government, and thereby removing local democratic control.

In the following section, the first four local government financial emergencies declared under PA 72 will be examined. Each of these resulted in the placement of an EFM in a local government to address a financial emergency. These cases will include the cities of Hamtramck, Highland Park, Flint and The Village of Three Oaks.

Hamtramck (2000)

It wasn't until the year 2000, ten years after PA 72 was passed, that a financial emergency was declared in a Michigan local government that required an EFM to be appointed. During the administration of Republican Governor John Engler, the city of Hamtramck, which had been suffering financially for years, was determined by the state to be experiencing a financial emergency. In November of 2000, Michigan's Emergency Financial Assistance Loan Board chose a familiar face to become the Michigan's first ever Emergency Financial Manager – Louis Schimmel, the former receiver of the city of Ecorse. Schimmel would become the first emergency manager in Michigan history, 13 years after he was appointed as the first receiver in Michigan history. Because of these important appointments, Schimmel is a central figure in Michigan's history of local government financial emergency management, and perhaps in the United States as well.

Hamtramck is a small manufacturing town that is mostly an enclave within Detroit. It shares a small border with another small enclave city, Highland Park, but is otherwise completely surrounded by the city of Detroit. In other words, Hamtramck may be thought of as a small, financially struggling city that borders another small, financially struggling city and is geographically surrounded by a larger, financially struggling city. Hamtramck was historically home to a sizeable Polish community. According to the U.S. Census, the city contains 2.1 square miles and was home to just over 22,000 residents. In 1950, the city's population was nearly twice as large, with over 43,000 residents. Hamtramck had been home to a large Polish community, but in the past 30 years the population had grown more diverse, with many Asian and Middle Eastern immigrants having settled in the city. By the 2000 census, the Bangladeshi population made up just fewer than 20% of the residents. Hamtramck has a rich automotive history, and was home to the famous Dodge Main plant, which turned the rural community of 1910 into a bustling industrial town by 1920. However, by 1980, caught up in a wave of deindustrialization for the automotive industry, the Dodge Main plant closed.

Hamtramck had financial problems since the 1970s, when the city was placed in some form of receivership, due to an inability to meet payroll for city staff. A 1973 Advisory Commission on Intergovernmental Relations study determined that Hamtramck's financial problems were due to three causes: (1) a lack of sound financial management policies and practices; (2) excessive pension obligations; and (3) state laws that limited the city's ability to raise revenues to meet its obligations (ACIR 1973).

In 1971 Hamtramck was forced to work with the Michigan Finance Commission to issue tax anticipation notes to ensure the city could still operate. As a condition, the

Michigan Finance Commission put stringent requirements on the city. In 1971, the city once again could not balance its budget due to political tension between the mayor and council. Creditors and unpaid employees took the city to Circuit Court, which threatened the city officials with contempt rulings if a balanced budget could not be put in place. The ACIR reports that there was continuing supervision from the Municipal Finance Commission, the Circuit Court of Wayne County, and the Michigan State Attorney General's Office (ACIR 1973, 39). While never appointed a formal receiver, the Hamtramck nonetheless was under some form of state oversight during the 1970s.

By 2000, Hamtramck was once again running deficits and in serious financial trouble. With a \$2.5 million deficit and \$7.5 million in bond debt, the small city was designated by the state as experiencing a financial emergency. While acting as the receiver of Ecorse from 1986-1990, Schimmel's actions impressed then-Senator John Engler, who would go on to become governor of the state from 1991 – 2003. In November of 2000, Schimmel was appointed by Engler to be the EFM of Hamtramck.

In a 2002 interview, Schimmel reflected on the trepidation he experienced before taking on the Hamtramck job:

“I never thought the state would take over a municipality – ever. I remember walking up the steps to this building and thinking, ‘What have I gotten myself into?’ It was so depressing. The physical facility itself is so depressing so bad. And I really wondered if I'd made a mistake, agreeing to do this. I thought about going back to Lansing and telling them I just couldn't do it.”
(Collins 2001)

Similar to the actions taken in Ecorse, Schimmel would privatize many Hamtramck services and eliminated positions where possible. Union contracts were renegotiated, but under PA 72, could not be unilaterally broken. In his first year, Schimmel reduced the city's workforce by 17 percent. Private firms were hired for trash

collection, fire hydrant repair and vehicle maintenance. Equipment Schimmel deemed no longer necessary was auctioned off. Schimmel declared, “The city will see services like it never has before. We’ll contract out everything” (Collins 2000).

Schimmel departed Hamtramck as EFM in 2006, and by 2007 the state revoked the financial emergency designation. Similar to Ecorse, despite the cost cutting and privatization measures, Hamtramck would soon once again be in fiscal distress. By 2010, the city was once again running a deficit and was found to have significant management turnover and dysfunction in government. In 2013, Hamtramck was again designated to be under a financial emergency by the state and assigned its second emergency manager. Similar to the first receivership in Ecorse, the first instance of an emergency manager in Michigan was able to cut the budget, but unable to create enduring fiscal sustainability.

Highland Park

As with Hamtramck, in the year 2000 financial conditions were not much better in Detroit’s other enclave city, Highland Park. Like Hamtramck, Highland Park is surrounded entirely by the city of Detroit. Also like Hamtramck, Highland Park would be placed in a financial emergency designation and be the second Michigan local government to receive an EFM in December 2000.

Highland Park, Michigan, despite its recent financial collapse, has a prominent place in Michigan, and United States history. The city is home to one of the most important manufacturing buildings in the entire world – The Henry Ford Highland Park factory. It was here where the assembly line process was invented. The National Park Service notes that:

“Probably no factory changed life in 20th century America as much as the Highland Park Ford Plant. It was here, that Henry Ford and his engineers developed many of the crucial principles of modern mass production. The most notable of these was the continuously moving assembly line; its introduction in late 1913 reduced the assembly time of a Model T from 728 to 93 minutes. By 1920 the plant turned out a car every minute, and one out of every two automobiles in the world was a Model T” (National Park Service 2015).

The Ford Highland Park Plant was the birthplace of the assembly line, and at the time of its inception, the largest manufacturing plant in the world. The plant has been closed for decades, but still draws interest. As of 2015, the plant remained in disrepair and could not be toured. In 2013, Deborah Schutt, Executive Director for the Woodward Avenue Action Community commented on the interest from abroad in Highland Park:

"There is not a week that goes by that someone from Europe or Asia doesn't arrive at the (complex) guard shack and ask how they come in to see Ford Highland Park" and the birthplace of mass manufacturing. "The Europeans and Asians are shocked when there's no public access" to the complex, which literally changed the world (Welch 2013).

According to U.S. census data, in 1910, the population of Highland Park was 425, and the area was mostly farmland. In 1911, the population was 4,120 and by 1920, the population was over 46,000. Like Hamtramck, Highland Park was a tiny enclave that avoided annexation by the city of Detroit and provided a form of tax shelter for Ford from the increasingly tax rates of Detroit, which surrounded Highland Park. While the Highland Park Ford Plant moved its assembly line to the colossal River Rouge Plant in the 1920s, Chrysler founded its headquarters in Highland Park in 1925. The tiny enclave city was an epicenter for automotive innovation in the early 20th century. In the early 1990s, Chrysler, led by Lee Iacocca, moved the headquarters to Auburn Hills, a suburb over 35 miles from Detroit. When Chrysler Headquarters left, Highland Park lost 25% of its tax base and 50 percent of its annual budget (Brown 1992). With the automotive departure, there was some discussion in having Detroit absorb Highland Park, but by

then, Detroit was not interested. As Mark Binelli, in a contemporary chronicle of Detroit, described, Detroit had “zero interest in adding more crime, blight, and desperately poor people to its own mean buffet of urban pathologies.” Highland Park, “officially the poorest city in Michigan, manages to tidily pack all of the problems of Detroit into just three square miles,” (Binelli 2012, 182-183).

Highland Park was a type of auto manufacturing boomtown from 1910 through 1950. The city, with only 2.9 square miles, was home to over 50,000 residents in the 1940s. By 2000, only slightly more than 16,000 residents remained in the city. Census data shows that over 93% of the city was African American. The median household income in 2000 was \$17,737, compared to \$46,181 for Michigan. In 2000, Per capita income in Highland Park was only \$12,121. This is compared to \$29,397 in Michigan. Over half of the residents in Highland Park lived below the poverty level.

In 2000 and 2001, the financial review team under authority of PA 72, reported that the city underestimated its general fund deficit for 2000 by \$700,000, and anticipated a general fund deficit of \$2.8 million for 2001. The report also found that the city failed to pay into the state retirement system and owed significant amounts of federal taxes and Social Security and Medicare payments, along with a debt estimated at \$1.5 million to Detroit Edison and Waste Management of Michigan (Carvlin 2001).

The state emergency loan board voted to appoint Ramona Henderson Pearson, a certified public accountant, who had previously served for 10 years as auditor general in Wayne County, to the position of emergency financial manager of Highland Park. Pearson had been appointed earlier in 2000, but a state court sided with a challenge by the city and prevented the state's takeover. Later in 2001, when a second review further

identified problems with the city's pension fund, the review team reiterated its first finding that a "financial emergency" existed and Pearson's appointment was sustained (Carvlin 2001). The second appointment survived legal challenges and Pearson assumed duties as emergency manager of Highland Park.

Initially, Pearson's plan of action sought to declare bankruptcy on behalf of Highland Park, which was allowed under PA 72, but required state approval. When this proposal was presented to emergency financial loan board and to the Governor, it was rejected because Governor Engler "did not want the embarrassment of a bankrupt city on his watch." Therefore, Pearson presented a second plan, which requested that the State of Michigan lend its good credit rating to Highland Park so that the city could float a bond for \$30 million to be repaid over 30 years. The funding from the bond would pay off the Highland Parks debts, repair buildings in serious disrepair and provide a revenue base to restore to limited city operations (Michigan Quarterly Review 2003). This rather ambitious plan was also ultimately rejected by the state.

Pearson also requested to the state that Highland Park be allowed to contract with the state police or National Guard for policing the city. These requests were also denied, and the state suggested that Highland Park contract with Wayne County, to provide police protection. However, when Pearson disbanded the police force in December of 2001, the Wayne County Circuit court ruled in March 2002 that the wholesale layoffs violated the city contract with the union and were ordered to return to work. After the ruling, Pearson was adamant that Highland Park could not afford to maintain the police force; Pearson declared to the press, "We're just increasing the number of people you can't pay. Small cities can't afford a police department." (Siegel 2002).

From the onset of her appointment, the state sent clear messages that it was unwilling to bail out the city. Pearson applied pressure on state officials by making recommendations via press conference, without providing prior notification to the Governor or the Financial Emergency Loan Control Board who appointed her. Media reports from the time indicate that she consistently voiced her frustration with the position of emergency financial manager (Carvlin 2002). In contrast to the warm relationship Schimmel had with state officials, Pearson appeared to be branching out of the state's comfort zone with some of the recommendations for further collaboration between the state and the city of Highland Park, as well as the lack of coordination on press conference talking points.

However, Pearson did cut costs and privatized services. City employees were laid off, libraries were closed, and services were contracted out, including the water department. There was much community anger over the high salaries paid to Pearson (in excess of \$100,000) and her appointed consultants, since under PA72, salaries for the EFM and their staff were paid out of the city's finances; and generally at the same time cities were broke and had to lay off employees. It was noted that Pearson's salary was more than that of the mayor and city council combined (Siegel 2005).

Through the controversy, due to the cutting of costs, the city's debt was reduced from \$20 million to \$3 million. Despite this, Pearson was forced to resign in March 2005 and was replaced by a second EFM, Arthur Blackwell II, a former Wayne County Commissioner, who was appointed during the administration of Democratic Governor Jennifer Granholm. Blackwell's father was the first black mayor of Highland Park. He was not a financial manager, but was a former legislator brought in to focus on economic

development for Highland Park, after the debt had been reduced by Pearson. Blackwell, according to the State Treasury press release, generously requested an annual salary of \$1. Blackwell told reporters that he was "tired of giving hundreds of dollars for outside legal counsel." The mayor and council members praised Blackwell's ability to get things down for less (Siegel 2005). This praise for Blackwell wouldn't last very long. By 2009, Blackwell was charged with embezzlement of city funds and was replaced as EFM. After a lengthy legal battle, in 2013 he was found guilty of lesser charges and sentenced to pay \$264,000 in restitution and serve 2 years of probation (Anderson 2013).

Blackwell was replaced in 2009 by Robert Mason, who was an experienced management consultant. Mason only served for 3 months, and his primary goal was to return control to the city of Highland Park. When he was appointed, it was uncovered that the city still owed a tremendous amount of debt. The city owed \$3.2 million in overdue lighting bills to DTE Energy, \$4.4 million in sewerage costs to the city of Detroit and over \$1 million to the Wayne County Sheriff's Office, for law enforcement services previously provided to the city (Lawrence 2009).

Despite these obstacles, EFM #3 left in 2009, and local power was returned to Highland Park, although the city was technically still operating under an emergency financial condition and had specific requirements it had to follow. After nearly a decade of emergency financial management, the city of Highland Park was not measurably better off, and perhaps may have been in some ways worse. In 2014, the state, once again would conduct a review along the process of placing an EFM in the city of Highland Park. The report stated:

"The city has not had an Emergency Financial Manager since July of 2009. Since that time, City official's essentially have responsible for making day-today financial and

operational decisions with some, but relatively minimal formal, involvement by the State. However, the original determination made in 2001, that a financial emergency existed in the City has not been revoked because the City's financial condition has not improved sufficiently to commend such a revocation. City officials have noted with some poignancy, and not without a measure of accuracy, that a decade of State intervention has not resolved the City's financial difficulties."

(Michigan Department of Treasury - Highland Park Review Team Report 2014, 8)

Flint

Under PA 72, the first EFM was placed in Hamtramck in 2000, and the second in Highland Park in 2001. The third EFM was outside of the Detroit area, 60 miles north, in the city of Flint. As with Hamtramck and Highland Park, Flint was a former automotive center,

In contrast to Ecorse, Highland Park and Hamtramck, all with populations under 20,000, Flint was a larger city, with 124,943 residents listed in the 2000 U.S. Census and was the 4th largest city in Michigan at the time.

Flint is the location where General Motors was founded by William C. Durant in 1904.

In the 1970s, GM had 80,000 workers across 15 factories, by 2002, there were only 20,000 workers across three factories (Hakim 2002). In 1960, after the incredibly prosperous post WWII years under Alfred B. Sloan, Flint's population was 196,940. In 1970 the population was 193,317. After the deindustrialization of the 1980s and 1990s, the 2000 population was only 124,943, a 35% decrease from 1970. As with Ecorse, Highland Park and Hamtramck, with the loss of manufacturing jobs went the tax base for the city. The only difference was that Flint was a larger scale, so the fall was much farther and the city debt and deficits much greater.

In May 2002, after the preliminary review was triggered by the Michigan Senate, Republican Governor John Engler sent in a financial review team review to Flint. The review reported that there was a general fund deficit of over \$26 million as of June 30, 2001, which was nearly double the \$13.9 million deficit reported in the previous year. Additionally, the review found that Flint owed the state \$12 million from unpaid tax payments between 1986 and 1991 and was delayed in issuing its past five most annual audits. The review team found that Flint was unable to implement its own plan for budget reduction. Governor Engler pushed the Emergency Loan Board to name retired college president Ed Kurtz as emergency manager of Flint. Kurtz, a Flint native, was the founder and president of Baker College the largest private college in Michigan (Hakim 2002; Carvlin 2002).

While the mayor of Flint and some city officials and residents acknowledged the financial emergency and wished to work with the new EFM Kurtz, others opposed the declaration of a financial emergency and appointment of an EFM. City Councilman Daryl Buchanan cited the experiences of Highland Park: "My constituents are telling me that based on me going to Highland Park and other places with managers; this is something that we should battle or try to resist to the fullest extent of the law" (Carvlin 2002).

The Flint City Council voted 8-1 to legally challenge the state takeover. In an interview, the lawyer hired to challenge the state takeover, Jon Kingsepp stated that Flint was already on its way to recovery and that the implementation of PA72 in Flint "usurped local control and disenfranchised voters." Flint's mayor at the time, Darnell Early, was opposed to the lawsuit, stating that "I have some concerns about pursuing a lawsuit given

the fact that we could spend our resources in a better way. We need to work together and solve our problems” (Shine, 2002). The city of Flint won the first round of legal challenges - Ingham County Circuit Court issued a temporary restraining order that prevented the state from taking over Flint and placing Kurtz as EFM. However, in August 2002, the Michigan Court of Appeals overturned the delay and cleared the path for state takeover and Kurtz to begin work as EFM. In October of 2002 the city of Flint ended the legal battle, after \$245,000 in total costs. Kurtz took over as EFM in Flint in September 2002. When asked to compare the situation of Flint with the other two Michigan cities under an EFM – Hamtramck and Highland Park Kurtz said that those cities' problems were much more severe than what Flint faced: "I think the state stepped in here at a time when it was still more easily salvageable. I think Flint can and will turn around and become a great city again" (Moses 2003).

Among Kurt's first actions as EFM was to cut the annual salary of the mayor to \$24,000, a dramatic decrease from the scheduled pay of \$107,000. The pay of the nine council members was also decreased from \$23,000 to \$18,000. Kurtz also cut health, dental and vision benefits for the majority of Flint's city officials. In November 2002, Kurtz ordered the city retirement board to put an end to a controversial pension benefit that would reduce the pensions for nearly 350 retirees by 3.7 percent. However, in December, the state attorney general ruled that Kurtz did possess the authority under PA 72 to issue orders to a retirement system. Future versions of the state intervention law will not have this restriction. Also, in December 2002, the city's recreation centers were closed. In May 2003, water bills were raised 11% for city residents to help address the debt. By September 2003, after months of negotiations, the city's largest union finally

agreed to a 4% pay cut. In February 2004, Flint's Retirement Board accepted proposals from the EFM that lowered the amount the city would pay into the system, due to Kurtz's threat of "massive layoffs and replacing the board" (Mostafavi 2011).

In 2002, Flint recorded a balanced budget and saw a surplus in 2003 and 2004, according to a Moody's analyst news release. The \$30 million debt was reduced to \$11 million in 2004. Moody's upgraded the outlook on Flint from negative to stable.

However, Moody's analysts still had concerns about the future, including plant closings from automotive-related manufacturing and a trend of decreasing revenue sharing from the state (Carvlin 2004); all of which were measures mostly beyond the control of the local government.

Kurtz's appointment as EFM of Flint lasted from 2002 through 2004. The state takeover ended in June 2004, when Kurtz departed, but the city remained under some form of state oversight through 2006. As with Ecorse, Hamtramck and Highland Park, the fiscal challenges Flint faced would return again. The city would once again receive a state review team in 2011, be declared in a state of financial emergency, and was appointed Michael Brown as EFM. Kurtz himself would return to be the city's third EFM in 2012. The case of Flint's second experience with emergency management, and the tragic events that would result, will be discussed in greater detail in Part Four of this Chapter.

Three Oaks (2008 – 2009)

The last local government to be placed under an EFM under PA 72 that will be discussed in this section was the small village of Three Oaks in 2008. The Village of

Three Oaks represents a strikingly different example from the previous implementation of PA72 appointment of EFMs in Hamtramck, Highland Park and Flint. In fact, the Three Oaks case has very little in common with the other examples, but does provide an interesting contrast.

Three Oaks is located in Berrien County, in the extreme southwestern corner of Michigan, very near to the Indiana state border. In the 2010 census, Three Oaks had a population of 1,622 living in the town that was less than one square mile in size. In the 2010 census the population was 93.2% white and barely 1% African American. In 2010, according to the U.S. census, the median income in Three Oaks was \$44,435. Historically, among Three Oaks' most prominent business was the Warren Featherbone Factory, "which stripped turkey feathers of their quills to use in women's garments of the era such as corsets, which used stiffeners." The village is perhaps best known as the primary filming location of the 1989 Christmas movie *Prancer*, the feel-good tale about a reindeer (Threeoaksvillage.org).

Three Oaks did not represent the "typical" rust belt city in decline. As reports from the village's financial emergency from the Chicago Tribune noted:

"Three Oaks, though, does not fit the Rust Belt persona of rotting, sinking cities. About 70 miles from Chicago and 10 miles from Lake Michigan it's a popular second-home locale for affluent Chicagoans. Upscale art galleries and coffee shops line Elm Street, the main thoroughfare through the small downtown" (Jones 2008)

The small village's financial problems started around 2005, when it did not correctly budget for its 20 percent share of a massive road project. The five-block-long, \$350,000 street project and its subsequent incorrect budgeting created an enormous deficit for such a small local government. By late 2008, the village's general fund, sewer fund and water fund were maxed out. Once officials were able to understand the total

cost of bills due from the previous four years, the deficit had reached \$600,000, which equaled the amount of the town's annual general fund budget (South Bend Tribune 2009). When asked to comment on the situation, Berrien County Treasurer Bret Wiktkowski replied that "None of these people were bad people. It's just that finances weren't their forte" (Jones 2008).

The state sent a review team into Three Oaks in the summer of 2008 and found that no plan was put in place to address the financial emergency. Pam Amato, experienced in matters of local government finance, was appointed as EFM by the Emergency Loan Board in December 2008. Three Oaks represented the first instance in which Democratic Governor Jennifer Granholm declared a financial emergency and placed an EFM into a Michigan local government. It was also the first time in over 6 years, since Flint 2002, that a financial emergency was declared in a Michigan local government. After less than a year as EFM, Amato's job was complete and control was returned to the city. Amato laid off the entire police force (4 part-time and 1 full-time) except for the chief, who would be the lone police officer in the village. Eventually, as Three Oaks financial condition improved, police officers were hired back. The Downtown Development Authority (DDA) which took up around 10 percent of the village's property tax base for projects that benefit the central business district, was also eliminated as part of the debt reduction plan (*Harbor Country News* 2009).

After less than a year serving as EFM, Amato's job was done and the state returned control to the village. According to news reports at the time, Amato's time as EFM was well received by the village of Three Oaks. The Village President Dave Grosse credited Amato as being very helpful:

“She came into the situation with a spirit of cooperation and not domination, and that made a big difference. She worked very well with us. "The state's Treasury Department told her before she left that Three Oaks was now the new gold standard when it comes to measuring how a municipality gets back on its feet and on the right track when it comes to working its way through a serious financial crisis."
(*Harbor Country News* December 10, 2009)

During the public comment portion of the Dec. 9 Three Oaks Village Council meeting, local resident Chris Siebenmark praised council members for the work that they've done to help the village get back on more firm financial footing:

"I just came out tonight to thank you, and I think you did a great job. I think there are two main reasons the village has been able to recover from this as quickly as it has. First, the names of the people sitting around the table at the front of this meeting room have changed, and you have brought a lot of credibility to the situation.

Secondly, this community didn't fight Public Act 72 and the state's involvement in helping to get this straightened out like so many other communities that have found themselves in similar circumstances have done. Instead, you welcomed it, and by your wanting to do it you were able to work side by side with (emergency financial manager) Pam Amato."
(*Harbor Country News* 2009)

As of 2015, Three Oaks had not returned to a declaration of financial emergency nor has it received another emergency financial manager, and as of early 2016, it does not appear to be on any path towards financial emergency. This is because unlike the other local governments that received emergency managers under PA 72, the Village of Three Oaks had low poverty, high incomes and a solid tax base that would still be there once the mistake was fixed by the EFM. This characteristic, a single-issue case versus the systemic issue cases of Hamtramck, Highland Park and Flint, will be discussed further in Chapter Five.

Ecorse (2009)

As previously discussed, Ecorse was the city that started the emergency financial management policy movement when it was placed in receivership, and Louis Schimmel in 1986 was named by the court to be its receiver. The city, by 2010 with a population under 10,000, had once again fallen on hard times, or at least, continued the stretch of hard times from before. In 2009, the city had returned to a declared state of financial emergency by the state and received another receiver, this time an EFM, when Joyce A. Parker was named to oversee the city. Shortly before Parker's appointment as EFM, the city's mayor, Herbert Worthy and city comptroller, Erwin Hollenquest were arrested on bribery and fraud charges that they accepted bribes in 2007 and 2008 in return for awarding contracts to a company that would send inflated invoices that would go unquestioned by the mayor and comptroller. Incredibly, Worthy was re-elected by the voters of Ecorse in November 2009, despite the federal indictment and his arrest at city hall just months before. By January 2010, with pressure mounting, Worthy stepped down as mayor, and in 2011 he pleaded guilty and was sentenced to 18 months in federal prison. The comptroller, Hollenquest was also found guilty, as well as, the business owners of contracting company who delivered the bribes (Foley 2009; 2011).

The Local Emergency Financial Assistance Board Granholm appointed Parker as EFM in late October 2009, after Democratic Governor Jennifer Granholm confirmed that an emergency existed in Ecorse. When Parker took over, Ecorse had a \$14.6 cumulative deficit and \$5 million structural deficit. The state review team that preceded Parker's appointment found a city that had virtually no internal controls and owed property tax that Ecorse collected to other taxing jurisdictions, including the state of Michigan, in the amount of \$6.8 million. The \$6.8 million tax debt, was a violation of Michigan state law,

when Ecorse utilized property tax revenues due to other units of government in order to maintain its own city spending levels and avoid making any budget cuts (Michigan Department of Treasury - Report of Ecorse Review Team 2009).

Parker's first move as EFM was to reduce the salaries and benefits of the mayor and all council members by 50% (MI Dept. of Treasury, Ecorse Order No.1). The second order was the cancellation of the contract with the company that ultimately resulted in bribery and fraud charges against the mayor, comptroller and business owners involved (Michigan Department of Treasury, Ecorse Order No 2 and 3). Other restructuring moves included merging the police and fire departments, privatizing EMS and other services, and securing bonds to stabilize debt and improve the city's credit ratings. By the time Joyce left, a \$14.6 million cumulative deficit and a \$5 million structural deficit had been eliminated (Al-Hajal 2013).

Benton Harbor (2010 – 2014)

The city of Benton Harbor is located in Berrien County, in the southwestern corner of the state of Michigan. In 2010 census, the town had a population of just over 10,000 over an area of 4.68 square miles. Benton Harbor, and neighboring city St. Joseph are known as the "Twin Cities" as they are only separated by a bridge across the St. Joseph River. However, despite their designation as twin cities, the two cities are quite different from each other.

According to census data the town of Benton Harbor was 89% African American and the average household income was \$18,208. Nearly half of the residents (48%) live below the poverty level. In contrast, the twin city, St. Joseph, had a population of just

over 8,000, and was 88% white with an average household over \$51,027. Less than 10% of the residents in St. Joseph lived below the poverty line. A bridge literally, if not figuratively separates the poor black town from the affluent white town.

In 2003, Benton Harbor was the scene of a riot that captured national news coverage. The riot was triggered by the death of an African American man in a motorcycle crash, while fleeing a white police officer on a motorcycle. The riots spanned two evening and required hundreds of state police in riot gear to respond; however news reports of the riots noted that frustration in the community had been going on for some time due to the economic disparity with St. Joseph (Guerrero 2003).

A 2011 *New York Times* Feature portrayed Benton Harbor as a city with incompetent leadership, trying to address major challenges in an impoverished community. From 2000 to 2010, the city had five city administrators that filed whistleblower lawsuits against the city, each claiming that they were removed once they questioned how the finances of the government were being run. The settlements costed over \$2 million alone (Mahler 2011).

In January of 2010, according to the provisions in PA72, the state sent in a review team to assess the financial situation in Benton Harbor. The review found that, among various concerns or violations of state law, that the city of Benton Harbor had incurred significant general fund operating deficits in multiple areas, and had had no deficit elimination plan. Additionally, the city did not file timely financial audit reports as required by Michigan state law. The city was delinquent in distributing property taxes collected for other governmental units; and withheld federal taxes from employees, but did not send those payments to the IRS in a timely manner. Overall, Benton Harbor was

unable to accurately assess its financial situation due to a lack of internal controls and account reconciliation; and continuously underfunded the city's pension (Michigan Dept. of Treasury, Benton Harbor Financial Review Team 2010).

The review team recommended an emergency financial manager be appointed, and Governor Granholm confirmed this recommendation. Joe Harris, former CFO of Detroit was appointed as EFM of Benton Harbor in April of 2010 and started cutting into the city's deficit by laying off 9 police officers as a first step toward addressing the city's \$3.5 million deficit. More sweeping changes would follow, especially once PA 4 was instituted in early 2010 shortly after Harris took over Benton Harbor. In 2011 under PA4, Benton Harbor would receive national news coverage addressing the controversial powers of PA4 as applied to Benton Harbor. Harris's approach was to reduce the city government services and clear a path for increased private development. The annual expenses were cut from \$8 million to \$6 million (Mahler 2011).

Pontiac (2010)

The city of Pontiac is located in Oakland County, a relatively affluent county that borders Wayne County, in which the city of Detroit resides. In the 2010 census, Pontiac had just over 66,000 residents. In 1970, over 85,000 residents called the city home. Pontiac is best known for its connection to General Motors, which included a number of manufacturing plants, many of which has since been closed. The city was also well known for its stadium, the Silverdome, which served as the home of the Detroit Lions from 1975 – 2001, Detroit Pistons from 1978 – 1988, as well as the site of WrestleMania III, where Hulk Hogan squared off against Andre the Giant in front of a record-setting

crowd (at the time). Pope John Paul II greeted large crowds at the Pontiac Silverdome in his visit to America in 1988, drawing immense crowds to the venue.

According to the 2010 U.S. Census, the City of Pontiac was 34.4% white and 52% African American. The median household income was just over \$27,000 and over 36% of residents lived below the poverty level. Both figures exceed state averages (\$48,000 and 16.8%, respectively). As a manufacturing town, Pontiac has much in common with other automotive manufacturing local governments in Michigan that have struggled. With the loss of manufacturing jobs that were prevalent in previous decades, as the population declined so did the tax base, and similar to other local governments in Michigan, the city of Pontiac was slow to respond to the changes.

In April 2008, the state conducted a review of Pontiac's finances to determine whether it was in a financial emergency. The review team found that the city of Pontiac had a deficit of over \$7 million; the city did not have sound financial management practices and was found unable to accurately monitor revenues and expenditures; and a large number of tax returns were not processed. On February 20, 2009, a letter of determination from Governor Jennifer Granholm declared a state of financial emergency in Pontiac, and the need for an emergency financial manager to be appointed (Governor Jennifer Granholm Letter to Pontiac 2009).

In March 2009, Fred Leeb who managed a consulting firm specializing in turnaround projects was appointed by the state of Michigan to be the emergency financial manager of Pontiac. After his appointment, Leeb constantly clashed with the mayor and city council, as well as residents. Leeb cut the city council's salaries by two-thirds, and blocked many of the city's legislative initiatives, which under PA72, he had the authority

to do. The most controversial decision was when the Pontiac Silverdome, which had become vacant, had fallen under city control and had been closed for years, was sold at auction to help address the debt. The Silverdome was a city asset, and under PA72, could be sold at the direction of the emergency financial manager. The winning and accepted bid was \$583,000, an amount that shocked Pontiac residents and sports fans across the state. The Silverdome, an 80,000 person capacity sports and entertainment complex, was built in 1975 for \$55 million, or nearly \$225 million in 2010 dollars. Residents were angered that the Silverdome, home of the Detroit Lions, and site of the much revered Pope John Paul II visit, was sold for roughly the same price a modest family house would cost in the Washington D.C. area. Leeb's argument that the costs of maintenance and security to maintain an empty Silverdome were unsustainable did not resonate with Pontiac residents, who were angered at the perception of a fire sale on city assets many times below market value (Faturechi 2010).

Leeb faced a difficult environment and resigned from the position in July of 2010, citing the criticism and political fights which led to "an environment of escalating hate speeches, slander, threats of violence and racism"(Oosting 2010). Leeb was replaced by Michael Stampfler, who was a former city manager of Portage, Michigan. Stampfler would remain as EFM for the remainder of PA72's lifespan, and for a portion of the much more controversial PA4 that would be signed into law in 2011. After PA4 was signed into law, a familiar name would become emergency manager of Pontiac – Louis Schimmel, who would advocate for many of the reforms to PA 72, and was the former EFM of Hamtramck and receiver of Ecorse.

Summary of PA72 and Implementation

For 20 years, from 1990 through the end of 2010, PA 72 was the law under which the state intervened in local governments experiencing financial crisis. Of the four cases highlighted in this section relating to PA 72 implementation in local governments, three of them returned to state-declared local government fiscal emergencies and would once again receive an EFM and have its local democracy suspended. This return to a state of financial emergency was despite dramatic cuts to local government's budgets.

Of the four “early” cases of EFM (pre-2009) we have examined, only one of the local governments – The Village of Three Oaks – did not experience a return to a financial emergency and placement of another emergency manager. This is due to the fact that Three Oaks did not experience the serious structural economic problems that took root in the other communities. Deindustrialization, job loss and population decline, was a factor in the other three communities. In contrast, the Village of Three Oaks' problem was relatively simple, due to the smaller scale upon which the city operates with just over 1,000 residents, and the relatively solid income numbers for its residents. In the relatively affluent, mostly white community of Three Oaks there were no major, wide-scale protests. This is likely due to the fact that the financial problems in the village could be directly tied to a single instance of financial mismanagement. It should also be noted that there was a lack of major historical racial issues in that community, which did not present the same sensitivity when local democratic control was removed by the state.

PA 4 of 2011

Generally speaking, PA 72 of 1990 did not generate a great deal of controversy except among the residents and local officials in the few local governments that were effected. In Village Three Oaks, even that was not the case, as the EFM was mostly a welcome relief for the small town officials who made poor financial decisions. This is in contrast to Hamtramck, Highland Park and Flint where there was a great deal of opposition to the placement of an EFM. Certainly it can be stated with some confidence that the scrutiny over PA 72 was not at the level of PA 4 of 2011, which dramatically increased the powers of the state, and the EFM.

While most of the increased scrutiny and controversy of PA 4 of 2011 was a reflection of the strengthened provisions in the law, it may also be related to the time in which PA4 was developed and implemented. By 2010, the digital age was in full swing, and increasing with each passing year. There was now social media – YouTube to share videos, blogs to express outrage - new mediums to share information and opinions that was not available a decade earlier. Additionally, under PA4, more local governments were targeted by the state for review.

In 2010, Republican Rick Snyder was elected Governor of the state of Michigan in the 2010 election cycle that resulted in a wave of Republican party gains across the country. Snyder, a venture capitalist, former CEO Gateway Computers and former CPA, was elected due to his perceived economical and financial competence. Michigan, despite voting President Obama to a double digit victory in in the 2008 presidential election, elected Republicans to control both chambers of Michigan's legislature, which were firmly in Republican control by 2010. Governor Snyder took office on January 1, 2011.

Just three months later, a new, more robust state intervention statute with increased authority was signed into law, and would bring state-wide and national media attention and controversy.

Kingdon (2003) refers to three major process streams in government agenda setting: problem recognition, formation and refining of policy proposals, and politics. These three streams converged in 2010 and 2011 when the controversial Public Act 4 of 2011, “The Local Government and School District Fiscal Accountability Act” was signed into law on March 16, 2011 by the newly elected Republican Governor Rick Snyder. Previously, the political climate was not favorable for action for strengthening PA72. While Republicans had held control of the state legislature over much of the decade, Democratic Governor Jennifer Granholm was unlikely to sign such legislation that may affect local government elective rights of large portion of the political base. However, in 2010, the streams of agenda setting converged and there was an opportunity for reform of PA 72 to strengthen state oversight of local government fiscal emergencies.

When considering the reforming of PA72 by the much stronger PA 4 of 2011, two sources of information are useful to understand the environment in which PA72: The Mackinac Center for Public Policy, and the Citizens Research Council. These are valuable sources because both are cited heavily in the legislative summaries during the debates and markups that ultimately resulted in PA 4 of 2011. In January of 2011, the Mackinac Center for Public Policy, the right-leaning think tank, advocated for reform of PA 72, and re-published a 2005 essay by Louis Schimmel, who was also an adjunct scholar and Director of Municipal Finance at the Mackinac Center. The essay was titled “Can Detroit’s Problems Be Corrected by an Emergency Financial Manager” which

speculated on Detroit's appointment for an emergency manager and called for reform to strengthen PA72. In the essay, Schimmel outlined four major recommendations that a revised law should have. These included: (1) making the EFM an employee of the state treasury department so that they cannot be sued by the local governmental unit; (2) providing total control of local government actions in the hands of the EFM, to effectively replace the governing body; (3) providing the power to review and change charter provisions that get in the way of restructuring; (4) The authority to void collectively bargained contracts (Schimmel 2005).

Each of the recommendations from Schimmel's 2005 essay, which was republished in January of 2011, would be adopted in the controversial PA4 just a month later, in February 2011. In March 2011, Mackinac Center for Public Policy published an article, titled "Mackinac Center Recommendations Found in the New Financial Emergency Legislation," and highlighted that all of its proposed reforms were included in the bill that passed the Michigan legislature and would become PA4 of 2011 (Hohman 2011). It's unknown exactly how much influence the Mackinac Center for Public Policy and Schimmel's 2005 views had in the drafting of legislation that became PA4, or the Governor's decision to sign the bill into law; a 2012 Mother Jones report explained a strong connection between Mackinac Center and Governor Snyder and the Republican Party in the formulation of the statute (Abowd 2012). At the very least, if we consider that the bill summaries reference some of Mackinac's analysis, and when we consider Schimmel's future appointment as EFM in the city of Pontiac, just months after passage, it is reasonable to assume there is some degree of influence. Ten months after PA4 was signed into law, Schimmel would be appointed by Governor Snyder to be the EFM of

Pontiac, his second appointment as EFM, and third time serving in a state takeover of a financially distressed city.

In April 2010, the Citizens Research Council (CRC) of Michigan, a nonpartisan, non-profit research organization that reports on state and local government organization and finance, was also busy with analysis on the local government emergencies taking place in Michigan. CRC Report 262 “Financial Emergencies in Michigan Local Governments” was published in April 2010. Included in the report was an identification of potential alternatives to PA 72 statute, especially in more complex situations such as if Detroit would need emergency financial management. The first potential alternative identified by CRC was including a provision that allowed local elected official (chief executive) to serve as EFM. This would remove the perception of an unelected “outsider” without a connection to the community. However, CRC pointed out that this option would not necessarily remove the local political considerations from the process. A second alternative was utilizing a model of public-private oversight, similar to what took place in New York City in the 1970s:

“The establishment of an Emergency Financial Control Board, similar to that created by the State of New York to oversee New York City’s financial affairs, may be more appropriate for a city the size and complexity of Detroit. That board could include both city and state officials as well as private sector experts, and could oversee the budget of the City of Detroit and direct implementation of deficit elimination plans. In order to be effective, the board would have to have authority to reject city budgets that contain unrealistic revenues, and to force the city to eliminate deficits as they arise. And in order for the board to be sufficiently well informed to make appropriate decisions, the city’s accounting system would have to be improved to the point that financial information is timely and accurate” (Citizens Research Council 2010, v).

A third alternative was a complete state takeover, but in a different manner than the appointment of an emergency manager. Instead of an emergency manager, the state could designate or create a state agency that would be responsible for financial and

operational management of a city in financial emergency. This option would include the authority to sell notes and bonds, and channel state resources to the local government.

The fourth alternative identified by CRC was bankruptcy:

“There is no prohibition in any Michigan statute on the voluntary renegotiation of local government contracts. There is, however, no possible amendment of any Michigan statute that would allow abrogation of local government contracts. Therefore, if the critical problem facing a local government is the inability to afford contractually obligated pay and benefits, and the union(s) refuse to make concessions, no remedy for that problem is possible outside of bankruptcy. Similarly, if the critical problem facing a local government is the inability to make payments on limited tax general obligation debt, and bond or note holders refuse to make concessions, no remedy for that problem is possible outside of bankruptcy” (vi).

This restriction on the abrogating local government contracts would be changed by PA 4 of 2011.

The CRC Report’s conclusion addressed the larger issue facing Michigan local governments in financial crisis, and the state’s attempts to solve the problem:

“While a simple bailout is greatly desired by many local officials, the state is unable or at least unwilling, and the federal government is so far unwilling to provide this kind of aid. Nor would a bailout address the underlying cause of local government financial distress in Michigan. At this time in our state, a challenge even greater than balanced local budgets with declining revenues and increasing spending pressures, is rebuilding an economic base devastated by the loss of manufacturing and the collapse of real estate values. The most stringent of costs cutting cannot address this fundamental problem” (vi).

This is a crucial point, and will be addressed in more detail in the concluding chapter – the consideration that the emergency manager statutes do not address the causes of fiscal stress, but rather simply attempt to manage the symptoms in the short-term.

PA 4 was introduced on February 9, 2011 by Republican State Representative Al Pscholka, who represents a district on in Southwestern Michigan that includes Benton Harbor and St. Joseph. On March 9, 2011 the Senate approved the measure 26-12, on a straight party line vote; all Republicans voting yes and all Democrats voting no.

Following the Senate, on March 15 the House passed the bill 62-48, with all but one Republican voting yes and all Democrats voting no (Michigan House Bill 4214, 2011).

The introduction text of the bill provides some insight into the theory behind the strengthened policy:

“The legislature hereby determines that the health, safety, and welfare of the citizens of this state would be materially and adversely affected by the insolvency of local governments and that the fiscal accountability of local governments is vitally necessary to the interests of the citizens of this state to assure the provision of necessary governmental services essential to public health, safety, and welfare.

The legislature further determines that it is vitally necessary to protect the credit of this state and its political subdivisions and that it is necessary for the public good and it is a valid public purpose for this state to take action and to assist a local government in a condition of financial stress or financial emergency so as to remedy the stress or emergency by requiring prudent fiscal management and efficient provision of services, permitting the restructuring of contractual obligations, and prescribing the powers and duties of state and local government officials and emergency managers. The legislature, therefore, determines that the authority and powers conferred by this act constitute a necessary program and serve a valid public purpose” (PA 4 of 2011).

The introduction and intent of the law is more strongly worded than PA 72.

Additionally, from the onset, the potential for restructuring of contractual obligations in local governments is made clear. The sections and provisions of PA4 will be summarized in the following sections.

PA 4 Preliminary Review

Under PA 4 of 2011, the trigger events that would generate a preliminary review were similar to those included in PA 72. The trigger events under PA 4 included:

- (a) A written request by the local governing body or the local chief administrative officer. *This was the same as PA 72.*
- (b) A written request from a creditor with an undisputed claim that was unpaid six months after due date and exceeds either \$10,000.00 or 1% of the annual general fund budget of the local government. *This was the same as PA 72.*

- (c) A petition that included specific allegations of local government financial distress signed by a 5% number of registered voters in the local government. *This was a decrease from the 10% requirement in PA 72.*
- (d) Written notification that the local government had not made a required pension payment in the minimum amount that was required by law. *This was the same as PA72.*
- (e) Written notification that the local government failed to pay wages, salaries or other compensation, including benefits owed to retirees seven days after the due date. *Benefits paid to retirees were not included as a trigger event in PA 72.*
- (f) Written notification from a trustee, paying agent, bondholder, or auditor of a default in a bond or note payment. *This was the same as PA 72.*
- (g) A resolution passed in either the Michigan Senate or Michigan House of Representatives *This was the same as PA 72.*
- (h) A violation of specified state laws by the local government. This includes 1943 PA 202, the Revenue Bond Act of 1933, 1933 PA 94, MCL 141.101 to 141.140, the Revised Municipal Finance Act, 2001 PA 34, MCL 141.2101 to 141.2821, or any other law that governed the issuance of bonds or notes. *This was the same as PA 72.*
- (i) A violation of the conditions of an order issued by the Local Emergency Financial Assistance Loan Board, pursuant to the Emergency Municipal Loan Act, 1980 PA 243. *This was the same as PA 72.*
- (j) A violation of the Uniform Budgeting and Accounting Act. *This was the same as PA 72.*
- (k) A failure to timely file an annual financial report; or, if the local government filed an audit report that did not follow the minimum procedures and standards of the state, as required for under the Uniform Budgeting and Accounting act. *This was the same as PA 72.*
- (l) Delinquency in the distribution of tax revenues, as required by state law, that the local government collected for another taxing jurisdiction. *This was the same as PA 72.*
- (m) A breach of obligation under a deficit elimination plan. *This was new to PA 4.*
- (n) A court ordered an additional tax levy without the prior approval of the local government. *This was the same as PA 72.*
- (o) A municipal government ended a fiscal year in a deficit condition as defined by the Glenn Steil State Revenue Sharing Act. Or, if the local government failed to comply with requirements of state law for filing and implementing a financial plan to correct a deficit

condition. *This was the same as PA 72.*

(p) A school district with a deficit failed to submit a deficit elimination plan within 30 days after the deadline for submission for its annual financial statement. *This was shortened from 3 months under PA72.*

(q) A local government was assigned a long-term debt rating within or below the BBB category or its equivalent by one or more of the nationally recognized credit rating agencies. *This was a new trigger event under PA 4.*

(r) The existence of other facts or circumstances, that in the State Treasurer's discretion is indicative of financial stress. *This was a new trigger event in PA 4.*

The preliminary review starts the process, and the path, toward declaring a financial emergency and appointing an emergency manager. Unlike PA 72, which required that the State Treasurer to perform a preliminary review if any of the 14 trigger events occurred, PA 4 provided 17 trigger events, including a provision for the State Treasurer to use his or her discretion in starting the process of preliminary review. This dramatically expanded the power of the Department of Treasury, and provided another avenue upon which state intervention could be undertaken, absent the trigger events required in PA 72.

PA 4 Review Team

As with PA 72, once a trigger event prompts a preliminary review, if the preliminary review found probable financial stress in the local government, the Governor was then required to appoint a review team. Under PA 4, this review team was to include:

- The State Treasurer or designee
- The director of the Department of Technology, Management, and Budget or designee;
- A nominee of the Senate Majority Leader
- A nominee of the Speaker of the House of Representatives
- Other state officials or other persons with relevant professional experience as the governor may determine.

The review team was required to meet with the local government and was empowered to examine the books and records of the local government and to utilize the services of other state agencies and employees. The state department of treasury provides staff support to the review team. A new provision under PA4 was that with state financial authority approval, the review team may appoint an outside individual or firm to perform the review and submit a report.

Under PA4, the review team was required to deliver a report within 60 days, or earlier if required by the governor. The governor had the ability to grant a 30-day extension of this 60-day time limit. The report had to include the existence, or any indication of the likely occurrence of any of the following:

- (a) A default in the payment of bonds, notes, or other municipal securities for which no funds or insufficient funds are on hand and, if required, segregated in a special trust fund. *This is the same as PA72.*
- (b) The failure for a period of 30 days after due date, to transfer employee income taxes; taxes collected for another taxing unit; or make a required payment to a pension, retirement, or benefit plan fund, to the appropriate agency. *This is the same as PA72.*
- (c) Failure to pay wages and salaries or other compensation owed to employees, or benefits owed to retirees, for a period of 7 days or more. *The time period in PA 4 was shortened from the 30 day in PA 72.*
- (d) The total amount of accounts payable for the current fiscal year is more than 10% of the total expenditures of the local government. *This is the same as PA72.*
- (e) Failure to eliminate an existing deficit in any fund within the immediately preceding two-year period. *This is the same as PA72.*
- (f) Projection of a deficit in the general fund of the local government for the current fiscal year in excess of 5% of the budgeted revenues for the general fund. *The amount in PA 4 was reduced from 10% in PA 72.*
- (g) Failure to comply with terms of an approved deficit elimination plan. *This was a new requirement under PA4.*

(h) The existence of material loans to the general fund from other local government funds that are not regularly settled. *This was a new requirement under PA4.*

(i) The existence of recurring unbudgeted subsidies from the general fund to other major funds as defined under government accounting standards board principles. *This was new under PA4.*

(j) Existence of structural operating deficit. *This was a new under PA4.*

(k) Use of restricted revenues for purposes not authorized by law. *This was new under PA4.*

(l) Any other facts and circumstances indicative of local government stress or financial emergency. *This was new under PA4.*

Under PA4, the review team had to reach one of four conclusions in its final report to the Governor.

1. The local government was not found to be in financial stress or was in mild financial stress.
2. The local government was found to be in severe financial stress, but a consent agreement was negotiated during the review and contained a plan to resolve the problem, which had been adopted between the state and the local government.
3. The local government was in a condition of severe financial stress and a consent agreement had not been adopted.
4. A financial emergency was found to exist and there is no satisfactory plan to resolve the emergency

Consent Agreement

PA4 provided greater detail regarding the consent agreement that could be negotiated between the state and the local government during the review. Under PA4, the State Treasurer, determines whether the consent agreement will include a continuing operations plan or recovery plan, which would be submitted by the local government and

approved by the State Treasurer. If the State Treasurer required that a consent agreement include a continuing operations plan, the local government was required to prepare and file the continuing operations plan with the State Treasurer as provided for in the consent agreement. The State Treasurer had 14 days to approve or reject the plan. If rejected, the local government had 30 days to refile an amended plan within 30 If that amended plan was rejected, then the local government is considered “to be in material breach of the consent agreement,” a declaration of a financial emergency would be made and there would be a placement of an emergency manager. The local government was required to file annual updates to its continuing operations plan.

Unlike the continuing operations plan, if required by the State Treasurer, the recovery plan was not drafted by the local government, but instead by the State Treasurer. The recovery plan replaced the local government’s budget with the plan adopted by the State Treasurer. Local government officials were required to adapt the local government’s operations and financial management to the recovery plan. Any violation would be a breach of the consent agreement, which would, once again, lead to an emergency manager. Instead of partial (perhaps very limited) local control, the emergency manager option provides no local control.

In regards to the consent agreements, PA4, was different from PA72 in two ways. First, a consent agreement under PA4 could grant expanded powers to the chief administrative officer, the chief financial officer, the local governing body, or other officers of the local government. These expanded powers included the powers prescribed for emergency managers, with approval of the State Treasurer. There was one notable exception to this provision, however - the power to reject, modify, or terminate an

existing collective bargaining contract could not be granted to any *local official* under a consent agreement. That was reserved for state-appointed emergency managers only. Second, during the consent agreement, the local government, unless the State Treasurer declared otherwise, was not subject to provisions of the Public Employment Relations Act, (PERA) which required that local government's collectively bargain with the representation of their employees.

Governor's Determination Under PA 4

As was the case under PA72, under PA4 the governor was required to make a determination within 10 days of receipt of the review team's report and recommendations. The governor's determination had to be one of four options (under PA72 there were only 3):

1. The local government was not in a condition of severe financial stress.
2. The local government was in a condition of severe financial stress, but no consent agreement containing a plan to resolve the financial stress has been adopted.
3. A local government financial emergency exists and there was no satisfactory plan to resolve the financial emergency.
4. The local government had entered into a consent agreement with the state, but was found to have materially breached that agreement.

As was the case with PA72, The governor was required to provide a written notification to the local government of the determination. Once that notification was provided, the local government had 10 days to file an appeal in Ingham County Circuit Court, which is the county in which Lansing, the state capital is located. The governor had the option of delegating duties to the State Treasurer.

Under PA4, if the governor confirms a financial emergency is taking place in the

local government and there is no consent agreement to address the problem, then the governor declares that the local government is in receivership and appoints an emergency manager. This is different than PA72, where the Local Emergency Financial Assistance Loan Board appointed the emergency manager. Under PA4, the appointment comes straight from the Governor, although this could be delegated to the State Treasurer. Another major change was in the terminology – the term emergency financial manager (EFM) was replaced by emergency manager (EM). PA4 increased the governor’s office role in the appointment of the EM to the local government in financial crisis.

Emergency Manager under PA4

The emergency manager under PA4 had dramatically increased powers when it came to managing the affairs of the local government they were appointed to. PA4 calls for the governor to appoint an emergency 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. The emergency manager shall have broad powers in receivership to rectify the financial emergency and to assure the fiscal accountability of the local government and the local government’s capacity to provide or cause to be provided necessary governmental services essential to the public health, safety, and welfare. Upon the declaration of receivership and during the pendency of receivership, the governing body and the chief administrative officer of the local government may not exercise any of the powers of those offices except as may be specifically authorized in writing by the emergency manager and are subject to any conditions required by the emergency manager (PA 4, Section 14 (4))

Under PA4 there is no ambiguity as to who is in charge of the local government once a financial emergency has been declared. EMs appointed by the Governor under PA 4 were required to have 5 years of experience, “demonstrable expertise in business, financial or local or state budgetary matters” they may be a resident of the local

government, but this was not a requirement. Unlike PA72, the EM served at the pleasure of the governor and was considered a state employee. As with PA 72, the EM's contract was negotiated by the State Treasurer, but was still paid for by the local government. The local government would also pay all expenses associated with the EM, including consultants the EM recommended be hired. This would remain a source of contention for the local governments that received emergency managers.

Under PA 4, the EM had 45 days to submit a written financial and operating plan to the State Treasurer for the local government in financial crisis. The plan was required to outline the actions that would return the local government to sustainability and result in payment in full of the scheduled debt. Within 30 days of submission of the financial and operating plan, the EM was required to conduct a public informational meeting on the plan, but there was no requirement for the EM to receive any form of public approval of the plan.

Section 19 of PA4 outlines the actions an EM can take. Under PA4 of 2011, EMs had the authority to:

- (a) Analyze factors contributing to the financial emergency of the local government and undertake steps to correct the situation.
- (b) Amend, revise, approve, or disapprove the budget of the local government.
- (c) Receive and disburse all federal, state, and local funds earmarked for the local government.
- (d) Require and approve or disapprove, plans for paying all outstanding obligations of the local government.
- (e) Require special reports from the finance officer of the local government.
- (f) Examine all accounting records and books relevant to an analysis of the financial condition of the local government.

- (g) Make, approve, or disapprove any appropriation, contract, expenditure, or loan, the creation of any new position, or the filling of any vacancy.
- (h) Review payrolls or other claims against the local government before payment.
- (i) Establish and implement staffing levels for the local government. This is regardless any requirement found in charter or contract.
- (j) Reject, modify, or terminate terms and conditions of an existing contract.
- (k) Reject, modify, or terminate terms and conditions of an existing collective bargaining agreement.
- (l) Act as sole agent of the local government in collective bargaining with employees, or representatives and approve any contract or agreement.
- (m) Remove one or more of the serving trustees of the local pension board or, if the State Treasurer appoints the emergency manager as the sole trustee of the local pension board, replace all the serving trustees of the local pension board.
- (n) Consolidate or eliminate departments of the local government and remove department heads, other than elected officials.
- (o) At the expense of the local government, the EM could contract for, auditors and other technical personnel considered necessary to implement PA4.
- (p) Retain consultants or firms to perform the duties of a local inspector or a local auditor.
- (q) Initiate court proceedings in Ingham county circuit court on behalf of the local government to enforce compliance with any EM orders.
- (r) Sell, lease, or transfer the assets, liabilities, functions, or responsibilities of the local government, provided the use or transfer of assets, liabilities, functions, or responsibilities for this purpose does not endanger the health, safety, or welfare of the local government residents.
- (s) Apply for a loan from the state on behalf of the local government, subject to any applicable restrictions in state law.
- (t) Order one or more millage elections for the local government consistent with the Michigan election law.
- (u) Authorize the borrowing for the local government as provided by law.

- (v) Approve or disapprove of the issuance of obligations of the local government on behalf of the local government.
- (w) Enter into agreements with creditors entities for the payment of existing debts, including the settlement of claims.
- (x) Enter into agreements with creditors to restructure debt on terms, at rates of interest, subject to approval by the State Treasurer.
- (y) Enter into agreements with other local governments for the provision of services, or the transfer of functions.
- (z) Enter into agreements with other units of municipal government to transfer property of the municipal government (for municipal governments, subject to approval by the State Treasurer).
- (aa) Enter into agreements with other local governments for the consolidation of services.
- (bb) Recommend to the state boundary commission that the municipal government consolidate with 1 or more other municipal governments.
- (cc) Dissolve the municipal government and assign its assets, debts, and liabilities as provided by law (for municipal governments, approval of the governor required).
- (dd) Exercise all authority and responsibilities of the chief administrative officer and governing body concerning the adoption, amendment, and enforcement of ordinances or resolutions of the local government as provided for by state law.
- (ee) Take any other action or exercise any power, relating to the operation of the local government.
- (ff) Remove, replace, appoint, or confirm the appointments to any office, board, commission, and authority in the local government.

Section 19a of PA 4 automatically eliminates the salary of the elected chief executive and all elected legislative officials. Unlike PA 72, where it was up to the EFM to decide whether or not elected local officials were paid, the EM under PA 4 of 2011 did not have to make that decision, it was done automatically as part of the statute. However, the EM did have the option to restore salary for the local government elected officials – which was likely a key negotiating tool available for the emergency manager to receive

cooperation. One can imagine the dynamics changing in many ways when local elected officials pay is automatically eliminated, and can only be restored by order of the emergency manager appointed to the local government.

PA 4, under section 22, required the EM to file reports every three months to the state legislature, Governor and City Clerk. The report also had to be posted on the internet website of the local government. The report was required to contain a description of all decisions on all expenditures and contracts made over \$5,000; a description of each loan over \$5,000 or more; description of any new position created; a description of any position that has been eliminated or from which an employee has been laid off; a copy of the contract with the EM including the salary and benefits of the EM; and the financial and operating plan as required under section 18 of the law.

Section 23 of PA 4 of 2011, authorized the EM to recommend to the Governor and State Treasurer that the local government file for bankruptcy under title 11 of United States Code. If the governor approved, the EM acts on behalf of the local government during the bankruptcy proceedings. Under PA4, section 24 provides authority to the EM to decide when the financial emergency has ended, and was subject to confirmation from the State Treasurer. PA 4, Section 25 provided immunity to the EM and EM staff from any liability pursuant to various state laws. To protect the EM from legal entanglements, section 25 also called for the attorney general to defend any challenges to PA4 or any individuals serving under it.

Summary of Changes in PA4 of 2011

While the full analysis of PA 4, with its many provisions, can be rather cumbersome, in summary, PA4 is noticeably different than the authority provided under PA 72 of 1990. PA4 eliminated the Local Government Financial Review Board's role in the emergency financial management process. Under PA4, the authority and responsibility rests with the Governor and State Treasurer. Greater flexibility is given in regards to who the governor can appoint to the review team under PA4, whereas PA72 was more limiting. Expanded authority was given to the previously named EFM position, now called the emergency manager (EM). The governor may also delegate some authority to the State Treasurer. The State Treasurer has authority over the form of consent agreement must take, if that option is utilized by the review team and the local government. Additionally, the State Treasurer has a number of approval actions over the EM. One of the few limitations on the EM, was a holdover of PA 72 of 1990, which limited the EMs ability to raise taxes, unless approved by a local election. PA 4 also ensured that the reforms instituted by EMs would remain after the EM left. Section 27 required that a 2 year spending plan be kept in place upon the EM's departure.

PA4 gave proponents of state control of local governments in financial crisis everything they could want. It was also a major victory for proponents of privatization and opposed to collective bargaining at the local government level. Under PA 4, the EM could terminate contracts, including collectively bargained contracts, and dissolve the unit of government, or recommend bankruptcy, if approved by the state, act on the local government's behalf during any subsequent proceedings. The authority to revise or eliminate contracts, including collectively bargained contracts, was by far the most

controversial provision. Due to the wide-ranging powers of the EM under PA4 of 2011, it is important to take a look at what the underlying theory of emergency financial manager is, from the perspective its proponents; which will be the focus of the next section.

Theory Behind PA4

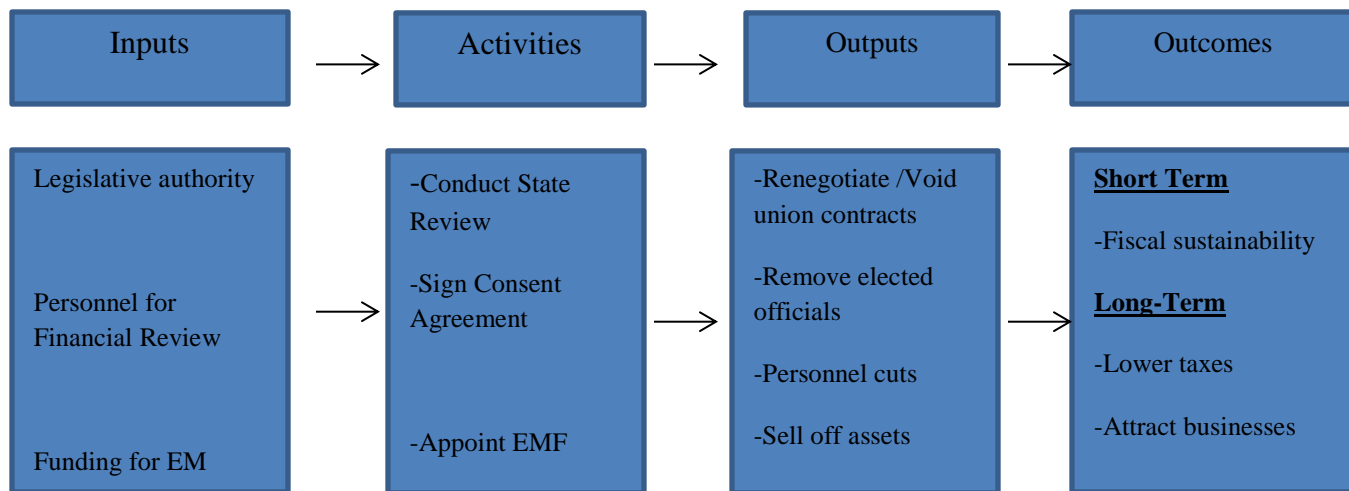
The underlying theory of supporters for the emergency manager statutes in general, and PA4 in specific, is the argument that local governments in a financial emergency are incapable of solving their own fiscal issues, either due to a lack of competence or political will. Because of this, according to the theory, control should be taken away from the local government and invested in the hands of an emergency manager, who is capable, and not bound by city charters, collective bargaining and local political forces. According to this theory, once the takeover of local government operations is in effect and the financial reforms are implemented, sustainability is restored. Consequently, once the local government is sustainable, business investment will be enhanced. As Louis Schimmel, the first receiver and emergency manager in Michigan's history wrote in 2005:

“If Michigan is sincerely interested in keeping and attracting new business it needs to face rather than ignore the issue of the state's excessively high, non-competitive municipal labor costs. High labor costs for municipalities result in high municipal taxes, which in turn make municipalities unattractive and create major fiscal problems” (Schimmel 2005)

Schimmel, who was a pioneer in the state takeover of local governments in Michigan, is a valuable source to follow if one wants to understand the rationale for the suspension of local democracy in an effort to lead to achieve stability. To better

understand the underlying theory of the emergency financial manager laws, and more specifically, the controversial a logic model has been created (Figure 4.1).

Figure 4.1 Logic Model



When considering the policy of state intervention of local governments in fiscal crisis with an emergency manager, the independent variable is the presence of the consent agreement or emergency financial manager, inclusive of the actions they may take. This is a broad category that is made up of the several actions that may be taken to restructure local government finances by cutting services, voiding contracts, eliminating positions and selling off assets. For the purposes of the policy, the mere presence of an emergency manager or consent agreement is logically thought to be the change agent involved in achieving its aims. The dependent variable is fiscal sustainability, lower municipal taxes and increased business investment.

Independent Variables

Consent Agreement Actions
municipality

Emergency Financial Manager Actions

Dependent Variables

Fiscal sustainability for the

Lower taxes

Increased business investment

Based upon the theory of the emergency manager statutes in general, and after reviewing the logic model, the obvious question, is does the policy work? Does removing local control and imposing an emergency manager lead to fiscal sustainability, lower taxes and increased business investment? While the nature of this exploratory case study is not to validate causal relationships, this question will be addressed in the concluding chapter.

PA 4 Controversy, Referendum and Repeal

Upon passage, PA 4 of 2011 generated a large amount of controversy that its predecessor statute, PA72, did not. The controversy and scrutiny of the law only grew as it was implemented. The period of debate regarding the merits of the law in 2011 and 2012 provides some of the most interesting context for what different factions believed was right, or wrong about the law. National exposure led to a great deal of debate regarding the right to local democracy versus the need for fiscal sustainability in local governments. There was some national conversation as to whether there should be limits to local democracy in relation to fiscal sustainability.

In Michigan, local community civil rights and religious leaders labeled the act a "dictator bill" due to the perceived excessive powers it provides the governor's potential appointee to void contracts, sell off assets, and remove local elected officials. Protests were held outside of the Governor's office and included civil rights and local religious leaders. The protestors pointed out that the cities targeted by the bill were majority African American cities and that there was a racial component to the law's implementation (Oosting 2012).

In April 2011, Rev. Jesse Jackson, while addressing church leaders across Michigan, called for residents to organize and fight against the "draconian cuts." Jackson compared the law to "one-man rule" in Libya, and highlighted the example of Benton Harbor and the placement of an emergency manager there:

"We don't like one-man rule, except in Benton Harbor. The government in Michigan is training one-man rule. We are setting up here what we are fighting there. Your vote for elected officials doesn't count, and that is decimating democracy" (Perkins 2011).

Much of the attention surrounding emergency financial managers focused on Benton Harbor. In spring of 2012, Stephen Colbert of Comedy Central's *Colbert Report* and Rachel Maddow on MSNBC's *Rachel Maddow Show*, highlighted and parodied the powers the emergency manager Joseph Harris in Benton Harbor, who removed the mayor and council of all authority and only permitted the city council to meet and approve minutes, with no actual authority.

In January of 2011, large scale protests took place outside of Governor Snyder's home in Superior Township (a suburb near Ann Arbor) to protest PA 4. Protests were organized via Facebook by a group called "Occupy for Democracy" and included United

Auto Workers, Washtenaw Community Action Team, AFSCME and the NAACP. As the News Herald reported:

“Johnie Douglas came with her church, the Tabernacle Missionary Baptist Church, from Detroit to Ann Arbor to protest Public Act 4. She believes the act takes away the right to vote and is potentially dangerous in the momentum it could gather across the country:

“The emergency manager takes away the citizen’s right to vote. And if they start taking away citizens’ rights in one place, that movement will escalate and there’s no telling just how far down the hill we’ll go from there on. So, it’s time to stop it now before it gets really going” (Gjestl 2012).

Under the leadership of Rep. John Conyers, the Ranking Member of the House Judiciary Committee, Democratic staff released an interim report with recommendations regarding the emergency manager laws. Titled “Democracy for Sale: Subverting Voting Rights, Collective Bargaining and Accountability under Michigan’s Emergency Manager Law” (Democratic Staff Report 2012), the report presented a scathing rebuke to the controversial law. The committee report reached three major findings. First, the report found that the law was unconstitutional because it violates the Contracts Clause of the Constitution. The report advocates that Chapter 9 bankruptcy is a preferred method for addressing potential renegotiation of contracts, including collectively bargained contracts, because it allowed for the parties to present evidence in court relating to burden of potential changes.

Second, the report concluded that the law’s controversy provisions would lead to “legal morass” due to the negative impact on minority voting rights and representative government, and the flurry of lawsuits that would follow. The report indicated that PA4 of 2011 violates the Voting Right Act, which prohibits practices that discriminate on the basis of race, color or membership in a language minority group. The report points out that if Detroit received an emergency manager, over half of the state’s African American

population would be living under an emergency manager, and would effectively take place in no local democracy.

Third, the committee's report contended that the emergency manager model has not worked in the local governments it was implemented. The report references the inability of emergency managers to change the financial condition of Ecorse, Hamtramck and Highland Park, each of which continued to have serious financial issues and would once again need emergency managers in the future. In addition, the report highlights some examples of mismanagement and by emergency managers, including the previously discussed example of EFM Arthur Blackwell II's criminal allegations in Highland Park. The report recommended that the statute be replaced with less controversial measures used by other states, and cites the example of New York in the 1970s, the state bailout of Cleveland in the 1980s, as well as Central Falls, Rhode Island and Harrisburg, PA of the 2000s. The report called for a more collaborative approach – Federal, state and local – to address the financial crises in communities (House Judiciary Committee Democratic Staff Report 2012).

Repeal Movement

In the Michigan Constitution, Article II, Section IV reserves the right for the people to subject a law to referendum if petitions are signed by registered voters, who number at least 5% of the number of votes cast for all candidates for governor in the last election. During the winter and spring of 2011-2012, Stand Up for Democracy, a union-affiliated group, began to collect signatures in an effort to put PA4 on the ballot in November for a voter referendum. On February 29, 2012, the organization turned in over

218,000 signatures. On the day of the submission, Herb Sanders, a legal director of AFSCME Council 25 told reporters:

‘I think it means a lot for the state of Michigan that thousands of people across the state believe that we should have democracy over dictatorship. That is loudly resounding and will resound even louder when we deliver those thousands of petitions to the great seal in Lansing tomorrow morning’ (Oosting 2012)

The enthusiasm was short-lived for Stand Up for Democracy and its supporters. “Citizens for Fiscal Responsibility” an organization financed by Michigan business leaders that were in support of PA4 of 2011, challenged the petition in court. The group did not challenge the number of signatures, but challenged the petition based upon a technicality that the petition did not have the correct font size as required by state law. The “bipartisan” Michigan Board of Canvassers would be deadlocked 2-2 with the votes splitting along party lines – democrats voting in favor of certifying the petition, suspending PA4 and allowing a vote in November, and republicans voting to deny the petition based upon the technicality of the font size. The issue bounced around the lower courts throughout the spring and early summer before being placed before the Michigan Supreme Court.

And so, in a way, the future of local government democracy in Michigan came down to whether the Michigan Supreme Court viewed the computer version of Calibri 14 point font, to be a “true” 14 point font as dictated by state law. The case received state-wide, as well as national media attention. The *Wall Street Journal* reported:

“Just how big is 14-point type? That's one of the hottest political disputes in Michigan as the state Supreme Court ponders whether a ballot question about fixing the state's troubled cities and schools should go before voters.

At issue is whether a summary of the question, used on a petition to gather signatures to get the question on the ballot, was written in a type size specified by state law: 14-point boldface. The typeface used on the petition was 14-point Calibri produced by Microsoft

Corp.'s Word software, but a dispute has arisen over whether the font renders the type at the full 14-point size” (White 2012).

One of the more memorable exchanges from the subsequent Michigan Supreme Court hearing took place when the court questioned the lawyer for Citizens for Fiscal Responsibility about a previous case where he had previously argued against font details:

“Mr. Pirich, the lawyer for the business-backed group, had an awkward moment when Justice Michael Cavanagh quoted words the lawyer had written in a different case when he was arguing that a ballot initiative shouldn't be blocked because of "nitpicking" over clerical flaws. “Different case,” Mr. Pirich replied, “Different client” (White 2012).

In August of 2012, the Michigan Supreme Court made a decision regarding the petition against the law. Justice Mary Beth Kelly, writing the majority opinion, outlined the stakes of the case, which seemed small, but had significant consequences:

“This appeal concerns a big constitutional issue, even though its focus is something as small as 14/72 of an inch. This matter turns on what many citizens may regard as a trivial issue: Whether a heading on a petition signed by over 200,000 people satisfies the statutory requirement that the petition heading be in “14-point boldfaced type. As technical as this appears, the rule of law is implicated here because this issue concerns the constitutional foundation of how we govern ourselves.”
(*Stand Up for Democracy v. Secretary of State and Board of State Canvassers* 2012, 6).

In its decision, the Michigan Supreme Court ruled in favor of Stand Up for Democracy and required the petition be placed on the November ballot to be considered by Michigan voters for repeal. The referendum was therefore placed on the ballot in November 2012, as Proposal 12-1. When Michigan voters arrived at the polls, they were faced with this question:

**A REFERENDUM ON PUBLIC ACT 4 OF 2011 – THE EMERGENCY
MANAGER LAW** Public Act 4 of 2011 would:

Establish criteria to assess the financial condition of local government units, including school districts.

Authorize Governor to appoint an emergency manager (EM) upon state finding of a financial emergency, and allow the EM to act in place of local government officials.

Require EM to develop financial and operating plans, which may include modification or termination of contracts, reorganization of government, and determination of expenditures, services, and use of assets until the emergency is resolved.

Alternatively, authorize state-appointed review team to enter into a local government approved consent decree.

Should this law be approved? YES ___ NO ___

(Proposal 12-1, Michigan.gov 2012)

Both sides made their arguments to the public in the weeks preceding the election.

Democrats, unions, liberal activists and African American community leaders generally supported repeal, while Republicans, and many members of the business community were in favor of the statute remaining. In competing editorials to the voters, Governor Snyder and Democratic Senator Bert Johnson laid out the case for and against PA4 to the voters. Governor Snyder stated the case for retaining PA4:

“It’s not about voiding contracts or circumventing collective bargaining, but about ensuring fair contracts and benefits while recognizing that the past status quo simply isn’t sustainable anymore. It’s about shared goals and sacrifice, and helping our communities and schools get back on track before insolvency or bankruptcy is the only option.

It’s not about voting rights. This updated measure was passed after a thorough legislative process and robust public discussion. Emergency managers are accountable to me and the Legislature, all of us whom are elected. It’s about working together, state and locals, to resolve the fiscal emergency and ensure quality of life for citizens and businesses. Safeguarding public health, safety and welfare through core services is an essential responsibility. It’s one that we must take seriously” (Snyder 2012)

Democratic Senator Bert Johnson responded with a guest column denouncing the statute and calling for repeal:

“Our nation was founded on the ideals of government in which the people were dutifully represented by individuals of their own choosing. Michigan’s EMs have lawmaking powers, but are unelected.

When lawmakers offer solutions to a problem facing their constituents, it is important they consider whether or not their plan will work. Governor Snyder and PA 4 supporters in the Michigan Legislature failed to do this. The provisions in the law are premised on the notion that the fiscal problems facing cities like Pontiac and Flint and school districts

like Detroit and Highland Park are due solely to mismanagement. This is false.

The true culprit behind local government fiscal stress is a systematic disinvestment by the state in our core urban centers. Revenue sharing dollars have decreased remarkably in the last couple years, leaving cities like Benton Harbor and Detroit without funding for necessities like police, fire and other core services" (Johnson 2012)

In September 2012, less than two months before the vote, The Center for Local, State and Urban Policy, part of the Gerald R. Ford School of Public Policy at the University of Michigan, conducted a poll of local government officials across the state to gauge their views on PA4. The survey found that local government leaders in Michigan were divided in their opinion of the law. Among respondents who stated that they had some familiarity with the law, 38% supported it, while 30% opposed it. The remainder of local leaders responded that they neither opposed nor supported the law (21%); or answered that they did not know how they felt (11%). The responses broke somewhat along party lines, with 51% of democratic respondents opposing versus 21% supporting, and republicans 45% supporting versus 21% supporting. Appointed officials supported the law (62%); whereas elected officials were perfectly divided, with 32% for and 32% against (Center for Local, State and Urban Policy 2012).

On Election Day 2012, Proposal 12-1 attracted a significant voter turnout, with over 4.5 million votes cast on the referendum issue. The act was repealed by a narrow majority, 52% to 48% vote, which therefore repealed Public Act 4 of 2011, the strongest state financial intervention law in Michigan, as well as in the United States. Reviewing the vote totals provides an interesting analysis of which parts of the state voted in different ways. For example, in Wayne County, the home to Detroit, Highland Park, Hamtramck, and River Rouge, among other struggling urban areas that had either already experienced an emergency manager, or may experience one in the future, 60% of

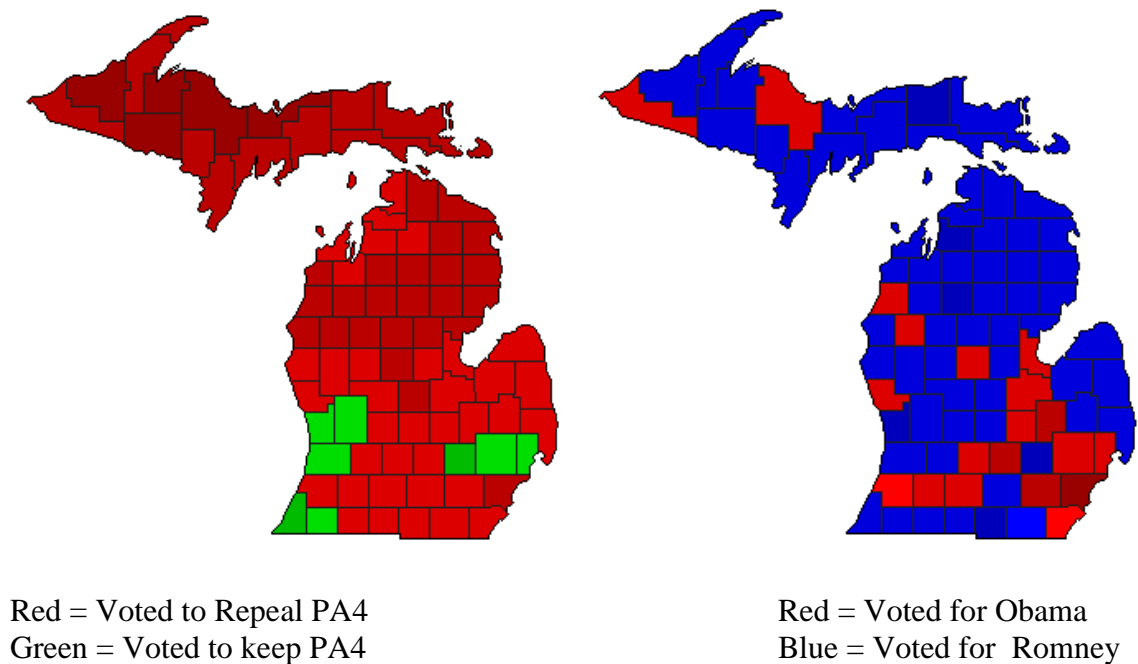
residents voted to repeal the law. However, in Wayne County's relatively more affluent neighbor, Oakland County, 57.8% of voted to keep the law. Oakland County includes the city of Pontiac, which had an emergency manager appointed, but the remainder of the county is relatively affluent, with a significant business community. In Macomb County, the other county that comprises the core of the tri-county area that makes up metro-Detroit, the vote was closer, with a slight edge to keeping the law – 47.1% voting to repeal versus 52.9% to keep the law.

As illustrated by Figure 4-1, the majority of the state's counties voted to repeal the law. Of the 83 Michigan counties, only 8 counties voted to protect the law. These counties included: Macomb, Oakland, Livingston which are in the Metro-Detroit area and home to large business community; Kent, Allegan and Ottawa, which are in the Grand Rapids Metro area, and generally lean more conservative in politics; and Berrien and Cass County; which are in the St. Joseph – Benton Harbor area, and are also home to republican representative Al Pscholka, who was the sponsor of PA4.

It is interesting that the majority the state, 75 of the 83 counties, voted against the measure. In the 2012 general election between Democratic President Barack Obama and Republican candidate Mitt Romney, President Obama won Michigan by 9 points, but only won 20 counties in the state. Therefore, the majority of Michigan's rural counties voted *for* Republican Mitt Romney, but *against* PA 4. This includes numerous rural counties where the vote totals are smaller. While home to a small number of African Americans or union interests, the cause of the rural vote may be viewed as opposition to the state's infringement upon local democracy and some preference to the localism.

Nonetheless, an interesting alliance of voting blocs – liberals, African American communities, unions, and rural counties, reached enough votes to defeat PA 4 of 2011.

Figure 4-2 - Statewide comparison of PA4 Referendum



(Source: Uselectionatlas.org 2012 Michigan Data; Michigan Department of State 2012 Election Results)

Summary of PA4 of 2011

Public Act 4 of 2011, the Local Government and School District Fiscal Accountability, lived a short, but turbulent life as Michigan law. The most controversial provisions of the law – the authority of emergency managers to dissolve local units of government and the ability to reject, modify or terminate collective bargaining agreements with employee unions were argued by opponents as undemocratic and unconstitutional. PA4 also allowed for earlier intervention by expanding the trigger events, provided further clarification as to how consent agreements between the state and

local government were to be developed and implemented, and allowed individuals from the local government to be eligible to serve as emergency manager, a provision that was prohibited under the early version.

Opponents, backed by Democratic-leaning organizations, unions and African American community leaders, decried the law as a “dictator bill” and through a well-coordinated campaign, were able to get the issue on the ballot as a state referendum, where it was ultimately rejected by the voters in a narrow 52-48 margin. This was after the petition drive survived a challenge based upon font size that had leaders on both sides measuring the height of a Calibri 14 point font, the basis upon which local democracy in Michigan would rest.

Why the increased statewide and national interest in PA4 versus PA72? Three explanations stand out. First, as previously mentioned, the time in which the act was passed may have had a large impact. By 2011-2012, protests against PA4 were organized via Facebook and other social media platforms. Online articles became debate forums for commenters who either supported or denounced the law. These mediums did not exist in 1990, or during much of the life of PA72. Second, the provisions of PA4 were much stronger, especially the ability to terminate union contracts, which provoked unions to put forth a tremendous amount of effort for the fight. Third, the law was implemented in many African American-majority local governments, which rallied community leaders to protest and oppose the perceived racial bias.

After a whirlwind campaign from both sides regarding the merits of the law, repeal led to some confusion. Following the 2012 repeal of PA 4, there was a great deal of confusion of what was to happen to the emergency managers already in place in

communities. Ultimately the state issued a determination that PA72, the milder version of the law went back into effect. The courts would affirm this decision, and emergency managers who had been waiting out the referendum, resumed power, but with the old, and weaker authority. However, it would not be long before the Michigan legislature passed yet another emergency manager law, one which would not be subject to another referendum.

PA 436 of 2012

In December of 2012, in a rapid response to the repeal of PA4 by the voters in Michigan just a month before, the Republican-controlled House and Senate each passed, and Governor Snyder subsequently signed, a replacement emergency manager law, Public Act 436 of 2012, which was titled the Local Financial Stability and Choice Act. This statute was passed barely a month after its predecessor was repealed by the voters and could not be repealed by referendum because an appropriation was tied to it. There was however some additional flexibility for local governments to remove emergency managers after 18 months with a 2/3 vote. Like PA4, the law allows the state government to intervene in financially struggling municipalities and school districts with nearly identical powers. The same civil rights and union supporters were outraged by the new law. Citing the similarities with the previous law, civil rights and grass roots organizations vowed to protest and fight the law in court. Greg Bowens, a spokesperson for the Stand Up for Democracy coalition was unimpressed with the new statute, in addition to making the case that municipal finance reform be part of the conversation to helping cities burdened by debt:

"All roads lead to an emergency manager. All this new bill does is allows the bondholders to get paid at the expense of cops and sanitation (Oosting 2013).

Considering the new statute, Bettie Buss, a Senior Researcher with the Citizens Research Council of Michigan explained:

"Local units will obviously have more choice under the new law...But how the state administers this choice is the thing that remains to be seen.

The fact that you can get rid of an EM is a huge difference. Obviously, if you're a locally elected official and some state appointee can come in and take all your power away, what elected official is going to welcome that? Basically, the emergency manager process has 18 months to run. The state wants the person to be able to get in there, fix what's wrong and get out" (Oosting 2013).

In the next section the new emergency manager statute, PA 436, which is the current statute as of this case study, will be analyzed.

Preliminary Review under PA436

In Section 4 of PA436, the “trigger events” for a preliminary review by the State Treasurer’s office are listed. Under PA 436 those events were nearly identically similar to those of PA4, with an emphasis on early intervention. As was the case under PA4, the final trigger event for a preliminary review is the catch-all, which gives the State Treasurer’s office great latitude to engage in review. A summary of the trigger events that start the process to state intervention are as follows:

- (a) The local government body or the chief administrative officer requests a preliminary review, citing the financial conditions that require a review.
- (b) The State Treasurer receives a request from creditors that have an undisputed claim against the local government of \$10,000, or 1% of the annual general fund budget of the local government, which has gone unpaid for at least 6 months after its due date.
- (c) The State Treasurer receives a petition from no less than 5% of the registered voters that live in the local government's jurisdiction.

- (d) The State Treasurer receives notification that the local government has not deposited its minimum obligation payment to the local government pension fund as required by law.
- (e) The State Treasurer receives notification that the local government is at least 7 days late in paying salaries or benefits to its employees and/or retirees.
- (f) The State Treasurer receives notification of a default in a bond or note payment
- (g) The State Treasurer receives a resolution from the Senate or the House of Representatives requesting a preliminary review of the local government.
- (h) The local government is found to have violated state law concerning local government finance, which may include the Revenue Bond Act, the Revised Municipal Finance Act, or any other law governing the issuance of bonds or notes.
- (i) The local government is found to have violated the conditions of an order issued by the Local Emergency Financial Assistance Loan Board pursuant to the emergency municipal loan act.
- (j) The local government is found to have violated requirements of Michigan's Uniform Budgeting and Accounting Act.
- (k) The local government did not file an annual financial report or audit in a timely manner, or the submission did not follow the requirements under state law.
- (l) For a school district, if the district fails to provide an annual financial report or audit that conforms to state law.
- (m) The local government is found to be delinquent in distributing tax revenues that it has collected for another taxing jurisdiction.
- (n) The local government is found to be in breach of its obligations under a deficit elimination plan.
- (o) A court orders an additional tax levy without the prior approval of the local government's governing body.
- (p) The local government ends a fiscal year in a deficit condition as defined by state law, or has failed to implement a financial plan to correct the deficit condition.
- (q) A school district ends the recent fiscal year with a deficit has not submitted a deficit elimination plan to the state.
- (r) The local government is assigned a long-term debt rating below the BBB category or equivalent.

(s) Other facts or circumstances are found by the State Treasurer which indicates that the local government is in probable financial stress.

Before the preliminary review can be undertaken by the State Treasurer's office, the State Treasurer is required to provide the local government with a written notification regarding the intention by the state to perform a preliminary review. Local government officials are required to assist the state employees in conducted the preliminary review. The purpose of the preliminary report is to confirm whether the trigger events took place, and if there is a serious financial situation. Once the preliminary review is completed, the State Treasurer is required to provide an interim report of its findings to the local government within 20 days. Copies of the report are also given to the state senator and state representative who represent the local government in question. The local government only has 5 days after the interim report, to provide comment to the State Treasurer.

The State Treasurer's office then must submit a final report from the preliminary review to the Local Emergency Financial Assistance Loan Board. The final report must be posted on the Department of Treasury's website within 7 days. Overall, the State Treasurer has 30 days to complete a preliminary review and issue the final report to the board. If a preliminary review confirms that one of the trigger events has taken place and that financial stress is occurring in the local government, the governor will appoint a review team. The review team will consist of the State Treasurer or designee, the Director of the Department of Technology, Management, and Budget or designee, a nominee of the Senate Majority Leader, and a nominee of the Speaker of the House of Representatives. The governor may also appoint other state officials or other individuals with "relevant professional experience" to serve on a review team.

While PA436 and PA4 are similar in regards to the preliminary review, the main difference involves the role of the Local Emergency Financial Assistance Loan Board. Unlike PA4, the board returns, and takes on a role similar to what it fulfilled under PA72.

Review Team

The review team is required to meet with the local government and “receive, discuss, and consider information provided by the local government concerning the financial condition of the local government.” Under PA 436, a new requirement is that the review team must hold at least one public information meeting in the local government which would allow the public to comment. There is no indication or direction as to how the public meeting is to be conducted. Once appointed, the review team has 60 days to review and issue a report to the Governor. The report must identify if any of the following situations have or are likely to occur:

- (a) A default in the payment of principal or interest upon bonded obligations, notes, or other municipal securities for which no funds or insufficient funds are on hand.
- (b) Failure to transfer taxes withheld on income of employees, taxes collected for another governmental unit, or required contributions for pension, retirement or benefit plan 30 days beyond the due date.
- (c) Failure to pay compensation owed to employees or retirees, 7 days beyond the due date.
- (d) The accounts payable total exceeds 10% of the total expenditures of the local government in the fiscal year.
- (e) The local government fails to eliminate an existing deficit within a 2-year period.
- (f) There is a projection of a deficit in the local government’s general fund of at least 5% of the budgeted revenues.

- (g) The local government fails to comply with the terms of an approved deficit elimination plan.
- (h) Loans to the general fund from other local government funds are not regularly settled or increase in scope.
- (i) Existence of recurring unbudgeted subsidies from the general fund to other major funds as defined under government accounting standards board principles.
- (j) The local government has a structural operating deficit.
- (k) The local government is found to have used restricted revenues for purposes not authorized by state law.
- (l) The review finds probability that the local government will not be able to pay obligations within 60 days of the review.
- (m) During the review, “any other facts and circumstances indicative of local government financial emergency” are found.

Under PA 436, unlike the previous PA4 or PA72, the review team only had to make a choice between two recommendations to the governor concerning the local government in question. Either: (1) A financial emergency does not exist; or (2) A financial emergency does exist.

Governor’s Determination under PA436

After receiving the review team’s report, the governor has 10 days to review and make one of two determinations. Either, (1) A financial emergency does not exist in the local government; or (2) A financial emergency does exist in the local government. Before making the final determination based upon the review team report, the governor may provide local government officials the opportunity to submit a written statement to communicate concurrence or disagreement with the report and determination.

If the governor determines pursuant to subsection that a financial emergency exists, the governor is required to provide the local government with written notification

of the determination and findings from the review team report that served as the basis for the determination. After the determination is made and notice given to the local government, the local government has seven days to request a hearing conducted by the State Treasurer's office. Following the hearing, or if no hearing is requested, the governor will confirm or revoke the determination in writing. If confirmed, the governor provides a report to the local government. The report must also be posted on the Department of Treasury's website.

Appeal under PA436

The local government in question may appeal the determination to the Court of Claims if 2/3 of the elected governing body chooses to do so. The Court of Claims is within the Court of Appeals that hears cases regarding civil actions filed against the State of Michigan. Conversely, PA 436 allows the local government to waive its right to appeal, by a 2/3 vote.

Local Government's Options under PA 436

This section is new to PA 436, and a departure from PA72 or PA4. If a financial emergency is found to exist in the review team's report, is confirmed by the governor, survives the hearing and any subsequent appeal to the court of claims, then the local government must choose, by resolution, one of four options within seven days after the final determination is provided by the governor. Each option is outlined further in the statute. If the local government has a "strong mayor" form of government structure, then the approval requires mayoral approval. The four options the local government has to choose, (by resolution) include:

1. A consent agreement option
2. The emergency manager option
3. The neutral evaluation process option
4. The chapter 9 bankruptcy option.

If the local government does not pass a resolution selecting any of the choices, then the local government proceeds under the neutral evaluation process option.

Additionally, local governments were not allowed to utilize an option more than once.

The Consent Agreement Option under PA 436

The first option available to local governments under PA 436 is the consent agreement. A local government, through the chief administrative officer, has the option to negotiate and sign a consent agreement with the State Treasurer. The consent agreement must “provide the measures necessary to address the financial emergency within the local government and provide for the financial stability of the local government.” A board appointed by the governor may be provided for in the consent agreement in order monitor the local government's compliance. For a consent agreement to go into effect, it must be both approved by resolution of the local government’s governing body, and approved and executed by the State Treasurer.

If a local government selects the consent agreement option, it then has 30 days to find an agreement with the State Treasurer regarding the terms of the consent agreement. If an agreement is not reached, the State Treasurer will require the local government to proceed under one of the other options (emergency manager, neutral evaluation or Chapter 9 bankruptcy). Additionally, in the event of a breach of the consent agreement

the governor has the option to place the local government under one of the other three options.

A consent agreement may require a continuing operations plan or a recovery plan, which must be filed within a deadline provided in accordance to the consent agreement. If the State Treasurer requires a continuing operations plan, it must be either approved or reject within 14 days of receiving it from the local government. If rejected, the local government has 30 days to file an amended plan. If the amended plan is rejected, the local government is considered to be in material breach of the consent agreement and may be moved to one of the other three options provided for under the law (emergency manger, neutral evaluation or Chapter 9 bankruptcy). Under the consent agreement option, the local government is required to file annual updates to the continuing operations plan. The annual updates are to be included in the local government's annual audit report as the continuing operations plan remains in effect.

The continuing operations plan is to be structured according to the State Treasurer; per PA436 it must include:

1. A detailed projected budget over the next three fiscal years that provide revenues and expenditures and shows that the local government's expenditures will not exceed revenues, and that the existing deficit will be eliminated.
2. A projection of the cash flow for the covered budget period.
3. An operating plan for the budget period that "assures fiscal accountability for the local government."
4. A plan that shows "reasonable and necessary maintenance and capital expenditures so as to assure the local government's fiscal accountability."
5. An evaluation of the costs associated with pension and post-employment health care obligations for which the local government is responsible, and a plan for how those costs will be addressed within the budget period.

6. A provision for submitting compliance reports to the State Treasurer on a quarterly basis that demonstrate the local government is in compliance with the continuing operations plan. Copies are to be sent to the House or Representative and Senate members for the local government, as well as a posted copy on the local government's website.

As part of the consent agreement option, the State Treasurer may require a recovery plan. The requirements are generally the same as the continuing operations plan. The continuing operations plan essentially allows the local government to maintain some authority, within certain parameters, while the recovery plan, on the other hand, includes the steps that are required to be taken in order to be removed from state oversight.

If either a recovery or continuing operations plan is required by the State Treasurer for a local government, the plan "shall supersede the budget and general appropriations ordinance adopted by the local government." Essentially, similar to PA 4, this means that the consent agreement could nullify the ordinance passed by the local government concerning the annual budget. As was the case under PA 4, PA 436 consent agreements could include granting some of the emergency manager powers to the chief administrative officer of the local government. Similar to PA 4, consent agreements under PA 436 allowed the local government to be exempt the Public Employees Relations Act (PERA) for the remaining term of the consent agreement. This is an important provision because PERA allows public-sector employees to organize and enter into collective bargaining agreements, and remains the statute that governs disputes involving public-sector labor organizations and government employers. However, under PA 436, the State Treasurer has the ability to waive this exemption for the local government.

The consent agreement may require the retention of consultants by the local government to achieve the goals of the consent agreement, as determined by the State Treasurer. Local governments under consent agreement are only released from the agreement when the State Treasurer determines that compliance has been met. Much of the consent agreement provisions are the same as PA 4; the most notable exception is the ability of the State Treasurer to move a local government found in material breach of a consent agreement into one of the other three options available under PA436.

Emergency Manager Option under PA436

The second option that may be recommended by the State Treasurer's review team and confirmed by the Governor is the emergency manager option. Similar to PA4, the term "financial" was dropped from emergency financial manager (EFM) and replaced with the shorter emergency manager (EM) designation. As was the case for provisions in PA72 and PA4 before it, the consent agreement in PA436 provides some level of local government collaboration with the State Treasurer in addressing the issues that lead to the financial crisis. However the provisions of the emergency manager are strongly worded to convey the authority of the position. Under PA 436, the emergency manager shall:

"Act for and in the place and stead of the governing body and the office of chief administrative officer of the local government. The emergency manager shall have broad powers in receivership to rectify the financial emergency and to assure the fiscal accountability of the local government and the local government's capacity to provide or cause to be provided necessary governmental services essential to the public health, safety, and welfare.

Following appointment of an emergency manager and during the pendency of receivership, the governing body and the chief administrative officer of the local government shall not exercise any of the powers of those offices except as may be specifically authorized in writing by the emergency manager or as otherwise provided by

this act and are subject to any conditions required by the emergency manager.” (PA 436, Section 9(2))

As was the case under PA 4, PA 436 lays out the same minimum qualification for emergency manager appointments, which include a minimum of 5 years' experience in “business, financial, or local or state budgetary matters.” The emergency manager may, but is not required to be a resident of the local government.

One key difference in PA 436 is in regards to compensation for emergency managers. Under PA 72 and PA4, emergency managers' compensation was paid for by the local government they were appointed to oversee, which was generally a contentious issue for the local government. However, in PA 436, the compensation for the emergency manager is paid for by the state, with the State Treasurer approving the contract. This is an important distinction, because it attached an appropriation to the statute, and under Michigan state law, appropriations cannot be put forth for a referendum, as was the case with previously repealed PA 4. Essentially, tying an appropriation to the statute made the statute immune to public referendum and repeal, such as the fate of PA4.

Similar to the predecessor law, the EM under PA 436 is required to submit quarterly reports to the State Treasurer and state legislators that outline the financial condition of the local government with a copy to the superintendent of public instruction if the local government is a school district, and a copy to each state senator and state representative who represents that local government. The reports are also required to be posted to the local government's website.

Another other key provision in the PA436 is in regards to how an EM is removed from the local government. There are 3 ways an EM leaves town. They could be:

1. Removed by the Governor or the legislature. If an EM is removed, the governor has 30 days to appoint a replacement.
2. Removed once “the financial emergency is rectified”
3. Removed after 18 months, with a 2/3 vote of the governing body of the local government. However, if the EM is removed and the local government has not previously breached a consent agreement the local government has 10 days to negotiate a consent agreement with the State Treasurer.

If a consent agreement is not agreed upon within 10 days, the local government moves to the neutral evaluation process option. Additionally, under PA436, if an EM has served for less than 18 months the local government has the option of passing a resolution to petition the governor to remove the EM as provided in and proceed under the neutral evaluation process option.

Similar to PA 4, the EM is required to develop a financial and operating plan for the local government that includes the operations of the local government within available resources, according to the EM’s revenue estimate. The plan includes a schedule for payment of the full scheduled debt service requirements; any modification, rejection, termination, and renegotiation of contracts; and the timely deposit of payments required for the pension fund. The EM has 45 days after appointment to submit the financial and operating plan. Another change to PA 436 is that within 30 days after the submitting the financial and operating plan to the State Treasurer and posting on the local government’s website, the EM is required to hold a public information meeting, but this does not require any form of public approval.

The powers of the EM under PA436 are virtually identical as under PA4. An analysis of the statute finds 33 powers attributed to the EM. Without any impediment from local charters that state otherwise, under PA 436 the EM has the authority to:

- (1) Analyze factors contributing to the financial emergency in the local government and develop measures to address the situation.
- (2) “Amend, revise, approve, or disapprove” the local government’s budget.

- (3) Manage all federal, state, and local funds earmarked for the local government.
- (4) Amend or revise a plan for the local government to pay off all outstanding obligations.
- (5) Require, and determine the structure of special reports to be prepared by the local government's finance office.
- (6) Examine all records and books of account, in order to analyze the local government's financial situation.
- (7) Initiate, approve or disapprove "any appropriation, contract, expenditure, or loan;" this includes the creation of, or filling vacant positions.
- (8) Review the local government's payroll.
- (9) Set the staffing levels for the local government, this is regardless of any charter provisions with minimum staffing level requirements.
- (10) "Reject, modify, or terminate 1 or more terms and conditions of an existing contract."
- (11) "Reject, modify, or terminate 1 or more terms and conditions of an existing collective bargaining agreement." This, of course, was the controversial provision from PA4 that fueled the petition drive that resulted in the repeal measure being placed before the voters in the November 2012 election, yet remained as part of PA436.
- (12) Act as the sole agent of the local government in collective bargaining.
- (13) Remove trustees on the local pension board if the local government's pension fund is not actuarially funded at a level of 80% or more.
- (14) Exercise the authority and fiduciary responsibilities of the local pension board. The EM is required to receive State Treasurer approval before making any changes to the local government's pension.
- (15) Consolidate or eliminate departments in the local government. The EM may also remove department heads.
- (16) Hire or contract for auditors and other technical consultants the EM considers necessary. While the EM is paid by the state, these consultant costs are at the expense of the local government and need to be approved by the State Treasurer. Any contract over \$50,000, is subject to competitive bidding; however, if a potential contract involves a cumulative value of \$50,000, the EM may receive a waiver from the State Treasurer.

- (17) Retain persons or firms, from a list approved by the State Treasurer, to perform the duties of a local inspector or a local auditor.
- (18) Initiate court proceedings in the Michigan Court of Claims or in the local government's circuit court jurisdiction to enforce compliance orders.
- (19) Sell, lease, or transfer the assets, liabilities, functions, or responsibilities of the local government, as long as the action "does not endanger the health, safety, or welfare of residents of the local government." One limitation on this power under PA 436 is that the EM may not sell or transfer a public utility furnishing light, heat, or power" without the approval of the local government residents in an election.
- (20) Apply for a loan from the state on behalf of the local government, subject to the conditions under state law.
- (21) Order millage elections for the local government consistent with Michigan election law. A millage election is a proposal put before voters where the residents of a local government decide whether or not to raise property taxes by a certain amount to address an issue.
- (22) Authorize the borrowing of money by the local government as provided by law.
- (23) Approve or disapprove of the issuance of obligations of the local government. An election regarding the issuance of obligations of the local government can only be held at the general November election.
- (24) Enter into agreements with creditors for the settlement payment of existing debts.
- (25) Enter into agreements with creditors to restructure debt.
- (26) Enter into agreements with other local governments for the provision of services.
- (27) Enter into agreements with other units of municipal government to transfer property of the municipal government, subject to state law and with the approval of the State Treasurer. This applies to municipal governments only.
- (28) Enter into agreements with local governments for the consolidation of services.
- (29) Recommend to the state boundary commission that the local government consolidate with other municipal governments.
- (30) Disincorporate or dissolve a municipal government and assign its assets, debts, and liabilities as provided by law. If required by law, this action would be subject to a local vote.

(31) Exercise “all other authority and responsibilities of the chief administrative officer and governing body concerning the adoption, amendment, and enforcement of ordinances or resolutions of the local government” in accordance with state law.

(32) Exercise any power or authority of any officer, employee, department, board, commission, or other similar entity of the local government, whether elected or appointed, relating to the operation of the local government. PA 436 makes clear that “the power of the emergency manager shall be superior to and supersede the power of any of the foregoing officers or entities.”

(33) Remove, replace or make an appointment to any office, board, commission, authority, or other entity which is within or is a component unit of the local government

The language from PA 436 differs slightly from PA4, however the powers essentially remain the same for the emergency manager. The controversial repeal of contracts, especially collectively bargained contracts remained, which upset the coalition that united to place the issue on the election referendum and led to its repeal. Also remaining is the clear indication that the emergency manager replaces the local government. PA 436 states that

“Except as otherwise provided in this act, during the pendency of the receivership, the authority of the chief administrative officer and governing body to exercise power for and on behalf of the local government under law, charter, and ordinance shall be suspended and vested in the emergency manager.” (PA 436 Section 12 (2))

The Neutral Evaluation Process under PA 436

New to PA 436 is the option for a neutral evaluation process, more commonly known as a mediator. The local government initiates the neutral evaluation process by providing notice for a request for neutral evaluation process to all “interested parties” – meaning creditors, bondholders, employees, unions, retirees of the local government, etc. Under this option, the local government and interested parties select a neutral evaluator, or mediator, to oversee the neutral evaluation process and facilitate efforts to resolve the

disputes. The neutral evaluator does not have the authority under PA 436 to impose a settlement on the participants, but rather, must use “best efforts to assist the participants to reach a satisfactory resolution of their disputes.”

The neutral evaluation process is concluded when:

1. The local government and interested parties execute a settlement agreement. However, the State Treasurer has the ultimate approval over the agreement, and may nullify it if not enough financial savings were achieved. The State Treasurer may then direct the local government to proceed under one of the other 3 options available under PA 436 (emergency manager, consent agreement, Chapter 9 bankruptcy).
2. The local government and interested parties reach an agreement or plan readjustment that requires the approval of a bankruptcy judge.
3. The neutral evaluation process extends past 60 days and no agreement, has been reached. There is an option to extend the process for an extra 30 days if all parties agree to it. Otherwise, once the 60 day deadline is passed, the State Treasurer will place the local government under one of the other 3 options (emergency manager, consent agreement, if possible, or bankruptcy).
4. The local government and interested parties were unable to begin the neutral evaluation process or unable to agree on a mediator.
5. The financial condition of the local government worsens to the point that the local government must file for chapter 9 bankruptcy.

The neutral evaluation process option is probably the least clear of the four options under PA436. As of early 2016, it has not been utilized, and therefore has not been tested. The neutral evaluation process is likely to be underutilized due to the need for the local government and interested parties to reach agreement on the mediator, and then any agreement that results from the mediator-driven process. The option provides a mechanism for the local government to engage with its creditors to negotiate and is intended to avoid a chapter 9 bankruptcy, or at least mitigate some of the effect a bankruptcy may have by achieving some agreement beforehand.

The Chapter 9 Bankruptcy Option

The fourth option available under PA436 is Chapter 9 bankruptcy. Written approval from the Governor is required in order for the local government to file for bankruptcy under Chapter 9. The local government must pass a resolution, that “the local government jeopardizes the health, safety, and welfare of the residents who reside within the local government or service area of the local government absent the protections of Chapter 9” and that the local government is “unable to pay its obligations within 60 days following the adoption of the resolution.”

If the governor approves of the bankruptcy option, additional requirements may be placed on the local government in order to proceed with the filing. This may include the local government appointing an individual to act and represent the local government during the bankruptcy proceedings. If the governor does not approve of the bankruptcy option sought by the local government, then the local government has to select one of the other 3 options. The important consideration from this is that final approval for filing Chapter 9 bankruptcy rests with the state, and specifically with the Governor’s office.

Summary of PA 436 of 2012

PA 436 is the current version (as of early 2016) of Michigan’s emergency manager statutes. It is essentially the same as PA4, but cannot be repealed by popular referendum because an appropriation is tied to the statute, which under state law, makes it immune to popular referendum. Under PA436, a local government that has been confirmed to be in a financial emergency is required to select one of four options: emergency manager, consent agreement, neutral evaluation process or Chapter 9

bankruptcy. Each option contains a high level of state oversight, and the state has intervention points for each option. While the local government is now given the choice of selecting the option it will utilize to address the financial emergency, if the state decides that progress has not been made, the local government would be subject to the emergency manager provision. This makes the local government's "choice" somewhat illusionary. The controversial provisions of the law, which give the emergency manager total control of the local government, including the ability to modify or terminate collectively bargained contracts with local government employees, remained in place.

The Case of Allen Park

Before examining the city of Detroit's path toward an emergency manager, it is useful to review a final case elsewhere in the state of Michigan, which fell primarily under PA 436. The City of Allen Park is a suburb located in Wayne County, approximately 10 miles southwest of Detroit. According to the 2010 census, the city's population was just over 28,000. Allen Park had a household income of over \$58,000 and per capita income of over \$27,000, both slightly higher than the average for the state Michigan. In comparison to Detroit and other Wayne County suburbs that border Detroit, Allen Park is relatively affluent. Only 7.8% of the population lived under the poverty level. The demographics of Allen Park reflect a mostly white (93%) middle class or upper-middle class suburban city. The Ford Motor Company, headquartered in neighboring Dearborn has a large presence in Allen Park. The city is also known for being training location of the Detroit Lions NFL team, and also notably, the sight of the

largest model tire in the world – an 80 foot, 12 ton Uniroyal Tire, that has greeted drivers traveling to the Motor City on I-94 since the 1960s.

In 2009, Allen Park faced many budget issues similar to other local governments across the country during the Great Recession. Additionally, as Michigan struggled more than the rest of the country during the recession, communities such as Allen Park, with greater reliance on the auto industry, faced even stronger challenges. However, the cause that led Allen Park on a course toward financial emergency was unique among the financial emergencies in the state – the city of Allen Park attempted to build a movie studio.

In 2009, the mayor at the time, Gary Burtka, and the City Administrator, Eric Waidelich developed a proposal for the purchase of 104 acres of land from a local businessman located near Allen Park's city hall. The plan was to acquire the land to open up a large movie studio, which would also serve as a training school to teach metro Detroit job-seekers the skills necessary to work in the movie and television industry. The city would partner with a Detroit-area native named Jimmy Lifton, who at the time was a president of an audio and video post-production company in Hollywood, and was believed by the Allen Park city officials to have significant connections in the movie industry (Christoff 2012).

In August of 2009, the city council unanimously voted to sell over \$30 million in bonds - without Allen Park resident voter approval - to buy and improve the land. Lifton, as a tenant of the city would then develop a \$146 million studio and movie training center. To many, the idea of a small metro-Detroit suburb jumping into the movie making business may appear to be a poor choice for a municipal gamble. However, by

2009 the Detroit area began to receive some attention from Hollywood, with the state offering large tax incentives encouraging film studios to shoot movies in Michigan, Clint Eastwood's film *Gran Torino* and George Clooney's *The Ides of March* being among the more notable examples from the time. When announcing the partnership, Mayor Gary Burtka declared that Allen Park was now "Hollywood 48101." Jimmy Lifton would speak of the dream to deliver movies in the same assembly line manner of Henry Ford, and estimated that 3,000 jobs would be created by the new company, named Unity Studios. At the time of the announcement, Lifton stated that "we will be here 25 and 50 and 100 years from now" (Christoff 2012).

However, the partnership with Lifton and the newly formed Unity Studios did not last 25, 50 or 100 years, but less than one. The partnership was disastrous from the beginning. Lifton, it would turn out, did not have the industry connections the city of Allen Park believed he had, and failed to attract the investment for the studio or training school. Additionally, Lifton and the city argued over the terms of the lease agreement for the land. Within 9 months, the city of Allen Park was threatening to evict Lifton from the city-owned properties because no rent had been paid and no documents could be produced that detailed the financial condition of the studio (Nunez 2010).

The studio and training school closed in 2010 after Lifton and Allen Park had further quarrels over the lease agreement. At this point, the city was charging Lifton \$168,000 in annual rent on an office complex and had loaned him nearly \$225,000 for renovations. Lifton fled the city of Allen Park without paying any of the due costs back under a "hold-harmless agreement." The city, however, remained on the hook for the significant municipal borrowing it had undertaken, which resulted in large bond

payments of over \$2.6 million a year. Without any revenue coming in to cover those bond payments, it became clear that the deal would drag the city into a financial crisis. Commenting in 2012, Harry Sisko, an Allen Park councilman stated that “we got hoodwinked” and that the city officials assumed that Lifton would be capable of lining up investors for the project (Christoff 2012).

To address the mounting city budget deficit, the city sought to raise property taxes on residents to help fix the damage created by the studio investment blunder. In the state of Michigan, the Headlee Amendment, which was approved in 1978, prohibits local governments from increasing taxes without voter approval. Therefore, Allen Park officials placed a measure to override the Headlee Amendment and increase taxes before the city’s voters in an August 2011 primary. Unsurprisingly, city residents voted against a property tax hike to bail out the failed movie studio gamble. When city residents refused to vote for increased property taxes, Allen Park found itself with mounting debt and no solution in sight. Additionally, during this time, property values were declining further as a result of the Great Recession. The city would have been in difficult financial condition regardless of the studio initiative, however with the failed studio initiative, the city was closing in on insolvency (Herndon 2011).

As Allen Park’s debt mounted, in August 2012, the city was selected for a review by the state to assess whether a financial emergency was taking place. The review team found that because of the studio investment, the city had not been able to make scheduled contributions to the city’s pension fund, had been missing payments to vendors, and had significant general fund deficits and significant cash flow problems. The review also found that the price offered by the city for the land was \$10.8 million more than it was

worth (Michigan Department of Treasury - Allen Park Financial Review Team 2012). On September 7, 2012 Governor Snyder announced that the city was in a state of emergency and would be appointed an emergency financial manager. In October 2012, the state appointed Joyce Parker, who had previously served as emergency financial manager of Ecorse, to be the EFM of Allen Park.

Parker undertook large financial reforms that included cutting city employment pay by 10 percent, eliminating vacant positions and restructuring city employee health care plans (*Detroit News* 2014). The city would eventually approve a property tax hike in 2013 after Parker warned voters that rejection of the tax increase would require significant cuts in Police and Fire departments, as well as additional charges for other city services (*The News Herald* 2013). The emergency was determined to be resolved in September 2014 and the city was moved into a transition board, per the requirements of PA 436. Unfortunately, the city's employees and taxpayers would face the consequences of the city council's movie dreams for years to come.

The Securities Exchange Commission (SEC) would bring fraud charges against the city of Allen Park and the former Mayor Gary Burtka and former City Administrator Eric Waidelich for the bonds connected to the movie studio investment. The SEC found that the city had misled investors of the \$31 million bond issue with false and misleading information about both the city's actual financial condition prior to the issuance, as well as the proposed movie studio and training school project's viability (Spangler 2014). In 2015, after the case was settled, the U.S. District Judge Avern Cohn, of the Eastern District of Michigan Southern Division, expressed frustration with Michigan's emergency financial manager law:

"The state of Michigan lacks a mechanism to review the legitimacy of municipal borrowing before debt instruments are issued. It is therefore fair to say that the state steps in only after the barn door is closed and the horse escapes. Who will guard the guards themselves?"

When questioned by local media about this claim, Michigan Treasurer's office stated that the city of Allen Park was under "qualified status" which meant it did not require state review in order to float a bond deal (Meloni 2015).

The case of Allen Park's selection for an emergency financial manager in 2012 under PA436 is similar to the case of the Village of Three Oaks in 2009, in that it involves a community whose elected officials made a disastrous single decision that dragged the government toward a financial emergency. Both Allen Park and the Village of Three Oaks had relatively few of the long-term structural challenges of the other local governments that had fallen under emergency management.

Fiscal Indicator Scores

Outside of the emergency manager statutes previously discussed it is useful to understand Michigan's fiscal indicator scores, and how they were used, or not used by the state of Michigan during the development and implementation of the emergency manager statutes. The Michigan Department of Treasury first developed fiscal indicator scores in 2003 for each of the local governments in the state. The state commissioned a study to evaluate fiscal indicators in local governments, working with the Michigan State Institute for Public Policy and Social Research. These scores were implemented in 2007 by the state (Plerhoples and Scorsone 2010; Kleine, Khola, and Weissert, 2003; Khola et al 2005). The scores are derived from 9 different indicators into a 10-point system.

The local government fiscal indicator scores were “intended to provide State officials, local officials, and the general public with objective, measurable, and straightforward information concerning the degree of, or absence of, fiscal health in units of local government” (Michigan.gov Fiscal Indicator Scoring 2010). The fiscal indicator scores were published on the Michigan Department of Treasury web site. The scores did not appear to lead to any direct action from the Secretary of Treasury, but were more informational to the public.

The scoring system was based on 9 factors:

1. Population growth
2. Real taxable valuation growth
3. Large real taxable value decrease
4. General fund expenditures as a percent of taxable valuation
5. General fund operating deficits
6. Prior general fund operating deficits
7. Size of general fund balance
8. Fund deficits in current or previous years
9. General long-term debt as a percent of taxable value

Each indicator is based upon pass/fail, meaning that depending on the data, the local government receives a zero (which is good) or a score (which is bad). The overall score is the composite. Each local government was scored, with 0-4 points representing a fiscally neutral position, which results in no further action; 5-7 points is considered a “fiscal watch” condition; and 8-10 points is considered a fiscal stress condition that could, but did not necessarily result in state review (Citizens Research Council 2010, 5).

The scores based on 2008 data were published to Michigan Department of Treasury website, and would have been available around 2009 – 2011. It appears this was the last year that the data was published for the Michigan Department of Treasury website. By the end of 2015 the scores are no longer found on the Michigan Department

of Treasury website, and no reference is given to their use in the emergency manager statutes, or other public information regarding the Michigan Department of Treasury. Currently, the only place the fiscal indicator scores can be found are with Munetrix, a company that specializes in financial reporting, management and forecasting tools for local units of government and schools. As of 2015, Munetrix has appeared to have adopted the original scoring algorithm from the study commissioned from the state, and has continued to update it (www.munetrix.com 2015).

When the scores were collected and used for informational purposes by the state, they did not appear to *directly* lead to preliminary reviews or any other state intervention, and even if they were a factor, any implementation was not conducted in a consistent manner that was made public. For example, the following local government's had a score of 8-10, which indicates extreme stress and "possible state review," based on the 2008 fiscal indicator scores:

Cities

Crystal Falls, Iron County
Jackson, Jackson County
Standish, Arenac County
Benton Harbor, Berrien County
Ecorse, Wayne County
Muskegon Heights, Muskegon County
Wakefield, Gogebic County

Villages

Elberta, Benzie County
Middleville, Barry County
Owendale, Huron County

Townships

McMillan, Ontonagon County
Middleville, Barry County
Bedford, Calhoun County
Genesee, Genesee County

Counties

Hillsdale

(Citizens Research Council 2010)

Detroit, the largest city in Michigan, was not scored by the Department of Treasury in 2008. Of the 272 local governments scored in Michigan, 14 (5%) received scores in the 8-10 range (a county – Hillsdale, also scored in this range). These scores indicate serious fiscal stress per the Michigan Department of Treasury language of the time (Citizens Research Council 2010). However, of the 14 local governments that scored in the highest range, only 3 would receive state action under the various emergency manager statutes. Benton Harbor and Ecorse received emergency managers in 2009 and 2010 and Royal Oak Township was placed under a consent agreement in 2013. The question may be asked, what about the other local governments scoring in the 8-10 range? Based upon this brief example, it was probably upsetting to critics of the emergency manager statutes, that these were the only three local governments scoring in the 8-10 score range that have a majority African American population. The remaining 11 local governments scoring in the “fiscal crisis” range represented mostly white, rural areas.

Fiscal indicator scores, as were developed in Michigan, are subject to many limitations and have received a fair amount of criticism concerning their validity (Crosby and Robbins 2010; Plerhoples and Scorsone 2010). Perhaps the greatest limitation of fiscal indicator scores is that fiscal health is inherently a complicated normative concept. A bondholder may judge a government making payments on time as being in great shape, regardless of any large cuts to the parks and recreation budget that were needed to make

that happen; on the other hand the citizens who visit and enjoy the city parks would likely have a much different viewpoint (Levine, Justice and Scorsone 2013, 44).

However, despite their limitations, fiscal indicator scores do offer a level of objectivity in the implementation of a state emergency manager statute. This becomes important when local governments with certain demographic characteristics are routinely targeted for state intervention, while local governments with other characteristics are not, despite similar scoring results. If an objective fiscal indicator scoring system is utilized, and leads to intervention, then all local governments would be subject to a greater degree of objective review, which would then lead to intervention based upon established criteria. Much has been debated about whether fiscal indicator scores are useful for predicting fiscal stress; however, an important consideration and argument for fiscal indicator scores is that they may help limit bias in implementing a controversial policy.

Summary of Chapter 4, Part 1

In this section, the emergency manager statutes of Michigan have been discussed, tracing their origins; similarities and differences; as well select examples of their implementation. Stemming from the receivership of Ecorse in 1986, PA 101 of 1988, PA 72 of 1990, the controversial PA 4 of 2011, and finally PA 436 were each addressed individually. When viewing the history of the statutes, it is observed that the emergency manager laws of Michigan began as a reaction to the unexpected receivership of Ecorse, and the fear that many similar events would follow and would take place without any level of control by the state. PA 101 of 1988 and PA 72 of 1990, while providing for a

large amount of authority to unelected emergency managers, were not utilized often and had relatively mild provisions when compared to the laws to come.

In the late 2000s, while Michigan's economic conditions worsened, several local government financial emergencies began to take place. In response to this wave of fiscal crisis, born out of political opportunity and conservative ideology, PA 4 of 2011 was passed. After a testy battle between opposing interest groups and stakeholders, the law was repealed by popular referendum, yet was replaced with a similar law, PA 436, that would not be subject to referendum, due an appropriation tied to the measure. To provide further context to the emergency manager statutes of Michigan and how they represent a departure from traditional state-local relations, Part 2 of the case study will follow the path of Detroit toward emergency management and subsequent bankruptcy filing – the largest such filing in U.S history.

Chapter Four: Results

Part Two - Detroit's Fiscal Crisis and Emergency Manager

The previous section traced the history of Michigan's emergency manager statutes, from the relatively obscure 1980s through the controversy of 2011 - 2013. This section will trace the path of Detroit's selection for an emergency manager and loss of local elective government, as well as how the city functioned under a government controlled by the emergency manager. With accumulating city deficits and long-term debt occurring on an annual basis, Detroit's elected officials were unable to come up with solutions. The state and federal government were either unable or unwilling to provide the city with resources and guidance to address the long-term problems. The result was the placement of an unelected emergency manager in the city of Detroit to address the financial crisis.

The fiscal decline of Detroit was addressed in in Chapter 2:5 and will not be fully repeated in full during this section. However, it is important to emphasize that the fiscal decline of Detroit was not due to mismanaged budgets and deficits alone. The challenges Detroit faced over the past sixty years are due to large socioeconomic forces and trends common in many urban cities, but were even more prominent due to the historical reliance on the automotive sector, and to an extent, the history of race relations in the city.

The right combination of federal, state and local political leadership to address these challenges never took shape, and the city finances spiraled out of control by 2012. Short-term fixes and accounting tricks would no longer suffice, as they had for years. The city had a declining population, (the second largest decrease only to New Orleans from

2000 through 2010); which corresponded to declining revenues. With an overall tax burden that was the highest in the state, and already far too high for the residents, raising taxes was not a viable option. Cutting city services was not desirable either, due to the high service needs in the geographically large city.

Economic Downturns

By 2010, the city was still reeling from the effects of the 2008-2009 recession that hit Michigan especially hard, considering the state never recovered from the previous 2001 recession. Michigan was in a “single state recession” for years after other states recovered from the recession of 2001. Michigan generally does worse than other states during recession times, but also generally fares better in recovery or high economic growth periods. These extremes are due to the Michigan economy being tied closely to the auto industry, and new automobile sales are generally delayed during economic downturns or when credit is tightened (Michigan Department of Technology, Management and Budget 2013).

This trend did not continue, as Michigan was unable to pull out of the 2001 recession, even though the rest of the country started to recover in 2002. Between 2000 and 2009, Michigan ranked last in the United States in population growth, real per capita GDP, and employment growth. In 2000 Michigan ranked 19th in per capital personal income; by 2009 the state ranked 41st. In February 2010, Michigan was finally relieved of the distinction of leading the nation in unemployment – which it had done the previous 47 months (Citizens Research Council 2013 Report 1124).

In 2007, as Michigan began to show signs of recovery, years after the rest of the

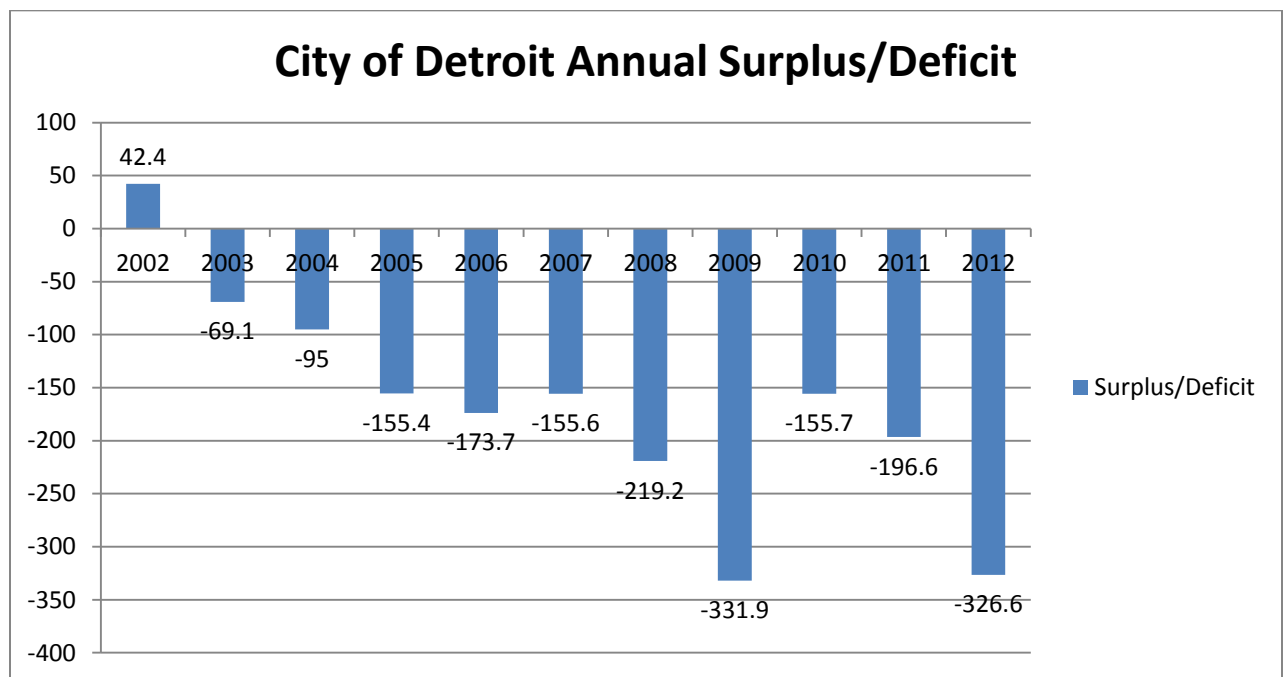
nation, another recession hit – the “Great Recession” of 2008 – 2009. By June of 2009, Michigan’s unemployment rate was 15% and Detroit’s unemployment rate was 25%, ranking last among the largest 50 cities in the nation. Detroit’s unemployment rate in 2010 was over 7 percentage points worse than the second to last city, Fresno at 18%, and over 10 points worse than the third to last city, Las Vegas at just over 14% (U.S. Bureau of Labor Statistics 2010). While the United States was struggling due to the economic downturn of the 2008-2009 recession, Michigan had been mired in a one-state recession and Detroit found itself an unfortunate statistical outlier in the unemployment rankings. Adding to the challenge was the fact that the city was losing residents at a record pace. The 2010 census showed that Detroit, once the 4th largest city in the nation with a population near 2 million, had only 713,777 residents remaining in the city. This decline in population also hurt the city when considering federal programs based on formula where population is a factor.

Path Toward Emergency Manager

In September 2008, Detroit Mayor Kwame Kilpatrick resigned from the mayor’s office after pleading guilty to obstruction of justice charges. The resignation marked a depressing period in Detroit’s local government where stories of corruption and scandal filled the local media on a nearly daily basis. City Council President Kenneth Cockrel became the city’s interim mayor after Kilpatrick’s departure. On May 5, 2009, Dave Bing won the election for mayor. Bing was a former NBA all-star with the Detroit Pistons in the 1960s and 1970s, and was later elected to the basketball hall of fame. After retiring from the NBA, Bing became a prominent businessman in the Detroit area. The

newly elected mayor won the election by running on his reputation for honesty and integrity, desperately needed for the city reeling from political scandal. However, newly elected mayor Bing took over one of the largest challenges in Michigan's local government history. Upon his election, Bing took over a city mired in debt, both short-term with persistent deficits, and long-term with ballooning debt. By 2012, Detroit had a deficit over \$326 million, long-term bonded debt of \$14 billion and credit ratings dropped to junk status (City of Detroit 2012 CAFR; Citizens Research Council 2012). In fact, over the previous 10 years, city of Detroit has run deficits (table 1).

Table 4:1: Detroit Annual Deficits



*In millions

(Detroit CAFR 2011-2012; Citizens Research Council 2012)

At the same time that Michigan's economy struggled with a one-state recession, ran into the 2008-09 recession, was losing population at record levels, running annual deficits for a decade, and lead all major cities in unemployment – the state dramatically

cut revenue sharing to local governments due to the economic downturn. In 2002, Detroit received \$338 million in state revenue share payments. This amount would trend downward over the next decade. By 2013 the amount was only \$171 million, or just 45% of the 2002 level (Citizens Research Council 2013). As the economic conditions and financial situation became worse for the city, state revenue significantly declined. Given all of the challenges the city faced, a perfect storm for financial crisis had developed.

Consent Agreement

As the city of Detroit continued to face a cash-flow crisis, the state decided to act. At the time of review, PA 4 of 2011 was the law of the land. On December 21, 2011, the Michigan Department of Treasury conducted a preliminary review of Detroit's finances to determine whether the city was experiencing financial stress. The review was conducted under the authority of Section 12(1) of Public Act 4 of 2011, which was titled the Local Government and School District Fiscal Accountability Act. In the letter announcing the preliminary review, the Department of Treasurer announced the trigger events under section 12 (j, m, o, q, r). This means the preliminary review was triggered by:

(j) The local government had violated a requirement of sections 17 to 20 of the Uniform Budgeting and Accounting Act, 1968 PA 2, MCL 141.437 to 141.440.

(m) The local government was in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan.

(o) The municipal government ended a fiscal year in a deficit condition as defined in section 21 of the Glenn Steil State Revenue Sharing Act of 1971, 1971 PA 140, MCL 141.921, or has failed to comply with the requirements of that section for filing or instituting a financial plan to correct the deficit condition.

(q) A local government has been assigned a long-term debt rating within or below the BBB category or its equivalent by one or more nationally recognized credit rating agencies.

(r) The existence of other facts or circumstances that in the State Treasurer's sole discretion for a municipal government are indicative of municipal financial stress, or, that in the superintendent of public instruction's sole discretion for a school district are indicative of school district financial stress.

(Michigan Department of Treasury - Report of the Detroit Financial Review Team 2012)

To summarize, the state determined that the city of Detroit was in violation of the state's budgeting and accounting act, failed to file a deficit elimination plan, ended a year in deficit position, was under junk bond status and had other factors the State Treasurer determined to be sufficient enough to warrant a preliminary review under PA 4 of 2011. This action is important, as it was the first official procedural step toward Detroit's eventual appointment for an emergency manager.

The preliminary review team studied Detroit's finances in December 2012 to determine whether or not probable financial stress existed in the city. On March 26, 2012, the determination was made under PA 4 of 2011 that Detroit was in fact in a condition of severe financial stress. Among the findings of the report, the preliminary review found that the financial audit reports for the past nine years illustrated large variances between revenues and expenditures as initially budgeted and amended, against the revenues and expenditures that were actually realized. The variances were found to be due to an ongoing practice of city officials knowingly adopting budgets that significantly overestimated revenues. The review also found that Detroit was experiencing a persistent cash shortage, with projections of a negative cash balance by June 2012 (Michigan Department of Treasury Report of the Detroit Financial Review Team 2012).

On March 12th State Treasurer Andy Dillion presented a draft consent agreement to the state appointed review team and the mayor. The state's consent agreement would include a financial advisory board that would include:

- The State Treasurer
- One person appointed by the Governor
- One person appointed by the State Treasurer
- Two appointed by the Mayor
- Three appointed by the Mayor and Council from a list of six candidates the Governor would supply
- One appointed by City Council

Under the State Treasurer's plan, 6 of the 9 members would be appointed by the state.

The state plan gave the board the power to review and approve operating and capital budgets; capital market transitions; propose changes in the city's debt structure; proposed modifications to contracts and pension agreements; or any other action that would have impact on the city's financial condition. In short, the state plan for the consent agreement would place the state appointed board in control of financial decisions for the city of Detroit.

Detroit Mayor Bing countered the state's proposal with a proposed consent agreement of his own. Under Bing's proposal, only 7 members are proposed, with 4 of those being appointed by the mayor. Under the mayor's plan the board would include:

- The State Treasurer
- One person appointed by Governor
- Two people appointed by Mayor
- Two people appointed by the Mayor and confirmed by city council from a list of six provided by the mayor.
- One person appointed by the city council

In the mayor's proposed consent agreement, the mayor would have the authority to negotiate, execute, amend, modify, reject or terminate contracts, in a way the mayor would have been able to operate with much of the authority given to a state-appointed emergency manager. The state and city were far apart in negotiations for the structure and terms of the consent agreement. The state's consent agreement transferred a large degree of financial and operational authority to the state appointed and controlled

financial board; the mayor's proposal increased the power of the Mayor and reduced the state's influence on the board to an advisory capacity (Citizens Research Council 2012).

After nearly a month of negotiation and protests, the city council voted to accept a third negotiated consent agreement. The Detroit City Council, after much debate, voted 5-4 in April 2012 to approve a consent agreement under PA 4 of 2011. The negotiation of the consent agreement took place while protests, court challenges and repeal of the statute, which provided a contentious environment for negotiation between the city and the state. The vote came just 24 hours before Governor Snyder's deadline for city acceptance before the state moved toward the emergency manager option. The approved consent agreement had greater balance between the state and city, and removed some language regarding future action involving city assets. The consent agreement was passed by the city council despite emotional appeals and protests from Detroit residents who demanded the city council reject the consent agreement. Several protesters referenced the fact that the debate was happening on the anniversary of the date of Martin Luther King Jr's death (Helms and Gray 2012).

Under the consent agreement, a nine-member financial advisory board was appointed to advise and review all of the city's fiscal matters. The governor made three appointees, the State Treasurer one appointee, the mayor made two appointees, and the City Council received two. A ninth member would be jointly appointed by the mayor and governor and had to be approved by the council. The financial advisory board was tasked with managing budget shortfalls, reopening union contract negotiations, and executing significant cuts in department spending. The advisory board was also to consider options of privatizing city services and potentially consolidating city departments and obtaining

refinancing options for the cities massive accumulated debt. Per the terms of the signed consent agreement, “on or before July 16, 2012, the City shall have either negotiated or imposed new labor agreements with those Unions whose contracts have expired or will expire on or about June 30, 2012” (Detroit Financial Stability Agreement 2012).

The consent agreement began with a promising start. In May 2012 Mayor Bing and the city council in late May agreed to cut nearly \$250 million from the city's \$1.1 billion budget for fiscal year 2012-13. However, shortly thereafter, a legal challenge by the city stalled progress. In June, Krystal Crittenden, the Detroit Corporation Counsel appointed by Mayor Bing, brought a lawsuit to Ingham County Circuit Court, alleging the consent deal was void because the state of Michigan owed the city of Detroit money. This produced an awkward situation whereby Mayor Bing and some council members wanted to proceed with the consent agreement, while the mayor's appointed legal counsel and other council members supported the legal challenge. State officials were angered by the legal challenge that took place after the consent agreement was signed. Meanwhile the city was once again about to run out of money in order to make payroll (Helms and Guillen 2013).

The Circuit Court dismissed the city's challenge, but progress on the advisory board stalled in the summer. By late summer and early fall, the repeal movement of PA 4 was under full effect, culminating with the statute's repeal in the November election by popular referendum. This meant that old statute, PA 72, became the law on the books that enabled the consent agreement to continue. While not as powerful as PA4, PA72 still allowed for the consent agreement to remain in effect. However, the PA4 repeal movement stalled the progress of the consent agreement in Detroit, as well as consent

agreements and emergency managers in other Michigan cities, as there was a great deal of confusion across the state as to what would happen if the law was repealed.

While not as severe as the emergency manager option, the consent agreement itself sacrificed a great deal of local government autonomy. The consent agreement advisory board requires negotiation and compromise, which proved too much to obtain over deeply polarizing issues involved with dramatic budget cuts, renegotiating contracts and potentially selling or leasing city-owned assets. With even more cash shortfalls projected, looming budget deficits and mounting long-term debt, state officials became frustrated, and that frustration increased with the city's further legal challenge and repeal of PA 4. What could have been a collaborative state-city partnership to solve the fiscal crisis would eventually be yet another breakdown in Lansing – Detroit; state/local relations. In December 2012, the State Treasurer sent in another review team to the city of Detroit; however this review was now there as a procedural step to start the process of appointing an emergency manager.

On December 11, 2012 the Department of Treasury conducted a second preliminary review of the Detroit's finances. This review was conducted under the authority of PA72, since the stronger PA4 had been repealed by voters, and PA 436 would be signed into law in March 2013. This second preliminary review was the first sequential event for the city's path toward an emergency manager and corresponding loss of local democratic control. The trigger events cited by the state for the review were Section 12 (j) and (k) which meant that the state was conducting a preliminary review once again due to repeated violations of the Uniform Budgeting and Accounting Act, and that it continued to fail in filing a deficit recover plan.

The second preliminary review reached the same conclusion as the first— that the city was still experiencing financial stress. This was communicated by the state’s December 14, 2012 letter to the city. The difference between the first and second Department of Treasury preliminary review letters is telling. In the first, several meetings are summarized between city officials, stakeholders and state officials. Over 4 months transpired between the entry of the preliminary review team and the letter to the city. In the second preliminary review, only three days transpired and no meetings are cited – the second review letter indicates that the review commenced on December 11, 2015. Because of this, it is clear that the second preliminary review had reached its conclusion - that Detroit would receive an emergency manager. The findings from the second preliminary review were generally the same as the first, citing violations of state law regarding local government and budget practices, and immediate cash flow shortages (MI Dept. of Treasury, Report of the Detroit Financial Review Team, 2012).

After the second preliminary review was conducted, the next step, according to statute, was for a state review team to travel to the city and conduct the more comprehensive review and issue a report and determination. The Detroit Financial Review Team met throughout December, January and February and issued the determination on February 19, 2013 that a local government financial emergency existed within the city of Detroit. The review team’s determination was made based upon four criteria: (1) perpetual cash crisis; (2) general fund deficits; (3) long-term liabilities; and (4) the inefficient bureaucratic structure (MI Dept. of Treasury Michigan Department of Treasury - Report of the Detroit Financial Review Team 2013).

Cash Crisis – The review team report referenced the city of Detroit’s continuing

exhaustion of its cash. The report cited projections that the city would have an estimated cumulative cash deficit of over \$100 million by the end of the fiscal year on June 30, 2013. The report gave some credit to the mayor and city council for considering, and at times implementing financial reform, but pointed out that those reforms were short-term fixes and were “heavily weighted toward one-time savings and usually applied to non-union employees who represented a relatively small portion of the Detroit’s overall wage and benefit burden.”

General Fund Deficits – The report referred to the city’s decade long history of running cumulative deficits. The report highlighted that the city had addressed these deficits by issuing long-term debt, and that even though this approach reduced the deficit in the year in which the debt is issued, it also reduced fund balance over time since the debt service payments would continue to increase.

Long-Term Liabilities – The report highlighted that as of June 30, 2012, the city’s long-term debt, including unfunded actuarial accrued pension liabilities and other post-employment benefits, was over \$14 billion, but noted that city officials had not yet developed a plan to address the challenges faced by long-term debt. Debt service payments made up an increasingly large portion of the city’s budget, further hindering any chance at budget reductions outside of defaulting on loans.

Bureaucratic Structure – The state’s report stated that Detroit’s city charter was too restrictive in enabling the city to make changes to address the financial emergency. The report stated that city charter restrictions “include numerous steps and time periods which must be observed before certain proposed changes may be implemented and provisions which make it all but impossible to restructure municipal services.”

On February 19, 2013 the review team report was submitted to Governor Snyder, and determined that a financial emergency existed in the city of Detroit. Under PA 72 the Governor then had to select one of three options: (1) A serious financial problem does not exist in the city; (2) A serious financial problem does exist, but a consent agreement has been adopted; or (3) A local government financial emergency exists and no satisfactory plan exists. Since the consent option was already attempted, and failed, the result was a forgone conclusion. On March 1, 2013, the governor concluded with the review team finding, that a financial emergency existed and no plan was in place to address the issues. The determination letter concluded:

“I have reviewed in detail the report and supplemental documentation submitted to me on February 19, 2013, by the Detroit Financial Review Team. I agree with the conclusion of the report, which was that a financial emergency exists within the City of Detroit because no satisfactory plan exists to resolve a serious financial problem.

Therefore, I wish to inform you that, pursuant to section 15(1)(c) of the Local Government Fiscal Responsibility Act, I have determined that a local government financial emergency exists within the City of Detroit because no satisfactory plan to resolve a serious financial problem exists.
(MI Executive Officer Governor’s Determination Letter 2013).

The Detroit City Council requested an appeal hearing on March 7, 2013. Appeal hearings may be granted Under PA 72, Section 15(2). With constituents angered over the possibility of an emergency manager appointed to the city, it was no surprise that elected officials chose to appeal the governor’s determination. The hearing was conducted on March 12th, with the Chief Deputy Treasurer, Mary G. McDowell presiding over the hearing. Detroit officials made that case that it had already taken measures to address the financial crisis, and needed more time for further progress.

Chief Deputy Treasurer McDowell submitted her report of the testimony to the governor on March 13, 2013. The next day, on March 14th, the governor issued a final determination and confirmation of the financial emergency:

“Having carefully reviewed the record of that hearing, and pursuant to Section 15(2) of the Act, I hereby confirm my determination that a local government financial emergency exists in the City of Detroit because no satisfactory plan exists to resolve a serious financial problem”

The governor’s confirmation letter concluded with the language that would seal Detroit’s fate to receive an emergency manager:

“I hereby assign responsibility for managing the financial emergency in the City of Detroit to the Local Emergency Financial Assistance Loan Board....Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, requires the Board to appoint an emergency financial manager for the city.”
(Michigan Executive Office Governor’s Confirmation Letter, 2013).

PA 72 of 1990 is the statute cited in the governor’s determination letter, the appeal, and the final determination letter. This is because PA4 of 2011 had been repealed, and PA436 did not go in effect until March 23, 2013. Therefore, PA 72 was the only statute available at the time for such intervention actions by the state.

Once the governor made the final confirmation of a financial manager, the Local Emergency Financial Assistance Loan Board was to appoint an emergency manager. The city of Detroit was out of procedural options under the state statute, having already attempted a consent agreement, and then appealing the decision to the State Treasurer’s option. After a year spent desperately trying to avoid an emergency manager, and the corresponding loss of autonomy in local government management, Detroit ultimately would have to accept its fate - that unfavorable fiscal and political forces combined to strip away its self-rule and place it under state receivership. Legal challenges were

proposed and ultimately filed, but within the procedures under the emergency manager states, Detroit had run out of options.

Once the governor confirmed the emergency, the next step was for the state to determine who the emergency manager would be for the city of Detroit. This was no small task, and in some ways may be one of the more important decisions made in the history of the city. The individual would certainly face constant scrutiny and protests and be tasked with successfully navigating the single largest takeover of a major city in United State history.

Appointing the Emergency Manager

On March 14, 2013 Kevynn Orr, a prominent bankruptcy attorney, was announced by Governor Snyder as his selection for emergency manager of the city of Detroit. Orr, 52 years old and African American, lived in Chevy Chase, Maryland, and was a partner at the Jones Day law firm, which specializes in complicated bankruptcy and reorganization cases. During a January 2013 meeting with state and city officials, the Jones Day law firm was attempting to become Detroit's restructuring law firm. Orr impressed state officials at the meeting, and was subsequently contacted by the governor's office for the position of emergency manager in mid-February (Meloni 2013; Egan 2013).

Orr had spent the previous decade at Jones Day working on complex and high profile bankruptcy cases, including Ohio-based National Century Financial Enterprise, which was described by some experts as one of the most complex and contentious reorganizations in United State history, and involved competing bankruptcies of more

than 500 separate medical provider entities in more than 2,000 locations and a shortfall of over \$2.5 billion in assets. Orr also played roles in the massive Chapter 11 reorganization of Kaiser Aluminum, and perhaps most notably for residents of Michigan, Orr was an integral part of the legal team that handled Chrysler's bankruptcy proceedings in 2009 (Davey 2013).

Orr's Michigan connections were mostly limited to his attendance at University of Michigan's law school decades before. Orr, who had spent most of his childhood in Florida, attended the law school and graduated in 1983. He practiced law in the Miami area for the rest of the decade and achieved a great deal of success before moving to the public sector in 1991. In that year Orr joined the litigation department of the Federal Deposit Insurance Corporation (FDIC) eventually transferring to the Resolution Trust Corporation (RTC), which was an entity created by Congress to liquidate the assets of savings and loans that toppled in the crisis of the late 1980s and early 1990s. While working with RTC, Orr became the Assistant General Counsel for complex litigation and bankruptcy and litigated several high-profile cases involving the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and related statutes. Orr joined the Department of Justice in 1995 as deputy director of the Executive Office for United States Trustees. In 2000, Orr was appointed as the Director of the United States Trustees Program (Michigan.gov Biography of Kevyn Orr, 2013; Davey 2013; Dickerson, Helms and Spangler 2013).

Orr, a Democrat, left federal employment in 2001, shortly after the election of George W. Bush. He moved on to the Jones Day law firm, where he was a partner and served on several high profile cases as previously mentioned. At his time of selection of

emergency manager, Orr had recently been appointed to run Jones Day's Miami office; however, he resigned his position with the law firm and accepted Governor Snyder's appointment as emergency manager. Instead of the beaches of Miami, Orr would be headed to Detroit late winter of 2013. Protesters greeted his announcement and press conference with contempt, including one protester displaying coffin shaped sign that read "RIP - They are Killing Detroit Over Our Dead Bodies" (Dickerson, Helms and Spangler 2013).

The contract for Orr's selection had an effective date of March 26, 2013. While Orr was appointed as emergency manager under Section 18(1) of Public Act 72 of 1990, The Local Government Fiscal Responsibility Act, the contract was effective under the new emergency manager law – Section 9 (10) and section 31 of Public Act 436 of 2012, the Local Financial Stability and Choice Act, that took effective in late March 2013.

Under the contract for EM services, Orr was tasked to:

"Remedy the financial distress of the City by requiring within available resources, prudent fiscal management and an efficient provision of municipal services by exercising the necessary authority conferred herein to take appropriate action on behalf of the city and its residents. In accepting this appointment, the Emergency Manager agrees to leverage all of the Emergency Manager's skills and abilities to accomplish these objectives on behalf of City residents." (Michigan Dept. of Treasury, Contract for EM Services 2013).

The first deliverable under the contract was, as required by Section 11 of PA 436, for the emergency manager to, within 45 days of appointment, to develop a written financial plan (Section 1.3). The contract required the EM to prepare and submit quarterly reports (Section 1.6) as required by Section 17 of PA 436. The first report was due within 6 months after appointment. The contract conferred upon Orr the powers under PA 436 of 2012 (Section 1.2; 1.3), which was similar to the powerful and

controversial PA 4 of 2011 that was repealed, and had the increased ability to terminate contracts, among other stronger provisions than were found in the old statute, PA 72. Per the contract, Orr was to seek state approval before entering into any new collective bargaining agreement with the city (Section 1.6).

Orr was to be paid an annual salary of \$275,000 from the state for his services (Section 3) while health and vehicle insurance to be paid by the city (Section 8). The contract allowed the EM to appoint additional staff and hire consultants as needed to fulfill the obligations of the contract. Any appointed staff and consultant costs were to be paid by the city (Section 4.1; 4.2). Additionally, no doubt in response to the scores of protests that followed the appointment, the contract provided Orr with security protection (Section 4.3).

Under the contract to serve as the state-appointed EM, Orr served at the pleasure of the Governor. There were some limitations to Orr's appointment under Section 9 of PA436, which states that if the emergency manager has served for at least 18 months, the emergency manager may then be removed by a 2/3 resolution by the local government elective body and mayor approval.

Why would Kevyn Orr, a successful law partner at the top of his profession want to sacrifice what was likely a comfortable life in the private sector, in order to take the position of emergency manager for Detroit? Most likely it is because the job presented Mr. Orr with the challenge of a lifetime in his field. Linda Stanley, a former U.S. trustee in San Francisco and former colleague of Orr's told reporters that it would be "a bankruptcy lawyer's dream to have this job" (Dickerson, Helms and Spangler 2013). Orr himself stated that Detroit represented the Olympics of restructuring" and that the turning

around the city would be challenging, but that he hoped one day to look back at one of the nation's great turnarounds (Davey 2013).

A chronology of the events of 2011-2013 that led to an emergency manager in Detroit is listed on the following page. In the subsequent section, the actions taken by the emergency manager will be summarized.

Chronology of Events in Detroit's selection for an Emergency Manager

December 11, 2011 – Michigan Department of Treasury begins preliminary review of Detroit's finances. The review is conducted under PA 4.

March 2012 – Consent agreement negotiated between the city and state.

April 4, 2012 – A consent agreement accepted by the city council, who vote 5-4 to accept the agreement.

May and June, 2012 – Detroit legal counsel Krystal Crittenden files a legal challenge in Ingham County Circuit Court to the state's consent agreement. The challenge is dismissed by the Circuit Court judge.

November 2012 – The controversial PA 4 of 2011 is repealed by voters in statewide referendum. PA 72 of 1990 goes back into effect.

December 26, 2012 – PA 436 is signed into law by the Governor. The statute keeps most of the controversial provisions of PA 4, but with a small appropriation tied to it – and therefore becomes immune to popular referendum vote. PA 436 will be effective on March 28, 2013.

December 11, 2012 – After state officials are frustrated by lack of progress under the consent agreement and legal challenges filed by the city, a second preliminary review is conducted by the state Department of Treasury. Once again the preliminary review finds financial stress in the city. The review is conducted under PA 72.

February 19, 2013 – Michigan Department of Treasury's Detroit Financial Review Team transmitted report to Governor's office. The Review Team concluded that a financial emergency exists in the city of Detroit.

March 1, 2013 – Governor Snyder concurs with the Review Team's report and issues letter of determination to the city that Detroit is in a financial emergency.

March 7, 2013 – The Detroit City Council requests an appeal.

March 12, 2013 –Appeal hearing is held by Chief Deputy Treasurer Mary G. McDowell where testimony is given by the city and state officials.

March 13, 2013 – Chief Deputy Treasurer McDowell submits appeal report to Governor Snyder. Governor Snyder reviews appeal report and confirms previous assessment that a financial emergency exists in Detroit and assigns the Local Emergency Financial Assistance Loan Board to appoint an emergency financial manager for the City. The confirmation letter is dated March 14, 2013.

March 14, 2013 – Kevyn Orr, law partner and restructuring specialist with Jones Day law firm is announced by Governor Snyder as the appointed emergency manager for Detroit.

March 27, 2013 – Emergency Manager Orr’s contract as emergency manager goes into effect.

March 28, 2013 – PA 436 becomes effective. Orr is appointed and assumes powers under PA 436.

Detroit under Emergency Manager

Orr’s time as emergency manager started rather rough. In mid-March before the official appointment began, local reporters discovered that Orr had four tax liens filed against his Maryland home for unpaid taxes associated with child care. This bolstered the numerous local critics of Orr’s appointment as emergency manager since he would be tasked with among many functions, improving Detroit’s tax collecting process. The governor’s office admitted that the issue was not found during the vetting process, but downplayed the importance of the tax liens. Orr said he was unaware of the tax liens, apologized for the oversight and quickly moved to settle the tax issue by paying the nearly \$11,500 in back taxes to the State of Maryland (Kurth and Livengood 2013; Helms and Gallagher 2013). This episode illustrates the level of scrutiny an emergency manager may face.

Another challenge for Orr was the increasing scope of protests from opponents to the placement of the emergency manager. On March 28, 2013 protestors gathered at Detroit's City Hall, located in the Coleman A. Young Municipal Center. A crowd of protestors staged a sit-down protest in the lobby after officials refused to let most of the crowd through security. The activists, coming mostly from Detroit and Flint, gathered at the Federal courthouse in the city after their lawyers filed a lawsuit against Michigan's emergency manager law. They then marched to City Hall in an attempt to meet Orr face-to-face and demand that he leave the city. The protestors did not make it past security, and remained there, sitting down and chanting slogans against the law. Rev. Charles Williams II, who was one of 22 plaintiffs in the federal lawsuit, organized the protest march. He told local media reporters that the legislation was anti-democratic and vowed to never stop fighting. Krystal Crittendon, the former chief legal counsel for the city who opposed the state at every turn, also attended the rally. Crittendon had previously been removed from her position for opposing the state involvement, and had since become a Detroit mayoral candidate (Al-Halaj 2013).

In the midst of intense media scrutiny and numerous organized protests, among the first decisions made by Orr as emergency manager, was to address the status (and pay) of the mayor and city council. Under Section 13 of PA 436, once an emergency manager is appointed to a city, the mayor and city council members' salary and benefits are automatically eliminated; however, the emergency manager may restore such benefits. Orr did just that, with emergency manager order No.1, on March 25th, to be effective March 28th (Emergency Manager, City of Detroit. 2013. Order No. 1).

In addition to maintaining the salary and benefits of the mayor and city council, Orr allowed them to continue to carry out the business, proceedings, administration, and operation of city service. However, despite this ability to operate as usual, the actual authority of the mayor and city council was removed:

“any orders, ordinances, resolutions, appointments, approvals, terminations, appropriations, contracts, permits or other related actions of the Detroit Mayor and City Council from and after March 28, 2013 shall be submitted to the Emergency Manager for consideration, but will not be valid or effective unless and until approved by the Emergency Manager or his designee in writing.”

This order was written on April 11th, and was effective retroactively to March 28th (Emergency Manager, City of Detroit Order No. 3, 2013).

In April of 2013 Orr began to assemble teams of consultants to assist him with his restructuring of city finances and operations. Orr entered into a contract of 6 months and \$3.35 million with his former law firm, Jones Day, to provide services to renegotiate the city's creditors (Emergency Manager, City of Detroit Order No. 4). The contract with Jones Day, Orr's most recent employer, prompted criticism from opponents of the law and city council members, who cited the contract as an example of a conflict of interest since Orr, who remained an equity partner, was likely to gain by Jones Day profits, regardless of his resignation from the firm to take the job as emergency manager.

As emergency manager, Orr was able to enter into contracts for services without any oversight from elected officials from the city. Only the state could disallow a contract, and in the case of Jones Day the state did not register any disapproval or concern. In fact, the state and city of Detroit had previously met with Jones Day law firm members to discuss the possibility of the law firm representing Detroit in the city's turnaround, prior to Orr's appointment. After the January meetings, City Attorney

Edward Keelan and Mayor Dave Bing were so impressed with the law firm and decided to work with them (Meloni 2013).

More consultant services were contracted throughout April 2013 to address restructuring needs of the city. By May 2013, the city had spent over \$14 million in consulting contracts since December, with some coming before emergency manager appointment, and some put into place after. Detroit began contracting with restructuring firms in December of 2012, as the financial crisis deepened and faced cash shortages. The city required state assistance to meet payroll and other expenses. The state did agree to issue \$30 million in bonds for Detroit, but only under the condition that the city put in place a restructuring team. The state agreed to reimburse Detroit for half of the costs for many of the contracts, which included the \$3.35-million contract for the Jones Day law firm. Other contracts that made up the majority of the \$14 million spent from December 2012 through May 2012 included Miller Buckfire of New York (\$1.8 million) to be the city's investment banker; Conway MacKenzie of Birmingham, MI (\$4.2 million) to be the operational restructuring adviser to find cost savings opportunities; and Ernst and Young accounting firm (\$1.2 million and \$6.6 million) (Guillen 2013).

In April and May of 2013, city council members and opponents of the emergency manager in Detroit questioned the size and complexity of the multiple restructuring contracts for consultants. The Governor's office, however, stated that they were pleased with the progress being made and had no concern. On April 19, 2013, Governor Snyder, speaking to local media reporters on the matter, stated:

"I think they're making progress. We're very early in that process, but I think things are moving ahead. I think there's a good relationship going with the mayor, the City Council and Kevyn Orr, and we need as many people on deck, all working together to solve these difficult problems" (Guillen 2013).

As Orr put together a restructuring team to address to assess and address the challenges of Detroit’s financial crisis, the first deliverable under his contract for emergency manager was due 45 days after appointment – the financial and operating plan. The financial and operating plan was required by statute, in Section 11 of PA 436, to be submitted to the State Treasurer. Per statute, the plan had to contain “objectives of assuring that the local government is able to provide or cause to be provided governmental services essential to the public health, safety, and welfare and assuring the fiscal accountability of the local government.” To this end, the financial and operating plan was required, under statute, to provide for:

- (a) Conducting all aspects of the operations of the local government within the resources available according to the emergency manager's revenue estimate.
- (b) The payment in full of the scheduled debt service requirements on all bonds, notes, and municipal securities of the local government, contract obligations in anticipation of which bonds, notes, and municipal securities are issued, and all other uncontested legal obligations.
- (c) The modification, rejection, termination, and renegotiation of contracts pursuant to section 12 of PA 436.
- (d) The timely deposit of required payments to the pension fund for the local government or in which the local government participates.

Emergency Manager’s Financial and Operating Plan

Orr’s financial and operating plan was submitted to State Treasurer on May 12, 2013. The plan is important because it represents the emergency manager’s official diagnosis of the city’s problems and proposes their solution. The plan assessed Detroit’s current financial condition. Orr’s report found that the city’s continued to experience difficult economic conditions due to challenging demographics, high levels of

unemployment, reduction in state revenue sharing, and decreases in revenue from income and property taxes. The plan found that Detroit's expenditures had regularly exceeded revenues by an average of over \$100 million per year from 2008 – 2012, these chronic shortfalls were addressed with the issuance of long-term debt, as well as deferring payments to the city's pension funds. The accumulated deficit was \$326 million at the end of the 2012 fiscal year, with an additional \$60 million estimated to be added (City of Detroit, Office of Emergency Manager's Financial and Operating Plan 2013, 1-2).

Orr's plan found that Detroit had a negative cash flow of \$115 million in fiscal year 2012 and had to borrow \$80 million from Bank of America in March 2012 just to avoid running out of cash. The City would have run out of cash in 2013, if not for the deferral of payments for the city's obligations, including pension contributions, and the receipt of proceeds from the escrow account established as part of the \$137 million August 2012 bond refinancing transaction, of which the disbursements are controlled by the State. Orr found that as of April 26, 2013, the City had cash on hand of \$64 million however, it had current debt obligations of \$226 million in the form of loans, property tax distributions, and deferred pension contributions and other payments. Orr's financial and operating plan concluded that Detroit's net cash position was actually -\$162 million as of April 26, 2013; Detroit had only avoided running out of cash due to a constant practice of deferring payments on current obligations, and would be forced to continue to do so in order to avoid depleting its cash (2-3).

Orr's plan reported that Detroit had total obligations of over \$15 billion, which included General Fund debt (\$1.1 billion), enterprise fund debt (\$6 billion), Pension Obligation Certificates ("POCs") and other derivative instruments (\$1.8 billion), other

post-employment benefit ("OPEB") obligations, which includes pension and retiree medical costs (\$5.7 billion) and other obligations totaling (\$400 million). The plan also found that the Detroit's pensions were underfunded by at least \$600 million, and perhaps significantly more once appropriate actuarial assumptions and current data would be factored. Because the city continued to defer pension contributions in order to meet budget shortfalls, annual payments on legacy costs had increased dramatically – to \$339 million or 33% of all 2013 revenues.

Due to the chronic short-term budget shortfalls, continuing challenges to stay solvent, and long-term debt, the city's credit ratings were found to be a historic low levels and in junk status. In fact, Detroit was found to have the lowest credit ratings of any major city in the United States, and in addition to legal debt limits, the city's ability to borrow had become limited (3). One striking critique in Orr's assessment for Detroit's financial management was that "the city's operations have become dysfunctional and wasteful after years of budgetary restrictions, mismanagement crippling operational practices and, in some cases, indifference or corruption" (21).

The financial and operating plan submitted by Orr summarized the actions undertaken by the emergency manager over the past 45 days while the plan was being prepared. This primarily included meeting with various interested parties and stakeholders, gathering information about Detroit's financial condition, hiring staff and consultants, issuing orders to the city council and city officials pertaining to the operation of the city, and beginning to develop a restricting plan (3-4).

The financial and operating plan found that over the previous five years, the Detroit Police Department (DPD) had five different police chiefs, each undertaking

different methods to reform the department. The plan found that the department's response times, case closure rate, crime reduction numbers and officer morale were all quite low. The plan states that DPD could be improved through "strategic redeployment of resources, civilianization of administrative functions, and other labor efficiencies and revenue enhancements" with additional investments needed in "information technology infrastructure, equipment, fleet, facilities and personnel," because such investments were ignored for years. The plan referenced a new outsourcing contract made with the Michigan Department of Corrections ("MDOC") that would consolidate the DPD jail operations involved with pre-arraignment jail operations into one centralized jail. A new Police Chief was to be hired, and as well as identifying an outside consultant to develop a strategic plan to improve police operations and implementing substantial structural, operational reforms to enhance public safety and reduce costs (6-7).

The financial and operating plan proposed much of the same reforms for the Detroit Fire Department (DFD) as it does for the DPD - strategic redeployment of resources, civilianization of administrative functions, labor efficiencies and revenue enhancements, as well as investments in IT infrastructure, maintenance and new recruits. As with the DPD, Orr's plan called for on the hiring of an outside consultant to develop a strategic restructuring plan for the DFD, which the plan states would produce structural changes that result in cost savings and improvements in public safety across Detroit" (7)

The plan called for the city to get out of the electricity and lighting business. The Public Lighting Department ("PLD") which owned and operates Detroit's electricity grid, had over 200 commercial electric customers and nearly all of the city's 88,000 streetlights, with the goal to provide safe and reliable power to its customers. The plan

found that the streetlights and the power grid were in dire need of major capital investments to provide dependable lighting and electricity. The estimated cost of the needed capital expenditures was \$160 million in improvements to lighting operations and \$250 - \$500 million for electricity/power grid operations. Since the city did not have any money, let alone \$660 million for capital upgrades, Orr's plan called for plan for the transition of the Detroit's lighting operations and electricity grid to a third party public corporation who would operate the system. The new public lighting authority would have the ability to issue debt, which would produce the capital needed to modernize the depleted infrastructure.

Some of this initiative was underway prior to Orr's appointment as part of previous reform efforts; in early 2013 the state legislature authorized the city to incorporate a new public lighting authority, which had articles of incorporation adopted in February 2013. The plan called for the Detroit's departure from the lighting and electricity business to begin in fiscal year 2014, and proceed over next five to seven years, ultimately resulting in a transfer of all customers to third party-owned meters (8).

For years, abandoned buildings and blight had been both a symbol of, and a contributor for Detroit's economic and financial challenges. The issue was addressed in the financial and operating plan, referencing that as of 2013 it was found that there were 60,000 parcels of vacant land; 78,000 vacant structures of which nearly half were estimated to be in dangerous condition. 15% of all city parcels were vacant. The plan called for adequate funding, coordination among various government, and non-government agencies, and a more aggressive enforcement of blight and building laws and ordinances. Additionally, it referenced reform that was required in the demolition process

in order to address the issues. In this part of the financial and operating plan, no concrete recommendations were made, but rather a need to study the issue further was described (10).

The Detroit Recreation Department was found to have chronic budget shortages and had become increasingly reliant on city subsidies. Because of this, the department was in danger of having to close several more recreational centers. Orr's plan referred to a current phase of Detroit's recreation plan which focused on the remaining 17 open recreation centers, and had a goal to increase their quality of service, while also decreasing dependence on city subsidies for continued maintenance and operation. The plan called for the recreational centers to be placed in an independent trust that would be funded by a mixture of Detroit funds, outside grants and fund-raising proceeds. The plan called for the Trust to manage Detroit's recreation centers - including capital improvements – and would be administered by an independent body consisting of a board of directors to be appointed by city officials. The Trust would still receive a reduced, fixed amount from the city each year, and the Trust would be responsible for obtaining additional funding from outside contributions to complement more fee-based programs to be delivered by third party operators (10-11).

The financial and operating plan acknowledged the challenges that the Detroit Water and Sewerage Department (DWSD) continued to encounter, as one of the largest municipal water and sewerage departments in the United States. Reaching across eight Michigan counties and 1,079 square miles, the water system serviced over 4 million people; with the sewer system serving nearly 3 million people. The plan found that Detroit's tremendous financial challenges, combined with "internal dysfunction and an

inability to raise rates for DWSD customers have resulted in significant historical under-spending on critical capital expenditures.” The DWSD continuously operated at significant losses, and the city did not have the funding available for much-needed infrastructure improvements. The plan states that DWSD’s 2012 capital improvement plan called for nearly \$1.5 billion over the next five years, with \$270 million budgeted projects in the next fiscal year. The financial and operating plan concludes that more time was needed to study how best to reform the DWSD (11-12).

The operational considerations in the financial and operating plan were based upon “guiding principles” when considering the restructuring of Detroit’s departments. These principles included: (1) improve service delivery to residents and businesses; (2) stabilize and enhance revenues; (3) establish more efficient processes, taking advantage of technologies where possible; (4) eliminate redundancies; and (5) operate comparable to benchmark cities using best practices.”(13).

The most controversial part of the financial and operating plan emergency managers are required to develop involve the recommended changes to collective bargaining.

Detroit had 48 collective bargaining agreements (CBAs) and Orr indicated that the city had made “great strides” by reducing costs under the Consent Agreement which was briefly in effect the previous year, prior to his appointment as emergency manager. Detroit, under the Consent Agreement, implemented City Employment Terms (CETs), which unilaterally reduced costs, which was approved by the Financial Advisory Board that was in place during the Consent Agreement period.

The plan highlights that PA 436 suspends Detroit's statutory requirement to collectively with employees under Michigan's Public Employment Relations Act (PERA). However, the plan indicates that the emergency manager directed Detroit to continue collectively bargain with Detroit's transportation employees covered by Section 13(c) of the Federal Urban Mass Transit Act. The U.S. Department of Labor requested assurances from Detroit that PA 436 and the emergency manager's position would not impact the City's ability to comply with its collective bargaining obligations under Federal law with covered transportation employees. In response, Orr had the city notify the transportation unions, which represented over 1,000 city employees, that it would continue bargaining as required by federal law

For all non-transportation employees, the city informed the unions that the requirement to engage in collective bargaining was suspended by PA 436. The city notified the Michigan Employee Relations Commission (MERC), the unions, and the arbitrators in these cases, that arbitration measures should be dismissed as allowed by PA 436. Orr's plan cites the authority given to him by Section 12 of PA 436, which provides the emergency manager with authority to "act as the sole agent of the local government in collective bargaining with employees or representatives and approve any contract or agreement, as well as the power to "reject, modify or terminate" any collective bargaining agreements.

The financial and operating plan makes it clear that concessions would be sought from city employees as this power was exercised. However, the plan also acknowledged that many Detroit city employees had previously been subjected to wage and benefit reductions under the CET, and that the Orr's comprehensive labor strategy would be

developed “with a view toward ensuring that any concessions are equitably distributed across all bargaining units, as well as across unrepresented employees, and that the impact of these concessions on employees are mitigated to the extent possible” (14-15).

Nowhere in the financial and operating plan is there any specific reference to a potential Chapter 9 bankruptcy filing. However, there are references toward the need for substantial debt restructuring. Additionally, the plan places a large emphasis on *increasing* investment for infrastructure public safety and development. The operating plan points to three areas essential for a successful rehabilitation for the city of Detroit: (1) improving public safety and promoting reinvestment in the City; (2) evaluating and restructuring the City's long term liabilities; and (3) evaluating and streamlining the city's operations (19). Additionally, the emphasis on restructuring is made clear in Orr's plan:

“The restructuring of the City's debt and other liabilities is essential to provide the City with a strong balance sheet and the financial foundation to raise new capital, attract new public and private investors and make the necessary reinvestments in the City. Without a significant restructuring of its debt, the City will be unable to break the cycle of damaging cutbacks in essential municipal services and investments.

Moreover, without a significant restructuring of its debt, the City will be unable to dedicate sufficient revenues to the critical task of reinvesting in needed improvements to public safety and quality of life for City residents and businesses. A restructuring is crucial for the City to grow. This Plan recognizes that interest rates, amortization, outstanding principal amounts, security interests, legacy liabilities and all other aspects of short- and long-term debt must be evaluated as part of the City's comprehensive restructuring. Significant and fundamental debt relief must be obtained to allow the City's revitalization to continue and succeed” (20-21).

Orr's financial and operating plan laid out some immediate actions to be taken, others to be taken in time, and yet other decisions that would require more study. Was bankruptcy always planned as the route taken by Orr? With the emphasis on debt restructuring and increased spending to address public safety, this is possible. The plan

clearly states Detroit's financial challenges, stating that the city has essentially become insolvent:

“The City of Detroit continues to incur expenditures in excess of revenues despite cost reductions and proceeds from long-term debt issuances. In other words, Detroit spends more than it takes in – it is clearly insolvent on a cash flow basis” (26).

It should be remembered that Kevyn Orr was among the more prominent bankruptcy and restructuring experts in the country. Therefore it should have come as no surprise that bankruptcy was ultimately considered to be the best option to restructure debt and achieve concessions in order to transform the city according to the outline and strategic initiatives provided in the financial and operating plan. Regardless of whether bankruptcy was always considered the practical end-game to the emergency manager of Detroit, any such filing requires that the city, under Orr's direction, first try and negotiate with its creditors.

Debt Restructuring Negotiations

Orr's financial and operating plan was greeted negatively by investors and credit rating services. The emphasis on debt restructuring was especially alarming. Following the public release of the plan, Moody's Investor Service issued a statement:

“The plan is negative for Detroit bondholders because it indicates that the city requires 'significant and fundamental debt relief' to help shore up its finances, a clear indication that a default or bankruptcy is a real option” (Al-Hajal 2013).

The creditor anxiety increased in June, when just over a month after submitting the financial and operating plan, Orr held a closed door meeting with Detroit's creditors, which would many felt would determine whether or not Detroit would avoid filing for bankruptcy.

Meeting at the Westin Hotel near the Detroit Metro Airport, Orr organized over 100 creditors, bond issuers and union officials to ask for large-scale concessions, in order to address the long-term debt in excess of \$15 billion. The purpose of the meeting was for Orr to issue a proposal to creditors to restructure Detroit's debt. Although the proposal would be made public after the meeting, Orr required all in attendance to turn in personal electronic devices, such as phones, laptops and tablets, at the front door. Orr's spokesman, Bill Nowling told reporters:

"We don't want them tweeting or texting or Facebooking. They're there to listen to our proposal and ask questions about it. We don't want to give anybody an undue advantage over anyone else in the room in trying to game the system or trying to move numbers in the markets" (Kowalsky 2013).

Franklin Resources, Inc. based out of San Mateo, California, and Nuveen Asset Management, based out of Chicago, held the highest and second highest amount of Detroit's debt, estimated at \$232 million and \$190 million respectively, and therefore had the most to lose in restructuring. Other entities were equally concerned, such as the leadership at the Detroit Institute of Arts, whose multi-billion dollar world renowned art collection was feared to be targeted by creditors in any restructuring debate (Al-Hajal 2013).

The 128-page debt restructuring proposal, made public after the closed door meeting, shocked the creditors. Orr essentially offered creditors 10 cents on the dollar of what was owed on unsecured debt, and informed creditors that the city would immediately begin to default on payments totaling over \$2.5 billion of debt. The restructuring plan presented to creditors was built upon some of the agreements made during the consent agreement with the city, but provided far greater detail as to how the city may achieve the costs savings and address needs. The debt restructuring plan filled in

some of the space left from the financial and operating plan submitted to the governor a month before (City of Detroit Proposal for Creditors 2013)

The debt restructuring was meant to set aside \$1.25 billion over 10 years for large-scale improvements for public safety, lighting and overall technological upgrades. The proposal called for \$400 million to go toward blight removal through 2018, with the city using police and fire department data to strategically demolish abandoned buildings with the goal of reducing crime. Additional upgrades in technology, data systems and equipment would be made. Among the more creative elements of the restructuring plan, was the establishment of a citizens “Radio Patrol” to assist law enforcement.

Additional upgrades were made to payroll systems for city employees to reduce costs associated with processing and errors. City-owned parking facilities were to be put up for sale, in order to pay down special revenue debt. The city’s largest park, Belle Isle, was to be leased to the state, a measure which the city council previously rejected before emergency manager rule and remained a sensitive subject. Union concessions would be sought, or unilaterally made via the power of the emergency manager statute, and more job cuts were planned (City of Detroit Proposal for Creditor 2013; Williams 2013; Al-Hajal 2013).

Speaking to local media after the restructuring plan was unveiled, Orr communicated that the city and stakeholders had to face the realities of the financial crisis that had been made worse by annual practice of procrastination and avoidance. He indicated that he was prepared for lawsuits filed by creditors who would not be pleased.

"If people are sincere and look at this data, you would think a rational person will step back and say, 'This is not normal ... but what choice do we have? Detroit's fiscal nightmare didn't occur overnight. It's been decades in the making as city leaders took out bonds at high interest rates to pay bills Detroit's general fund couldn't cover.

The average Detroiter has to understand this is a culmination of years and years of kicking the can down the road. We can't borrow any more money. We started borrowing from our own pension funds."

Orr stated that the long-term debt was likely over \$17 billion with an annual deficit of \$380 million approaching by July 1, 2013. At the time, Orr believed that the chances of bankruptcy were 50-50 Detroit (Williams 2013).

The debt restructuring plan involved significant cuts to accrued vested pension amounts for both active and currently retired city workers. In response, unions filed lawsuits challenging the constitutionality of the PA 436. One of the lawsuits, filed by former and current city employees vested in the city's General Retirement System, sought to have the state's PA 436, the emergency manager law, ruled unconstitutional, because it allows the state to seek to cut pension benefits, in violation of the Michigan Constitution. The lawyer for one of the lawsuits, John Canzano, told reporters that the case to repeal the statute makes a basic argument: "that the state constitution says very plainly that accrued pension benefits of public employees shall not be diminished or impaired, and therefore, the emergency manager cannot violate that constitutional protection (Helms and Guillen 2013; Helms, Guillen and Egan 2013).

The talks with union officials did not advance much further on June 10th, union members and officials were angered about the secretive nature of the meetings, viewed any concession as against the Michigan constitution, and were upset that specific details about Orr's offer were not made. Additionally, union representatives pointed out the high level of spending on consultants that the emergency manager had undertaken, specifically

to his former law firm, Jones Day. Orr's staff communicated to unions that it would likely be in their best interest to accept an offer, because they might not receive a better deal if the city files for bankruptcy. In response, union members, such as Joseph Barney, a president of a union representing Detroit's EMS workers, complained about the tactic: "It's basically, 'This is what we're offering you. If you don't take it, we'll file bankruptcy'" (Helms, Guillen and Egan 2013).

Meanwhile, while the emergency manager had hired a large amount of consultants and staff and produced the financial and operating plan, a 128 page detailed proposal for debt restructuring with creditors, including seeking concessions from unions, the elected officials of the city - the mayor and city council members - remained on the sidelines. In relation to the Detroit City Council, Orr used the powers granted to the emergency manager under PA 436 to modify his first order of restoring council and mayoral pay. Orr removed the council president Charles Pugh from his position after allegations surfaced that he had an inappropriate relationship with a teenager he was mentoring. Simply by issuing an order from the position of emergency manager, Orr removed Pugh from his position as council president, including his salary and benefits (Emergency Manager – City of Detroit Order No. 9, 2013; Helms and Guillen 2013).

By July 15, 2013, editorial boards and analysts were speculating that Emergency Manager Orr's financial and operating plan, restructuring proposal to creditors, and negotiations with union officials were setting the stage for a potential Chapter 9 bankruptcy filing. Missing payments to creditors and negotiating in "good faith" with creditors are requirements under any Chapter 9 bankruptcy. Some experts commented that concessions from unions were unlikely, until a court forced them. Michigan's

Constitution protects contracts, but Orr and his team believed that a Federal bankruptcy under Chapter 9 would trump those state constitutional protections (Bomey 2013).

Detroit Files for Bankruptcy

Ever since Kevyn Orr was appointed to be emergency manager for the city of Detroit, there was speculation that Orr, among the nation's most prominent bankruptcy attorneys, would look to the protection of a Chapter 9 bankruptcy filing in order to restructure Detroit's debt if concessions from creditors and unions and other stakeholders were not made. The bankruptcy laws, after all, were his home field. In mid-July, the speculation would end. On July 18, 2013, the City of Detroit officially filed for bankruptcy - the largest municipal declaration of bankruptcy in the history of the United States. The emergency manager behind the petition, Kevyn Orr, did not live in the city of Detroit, or the state of Michigan, and was never elected by residents of Detroit or Michigan to any public office. However, Mr. Orr, who had just arrived in Michigan 4 months ago, under PA 436, had authority to petition the courts and to shepherd the city of Detroit through the largest municipal bankruptcy in U.S. history.

Section 18 of PA 436, provides the emergency manager with the authority to recommend to the governor that the city file for municipal bankruptcy:

“if in the judgement of the emergency manager, no reasonable alternative to rectifying the financial emergency of the local government which is in receivership exists, then the emergency manager may recommend to the governor and the State Treasurer that the local government be authorized to proceed under chapter 9. If the governor approves of the recommendation, the governor shall inform the State Treasurer and the emergency manager in writing of the decision, with a copy to the superintendent of public instruction if the local government is a school district. The governor may place contingencies on a local government in order to proceed under chapter 9.

“Upon receipt of the written approval, the emergency manager is authorized to proceed under chapter 9. This section empowers the local government for which an emergency manager has been appointed to become a debtor under title 11 of the United States Code, 11 USC 101 to 1532, as required by section 109 of title 11 of the United States Code, 11 USC 109, and empowers the emergency manager to act exclusively on the local government's behalf in any such case under chapter 9.”

Order No. 13 recommended such a course of action to the Governor Snyder, and already had the state's approval attached to the order. Thus, Order No. 13, along with Governor Snyder's official approval sealed Detroit's fate as the largest municipality to file for bankruptcy. The text of which states:

“It is hereby ordered that: The City shall file a petition for relief under chapter 9 of the Bankruptcy Code (the “Petition”) in the United States Bankruptcy Court for the Eastern District of Michigan” (Emergency Manager, City of Detroit, Order No. 13).

On the same day, July 18, 2013, at 4:06 PM, the City of Detroit officially filed the petition for Chapter 9 bankruptcy protection with the United States Bankruptcy Court, Eastern District of Michigan.

At a press conference after the Chapter 9 filing, Orr attempted to calm fears regarding the bankruptcy filing. For a public official who had just submitted the largest Chapter 9 bankruptcy filing in U.S. history, Orr appeared remarkably calm and upbeat at the press conference later that day:

"In each restructuring I've been in... I've heard the same thing: 'This is a crisis. The magnitude is huge. How can this ever happen? This is a testament to failure. Not at all...

This is a tool. This is a tool to address the externalities and reality of debt we simply cannot carry anymore, so we can get to providing the services that the citizens and residents of this city deserves and put this city on a footing that is sustainable so they can continue to grow and thrive.

I understand people who don't do this for a living think of this as negative. Bankruptcy has a certain connotation to it. But for me, stay tuned. I've heard this before and it hasn't proven to be true" (Al-Hajal 2013).

On the other hand, retirees in the pension system, and city employees were much less enthusiastic about the bankruptcy filing. Orr planned for a rapid bankruptcy filing, with a goal to be completed by September of the next year. This is in stark contrast with Orange County, California which was in bankruptcy for over 18 months in the 1990s or Jefferson County, Alabama, which at the time had been in bankruptcy court for the past 3 years. Local media, residents and state and local officials were scrambling to understand what the next steps would be in this misunderstood and rarely utilized process for local government, as Chapter 9 bankruptcy filings are exponentially less common than Chapter 11, and had never been filed in such a large city before.

Orr planned to chart a path similar to the Chrysler bankruptcy he led in 2009, to streamline the process by “using novel legal arguments and identifying loopholes to reduce or eliminate some of the laborious requirements typically associated with bankruptcy.” Creditors complained about the filing, stating that the city did not negotiate in good faith. However most legal experts agreed that the city had demonstrated it had negotiated for months, and such challenges were unlikely to be upheld in federal court (Bomey, Snavelly and Priddle, 2013).

The bankruptcy filing, the largest in U.S. history captured the attention of local and national media. Since there was never a municipal bankruptcy this large before, many were unsure of how the next months would unfold. The local news was filled with potential liquidation scenarios – How much was a zebra worth? A giraffe? (up to \$80,000 if healthy). What about the Detroit Institute of Art’s famous Rembrandt or Van Gogh paintings? Detroit’s Belle Isle? City-owned assets such as the animals of the Detroit Zoo,

or paintings in the Detroit Institute of Arts were being appraised to determine their worth in case they would be required for liquidation. Art lovers were especially nervous when creditors began eyeing the multi-billion dollar collection of the DIA, which contained a mixture of city-purchased art (mostly from the booming 1920s) as well as trust collections. Classic cars owned by the Detroit Historical Society, such as the 1963 Ford XD Cobra, could fetch over \$1 million a piece on the open market, if such assets were liquidated (Stryker and Gallagher 2013).

On the other hand, less concerned with preserving the zoo or DIA experience, and other Detroit cultural institutions, were pensioners and employees concerned about cuts to their pay and benefits that may prevent them from paying their bills. Most of the discussion over fire sale of all city assets was overstated, as Chapter 9 bankruptcy filings generally do not contain such broad liquidations as compared to Chapter 11.

The bankruptcy filing survived numerous legal challenges, as did the PA 436, the emergency manager statute; both were found to be quite resilient despite the protests and controversy surrounding them. As the case for bankruptcy was made, the costs of consultants would increase, as would the scrutiny from city council members and opponents. By November the cost was over \$22 million, with \$11 million going to the Jones Day Law firm. The city (Orr) had agreed to pay the consultant firms, including Jones Day, more than \$62 million to assist with the restructuring, and the contracts were expected to be modified as the bankruptcy case proceeds (Guillen 2013).

Detroit's bankruptcy trial began on October 24, 2013, where creditors and union representatives protested that the city had no right to file for bankruptcy and that outstanding debt and pension and health benefits could not, and should not be reduced.

After months of arguments, on December 3, 2013, U.S. Bankruptcy Judge Steven Rhodes ruled that Detroit met the legal criteria to proceed under Chapter 9 bankruptcy and receive protection from its creditors (U.S. Bankruptcy Court, Case No. 13-53846). This was a landmark ruling for municipal government across the country. Rhodes ruled that the federal bankruptcy law takes precedence over the state law in regard to protecting public employees' pensions. Despite this, Rhodes communicated that the court would use caution before approving any cuts in monthly payments to retirees. The ruling ended several months of uncertainty, but made public employees in local governments across the country anxious about the security of their pensions. The bankruptcy process then moved on to mediation.

The bankruptcy process for Detroit would fill a comprehensive case study on its own, and future public administration and municipal bankruptcy legal research should, and will likely examine the intriguing dynamics of Detroit's municipal bankruptcy experience. However, as the topic of this particular study is the emergency manager statutes of Michigan and their implementation in Detroit, the bankruptcy proceedings will not be discussed in great detail here, and a comprehensive legal analysis of the impacts of the bankruptcy case are beyond the scope of this research paper.

After Judge Rhodes ruled in December that Detroit may proceed under Chapter 9 protection, mediator United States Chief District Judge Gerald Rosen was tasked with reaching a bargain between the city and its creditors and pensioners. After Rosen reached out to Detroit-area foundations, the Detroit Institute of Arts, and other stakeholders, a so-called "Grand Bargain" was reached to alleviate the scale of the cuts on pensions for city employees. The Grand Bargain that was reached protected the DIA's art collection, with

numerous local nonprofit foundations pledging over \$366 million over the next 20 years to reduce pension cuts. The bargain included \$100 million pledge from the DIA and \$195 million from the State of Michigan. Civilian pensioners voted to accept the plan, which included a 4.5% reduction and no cost of living adjustment; police and fire did not receive a cut, but received a smaller cost of living adjustment, from 2.25 to 1%.

Bondholders agreed to accept larger cuts. On November 7, 2014, after months of tireless negotiations, Judge Rhodes accepted the 8th and final proposed plan from the cities, creditors and foundations. Detroit cut more than \$7 billion in unsecured liabilities and invested \$1.4 billion over 10 years into services. Over \$800 million came in from the state of Michigan, the DIA and nonprofit foundations. Pension cuts were significant, but were the deal was clearly made in favor of the pensioners rather than the creditors.

Reading from the bench, Judge Rhodes spoke to the city of Detroit:

"We have used the phrase the grand bargain to describe the group of agreements that will fix the city's pension problem. That description is entirely fitting. In our nation, we join together in the promise and in the ideal of a much grander bargain. It is the bargain by which we interact with each other and with our government, all for the common good. That grander bargain, enshrined in our Constitution, is democracy. It is now time to restore democracy to the people of the City of Detroit" (Bomey, Stryker and Gallagher 2014)

Detroit emerged from bankruptcy on December 10, 2014. The same date that Kevyn Orr stepped down as emergency manager and issued his final order, Order No. 44 laying out budget conditions and other matters the city would be required to follow for the next two years. Mayor Mike Duggan, who had just been elected in November, and the city council were once again given some control over local government matters. The final emergency manager order read:

“To the extent not already restored pursuant to the EM’s Order No. 42, and except as provided by this Order or other or applicable Michigan or Federal statute, the powers and authority of the Mayor and the Council previously exercised by the EM shall be restored as of, and conditioned upon the occurrence of, the Effective Date” (Emergency Manager City of Detroit Order No. 44, 2014).

Emergency Manager Orr, who arrived in March 2013 and did not get off to the best start with local residents or protestors, left town with far less disdain than could have been expected. Certainly, pensioners, despite ultimately approving the measure were in no mood to celebrate the very real cuts to their benefits. Yet the so-called Grand Bargain was hailed as a triumph from the local media, analysts and a sizeable portion of the residents. Detroit’s bankruptcy experience was tentatively viewed as a success.

Nearly a year after emerging from bankruptcy, Detroit no longer had the cash solvency issues it had during the financial crisis. Significant levels of redevelopment were seen in the city, but had yet to reach the majority of the large sections of the city in poverty. There were still concerns about legacy costs over the next ten years, as most large cities are facing, but the city of Detroit was no longer in danger of running out of money on an annual, or monthly basis, and faced no immediate threat of return to emergency manager takeover, as had been the case in many Michigan cities who received an emergency manager.

Summary of Detroit’s Selection for Emergency Manager

In this section of the case study, Detroit’s path toward emergency manager was traced, followed by an analysis of the actions taken by the emergency manager. These actions culminated in the largest takeover of a city by a single unelected state-appointed official, and subsequent filing of the largest municipal bankruptcy in United States

history. In another way, the placement of an emergency manager in the city of Detroit was the culmination of twenty five years of the emergency manager statutes that allowed for the removal of local control and state intervention in Michigan cities. This was the scenario the worst case scenario – that the state’s largest city, a symbol of Michigan and the industrial Midwest – would face immediate default and would need to be taken over by the state. Adding to that worst case scenario was the fact that the emergency manager would go on to declare bankruptcy.

Detroit was without local democratic control of the city from March 2013 through December 2014. In that span, an unelected emergency manager from outside the state made monumental changes to the city which will resonate for the next 10-20 years, if not longer. In his nearly 19 months as emergency manager, Orr’s tenure controlling the city will rank in importance with longest-serving mayors of Detroit’s long history. This placement of an emergency manager took effect after a consent agreement between the state and city fell apart, and years of postponing measures needed to address the city’s problems – both at the city, state and federal level.

Procedurally, the first step in the process of Detroit’s path to emergency manager was in December 2011, when the state sent in the first preliminary review team to review the city’s finances. However, the true origins of Detroit’s fall into emergency management and eventual bankruptcy began decades before, and were a result of larger socioeconomic challenges that many older, urban cities face, but which were magnified in Detroit. In the final chapter, this point will be considered further, when a concluding theoretical inquiry is undertaken to address the research questions outlined in Chapter One.

In the next section of this case study, we look toward the largest local government fiscal crisis in United States history prior to Detroit – the fiscal crisis of New York City in the 1970s. Many of the socioeconomic issues and budgetary practices are similar; however, the level of state, local and business community involvement in local government matters draws an interesting contrast. By briefly examining the New York City fiscal crisis, it will enable for further analysis of the Detroit fiscal crisis and subsequent emergency manager experience. A comparison of the New York City fiscal crisis enables better exploration as to which method, if any, is preferable, or what considerations should be given in future local government fiscal emergencies.

Chapter Four: Results

Part Three - The New York City Fiscal Crisis

How does the complete state takeover of Detroit compare with other local governments that have faced similar levels fiscal emergency? As the underlying proposition of this case study is that the selection of Detroit for an emergency financial manager represents an unprecedented phenomenon in United States intergovernmental relations, analyzing another high profile cases is critical to test this assumption and perhaps generate new theory. To this end, the most prominent case of state intervention in a local government fiscal crisis was chosen: New York City in the 1970s.

Why is New York City the best comparison to Detroit's financial struggles and corresponding loss of local democracy? First, the fiscal crisis that struck New York City was the largest fiscal crisis in United States history. Most likely, Detroit, as the largest municipality to declare bankruptcy, now holds this title. Second, New York also received a loss of local government democracy as a result of financial stress. Regardless of precedence, Detroit in the 2010s and New York City in the 1970s represent the first and second largest local government financial emergencies in United States history. Therefore, it is fitting that we analyze these cases better understand similarities as well as differences in how the respective states handled the local government fiscal emergency.

Among the country's largest cities, New York City of the 21st century, certainly has its issues, but is in fairly stable financial condition, with a relatively diverse economy assisted by strong service, finance and tourism sectors. However, in the 1970s the city was on verge of financial ruin and collapse. The fiscal crisis required a state response.

Therefore, this part of the case study will be broken up into two larger sections: (1) The causes of New York City's fiscal crisis; and (2) the state response to the fiscal crisis.

Causes of New York City's Fiscal Crisis

Gramlich (1977) explains that local governments generally borrow money for one of three reasons, with two being acceptable, and the third generally thought of as dangerous. The first acceptable reason a local government borrows money is to finance long-term capital projects. The second acceptable reason is to use short-term borrowing to even out seasonal fluctuations in revenues and expenditures. The third, and unacceptable reason, is to borrow money with the purpose to cover up a current account deficit (Gramlich 1977, 415). Due to a number of factors, this third option was what put New York City into a serious fiscal emergency in the 1970s.

The financial crisis 1970s New York City was not an isolated event in the city's long history. Similar to the crisis in Detroit and other large urban industrial cities, the roots of fiscal crisis go back several decades prior. Scholars have pointed out that in three separate occasions in New York City's history, 1871, 1933 and 1975, the increases in spending led to fiscal crisis, which enabled banks owning the city's debt to insist that municipal expenditures be drastically reduced as part of a bailout plan (Schefter 1985).

When considering the fiscal crisis in New York City, Shalala and Bellamy (1976) outlined four basic causes (1) Changing demographics and economic characteristics; (2) national economic difficulties; (3) state and federal government actions; and (4) inaction and weakness in the political system (1119). These four causes attributed to New York City in the 1970s mirror the causes of Detroit's financial emergency, as well as many other older cities facing financial stress.

By the 1970s, New York's population and economic base was transitioning, similar to other large Northeastern and Midwestern cities. The middle class left the city to seek higher quality schools, more land and lower taxes. Manufacturing and industry went to the suburbs and where more land was available for a lower cost. The redistribution of population that took place left larger cities such as Detroit and New York with higher concentrations of residents who lived in poverty, resulting in a shrinking tax base at a time when more services were needed for the poor, as well as infrastructure needs in an older urban city (Blaydon and Gilford 1977, 1066).

Beyond the issues within New York City, national economic struggles played a part in New York's fiscal crisis. In 1974, a national recession, perhaps the worst economic downturn since the Great Depression, hit the country. New York's unemployment rate rapidly jumped from 6.8% in June 1974, to 11.4 in June 1975. Over the one year time period, New York's unemployment rate increased by 4.6 points, versus 3.4 points for the 24 largest U.S. cities (Joint Economic Committee Staff Report 1977, 19-21). Because New York relied on sales and income taxes for a large portion of revenue, it was more susceptible to larger economic trends that may decrease those revenue sources (Ott and Yoo 1975). Fewer jobs and less consumption of goods due to factors in the national economy resulted in decreased revenue sources for cities such as New York.

State and Federal policy presented further challenges for New York City in the 1970s. The city assumed a larger portion of services for the residents, taking on many roles reserved to the states in other American cities. Unlike other states, the City of New York also bears a much larger portion of welfare programs. As one study explained:

“no other city in this country has as many services assigned to it as the City of New York. In addition to normal housekeeping functions – police, fire, and sanitation – New York operates hospitals, elementary, secondary and higher education facilities, and subsidizes health care and mass transportation” (Shalala and Bellamy 1977, 1121).

New York City was the largest city in the U.S. and in many ways functioned as a state.

State policy or statute either mandated such a role, or at the very least, did not adequately monitor New York City to ensure that it was not being stretched too thin.

Federal program mandates from the 1960s were placed upon local governments, and federal policy, such as the FHA in addition to the construction of an expanding federal highway system enabled, and encouraged the movement of middle and upper class city residents to expand to the suburbs (Campbell and Shalala 1970). While some Federal policies encouraged migration and population shifts, a concrete collaborative policy to deal with the consequences never emerged.

Political considerations made it difficult for New York City elected officials to make decisions to address mounting deficits and debt. Government budgets are political statements that reflect the views of their constituents. In an increasingly mobile society, long-run promises had become “politically useless” and even among constituents that remain, the mentality was “what have you done for me lately?” Maintaining current services and election promises took precedence over long-term planning. Among voters, today’s taxes and today’s services are what voters respond to (Fair 1978). In an ever-expanding local government economy, such political realities do not represent insurmountable challenges; however in declining local governments, the political reality and economic reality collide, with fiscal crisis as the result (Inman 1983).

Like most local government fiscal crises, the 1970s New York fiscal crisis has roots that began long before. The 1920s building boom that culminated in skyscrapers

dominating the New York skyline enabled the city to project growth and increased levels of borrowing to provide expanding services. In the 1930s, after the Great Depression put an end to the unlimited projected growth, New York was subject to a fiscal crisis as the city spent over a third of its annual budget on debt services. Similar to the actions that would take place in the 1970s, the banks refused to extend credit until budget reforms would be made. It wasn't until city workers were required to take a one month leave without pay that the bankers resumed extending credit again (Tabb 1982, 18-19).

While New York City, like much of the country, experienced relative prosperity in the 1940s and 1950s, a 1952 report, projected increasing gaps between revenues and expenditures, unless spending was reduced and revenues increased via taxes; yet pointed out that such problems were tempered by a growing economy with corresponding inflationary movements. The city was "dependent on the success of the federal government in dealing with these forces" (Haig et al. 1952, 107). By 1966, the Schwulst Commission reported the continuing issues with projected budget deficits, as revenues could not keep pace with climbing spending and service needs. From 1962 to 1966, spending grew at a rate of 75% and budget deficits were between \$150 million to \$550 million in that timeframe (Schwulst 1966, 1).

New York City, like many other industrial cities in the 1960s, was tasked with absorbing rural migrants into their economy at around the same time when the industries and manufacturers began to shift their operations away from urban areas. Due to immigration from the South, the white middle classes' flight to the suburbs, and the aging of the city's population, city residents that were more dependent on city services took on a larger share of the city's population. For example, between 1950 and 1970 the

percentage of the city's population over 65 years old, age has increased from 8.0 to 12.1%, while the percentage of families with incomes below the nation's median income level increased from 36 to 49% (Congressional Budget Office 1975, 7).

State and Federal aid increased due to the tremendous changes taking place in the city. During the 1960s, state aid from New York increased toward New York City, by 200% and Federal aid by 700%. While in 1959, 28% of total city revenue came from state and federal aid, by 1969 this number had increased to 47% (Tabb 1982, 22). Federal money poured into struggling cities across the nation, as the federal social programs of the 1960s took form. However, several Federal programs required city matching amounts that increased over time. As the Schwulst Commission reported:

“Right now, the federal government puts up 90 percent of the funds for many anti-poverty activities, while the remaining 10 percent is provided by the City or nonprofit organizations. The basic federal law provides for a gradual reduction of the federal share, eventually to 50 percent. Neither the City nor the social agencies could afford to continue the anti-poverty programs at present levels, higher than the municipality itself would have set, if they are required to cover 50 percent of the costs.” (Schwulst 1966, 65).

In addition, the state of New York required the city to take on a larger share of services, including that of Federal programs. In 1975, only 21 states required local governments to provide financial support toward the cash assistance to families with dependent children (AFDC) or toward Medicaid payments. Of these 21 states, New York was by far the highest, requiring a contribution of 23% toward the nonfederal share of such programs (CBO 1975, 13). While there was much attention towards New York City providing too generous of benefits and services, state-local, and Federal-local intergovernmental relations provided a framework for this dynamic to take place and New York's movements toward reform were somewhat constrained.

Beyond the larger economic downturn, the socioeconomic and population trends, and difficulties with federal and state policies, political forces contributed to the development of New York's fiscal crisis, as well as the inability to make needed budgetary reforms. City leaders often did not make the situation better, and in many cases may have compounded the struggles with questionable financial practices. In the case of New York City's fiscal crisis of the 1970s, chronic budget shortfalls resulted in accounting tricks to hide the severity of financial problem, while postponed action to address the issues was the norm.

As previously stated, all local governments borrow money, and generally this borrowing is for long-term capital projects, or short-term cash flow during revenue fluctuations. Bonds are long-term obligations, maturing in not less than one year, that are generally sold to finance long-term capital investments, and had traditionally comprise the majority of state and local government financing. On the other hand, notes are short-term obligations with a maturity of one year or less. Notes are generally used to even out the differences in cash flow between revenues and expenditures, address unexpected deficits, or provide temporary financing of capital projects in expectation of future bond sales (Forbes & Petersen 1976).

New York City borrowed against accrued, yet truly uncollectable tax revenues, and applied the proceeds of long-term debt toward making payments required by collective bargaining agreements and other politically sensitive spending areas. Payment was then moved toward future fiscal years. In addition, the city moved general operational spending into the capital budget, and used long-term capital debt to finance short-term, non-capital services. Using such tactics, New York City appeared to be

balancing the budget each year, but in reality, the actions created additional and growing debt. As the Municipal Assistance Corporation 1975 Annual Report stated: “Once on the treadmill, the City had to continue borrowing, in order to pay off previous debts and to finance new deficits. To market this growing debt, both higher interest rates and shorter maturities were required” (Municipal Assistance Corporation Annual Report 1975, 7).

In successive mayoral administrations, the trend continued, despite candidates denouncing the practice. In 1965, John Lindsay was elected after denouncing the budget deficit’s under Mayor Robert Wagner, and once in power would rely on the same short-term borrowing techniques. Lindsay’s 1973 budget moved \$564 million in operating expenses in the capital budget, which enabled the city to contract new obligations. By 1974, Mayor Beane continued the budgetary gimmicks, placing \$750 million of operating expenses into the capital budget in order to borrow further (Tabb 1983, 23-24).

By 1975, the city was nearly out of money and could no longer market its debt to banks. Compounded with the effects of a national recession, New York City’s accounting practices and long-term challenges made banks wary of investing in either long term or short term bonds and notes. From October 1974 through March 1975, the banks, which enabled the city to continue its misguided short-term borrowing practices for years, began to leave the municipal debt market for the city. After months of struggling to market its debt, in April of 1975 the city was unable to sell short-term securities at record-high interest rates. By June, the city’s debt was \$12.3 billion, with 40 percent in notes to be paid off within a year. When the city’s accounting practices came to light, the banks wanted nothing to do with New York municipal debt. Some researchers have highlighted the irony that the banks who profited handsomely in contributing to and enabling the

fiscal crisis would profit again in the “rescue” of the city. State and eventually federal involvement was necessary for the city to survive. (Tabb 1983, 25).

The rescue and intervention took three forms: the Municipal Assistance Corporation (MAC); the Emergency Financial Control Board (EFCB) and finally, federal intervention in the form of a loan guarantee program. In the next section the state and federal response to New York City’s crisis will be discussed; followed by a summary to identify the similarities and differences with the Michigan emergency managers, and especially their application to Detroit.

State and Federal Response

By 1974, New York City was out of money, and could no longer borrow from the banks, which were skeptical about the city’s ability to repay debt. Facing a default, the city turned to the state for assistance. Bankruptcy and default were not generally considered viable options by state policymakers. The state of New York considered four different approaches: (1) Increasing aid; (2) Assuming the cost of some city services directly; (3) Increasing taxes; and (4) Borrowing to cover the city’s bad debts. Additionally, the state advanced \$800 in state aid to the city (Shalala and Bellamy 1127-1130).

One of the first state actions took place in May of 1974, when the New York State Legislature passed legislation to create the Stabilization Reserve Corporation (SRC), which was the first effort to form an entity with the propose to finance city services by

generating bond sales to the public. The SRC was to establish a capital reserve fund which would pay the principal and interest on bonds that it issued. The SRC statute did not compel the city to make contributions, and the city did not. A lack of committed funding source continued the bond market's anxiety over purchasing New York bonds, including SRC bonds. Consequently, SRC obligations could not be sold, and the SRC dissolved under its own terms (Gutekunst-Roth 1977, 66-68).

In June of 1975, the New York State Legislature created The Municipal Assistance Corporation (MAC). MAC was established on June 10, 1975 by statute enacted by New York's state legislature and subsequently signed into law by Governor Carey. MAC had two purposes under the statute: (1) "Assist the City in providing essential services to its inhabitants without interruption;" and (2) "Instill investor confidence in the debt obligations of the city." To achieve these aims, MAC was given authority by the state to sell bonds and notes, and to forward the proceeds to New York City. In order to ensure investor confidence, the city was required to implement reforms and to its financial practices and balance the budget for fiscal year 1978 (MAC Annual Report 1975, 11).

The MAC statute provided for a state corporation that would be administered by 9 directors, appointed by the Governor and required the approval of the New York State Senate. The corporations bonds and debt were not considered to be the obligations of the state of New York. Under statute, MAC was authorized to borrow \$3 billion by issuing long-term obligations in order to refund the city's short-term maturing debt, in addition to paying a portion of New York City's operating expenses. The new MAC bonds were

backed by a sales tax of 4 percent levied in New York City, as well as a stock transfer tax (Shalala and Bellamy 1976, 1128).

MAC bonds were issued by an agency created by the state; backed by sales tax and stock transfer taxes, and required reforms of the city with MAC monitoring. Despite these assurances, by the end of summer 1975, MAC was still unable to market the city's debt.

After MAC's failure to market New York City debt, further state intervention was taken. In September of 1975, the legislature passed the New York State Financial Emergency Act for the City of New York, which established an emergency financial control board (EFCB) to assume financial control of the city. The EFCB was comprised of the Governor, the Mayor, City and State Comptrollers, and three appointees of the Governor, which ultimately were representatives of the private financial sector. The EFCB was provided with authority to approve a three-year financial plan for the city, as well as the power "to review, supervise, and veto if it desired all of the city's financial dealings, including labor contracts, and to approve the city budget" (Tabb 1983, 26). The EFCB had some overlap of functions with MAC, and the enabling statutes for both measures suggested there were some duplication of efforts (Gutekunst-Roth 1977, 72).

Even with the MAC to help assure investors, and the EFCB assuming state control of the city, New York City still could not raise funds necessary to keep the city's government operating. City and state officials lobbied the federal government for assistance with the fiscal crisis. The federal government had undergone a transformation, from the liberal redistributive policies of the 1960s to the neoconservative reprivatization of the 1970s, which would continue into the Reagan administration of the 1980s (Tabb 1983, 12).

President Nixon exemplified a level of trepidation, if not outright disdain, for urban cities in crisis, and New York City in particular. In the infamous tapes subsequently released, Nixon is quoted with resentment toward the city: "Goddamn New York....it is filled with "Jews and Catholics and Blacks and Puerto Ricans." Nixon spoke of the "law of the jungle where some things don't survive," Adding that "Maybe New York shouldn't survive. Maybe it should go through a cycle of destruction" (Rosenbaum 2003)

In October of 1975, President Gerald R. Ford gave a speech declaring no aid would be given to New York City. The next day on Octo 30, 1975 the New York Daily News ran the infamous headline: "FORD TO CITY: DROP DEAD." However, President Ford never said those words, but did express reluctance to bail out New York City, declaring that "the people of this country will not be stampeded. They will not panic when a few desperate New York officials and bankers try to scare New York's mortgage payments out of them" (Roberts 2006). State and local officials became increasingly desperate, and began to make the case that the city was "too big to fail" and should receive Federal assistance by warning, (as a precursor to the Great Recession financial bailout 2008-2010 arguments) that if New York defaulted:

"it would freeze up the entire tax-free bond market, causing a series of rolling defaults by dozens, perhaps hundreds, of cities and states across the country as investors refused to buy more bonds....and could take modern capitalism down with it" (Flood 2011, 260).

The Cold War was also used as an argument for federal intervention, in that it would be viewed by the Soviet Union as evidence of deficiency of American capitalism and emboldens the soviets (Tabb 1983, 27).

Ultimately, after the EFCB and MAC were in place and city financial reforms were made, the federal government gave in and provided loan guarantees to the struggling city under the New York City Seasonal Financing Act of 1975 (PL 94-143). The federal statute was passed in December of 1975 and provided seasonal loans of \$2.3 billion to the city in order to “carry the city through its mid-year cash shortfalls and were to be repaid by the end of each fiscal year,” while providing the Government Accounting Office (GAO) with “access to the records of both the State and City of New York” among other Federal control measures (Government Accounting Office 1976).

With the Federal loan guarantees in place to help ensure short-term borrowing to provide the city with seasonal financing and to avoid default, the EFCB began to remove local control from elected city officials while addressing the city’s long-term financial issues. The EFCB proceeded along a path of controversial budget cuts that the administrations of John Lindsay and Abraham Beame were unable, or unwilling to undertake. The EFCB instituted thousands of layoffs for city employees. The board had the power, and used it, to reject contracts with teachers and transit workers. Multiple wage freezes were put in place. New York State took over the city university system, which had previously provided free or subsidized tuition, and removed the free tuition, removing the city from its subsidies to the university. New York City hospitals were closed, or had budgets reduced and reformed. The result was described as “Imposition of austerity and the sort of budget the International Monetary Fund imposes on third world countries as a condition for renewed borrowing” (Tabb 20).

In 1975, the city’s budget was about \$13 billion. The EFCB required the city to cut \$200 million in spending, representing nearly 6% of operating expenses, for the next

3 years. Due to federal and state mandates for entitlement programs, debt services, and other fixed costs, the city could only make the required cuts from 25% of its budget, which resulted in city government sectors dependent on discretionary tax levy funds receiving much larger reductions (Imperato 1997; Freudenberg et al., 2006).

The difference in New York City's case is that there were three levels of austerity placed upon the city that corresponded with removal of local elective control. The New York fiscal crisis served as a triangulation of austerity: the state government, as a condition of advancing shared revenue and guaranteeing loans; the business community, especially the banking industry, as a condition to lend money to the city; and the federal government, as conditions to guarantee further loans needed. New York courts upheld various challenges to MAC and EFCB, "the court appears to have rejected an approach grounded in strict adherence to prior case law in favor of one based on an awareness of the current and future fiscal repercussions of its rulings" (Gutekunst-Roth 1977, 100).

The End of the EFCB

Over a decade after the crisis, in 1986, the EFCB – which had eventually been renamed the Control Financial Board (CFB), authorizing statute provisions to sunset. While the city continued to struggle along the way during the early 1980s, by the mid-1980s the austerity measures, coupled with a second round of federal guarantees, enabled the city to regain a solid financial footing. With New York City officially emerging from state and business community oversight, it was a period of reflection.

Once the second round of federal loan guarantees were made, and the austerity measures took effect, the EFCB/FCB became less involved in the city's operations. In

1986, the New York Times reflected that “The board has sometimes disagreed strongly with the city's fiscal projections, but it has left to municipal officials the key decisions on how to raise and spend the city's money.” Mayor Koch, who embraced the austerity measures upon taking office in 1978 and achieved great popularity as mayor during the 1980s, reflected upon the EFCB’s role and involvement during the crisis: "The city of New York was like an indentured servant. The city, in order to survive bankruptcy and to get Federal assistance, indentured itself, and the letters of indenture, figuratively, will be burned on the day the sunset takes place" (Finder 1986).

While financial stability returned to the city, the legacy of the state and business community control of New York City goes beyond the financial stability that was achieved. While many were happy that the city’s fiscal condition had improved a decade later, many pointed out to the hardships the austerity measures produced. The austerity measures targeted the city’s public health spending especially. Analyzing the fiscal cuts in New York City, Freudenberg et al (2004) studied the public health consequences associated with the fiscal crisis and subsequent budget cuts and identified three epidemics that coincided with the austerity measures - Increases in tuberculosis, HIV and homicide rates. It was estimated that the cost toward controlling these epidemics was over \$50 billion which does not contrast favorably with the \$10 billion in budget savings accomplished the fiscal crisis (Freudenberg, et al 2004).

Between 1974 and 1977, the Department of Health’s budget was reduced by 20%, 7 of the 20 district health centers were eliminated, and 28% of the department staff had been cut. Of the 14 clinics responsible for TB screening, 6 of them were closed (Imperato 1978). After a century of decline, TB rates in New York City suddenly rose in 1978 and

would do so every year until 1993. The lack of screening due to the budget cuts has been estimated to have led to 52,000 additional TB cases in the city (Paolo 2004).

The fiscal austerity imposed by the ECFB also played a role in the city's ability to control the HIV outbreak in the 1980s. Researchers have found that HIV infection first appeared among the male homosexual population and injection drug users in the 1970s (Des Jarlais et al 2000). By the end of the 1980s, 200,000 New Yorkers were estimated to have been infected with HIV (Bayer 1995). In New York City, drug users comprised a large portion of the HIV transmission rates and a heroin epidemic coincided with the HIV epidemic. The city's Addiction Services Agency was essentially eliminated due to the fiscal reforms imposed by the control board. The elimination of the city's ability to address with substance abuse issues compromised the city's capacity to respond effectively for future decades (Freudenberg, et al 2004; Newfield and Dubrul 1981).

A 20% decrease in the New York City Police Department coincided with a large increase in the crime rate, and the homicide rate especially, during the late 1970s and 1980s. Teen job programs were slashed, as the cocaine epidemic of the 1980s was not met with lower levels of treatment and addiction services, further contributing to higher crime, higher drug use rates and increases in fatalities. Nearly 27,000 New Yorkers were homicide victims between 1975 and 1993 (Freudenberg, et al 2004).

As is often the case with fiscal crisis, the cuts imposed by the EFCB disproportionately targeted minority populations. Later studies found that by 1976, the city lost 50% of Hispanic employees; 40% of black male employees and 33% of female employees. Among city employees, minorities made up 31 percent of the city's workforce, yet suffered 44 percent of the job cuts (Tabb 1982, 30).

Comparison to the Michigan and Detroit

Both Detroit and New York City had basic immediate causes for their financial emergencies – each ran out cash and was essentially insolvent. Both cases include the “long-term transfer of power to a state-dominated board with extensive authority over city finances and operations” (Citizens Research Council 2012, 4). As is the case with Michigan, the New York statutes that provided for state intervention into city government control were brought forth as a reaction to a crisis. In Michigan, the initial law, PA 1988, was in response to the receivership of Ecorse that took place in 1986; this left lawmakers scrambling for a solution to manage future financial emergencies. Similarly, the New York City financial crisis resulted in reactionary measures to avoid default of the largest city in the country.

Two main criticisms of New York’s EFCB system can be found. The first involves a circumvention of the democratic process by removing the governing authority from elected officials. The second is that the EFCB, or similar control boards, are only able to provide solutions to local sources of fiscal distress. The broader demographic, socioeconomic and economic structural issues are generally not addressed and the EFCB was unable to make changes that result in long-term financial stability (Blanchard, Baranello and Lowe 2013). These complaints are similar to the issues many Michigan residents had toward the emergency manager statutes in Michigan, which culminated in a referendum and one of the statutes repeal.

Regarding the first criticism, while the EFCB and MAC did remove local control from the city, local elected officials were not automatically dismissed from positions, and

in fact, the elected mayor retained a seat on the EFCB. It appears that after the initial cuts were made, the majority of local control was returned to the city, although the EFCB remained in effect for over 10 years. The EFCB wielded extraordinary power in approving financial arrangements and budgetary controls, but such powers do not come close to those of the emergency managers of Michigan. Looking at both cases, the emergency manager model removes a greater level of local democracy than a local-state-business control board, as was implemented in New York City.

Regarding the second criticism, certainly, as is the case with New York City, the Detroit fiscal emergency was not brought forth due to mismanagement alone. However, as with the case with New York City, it was a contributing factor. Detroit, in a similar fashion of New York City in the 1970s, was faced with long-term socioeconomic and demographic challenges that required more than the removal of local control to address. Both the emergency manager laws of Michigan and the measures taken in New York City were reactionary, and were put in place to deal with the fallout from major socioeconomic trends that state, local and federal policymakers failed to address, despite ample warnings and evidence of impending local government fiscal emergencies.

The structure of the New York's EFCB resembles in some form, the similarity between consent agreement between the City of Detroit and the State of Michigan that preceded the placement of an emergency manager in the city. However, the consent agreement did not provide for board positions for business leaders, as was the case in the EFCB. Therefore, it can be said that the business community in New York City, especially the bondholders, exercised a far greater measure of authority than was the case in Michigan financial emergencies including Detroit, where such a presence was absent.

Considering that bond holders ultimately had to give up a larger portion of the debt owed to them in favor of pensioners, Detroit's bankruptcy process was far less friendly to the investor class than New York City, where the business community emerged relatively unscathed.

The major difference between the fiscal crises in New York City and Detroit is in the presence of an emergency manager versus a control board, and the degree to which local autonomy and elective processes are subverted. In Michigan, under the emergency manager statutes, local government's placed under state control may be subject to major financial decisions made by a single unelected emergency manager with relatively few controls in place. In the New York City fiscal crisis, four of the EFCB members were elected officials, and the elected mayor generally thought of as the head of the EFCB, as well as its spokesperson, and the appearance of mayoral power was not necessarily diminished (Bailey 1984).

During the New York City fiscal crisis, normal elective local government process was substituted for a control board, with elected officials serving in an ex-officio capacity, and unelected financial community members having a large degree of influence. Contrasted with the emergency managers in Michigan – where local government is entirely cast aside, and mayors and city legislature's relegated to spectator role – the Michigan state intervention statutes are far more disruptive to the traditions of local democracy. This is also evidenced by the 2012 Democratic House Judiciary Committee's report that referenced the New York model as preferable to the emergency manager model.

The fiscal crisis of New York City in the 1970s is a complex story with many events and characters involved, and would require far more attention to comprehensively tell the story. However, by briefly highlighting the case of New York, we are able to draw contrasts and comparisons to the example of the second largest municipal financial crisis in U.S. history, and the level of state intervention – with temporary loss of normal elective government – that resulted from such intervention. When comparing the placement of an emergency manager in Detroit versus the situation in New York City, the latter maintained a greater degree of elective control, power was dispersed across a control board, and the state and Federal government provided greater aid to correspond to the disruption of local control.

As some time passes from Detroit's placement under an emergency manager, researchers should begin to look at the results, and potential consequences, of Detroit's emergency manager process, and then compare those with that of New York City. In the case of New York, the results are mixed, with a return to financial stability, coupled legacies of increased crime, drug use and public health issues that lasted for decades. Future research should look at the two cases to better understand the impacts, if any, of the removal of local control, financial stability and other long-term effects.

In the next part of this exploratory case study, the city of Flint and issues related to emergency manager power will be examined through the tragic case of the Flint River drinking water crisis. The purpose of the next section is to bring the analytical lens toward a single case to develop a better understanding as to the consequences that may occur when an unelected official takes on duties that were previously completed by local elected officials accountable to local voters.

Chapter Four: Results

Part Four: The Flint Water Emergency

In 2013 the city of Flint was under its third emergency manager in the past 10 years. Significant budget cuts still had to be made in order to put the city on a viable financial path. In an effort to save money to address its chronic budget shortfalls, the city terminated a 50-year-old water contract with the city of Detroit. Flint was moving to a new regional water pipeline that was still in development, but would not be ready for a few more years. In the interim, the city tapped the local Flint River for its drinking water. In the fall of 2015, after several months of local resident complaints, researchers found that the city's water had dangerously high levels of lead, and a public health emergency was declared. The situation attracted statewide and national news attention. Residents were enraged at the complete failure at multiple levels of government.

In this section, the role of the emergency manager will be analyzed in this situation. By the fall of 2015, public officials involved in the decisions sought cover and shifted blame to others. The role of the emergency manager in the decision came under a great amount of scrutiny. The case study involving the Flint water supply provides a window into the decisions an emergency manager is pressured to undertake in order to save money, and how the consequences may differ when the decisions are not made at the local level, by elected representatives who are held accountable by their fellow local residents.

As previously discussed in Part One of this chapter, the city of Flint had been placed under an emergency manager off and on, across the various state intervention laws. Ed Kurtz, the founder of a private college system, was appointed as EFM of Flint from 2002 through 2004. The state takeover ended in June 2004, when Kurtz departed,

but the city remained under some form of state oversight through 2006. Within a few years, the fiscal challenges Flint faced returned, and the city was declared to be in another state of financial emergency in 2011, and was appointed a new emergency manager named Michael Brown. Kurtz himself would return to be the city's third emergency manager in 2012, followed by Darnell Early and then Jerry Ambrose, through 2015. All three would play some part in Flint's water crisis.

For over 50 years, Flint purchased its drinking water from Detroit, via the Detroit Water and Sewage Department (DWSD) which arrived already treated and ready for consumption. In March 2013, the Flint City Council voted 7-1 to discontinue buying water from Detroit, and join a regional new water pipeline project that included Genesee, Sanilac and Lapeer counties in the Karegnondi Water Authority (KWA) which would pull water from Lake Huron, to be treated by Flint's facilities. The switch was projected to save the city of Flint \$19 million over the next eight years (Wilson 2015).

Additionally, the move to the KWA locked in a fixed rate to the city over the next 25 years, rather than Detroit's continuously increasing water rates. In 2013 Flint's mayor Dayne Walling stated:

"Every analysis keeps showing the same result – that the new raw water pipeline is the cheapest source and it has the additional benefits of partial ownership and economic development." "This is the single biggest decision for the city of Flint in decades" (Adams 2013).

The emergency manager, Ed Kurtz, and the state had final authority to approve or deny the measure. He ultimately approved, as did the State Treasurer, Andy Dillon. Kurtz gave his approval on April 16, 2013 (Wilson 2015). The KWA was scheduled to be completed in mid-2016, nearly 3 years after the decision to switch was made. The city council and emergency manager agreed on this measure, and the switch in itself, was not controversial, and was generally considered to be a prudent cost savings measure.

However, the events that took place after the switch are the subject of controversy and can be analyzed for the implications they have for the emergency manager form of local government control.

After the city council voted to discontinue the Detroit contract, the emergency manager, and State Treasurer agreed, and signed off on the decision. After Flint officially joined the KWA, Detroit notified Flint that it was terminating the nearly 50-year-old contract for selling water to Flint and Genesee County. The April 14, 2013 notice to Flint, from Detroit Water and Sewerage Department Director Sue McCormick did not state that water sales would unilaterally end after April 17, 2014, “only that the current arrangement would end” (Fonger 2013).

With the KWA not scheduled for completion for three more years, the city of Flint had to decide how it would continue to receive its water in the interim. Two options were considered; the city could either: (1) continue to buy treated water from Detroit; or (2) utilize the local Flint River for water, that would then have to be treated by the city. There was no city council vote on this measure; the final decision was made by emergency manager. In June, Emergency Manager Kurtz signed an order to enter into a sole source contract with Lockwood, Andrews & Newnam, Inc:

“for professional engineering services to put the Flint water treatment plant into operation using the Flint River as a primary drinking water source for approximately two years and then converting to KWA delivered lake water when available” (Fonger 2013).

The decision made by the emergency manager was expected to save cash-strapped Flint over \$5 million dollars over the next two years while the city waited for the KWA water pipeline to be completed (Associated Press 2015).

In April 2013, Flint, under the direction of the Emergency Manager Kurtz opted for the Flint River option. However, there was always the option to continue to purchase drinking water from Detroit. In a letter obtained by the ACLU of Michigan, it was found that emergency manager Earley declined Detroit's offer to continue buying water from Detroit while the KWA was being built. Early wrote to Detroit affirming that "The Flint Water Treatment Plant will be fully operational and capable of treating Flint River water prior to the date of termination" (Egan 2015). In the year that followed, Flint spent around \$4 million to update its water treatment plant, including paying consultants and upgrading equipment. All decisions were subject to final approval of emergency manager Darnell Earley. The plant, which was traditionally used as a backup water supply for Flint and Genesee County, was to go from being used only a few times a year, to heavy daily usage. (Adams 2014).

In April of 2014, Flint received the state permits necessary to use the Flint River as the source for its drinking water, utilizing the upgrades at the Flint water treatment plant. Later in April 2014, Flint officially tapped the Flint River for its drinking water. At the event, city officials celebrated the transformation with toasts with glasses of water. At the time, the decision was championed as a smart cost-saving measure to utilize a local water source. The Michigan Department of Environmental Quality (DEQ) was also involved in the ceremony, as city officials "officially" closed the water valves to Detroit water, and opened the valves to Flint River water. Steve Busch, then a district supervisor for Michigan DEQ's office of drinking water, said at the event: "Individuals shouldn't notice any difference." Flint had a final bacteria test that it passed Friday morning,

allowing Flint to close the valve to Detroit and open up the valve to the Flint River (Adams, 2014)

At the Flint River water ceremony, Flint Mayor Walling, celebrated Flint's return to a local water source, stating that "Water is an absolute vital service that most everyone takes for granted. It's a historic moment for the city of Flint to return to its roots and use our own river as our drinking water supply." The new emergency manager, Darnell Early, who had replaced Ed Kurtz upon his retirement in May 2013, also commented on the move: This is indeed the best choice for the city of Flint going forward" (Adams 2014).

Within a month, some residents started to complain about the hardness, and different smell and taste of the new water. Residents began to claim that their children were getting sick at a greater rate since the change in water source. The Michigan Department of Environmental Quality and city officials dismissed the reports, arguing that water may be over twice as hard, but passed all of the necessary tests. However, by September 2014 the sporadic complaints lead to boil water advisories from the city, as testing found high levels of bacteria. In October 2014, General Motors stated that it would no longer use Flint River water in its auto manufacturing plants due to concerns about corrosion to its facilities and parts, and switched to Lake Huron water. General Motors was a major user, and the switch away from the Flint River would cost the city an estimated \$400,000 annually in water revenue (Fonger 2014).

The troubles with Flint's water escalated again in January 2015, when the city was forced to mail out notices to residents that the water contained too much disinfectant byproduct which could cause liver, kidney or central nervous system problems and an

increased risk of cancer, especially to those with compromised immune systems. The notices followed a Michigan Department of Environmental Quality notice of violation of the Safe Drinking Water Act for Flint due to exceeding the maximum contaminant levels for trihalomethanes (TTHM), which are chemicals formed as a byproduct of water disinfection. As one reporter noted,

“City officials are learning something in a hurry about water chemistry: Keeping Flint River water ready to drink by the time it reaches faucets throughout the city is a lot trickier than buying treated Lake Huron water from the city of Detroit” (Fonger 2014; 2015).

Shortly after the TTHM notices, in January 2015, the Flint City Council held a special session to voice concern over the water and question officials. In March of 2015, the City Council took action, and voted 7-1 to do “all things necessary” to end the usage of Flint River water and reconnect to the Detroit water system. The vote was in response to a tidal wave of resident complaints and increasing critical local media coverage. However, under an emergency manager, the council vote had no authority behind it. The emergency manager, appointed by the state, had final say on any council activity, or essentially any action by the local government.

The city of Detroit was even willing to reconnect the city of Flint to the Detroit water system, at the old rates, and without the reconnection fee of \$4 million. However, in response the Flint City Council’s vote, Flint’s new emergency manager, Jerry Ambrose, informed the city council that their vote was “dead on arrival” and that the measure was “incomprehensible.”

"Flint water today is safe by all (U.S. Environmental Protection Agency) and (Michigan Department of Environmental Quality) standards, and the city is working daily to improve its quality. Users also pay some of the highest rates in the state because of the decreased numbers of users and the age of the system” (Fonger 2015).

A March 2015 *New York Times* feature investigated the issues with Flint's water supply that was compounded by, and continued to hamper the city's ability to emerge from fiscal crisis.

"As Flint has shrunk, its network of water pipes built for a much larger metropolis has deteriorated. With fewer customers, water sometimes languishes in the system, becoming discolored. Moreover, water bills in Flint are far higher than those in neighboring communities. Officials say the switch away from Detroit water saves the city \$12 million a year. Some residents say they would rather not debate the cost until they are confident that the water is safe. When fecal coliform bacteria showed up in parts of the city last summer, residents were told to boil their water before using it. Officials addressed the issue by pumping extra chlorine into the system, but in solving one problem, they created another."

"The high chlorine levels led to elevated levels of total trihalomethanes or T.T.H.M., which required another public notice in January. Residents will again receive a notice of elevated T.T.H.M. levels in the mail later this month, Mayor Dayne Walling has said. Long-term consumption of water with high T.T.H.M. levels can lead to liver or kidney troubles and an increased risk of cancer, according to the Environmental Protection Agency" (Smith 2015)

In September 2015, researchers at Virginia Tech, responding to Flint resident complaints, conducted a study that analyzed Flint water samples. The results, beyond the TTHM and bacterial issues from earlier, demonstrated another, and perhaps far graver issue with the water. Flint was found to have, "a very serious lead in water problem." The Flint River was determined to have 8 times the level of chlorine, which in turn makes it over 5 times more corrosive. Over 40% of the samples contained amounts that exceeded EPA standards. The 90% percentile was over 25 ppb, which was "a range where water consumption has caused lead poisoning in children and led to adverse pregnancy outcomes" (Virginia Tech FlintWaterStudy.Org, 2015).

By October of 2015, after the Virginia Tech findings were announced, a media storm of controversy descended upon Flint. Consultants, local, state and federal officials involved in the decision-making and oversight scrambled to distance themselves from

blame and scrutiny; or shift the blame to other decision-makers. The role of the state-appointed emergency managers also came under some question and scrutiny. Ultimately, the state and city crafted a plan to reconnect to the Detroit water supply. The governor's office, in full damage control mode, and much too late, offered additional assistance to the city of Flint.

On top of the bacteria, THHM and elevated lead levels, from 2014 through 2015, Flint experienced an outbreak of Legionnaires disease which resulted in 87 people hospitalized, including 9 fatalities. Genesee County researchers suspected the Flint River as the cause for the outbreak, as well as did national scientific researchers such as Janet Stout, with the University of Pittsburgh, stating that it was a "reasonable conclusion" that the water was a cause for the outbreak, given the link between poor water quality and Legionnaires' disease in studies conducted elsewhere (Tanner and Anderson 2016).

The decision to tap the Flint River proved to be a catastrophic mistake, with health impacts that will likely last for years, if not decades. A Federal state of emergency would be declared in January 2016. The drinking water crisis would become an issue in the 2016 election, with Democratic primary candidates holding a debate in Flint in March 2016. The cost savings of tapping the Flint River, estimated at the time to be about \$5 million, would ultimately result in astronomical cost increases due to the corrosive water destroying the pipe system. In January 2016, some estimates were as high as \$1.5 billion (Egan 2016). Receiving water from the Flint River was a state-driven decision, with the local government powerless to change course when the early response from the community indicated there was something seriously wrong. When the local elected government, responding to the complaints of its constituents, held a vote, conducted by

elected representatives, to move back to the safer Detroit water supply, the state-appointed emergency manager declined to pursue this action, and stated such a vote was “incomprehensible.” This resulted in several additional months of water that was not safe, being used by children in the city of Flint.

The case study of Flint’s water crisis highlights the role of emergency manager. In this instance, emergency manager Kurtz signed the order to move from the Detroit water system to the KWA. However, in the meantime, in an effort to save costs, instead of remaining with the more expensive Detroit water system, Kurtz decided to use the Flint water system. At the early stage of the crisis, when the local government attempted to respond, the subsequent emergency manager, and by extension, the state of Michigan, blocked the change from taking place.

The situation with Flint’s drinking water represents failures at multiple levels of government that is beyond the scope of this section or paper. However, the key point from the emergency management standpoint, stems from when the city’s elected officials attempted to address the crisis and were denied that procedure because they had no power in their local government. It would be fair to conclude that because an emergency manager was involved in Flint’s affairs, the result was several additional months of residents exposed to dangerously polluted drinking water. One of the consequences of removing representative democracy is that there is no longer the presence of local elected officials that are inherently closer to the needs of their constituents. Such a removal results in a blind spot for accountability to the needs of the local public that is generally filled with local democratic control. While at times, local democracy in struggling cities results in political paralysis and putting off difficult decisions for short-term fixes, it also

results in elected officials being held accountable and responsible for the safety of their residents.

Flint Water Crisis – Timeline of Events

May 2002 – Ed Kurtz Named emergency manager of Flint under PA 72.

2006 – Flint's is removed from emergency manager oversight.

November 2011 – After a state review, Flint is once again declared under a financial emergency. Michael Brown is appointed as EFM.

August 2012 – Ed Kurtz appointed again as emergency manager.

March 2013 – City Council votes 7-1 to terminate water agreement with Detroit, and switch to the KVA, a regional pipeline scheduled for completion in mid-2016.

June 2013 – As a cost savings measure, Emergency Manager Kurtz signed an order to authorize a sole source contract for engineering services to treat the Flint River until the KVA is functional. Kurtz retires at the end of June 2013.

June 2013 – Michael Brown reappointed as emergency as manager.

November 2013 – Darnell Early named as emergency manager.

April 2014 – Final decision made to utilize Flint River. State approvals are received.

Celebration is held by state and local officials.

May 2014 – Complaints start trickling in to city council regarding the odor, color and taste of water.

September 2014 – The city issues boil water advisories after high levels of bacteria are found.

January 2015 – High levels of THHM, a disinfectant byproduct is found in the water.

The city mails out notices to residents.

March 2015 – City Council votes to move back to Detroit water source. Immediately after, Emergency Manager Earley calls the vote “incomprehensible” and does not allow the motion.

September 2015 – VA Tech researchers complete a study of water samples from Flint homes. Dangerous levels of lead are found in over 40% of the samples collected.

Researchers issue dire warnings to residents not to drink the water.

October 2015 – State and local officials scramble to reconnect to Detroit water source.

The state offers aid to Flint to mitigate the effects of the dangerous drinking water.

January 2015 – Media begin to report on the Legionnaire’s disease outbreak that occurred in Flint during the rive switch, resulting in 87 hospitalized and 9 fatalities.

January 2015 – Flint is declared a national state of emergency.

Chapter Five: Discussion and Conclusion

The previous chapter was broken up into four parts. In the first section, the emergency manager statutes were explored in a chronological format to highlight the differences and trace the evolution of the statutes from their origins. Select cases from local governments in Michigan were explored to provide further context. In the second section, the events and decisions that led to Detroit's selection for an emergency manager were presented, and the actions taken by an emergency manager were traced and analyzed. In the third section, New York City's fiscal crisis was examined to draw comparisons and contrasts to the Michigan statutes and their implementation in Detroit. And in the fourth section, the emergency manager experience in Flint, where removal of local government control had disastrous consequences when high levels of lead were found in the local drinking water.

Based upon these four unique, yet interrelated sections, it is possible to draw some conclusions regarding the emergency financial manager statutes of Michigan, and their implementation in a large city such as Detroit. This concluding chapter will address the research questions posed in Chapter One, as well as develop recommendations as to how, based upon the exploratory case study, state intervention into local governments could be implemented more objectively to maintain greater levels of local democracy and ensure social equity is preserved.

1. How do the actions of public institutions and key players account for the placement of an emergency financial manager in the city of Detroit?

Part One and Part Two of the exploratory case study chapter traced the chronology of the emergency manager statutes in Michigan as well as the implementation in Detroit. In the United States, Michigan has the most onerous level of state intervention for local governments (Levine, Justice Scorsone 2013, 395). These statutes and their implementation have origins dating to before the first receivership in Ecorse in 1986, but in the structural transformations that took place in urban, industrialized cities beginning in the 1950s and that continued through the rest of the 20th century. However, it was the industrial metro-Detroit city of Ecorse in 1986, a city that ran out of money to pay its debts, which prompted state legislators to react. In this reaction was the development of a policy that provided a framework for the management of local government financial emergencies.

In Ecorse, it was Receiver Louis Schimmel's actions, as the first receiver of Michigan, that helped shape the statutes that would follow. Schimmel's activities in Ecorse influenced future Governor John Engler, who then, as a state senator, helped push for PA 101 of 1988, and PA 72 of 1990. The statute lay dormant through the relatively prosperous 1990s, a sleeping giant for state power, during a decade of relative economic prosperity, as well as the likely reluctance to wield such a power. It came alive in 2000, when the city of Hamtramck became the first Michigan city to receive an emergency manager – once again Louis Schimmel, who revisited upon the experiences he encountered during the Ecorse receivership. This time the privatization efforts were backed by the state of Michigan, rather than a Circuit Court judge.

In the case of Ecorse and Hamtramck, Schimmel in many ways set the playbook that future emergency managers would follow. This involved privatizing as many city services as possible, consolidating departments, renegotiating contracts, slashing budgets and laying off city employees. If pensions costs could be restructured this would be done, but often, under PA 72 of 1990, this option was not readily available. Ensuring that the city lived within its means was the focus, regional collaboration and economic development was not addressed; the mindset was that if only the local governments could get their accounts in balance, those elements would follow.

In 2010, Rick Snyder was elected governor in the nationwide landslide by Republicans. The political forces aligned and the opportunity presented itself for a strengthening of the emergency manager statute to address the increasing trend of Michigan's urban, industrialized cities falling into financial crisis. The controversial PA 4 of 2011, with its nearly unlimited authority bestowed upon an unelected emergency manager, was born out of a political opening for strengthening the statute to further align with a more conservative, free-market ideology. This is evident in the Mackinac Center for Public Policy's advocacy in the development of statute. Louis Schimmel may be thought of as the founding father of emergency financial management in Michigan. After all, Schimmel was the first receiver in the state of Michigan (Ecorse) as well as the first emergency manger (Hamtramck). He would also go on to be emergency manager of Pontiac. In the interim, Schimmel, was a contributor and director at the Mackinac Center for Public Policy think tank, and advocated for enhancements to the emergency manager laws, all of which would pass in nearly the form requested.

The logic model presented in Chapter Four, Section One, presents the case that supporters of the statute make. The theory for state intervention in the form of emergency management calls for less local government spending, lower taxes and a larger degree of privatization of city operations. These actions are predicted to lower costs, lower taxes, maintain financial sustainability and increase economic development in the struggling cities. This is the ideological argument made by proponents of the statutes. In practice, the long-term goal of economic development and lower taxes is often replaced with short-term goals of making the city solvent and avoiding default while continuing to provide limited services.

The exception to this line of thinking can actually be found in the case of Detroit, where Emergency Manager Kevyn Orr's financial and operating plan, the restructuring of debt to creditors during bankruptcy proceedings, and negotiation of the Grand Bargain provided a focus toward future investments in city services as well as a regional and collaborative approach. This is in contrast with several other cases where emergency managers had arrived with mandates, perceived or real, to simply balance the budget regardless of the long-term outcome. This likely accounts for the recidivism of early emergency manager cases discussed in Part One – the lack of long-term planning and advocacy for state-local, nonprofit and regional collaboration.

Political realities play a large role in both the financial crises that increasingly take place in urban areas, as well as the statutes used to remedy them. As was discussed in the Chapter Two Literature Review, and highlighted to some degree in case study, elected local officials are generally less concerned with 10 or 20 year projections, than they are with the immediate concerns of providing services to constituents that result in

political support. The history of the Detroit and New York City fiscal crises illustrate this point. Each city continued to issue short, and increasingly, long-term debt in order to delay making painful budget cuts. Each city declined, when economic conditions were favorable, to prepare for the larger challenges that lay ahead (New York 1950 and 1960s; Detroit 1990s). In some circumstances, it may be that the imposition of austerity must come from the outside due to the political realities of the city. This is not always the case; there are certainly locally elected officials that take the long-view and think about the condition of local governments over the long-term. However, this requires a special kind of leadership, and a form that must somehow survive political pressure and communicate the vision, and this is the exception rather than the rule.

Political realities were found in the Michigan Legislature and the Department of Treasury and Governor's Office. The Michigan state legislature that passed PA4 of 2011, and once that was repealed, passed PA 436 of 2012, was motivated by ideological and political forces. The votes were taken down party lines, with Republicans voting for, and Democrats against. The Republican legislators voted according to the will of their constituents and supporters who do not wish to be tasked with bailing out local governments in financial crisis. Likewise Governor Snyder was elected in the 2010 by a wave of frustration with perceived government overreach, and the State Treasurer is appointed by and serves at the pleasure of the elected Governor, and acts accordingly.

An interesting discovery made during this exploratory case study is in regards to the statewide repeal of PA 4 of 2011. In the majority of the state - 75 of the 83 counties – Michigan residents voted against the law, and in favor of its repeal. In the general election between Democratic President Barack Obama versus Republican candidate Mitt

Romney, President Obama won Michigan by 9 points, although he only won 20 of the 83 counties in the state. On the other hand, only 8 counties in the entire state voted to keep PA4 of 2011. Therefore, the majority of Michigan's rural counties voted *for* Republican Mitt Romney, but *against* PA 4. This includes numerous rural counties. The rural vote could be seen as an indication that there was a genuine opposition to the infringement upon local government democracy that cut across many demographics and geographic areas. In 2011 this opposition against local democracy removal overcame a competing conservative opposition toward requiring taxpayers to bail out struggling cities.

The emergency manager statutes were born out of political opportunity which created an opening for the emergency manager statutes to be put in place. The statutes were initially developed as a reaction to the financial crises taking place in cities across the country, notably New York City in the 1970s, and locally, Ecorse in 1986. Later versions of the statute (PA 4 of 2011 and PA 436 of 2012) were developed to a greater degree based upon ideology. However, in the largest case, the emergency management of Detroit, the statute, and corresponding emergency manager actions were undertaken more pragmatically as the city was mired in a deep financial crisis with default and complete financial collapse a very realistic possibility.

2. What are the intergovernmental implications of complete state takeover of local governments?

The emergency manager statutes of Michigan present a compelling case for the study of intergovernmental relations. From the intergovernmental perspective, the problems found in most financial struggling cities are not solely the fault of local governmental officials. State and federal levels of government generally have lacked any

concrete policy to address the issues of deindustrialization, suburbanization, and globalization that had taken place over the past sixty years. Moreover, at times, state and federal policies contributed further to the fiscal challenges, by encouraging the suburbanization movement, while not planning for the difficulties such demographic trends would cause. Decreased revenue sharing to local governments, in recessionary times when property values decreased, further exacerbated the financial challenges.

Looking back at the past twenty-five years of emergency manager statutes in Michigan, and the fact that these statutes have routinely been upheld from various legal challenges, the case of Michigan's state intervention laws appears to affirm Dillon's Rule and the supremacy of state governments over local government autonomy. Based upon the example in Michigan, other states, if they wish to do so, would have an example for further intervention in local governmental financial emergencies to temporarily remove the local elective government's authority. The experience of local governments under the emergency manager statutes in Michigan is Dillon's Rule fully realized. As Dillon stated: "Municipal corporations owe their origin to, and derive their powers and rights wholly from, the legislature. It breathes into them the breath of life, without which they cannot exist. As it creates, so it may destroy. If it may destroy, it may abridge and control. We know of no limitation on this right so far as the corporations themselves are concerned. They are so to phrase it, the mere tenants at will of the legislature" (*City of Clinton v. Cedar Rapids & Missouri River Railroad* 1868)

Local governments in Michigan have indeed become "tenants at the will of the legislature" and outside of sporadic cases of financial defaults, one would be hard pressed to find an example of another time in U.S. history that a state has applied the theory of Dillon's Rule so fully.

Reviewing the U.S. intergovernmental relations structure for state intervention into local government fiscal crisis further highlights the uniqueness of Michigan's

policies and allowance for emergency management (Chart 5-1). In total, there are 19 states in the U.S. that designate a form of fiscal stress (Chart 5-2) and 19 states have some form of fiscal intervention program (Chart 5-3). Overall, only 27 states authorize local governments, in some way, to file for bankruptcy. There are 10 states that contain all three elements – that designate fiscal stress, have fiscal intervention programs and allow states to file for bankruptcy (Chart 5-4). It may be reasoned that these 10 states have a policy structure in place for the largest share of financial control over local governments. However, among these 10 states, Michigan is the only state that allows for a single individual, the emergency manager, to be placed in local governments in fiscal stress, with the power of both the executive and legislative branches, including the power to file bankruptcy and manage bankruptcy negotiations on behalf of the state.

In Chart 5-5, states that have filed for municipal bankruptcy and the local governments involved are highlighted. Ten states have had a local government file for bankruptcy in the period of 2008 – 2015; with a total of 14 bankruptcy filings (4 of these were dismissed). Among the ten states that had local governments file for bankruptcy, only Michigan, in the case of Detroit, had a filing essentially determined by the judgement of a single unelected individual – the emergency manager Kevyn Orr. In this regard, Michigan is truly an outlier in the intergovernmental system of state-local fiscal management and intervention.

Chart 5-1 – State –Local Overview

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing since 2008 - 2015	Local Governments Filed for Bankruptcy 2008 – 2015
Alabama	No	Yes	No	Yes	1. Prichard 2. Jefferson County
Alaska	No	No	No	No	None
Arizona	Yes	Yes	No	No	None
Arkansas	No	Yes	No	Yes	Gould (Dismissed)
California	Yes	Yes – Conditional	No	Yes	1. Vallejo 2. Stockton 3. Town of Mammoth Lakes (Dismissed) 3. San Bernandino
Colorado	No	Yes – Limited	No	No	None
Connecticut	No	Yes – Conditional	Yes	No	None
Delaware	No	No	No	No	None
Florida	Yes	Yes – Conditional	Yes	No	None
Georgia	No	No	No	No	None
Hawaii	No	No	No	No	None
Idaho	No	Yes	No	Yes	Boise County (Dismissed)
Illinois	Yes	Yes – Limited	Yes	Yes	Village of Washington Park
Indiana	Yes	No	Yes	No	None
Iowa	Yes	No	No	No	None
Kansas	No	No	No	No	None
Kentucky	No	Yes – Conditional	No	Yes	Hillview
Louisiana	No	Yes – Conditional	No	No	None
Maine	Yes	No	Yes	No	None
Maryland	No	No	No	No	None
Massachusetts	No	No	Yes	No	None
Michigan	Yes	Yes – Conditional	Yes	Yes	Detroit

Chart 5-1, State-Local Overview, continued..

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing since 2008 - 2015	Local Governments Filed for Bankruptcy 2008 - 2015
Minnesota	Yes	Yes	No	No	None
Mississippi	No	No	No	No	None
Missouri	No	Yes	No	No	None
Montana	No	Yes	No	No	None
Nebraska	No	Yes	No	No	None
Nevada	Yes	No	Yes	No	None
New Hampshire	No	No	Yes	No	None
New Jersey	Yes	Yes - Conditional	Yes	No	None
New Mexico	Yes	No	Yes	No	None
New York	Yes	Yes - Conditional	Yes	No	None
North Carolina	Yes	Yes - Conditional	Yes	No	None
North Dakota	No	No	No	No	None
Ohio	Yes	Yes - Conditional	Yes	No	None
Oklahoma	No	Yes	No	Yes	Town of Moffet
Oregon	Yes	Yes – Limited	Yes	No	None
Pennsylvania	Yes	Yes - Conditional	Yes	Yes	1. Westfall Township 2. Harrisburg, PA (dismissed)
Rhode Island	Yes	Yes - Conditional	Yes	Yes	Central Falls
South Carolina	No	Yes	No	No	None
South Dakota	No	No	No	No	None
Tennessee	Yes	No	Yes	No	None
Texas	No	Yes	Yes	No	None
Utah	No	No	No	No	None
Vermont	No	No	No	No	None
Virginia	No	No	No	No	None
Washington	No	Yes	No	No	None
West Virginia	No	No	No	No	None
Wisconsin	No	No	No	No	None
Wyoming	No	No	No	No	None

Source: Pew Trust 2013; Maciag 2015.

Chart 5-2 – States that designate fiscal stress.

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing since 2008 - 2015	Local Governments Filed for Bankruptcy 2008 – 2015
Arizona	Yes	Yes	No	No	None
California	Yes	Yes - Conditional	No	Yes	1. Vallejo 2. Stockton 3. Town of Mammoth Lakes (Dismissed) 3. San Bernardino
Florida	Yes	Yes - Conditional	Yes	No	None
Illinois	Yes	Yes – Limited	Yes	Yes	Village of Washington Park
Indiana	Yes	No	Yes	No	None
Iowa	Yes	No	No	No	None
Maine	Yes	No	Yes	No	None
Michigan	Yes	Yes - Conditional	Yes	Yes	Detroit
Minnesota	Yes	Yes	No	No	None
Nevada	Yes	No	Yes	No	None
New Jersey	Yes	Yes - Conditional	Yes	No	None
New Mexico	Yes	No	Yes	No	None
New York	Yes	Yes - Conditional	Yes	No	None
North Carolina	Yes	Yes - Conditional	Yes	No	None
Ohio	Yes	Yes - Conditional	Yes	No	None
Oregon	Yes	Yes – Limited	Yes	No	None
Pennsylvania	Yes	Yes - Conditional	Yes	Yes	1. Westfall Township 2. Harrisburg, PA (dismissed)
Rhode Island	Yes	Yes - Conditional	Yes	Yes	Central Falls
Tennessee	Yes	No	Yes	No	None

(Source: Pew 2013; Maciag 2015)

Chart 5-3 – States that have a financial intervention program

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing since 2008 - 2015	Local Governments Filed for Bankruptcy 2008 - 2015
Connecticut	No	Yes - Conditional	Yes	No	None
Florida	Yes	Yes - Conditional	Yes	No	None
Illinois	Yes	Yes – Limited	Yes	Yes	Village of Washington Park
Indiana	Yes	No	Yes	No	None
Maine	Yes	No	Yes	No	None
Massachusetts	No	No	Yes	No	None
Michigan	Yes	Yes - Conditional	Yes	Yes	Detroit
Nevada	Yes	No	Yes	No	None
New Hampshire	No	No	Yes	No	None
New Jersey	Yes	Yes - Conditional	Yes	No	None
New Mexico	Yes	No	Yes	No	None
New York	Yes	Yes - Conditional	Yes	No	None
North Carolina	Yes	Yes - Conditional	Yes	No	None
Ohio	Yes	Yes - Conditional	Yes	No	None
Oregon	Yes	Yes – Limited	Yes	No	None
Pennsylvania	Yes	Yes - Conditional	Yes	Yes	1. Westfall Township 2. Harrisburg, PA (dismissed)
Rhode Island	Yes	Yes - Conditional	Yes	Yes	Central Falls
Tennessee	Yes	No	Yes	No	None
Texas	No	Yes	Yes	No	None

Source: Pew Research Trust 2013; Maciag 2015)

Note: Iowa and Minnesota have laws that designate fiscal stress but do not have an intervention program. Massachusetts, New Hampshire and Texas do not designate fiscal stress, but do have an intervention program.

Chart 5-4 - States that do it all – designate fiscal stress, have an intervention program and authorize local governments to file for bankruptcy.

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing since 2008 - 2015	Local Governments Filed for Bankruptcy 2008 - 2015
Florida	Yes	Yes – Conditional	Yes	No	None
Illinois	Yes	Yes – Limited	Yes	Yes	Village of Washington Park
Michigan	Yes	Yes – Conditional	Yes	Yes	Detroit
New Jersey	Yes	Yes – Conditional	Yes	No	None
New York	Yes	Yes – Conditional	Yes	No	None
North Carolina	Yes	Yes – Conditional	Yes	No	None
Ohio	Yes	Yes – Conditional	Yes	No	None
Oregon	Yes	Yes – Limited	Yes	No	None
Pennsylvania	Yes	Yes – Conditional	Yes	Yes	1. Westfall Township 2. Harrisburg, PA (dismissed)
Rhode Island	Yes	Yes – Conditional	Yes	Yes	Central Falls

Source: Pew Research Trust 2013; Maciag 2015)

Chart 5-5 – local government bankruptcy filings since 2008.

State	Law Designating Fiscal Stress?	Authorize Bankruptcy?	Intervention Program?	Bankruptcy Filing 2008 - 2015	Local Governments Filed for Bankruptcy 2008 - 2015
Alabama	No	Yes	No	Yes	1. Prichard 2. Jefferson County
Arkansas	No	Yes	No	Yes	Gould (Dismissed)
California	Yes	Yes - Conditional	No	Yes	1. Vallejo 2. Stockton 3. Town of Mammoth Lakes (Dismissed) 3. San Bernardino
Idaho	No	Yes	No	Yes	Boise County (Dismissed)
Illinois	Yes	Yes - Limited	Yes	Yes	Village of Washington Park
Kentucky	No	Yes - Conditional	No	Yes	Hillview
Michigan	Yes	Yes - Conditional	Yes	Yes	Detroit
Oklahoma	No	Yes	No	Yes	Town of Moffet
Pennsylvania	Yes	Yes - Conditional	Yes	Yes	1. Westfall Township 2. Harrisburg, PA (dismissed)
Rhode Island	Yes	Yes - Conditional	Yes	Yes	Central Falls

Source: Pew Research Trust 2013; Maciag 2015)

The spirit of Dillon's rule has prevailed as the emergency manager statutes survived several state and federal legal challenges; including a popular referendum repeal of one version of the statutes. It is understood that local governments are not mentioned in the United States Constitution. However, placing such a focus on the federalism between the federal and state governments ignores "the people" who from the beginning of colonial government have organized themselves into communities - local government units. The colonial government experience in the area that would become the United States was one that placed a great deal of emphasis on local autonomy, and local government organization predates any state or national structure in representative government.

The United States Constitution preamble begins with "We the People." These people are also referenced in the Tenth Amendment, in the final clause of the Bill of Rights – "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." The concluding phrase "or to the people," provides a constitutional protection for the preservation local government autonomy, and empowers "the people" to express their will through their own local community governments. Therefore, the Tenth Amendment grants the people the right for local self-determination (Sullivan 2003).

States write their own constitutions, and through the drafting of a constitution or other chartering process, outline the powers that local governments may exercise. Even in this regard, many state constitutions, which often emulate the philosophy and tone of the U.S. Constitution, may implicitly carve out a protection for local government as a matter of principle. Even the Michigan Constitution states forcefully in Article I, Section I:

“All political power is inherent in the people. Government is instituted for their equal benefit, security and protection.”

While Dillon’s Rule has generally dominated the state-local intergovernmental dynamic, one could make an equally compelling argument that the emergency manager statutes of Michigan have strayed quite far from the historical foundations of local government autonomy; including a significant departure from the protection for “the people” to govern themselves in their communities - a fundamental right found in both the United States and Michigan Constitutions.

3. How does the placement of an emergency manager account for the larger socioeconomic causes for that local government’s fiscal crisis?

Viewing the case study of Michigan’s emergency manager statutes through the vantage point of the larger socioeconomic causes of local government fiscal decline, it becomes apparent that the removal of local elective control, and placement of an emergency manager, in itself, generally does not address the problems that lead to a local government’s financial emergency.

In total, from 2000 through 2013, there were nine cases in Michigan where an emergency manager was appointed by the state to assume control of a local government (Chart 5-6). Of the nine local governments that fell under emergency manager control, two would be best classified as having “single issue” causes: (1) the Village of Three Oaks with the mismanagement of the village’s share of a road project; and (2) Allen Park with the fraudulent attempt by the mayor and city administrator to open up a city-owned movie studio. Allen Park did have some automotive-related recession pressures in 2009, and certainly did face revenue challenges, however these challenges were not likely to

lead to a financial emergency, and it is therefore best to describe the city's movie studio investment as the single cause for the city's plunge into fiscal crisis.

Chart 5-6 - Michigan Local governments under emergency manager

Local governments in Michigan Under Emergency Manager 2000 -2013							
Local Govt	Population	Per Capita Income	Household Income	% Poverty	% Caucasian	% African American	Single Issue or Systemic?
Highland Park	11,776	\$13,359	\$18,981	51.1	3.2	93.5	Systemic
Benton Harbor	10038	\$10,083	\$18,208	48.4	7.0	89.2	Systemic
Hamtramck	22,423	\$10,890	\$25,659	43.4	53.6	19.3	Systemic
Flint	102,434	\$24,834	\$14,360	41.5	37.4	56.6	Systemic
Detroit	713,862	\$14,870	\$26,325	39.3	10.6	82.7	Systemic
Pontiac	59515	\$15,906	\$27,528	36.6	34.4	52.1	Systemic
Ecorse	9512	\$15,564	\$28,013	32.5	44.0	46.0	Systemic
Three Oaks	1622	\$20,560	\$44,435	16.5	93.2	1.1	Single Issue
Allen Park	28,210	\$27,082	\$58,654	7.8	92.9	2.1	Single Issue

Isolating these two “single issue” financial emergencies, we find shared characteristics of predominately white, middle class towns, with median income at, or above the state average, and poverty at or below the state average (Chart 5-7).

Chart 5-7 - “Single Issue” Financial Emergencies in Michigan 2000 - 2013

Local Govt	Population	Per Capita Income	Household Income	% Poverty	% Caucasian	% African American	Single Issue or Systemic?
Three Oaks	1622	\$20,560	\$44,435	16.5	93.2	1.1	Single Issue
Allen Park	28,210	\$27,082	\$58,654	7.8	92.9	2.1	Single Issue
Average	14,916	\$23,821	\$51,545	12.2	93.1	1.6	

Conversely, local governments in Michigan without single issues, but rather with complex, deeply rooted “systemic issues” that caused financial emergency appear much different. Household income levels are less than half of those in the single issue cases. Poverty levels are over three times as high. The systemic issue local governments have generally been majority African-American, and typically in former hubs of manufacturing (Chart 5-8).

Chart 5-8 - “Systemic Issue” Financial Emergencies in Michigan 2000 – 2013

Local Govt	Population	Per Capita Income	Household Income	% Poverty	% Caucasian	% African American	Single Issue or Systemic?
Highland Park	11,776	\$13,359	\$18,981	51.1	3.2	93.5	Systemic
Benton Harbor	10,038	\$10,083	\$18,208	48.4	7.0	89.2	Systemic
Hamtramck	22,423	\$10,890	\$25,659	43.4	53.6	19.3	Systemic
Flint	102,434	\$24,834	\$14,360	41.5	37.4	56.6	Systemic
Detroit	713,862	\$14,870	\$26,325	39.3	10.6	82.7	Systemic
Pontiac	59,515	\$15,906	\$27,528	36.6	34.4	52.1	Systemic
Ecorse	9,512	\$15,564	\$28,013	32.5	44.0	46.0	Systemic
Average	132,794	\$15,072	\$22,725	41.8	27.2	62.8	
Median	22,423	\$14,870	\$25,659	41.5	34.4	56.6	

Unlike the single issue cases, the systemic issue cases may experience protests surrounding the placement of an emergency manager, and many have had cases a history of poor race relations and a legacy of racial discrimination. Poorer local governments often have higher service level needs, or at the very least, any reduction in service levels impacts poor residents especially hard. The loss of local government control strikes a nerve in the communities of the systemic issue cases. On the other hand, no major indications of protests can be found in the single issue cases – it appears the community was generally angry toward the mistakes of the local government, accepting of the need for assistance, and the local government was able to absorb the recommended cuts without fundamentally altering the quality of life. There is a clear contrast between the two types of cases of emergency management in Michigan.

Now that we have separated the nine cases into two types, systemic and single-issue, what does this mean? As we have seen, local government's decline for a number of reasons, some such as Harrisburg, Pennsylvania, or in Michigan, Allen Park or the Village of Three Oaks, face financial collapse due to mismanagement that centers more or less around a central cause, which may last a year and can be remedied with technical assistance and reform imposed from the outside, or which may persist for decades.

However, in the majority of cases where Michigan local governments face financial crisis, there is no single cause to point to that indicates the local government is incapable of managing itself. In the systemic issue cases, local officials of older cities with challenging demographics and economic conditions are often swimming against a tide of decades of social forces that led to the financial emergency. Coupled with the loss of manufacturing in the U.S., and across the Rust Belt, is the legacy of decades of racial

discrimination against African Americans in employment, education, housing and criminal justice. While there may be mismanagement or corruption found in the systemic issue cases, and often there is, the causes of the financial emergency simply cannot be addressed solely by removing local control and appointed a single state official to slash the budget.

The placement of an emergency manager, the treatment, does not in itself address the cause of the problem. The placement of an emergency manager does remove the political considerations from the equation. However, these political considerations are a necessary byproduct of living in a democratic society – where democracy, messy as can be, is a value that permeates all levels of the federal system.

Based upon the exploratory research in this case study, from the lens of local government fiscal decline and greater socio-economic conditions, we conclude that the placement of emergency managers in local governments experiencing financial crisis does nothing to address the larger issues, it only limits the consequences of democracy. Furthermore, in many examples of emergency managers, the placement of the emergency manager has led to little or no noticeable improvement; and in some cases, such as Flint, created exponentially more problems than the local government would likely have faced otherwise. More research is needed on the effectiveness of emergency managers, especially in the case of Detroit, where in the short-term; the experience has been judged a tentative success.

4. How should future public administration research approach the state imposed emergency financial management of local governments?

The state takeover of local governments in Michigan is a relatively new phenomenon, and limited mostly to the state of Michigan, therefore the research is rather sparse. This case study has attempted to trace the statutes through their development and evolution, as well as better understand the implementation in the largest case – the city of Detroit. In addition, cross cases were examined, in New York City and Flint, to explore characteristics and trends to better understand how the state intervention in local governments experiencing financial crisis is implemented.

Future research, given the benefit of some additional time, should examine the effects of state removal of local control, including Detroit’s emergency manager experience. There will likely be several studies planned to chronicle the bankruptcy proceedings of Michigan and how the various decision makers achieved the “Grand Bargain” to restructure the city’s debt and give Detroit a second chance. However, there will likely be much less attention to the policy that allowed for Detroit to declare bankruptcy – the emergency manager statutes of Michigan.

Future public administration research should further examine the cases of emergency managers and how they left the communities they were appointed to - how they left the communities in which they replaced local government democracy. If, based upon further analysis, emergency managers are found to have no, or marginal impact, then the policy should be revised or the implementation modified. However, if the communities are found to be demonstrably better off than before, perhaps there is some utility to the emergency manager practice – provided that some version of the recommendations presented in the final section of this chapter are implemented to promote greater social equity.

Based on the cases explored in this research study, it is unlikely that the placement of an emergency manager measurably improves the financial condition or the quality of life in a local government. As we have seen with the cases of Ecorse, Hamtramck, Highland Park and Flint, the first four local governments to have either a receiver (Ecorse 1986) or emergency manager, after the emergency managers issued the final order declaring the emergency over, each of the local governments would return to a state of financial crisis and have emergency managers appointed again. Except for the “single issue” local governments, the recidivism level for local governments with systemic issues appears to be quite high. With additional time and study, the effectiveness could be further studied and perhaps generalized to the outside – to provide information for other states considering developing or implementing a policy similar to Michigan.

It is no easy task for future research to determine whether or not public administrators were successful as emergency managers in local governments experiencing financial crisis. Empirically and quantitatively, budget stability and financial condition will provide baseline data and enable researchers to understand the quantitative financial changes. Future research may use fiscal stability scores, either new or existing, as well as economic data, and perform an analysis of the financial conditions before, and after the placement of an emergency manager.

Another useful approach would be to analyze the public safety implications – such as crime and fire incident data before and after emergency manager appointments. Since emergency managers generally reduce police and fire personnel, or merge with other governmental units, this may prove to be a useful dimension to an analysis study.

Such future studies would be informative and useful. Additionally, similar to some of the research discussed in Chapter Four Part Three, pertaining to the New York fiscal crisis and public health consequences of the austerity measures, studying public health data may be a useful research strategy as well. Certainly, one can see the impact an emergency manager may have on the local government's public health when the situation of Flint water crisis is considered. However, a purely quantitative approach is limited, and given the limited amount of cases, may not be enough to generate solid conclusions from the data. Therefore, future research will likely need to be of the mixed-method variety; considering the economic, financial, public safety and public health quantitative changes in the communities, as well as considering qualitative features; such as asking the question – how do the residents feel about the local government since the emergency manager took place? What is the quality of life like since democratic control was taken away? What does the local government look like after the emergency manager took action?

If future national economic conditions lead to increased state intervention in local governments across the nation, researchers should look to Michigan and its experiences with emergency managers to better understand whether or not the practice is effective, versus other models that take a more collaborative approach and less interventionist approach. Additionally, future research should highlight the differences that long-term planning, collaborative negotiations and regional approaches have, versus bottom-line budget cutting to achieve short-term financial stability on paper. For example, the contrast between a case such as Detroit, where with the assistance of Chapter 9 bankruptcy proceedings a more long-term approach was implemented, versus a case such

as Flint, where cost-cutting was dominant and long-term planning was not as much a factor.

Based upon the emergency manager laws in Michigan, and specifically the Chapter 9 filing in Detroit, the role of the courts and scope of their power in reviewing legislation and the actions of administrators should be analyzed in future research. Cases where the court orders administrative practice often raise concerns, because there is tension between the constitutional rights and government practices. Researchers have looked into the active judicial supervision that sought to remedy discrimination in schools (Wise and O’Leary 2003; or the judicial supervision of prison conditions (Rosenbloom and O’Leary 1997). Much of the literature on the role of the judiciary in public administration concerns areas such as the court’s involvement with schools and prisons to protect rights or enforce orders. There is less literature on the partnership between a judge and receiver/emergency manager during the complete takeover of large urban cities financial emergency, due to fewer instances in which to study. This should be a source of future research, especially related to judicial involvement of the public administration of cities during a Chapter 9 bankruptcy filing or other form of state receivership. Such research would be useful, because opponents of the emergency manager laws provide the argument that Chapter 9 bankruptcy is preferable to the placement of an emergency manager by the state. Additional research should determine if this is a reasonable conclusion. The experience with Detroit’s bankruptcy provides some interim evidence that a Chapter 9 bankruptcy filing is not necessarily the doomsday scenario it was often thought to be.

5. In a local government fiscal emergency, who should rule?

Local government is the level in the United States intergovernmental system that is closest to the people. Local government democracy has always been important, but in minority communities it has perhaps taken on a greater significance due to a recent focus on civil rights issues that have resulted from high-profile, and often tragic confrontations between the African American community and police departments in urban areas across the nation. In 2015, in locations such as Ferguson, Missouri; Baltimore, Maryland; and New York City - just to name a few – fatal encounters involving unarmed black residents and white police officers, and the subsequent protests, have forced a national conversation regarding police tactics with consideration of race. Accountability of police procedures has federal and state involvement, but overall this is largely a local government function. In light of heightened racial tensions across the country, it is important to consider the consequences of removing local government democracy from residents – generally minority residents – when that level of local government control may be one of the few avenues to address the perceived discriminatory challenges.

Residents in the local government should be governed through the election of duly-elected representatives; this is a cornerstone of American democracy and is unlikely to be a controversial statement. And yet, some may envision, to varying degrees depending on ideology, the appeal of an emergency manager to achieve results, in the mold of “Getting Things Done” as Robert Caro (1975) referred to the power philosophy and leadership style of Robert Moses as the power broker in New York in New York from 1930 – 1960s, with local democracy concerns ignored to the greatest extent possible, in order to create public works projects along with the power that came with

them. To go even further with the analogy, we may consider historian Raymond Moley, who wrote the introduction to Moses' 1970 biography and stated that:

“From the pyramids of Egypt, to the rebuilding of Rome after Nero's fire, to the creation of the great medieval cathedrals and the reconstruction of Paris by Baron Haussmann, all great public works have been somehow associated with autocratic power. For pure democracy has neither the imagination, nor the energy, nor the disciplined mentality to create major improvements” (Moley 1970, xi)

Is this what it truly takes for major rebuilding projects; whether they are public works or the rebuilding of a city in financial crisis? Do proponents of the emergency manager statutes have a sympathetic ear toward limited autocratic rule for achieving major initiatives; or, are they simply echoing the sentiments of many taxpaying residents, who have been frustrated by the local government official's perceived corruption, political paralysis, shortsightedness, or just plain incompetence, and may simply appreciate the ability for an emergency manager to cut through the red tape and make decisive moves to address financial crises? The idea of a public administrator largely immune from the political considerations of the present day may represent an appealing theory, whether or not there is any evidence in support of long-term success.

Yet this theory ignores the fact that at numerous times, and in many policy areas, federal and state governments have not enabled struggling local governments to address the challenges they face. Unfunded mandates, decreases in revenue sharing at poorly timed intervals, ineffective intergovernmental policies, and in some cities, the legacy of racial discrimination, both institutionalized and informal, have hindered local governments in fiscal stress from responding as required.

As a character study, it is fascinating to follow the path of the emergency financial managers. The level of scrutiny, the media focus, and the political animosity is

intense for these public administrators. It is rather difficult to imagine why an individual in the public service would desire to serve in such a hostile environment; it would be hard to find a more challenging situation than being selected as an emergency manager, to manage a local government that did not vote for you, and wishes for you to leave immediately. However, while we can admire the ability to get things done and the courage it may take to face so many detractors and face such a challenge, we should remember that the selection of emergency managers to replace local elected officials is inherently incompatible with the local democratic traditions of the United States, where residents have historically been free to elect officials to manage the affairs of the respective political jurisdiction.

In a local government, where representatives are chosen by residents via an election, if the elected official does not perform up to the electorate's expectations, then they are replaced at the next election cycle. Throughout the process, there is the linkage - that the elected official is accountable to the voters. That linkage and accountability contract between the government and governed is broken once an emergency manager is put into place.

When democracy is suspended from local governments, the burden of proof should be on the emergency manager statute to demonstrate measurable long-term results. Thus far, it does not appear to be the case that Michigan cities placed under control by the state are any better off than before. So then, the question must be, why remove local control, if it has not been found to work? Ecorse, Hamtramck, Highland Park and Flint - these are the first four Michigan local governments placed under receivership and emergency management, resulting in the first receiver and emergency

managers in Michigan history. How have they fared since? All four of these local governments have continued to experience persistent financial crisis well after the receiver or emergency manager left town, and they would each, every one of them, once again have local democracy suspended as eventually a new financial emergency would be declared and new emergency manager appointed. In Flint, even the most strident proponent of the emergency management statute would be forced to admit that the policy made the city's plight exponentially worse. The problem is that the emergency managers are not able to address the underlying problems with a large-scale economic development vision to create a sustainable tax base that can return the cities to the level of services and quality of life that is required for prosperity. Simply put, the treatment of emergency financial management addresses the symptoms, but not the cause of the financial crisis.

Emergency managers do cut deficits and save money. But are the local governments any better off? One could argue that Detroit may, in time, be better off because of Kevyn Orr's tenure as emergency manager and the Grand Bargain that was reached through Chapter 9 bankruptcy to give Detroit a second chance. However, more time is needed to determine if that is the case. Conversely, under Flint's experience during its string of emergency managers the city will likely to face years of dire public health consequences from the decision the emergency manager made to remain with the polluted Flint River as the city's drinking water source, over objections of residents and a vote by the local elected officials, who no longer had any real power in the city. The removal of local democratic oversight, such was the case in Flint, results in a "blind spot" for accountability, created by a lack of local government democratic representation, where a state official is unable to truly perceive the importance of an issue, and where a

locally elected representative would have increased sensitivity toward the concerns. This is the reason why the states, far removed from the daily concerns, do not manage the day-to-day affairs of local governments.

Emergency management experiences and results vary dramatically. Of course, every emergency manager is different, with a different temperaments and skill sets; and each inherits a different set of conditions. However, some may have a skill-set or ideology for short-term budget cutting to improve the bottom line, while others may be equipped to diagnose the true root problems of a city's decline, place more importance on service delivery and preservation of public safety, and have the ability to bring opposing sides to the table for true collaboration.

Because there is no guarantee as to the effectiveness of emergency managers, a financial control board option, similar to the case of New York City in the 1970s; or even the consent agreement option available under PA 436, is a preferred option for addressing financial emergencies. With a mixture of state and local members, a financial control board preserves some measure of local democracy while enabling the difficult decisions to be made with increased authority. If the board is unable to come to agreement, the case of Detroit illustrates that Chapter 9 bankruptcy, while certainly not a preferable policy outcome, is not quite the municipal death sentence it was made out to be by detractors, as it allows for the restructuring of debt only after opposing sides provide evidence and reasonable arguments in a public setting before a court of law.

Recommendations for Implementation of the Michigan Emergency Manager Law

Given the premise that emergency managers replacing the role of local government is generally incompatible with the United States' local representative democracy tradition; yet such actions are inevitable in Michigan based upon current statute, it is useful to develop recommendations in which the implementation could be undertaken with a larger degree of social equity. The issues involved in financial decline of local governments are complex, as is the state takeover and removal of local government representatives. Based upon the research conducted during this case study, two recommendations are proposed: First, the selection of local governments for state review should be objective and transparent; and second, the statute, and its implementation, should be revised to further address the larger socioeconomic issues that cause local governments to face perpetual financial crisis.

1. The selection of local governments for preliminary review should be objective and transparent.

As covered in Chapter Four, Part One, each of the emergency manager statutes, as written and implemented in Michigan, have contained a set of criteria that leave much to the discretion of the Michigan Department of Treasury in determining which local governments will be subjected to the provisions of the law. The first step in the emergency manager statutes is for the state to undertake a preliminary review. Several conditions are listed, most following requirements under state law for local governments to follow certain financial practices. However, there is also a broad provision that allows the state to conduct a preliminary review based upon any other factors as determined by

the State Treasurer. This provision should be removed from the statute, or disregarded in its implementation, as a first step toward objectivity.

The Treasury Department should return to using a local government fiscal stress scoring system, but, more importantly, to publish such criteria and results to the public. Based upon these scores, the state should, objectively, and based upon a clearly laid out methodology, conduct preliminary reviews of local governments, upon which, if fiscal stress is found, may then lead to full reviews. Michigan's emergency manager statutes have lacked an objective basis for state intervention that could be clearly communicated to residents of the local government in question, as well as Michigan residents in general. An example of this lack of objectivity can be seen when the law is implemented in urban, majority-African American communities, but not implemented in rural white-majority communities with the same local fiscal stress or fiscal conditions. This is at best, an unfortunate and alarming oversight, and at worst, as pointed out by detractors, a possible violation of the Civil Rights Act, which prohibits voting practices or procedures that discriminate on the basis of race, color or membership in a language minority group.

As previously discussed in Chapter Four, Part One, based upon 2008 data, of the 272 local governments in Michigan that were scored using fiscal stress scores, 14 received scores between 8-10, which indicates fiscal stress. However, of the 14 local governments only 3 received some state action under the various emergency manager laws - Benton Harbor and Ecorse received emergency managers in 2009 and 2010 and Royal Oak Township was placed under a consent agreement in 2013. However, these are the only three local governments scoring in the 8 - 10 scoring range that had a majority African American population. The remaining 11 local governments scoring in that same

fiscal crisis range represented mostly white, rural areas. Coupled with the fact that half of the state's African American population was at one time without local government democracy, it is reasonable to understand why protesters were angered at the emergency manager statutes and how they have been implemented in Michigan.

Objective criteria for implementation of the statute will protect the state from perceived discrimination, and more importantly, protect minority residents from asking why their local government was selected for review over a community that had a different demographic makeup. When over half of the state's African American population had essentially no local democratic voting rights, this is a major social equity concern in public administration. This problem is even more prominent when we consider the troubled history on racial relations in Detroit and other urban cities in Michigan.

Instead, the state should return to a scoring system on an annual basis to rank Michigan's local governments to predict fiscal stress. If the similar system implemented from 2003 – 2007 is utilized, then scores that range from 8-10, which indicate a high level of fiscal stress, should receive a preliminary review. Local governments with scores from 6 - 8 should be notified that they are on watch status. If in the event that there are more communities in the 8 - 10 range than the Treasury Department has the capacity to review, then the local governments should be prioritized by a clear methodology that may include factors such as population, level of debt, annual budget, etc. – and such factors should be incorporated into an overall risk assessment methodology for Michigan local governments that is clearly communicated to the public.

Utilizing a clear methodology for implementing the statute is a common sense measure that will help remove any perception of bias. If the law was equally implemented in several of the white-majority population local governments with stress scores from 8-10, would PA4 have been repealed? Would the opposition in Detroit have been so great? It is impossible to know the answers to these hypothetical questions, but the thought experiment reinforces the point – objective implementation can be a critical factor of a sensitive policy’s perception, and should ensure a greater degree of social equity. The statute is inherently flawed because it cannot reconcile with local democratic government traditions; however revising the policy and implementation to emphasize objectivity and transparency may mitigate some of the policy deficiencies while preserving a larger measure of social equity for the residents.

State lawmakers and state officials underestimated the Michigan residents’ attachment to the idea of local democracy. This is evidenced by the scores of protests when emergency managers are announced and placed in communities, as well as the overturning of PA4 of 2011 by popular referendum. The repeal of PA 4 Of 2011, as we saw in Chapter Four, Section One, cut across rural and urban, and black and white communities. After that measure was overturned by the people of Michigan, the state legislature replaced the statute with PA436 of 2012, which had an appropriation tied to it and therefore could not be repealed by a referendum, under the State constitution. This legislative maneuver essentially acknowledged that the state legislature was apportioned in a way that favored the party in control, and that popular support was not with the measure, therefore, the public was removed from the equation. Given the importance the people of Michigan placed on local democracy, enough that they rejected a similar law,

the law should at the very least be implemented objectively and fairly. This means a return to transparent fiscal stress scoring, and utilizing an objective methodology for determining which local governments receive preliminary reviews by the state, as the potential first step toward emergency management.

2. The statute and its implementation need to recognize and address the larger socioeconomic issues that lead to local government financial emergency.

As Detroit fell into financial collapse, there was much talk about the “decline of Detroit.” The premise being that Detroit, once the fourth largest in the United States, once a source of great wealth and power; once the “Arsenal of Democracy,” had fallen far from its golden age - which is roughly thought to be the 1920s through the 1950s – due to mismanagement of the local officials in the 1960s and beyond. However, this narrative does not fit well with history.

Detroit certainly had a booming economy and developed a large middle class, but this prosperity was not experienced by all of its residents, especially the African American community, many who had migrated from the South to Detroit for opportunity during the auto industry’s peak. While the auto industry surged, African Americans in the city were often relegated to the worst housing choices in the city and discriminated against in employment opportunities. When African Americans attempted to move into nicer areas, they were generally met by great resistance by the local white community, whose actions were reinforced to varying degrees by local, state and federal policy. When some hard-fought gains were made in housing, the white middle class population largely abandoned communities, and ultimately, the city, as was the case across the nation, in the

white flight that took place in the 1950s through 1980s. This left Detroit with, as Mayor Coleman Young pointed out, “the damnedest demographic in America.”

“The same problems that beset every American city, except that they are magnified by the fact that modern Detroit was built around the auto industry, which has been losing blood for two decades and the accompanying reality that white flight, industrial and social, has left Detroit with the damnedest demographics in America.

“I was in the right place at the right time, and that my fortune was a direct result of my city’s misfortune – of the same fear and loathing that had caused all of my problems and Detroit’s problems in the first place. I was taking over the administration of Detroit because the white people didn’t want the damn thing anymore” (Young and Wheeler 1994, 204)

At the same time, large socioeconomic forces, far beyond Detroit’s control - deindustrialization and globalization – reshaped Midwestern manufacturing in general, and the automotive industry especially. A history of racial discrimination, major demographic shifts, deindustrialization and globalization, - these are the root causes of the Detroit’s financial struggles – and the intergovernmental system never developed a coherent strategy to address them. This is not unique to Detroit, but reflects a trend that many large, old, and urban cities experienced since the 1970s. Parallels are seen in the example of New York City, which was discussed in Chapter Four, Part Three.

How does the imposition of an emergency manager address these larger socio-economic issues that local government increasingly are confronted with, and have faced for generations, that has led to their decline? Does the presence of an emergency manager have any effect on a local government’s overall financial condition? Does the intervention produce results? Thus far, there does not appear to be any clear evidence that this is the case. Supporters claim that emergency managers make communities solvent; opponents argue that they make things worse.

In the case of Flint, as discussed in Chapter Four, Part Four, cutting short-term costs without long-term planning may bring a significantly larger price tag in the long-term. Likewise in Hamtramck or Highland Park, the short-term spending cuts did relatively little to address the larger issues that brought the city into financial emergency, and in both cases the city eventually fell back into financial crisis.

Michigan is an outlier in the United States intergovernmental system, in that its emergency manager statutes allow for state takeover of local government, generally without any accompanied state resources. Rhode Island has passed a similar law, but it has not been implanted such a scale as Michigan. As Michelle Wilde Anderson explained, there is a “democratic dissolution” that takes place in Michigan and Rhode Island under the emergency manager statutes, but without the traditional resource assistance from the state:

“the new laws passed in Michigan and Rhode Island represent a major change from older models of state receiverships, in which states generally granted emergency bailout funding in exchange for local consent to the appointment of state receivers, and these receivers then guided financial recovery planning alongside local officials. Breaking with these models in the name of fiscal exigency, Michigan and Rhode Island now permit a state takeover without bailout funding or local consent, and they dramatically increase the powers granted to emergency managers” (Anderson 2012, 581).

Any removal of local government democracy should be accompanied with state resources to help address the larger issues behind the financial management. In a sense, these resources constitute an “offset” for the temporary loss of democracy, with the goal of restoring normal representative government in a timely manner. The emergency manager experience in Detroit can provide some instruction. Ultimately, as part of the “Grand Bargain” brought forth by the bankruptcy process, the state agreed to provide \$190 million in funding to the help city, in addition to joining the support of nonprofit

foundations and further regional collaboration. However, it is important to note that the state resources only arrived after Chapter 9 bankruptcy was filed and approved. The emergency manager statutes contain no provision for additional state resources, and do not encourage long-term regional collaboration to assist local governments whose local control is removed.

As either a revision to the statute, or in the course of implementing it in the future, the state, especially in times of relative prosperity and state budget stability, should establish and strengthen a local government financial stability fund. This funding stream should be used to provide assistance to local governments who receive a consent agreement or emergency manager that removes local control of the local government. At the very minimum, it will help secure much needed borrowing as part of any debt restructuring package brought forth by a financial control board, or emergency manager. The premise is simple, local democracy should be maintained, but in the event where it will be encroached upon, the intrusion should be temporary and accompanied by state resources and provisions to spur regional collaboration to address the systemic issues.

The funding should also be used to ensure that basic levels of service are maintained, and along with the state-local collaboration, to address the larger issues behind the city's decline. The argument can be made for state assistance to local governments because, as local democracy is an important value central to the political and governing way of life in the United States, any imposition upon it must be offset by state resources to return the local government to local democratic control, but in a better strategic position than it was previously found.

Because of the traditions and importance of local democracy previously discussed in this section, any removal of local democracy should be: (1) temporary; (2) accompanied by state resources to address the larger issues at play; and (3) inclusive of long-term planning, along with brokered state-local and regional collaboration to address the causes of financial emergency. Regardless of how many times local elected leaders delay much needed reforms, or make mistakes, experience shows that it is far more likely that larger forces played a role in the local government's demise, rather than mismanagement alone.

When joined with the recommendation for increased objectivity and transparency in the way the emergency manager statutes are implemented, the emphasis on the temporary nature of the emergency manager status, along with accompanied state resources and regional collaboration would dramatically improve both the perception and implementation of the controversial statute. Measures such as these should be taken, because despite the large amount of controversy the emergency manager statutes created in local and national media, the importance of local democratic control, especially in minority-majority communities, was seemingly dismissed as an inconvenience to achieving short-term fiscal reform. This is concerning. Local government democracy should not be viewed as a mere inconvenience to financial reform, but instead it should assume its proper place as a central principle of public administration, to be preserved; and if encroached upon, accompanied with safeguards to ensure that such an infringement is limited in its duration and scope.

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