



Effects of fiscal stress labels on municipal government finances, housing prices, and the quality of public services: Evidence from Ohio[☆]



Paul N. Thompson

Department of Economics, School of Public Policy, Oregon State University, 340 Bexell Hall, Corvallis, OR 97331, United States

ARTICLE INFO

JEL classification:

H7
H11
R31

Keywords:

Fiscal stress
House prices
Municipalities
Public services

ABSTRACT

This paper analyzes the Ohio fiscal stress labeling system, which labels municipal governments that are in financial trouble and requires them to implement financial recovery plans. These recovery plans are undertaken by the municipality or by the state depending on the type of label. I examine the effect of these fiscal stress labels on municipal government financial behavior, crime, and housing prices from 1999–2012. Using difference-in-differences, I find that municipalities with fiscal stress labels reduce total expenditures per capita by nearly 25 percent. Although municipalities make reductions to both per capita capital and operating expenditures, the largest percentage reductions occur in per capita capital expenditures. There are heterogeneous responses by the type of municipality and type of governance structure in place, especially in the reductions made to operating expenditures. Cities and municipalities with council-manager governance structures much more heavily focus on reductions in spending for specific public services (e.g., safety services, roads), while villages and municipalities with mayor-council governance structures primarily reduce general operating expenditures and increase local tax revenue. These labels have minimal impacts on crime rates and police employment. While I find no statistically significant effect of label receipt on housing prices, I do find that residential home sale prices fall following fiscal stress label removal. Thus, the reductions in public service expenditures may have long-lasting ramifications on the quality of public services offered by these municipalities.

1. Introduction

In the current financial climate, local governments have not been immune to financial hardships, especially those resulting from large budget deficits. In recent years, several municipalities have filed for bankruptcy due to severe financial issues. The two most populous municipalities to file for bankruptcy in the United States are Detroit, MI and Stockton, CA and the 2013 bankruptcy filing by the City of Detroit is the largest municipal bankruptcy filing on record. Under Michigan's Emergency Manager law, a state-appointed "emergency manager" was placed in charge of Detroit's financial decision-making and spearheaded the financial recovery from a debt of nearly \$20 billion. Beyond the direct impact that municipal financial issues have locally, municipal bankruptcies may also have potentially larger, state-wide ramifications. For example, East Cleveland, OH, the most recent

municipality facing bankruptcy, has faced stiff opposition from the state in declaring bankruptcy due to the Ohio Auditor suggesting that the state's bond rating could be negatively affected.

While many of the financial issues facing local governments do not reach such a dire level, the fiscal health of local governments is still a policy concern for many states. Several states have developed financial intervention systems that monitor local government finances and provide various forms of intervention to help local governments address growing budget deficits and other financial problems (e.g., Michigan's Emergency Manager law).¹ Despite the presence of these policies in several states, little is known about the effects the policies have on local government outcomes. Towards filling this gap, this paper analyzes the fiscal stress labeling policy in the State of Ohio, which requires the implementation of a financial recovery plan that is operated by either the municipality or the state depending on the

[☆] The author is grateful to Mike Conlin, Eric Brunner, Tom Downes, the participants of the 2015 and 2016 Western Economics Association International conferences, and the participants of the 2016 Lincoln Institute of Land Policy Young Scholars Program for their helpful comments and discussion. A special thanks to the various county Auditor's offices and members of the Ohio Auditor who helped me during the collection of the data and Jan Thompson, Joe Whitley, Rebecca Ott, Eleanor Daniels, and Kat Mackay for expert research assistance.

E-mail address: paul.thompson@oregonstate.edu.

¹ Honadle (2003) and Kloha et al. (2005) found that 15 states had some fiscal health evaluation system in place and nearly a third more states are considering using these indicators. A 2013 Pew Charitable Trusts report (Trusts, 2013) on a survey conducted found that 19 states currently have a financial intervention system in place for local governments (e.g., municipalities, townships).

<http://dx.doi.org/10.1016/j.regsciurbeco.2017.03.001>

Received 7 September 2016; Received in revised form 23 February 2017; Accepted 1 March 2017

Available online 02 March 2017

0166-0462/ © 2017 Elsevier B.V. All rights reserved.

severity of the label.

This paper provides the first analysis of the effects of these fiscal stress labels on municipal government (i.e., city or village) outcomes, crime, and housing prices. I compile a balanced panel of all 932 municipalities in Ohio from 1999–2012; collecting data on dates of label receipt and removal, municipal government expenditures and revenues, crime rates, and housing transactions. Using difference-in-differences, I find that municipalities with fiscal stress labels reduce total expenditures per capita by nearly 25 percent. Although municipalities make reductions to both per capita capital and operating expenditures, the largest percentage reductions occur in per capita capital expenditures. There are heterogeneous responses by the type of municipality and type of governance structure in place, especially in the reductions made to operating expenditures. Cities and municipalities with council-manager governance structures much more heavily focus on reductions in spending for specific public services (e.g., safety services, roads), while villages and municipalities with mayor-council governance structures primarily reduce general operating expenditures and increase local tax revenue. These labels have minimal impacts on crime rates and police employment. While I find no statistically significant effect of label receipt on housing prices, I do find that residential home sale prices fall following fiscal stress label removal. Thus, the reductions in public service expenditures may have long-lasting ramifications on the quality of public services offered by these municipalities.

2. Previous literature

This is the first study to analyze the effects of these labels in the context of local municipal governments. This study most closely relates to Thompson (2016), which examined the effects of these labels in the context of local school districts and found statistically significant changes in school district financial behavior in response to the mandated recovery plans associated with these labels. These changes included increases in local tax revenue for operating expenditures and decreases in both operating and capital expenditures. The study also found that residential home sale prices fell following fiscal stress label receipt and educational services were reduced, as evidenced by reductions in teachers, schools, and test scores. Given that the current study examines both municipal government financial behavior, public service quality, and housing prices, the results of this analysis serve as a complement to these earlier school district results.

This study also contributes to the literature examining how local governments react to budgetary problems. Much of this literature has focused on voluntary changes to finances as a result of budget deficits and finds that many financially troubled local governments seek additional revenue sources, including increases in state and federal aid, local taxes, and user fees (Pagano, 1993). These local governments also reduce administrative expenditures (Forrester and Spindler, 1990; Honadle et al., 2004; Kodrzycki, 1998) and delay capital expenditures in order to balance budgets, but are often forced to also make reductions to essential public services (Higgins, 1984; Maher and Deller, 2007; Trussel and Patrick, 2012). A more recent set of papers has examined how local governments respond to the greater financial oversight associated with these financial intervention systems. Several of these studies have examined local government responses to North Carolina's Local Government Commission and find that the greater oversight led to higher municipal bond ratings, larger fund balances (Coe, 2007), and local officials becoming more informed about their government's financial status (Rivenbark and Roenigk, 2011). Spreen and Cheek (2016), however, find no statistically significant difference in the financial stress indicators of local governments in Michigan relative to local governments in control states following the introduction of Michigan's Fiscal Stress Indicator System.

This study also contributes to the literature on the relationship between local governance structure (e.g., mayor-council, council-man-

ager) and fiscal policy by examining differential responses to these labels depending on the governance structures used in these municipalities. While several studies have shown very little difference in public services expenditures between the two governance structures (Campbell and Turnbull, 2003; Carr and Karuppusamy, 2010), a few studies find that the council-manager structure is associated with higher expenditures (Coate and Knight, 2011; Craw, 2008; Jung, 2006). There also appears to be very little difference in municipal wages across the two types (Bartel and Lewin, 1981; Deno and Mehay, 1987; O'Brien, 1995, 1992), although mayor-council governments have been shown to have significantly larger proportions of full-time employees compared with council-manager governments (Enikolopov, 2014). Mayor-council governments have also been found to be more prone to political business cycles (Vlaicu, 2008) and less likely to privatize public services compared with council-manager governments (Levin and Tadelis, 2010).

Finally, this study also contributes to the literature on the capitalization of public service quality into housing prices. While there is a large literature on the capitalization effects of test scores (Bayer et al., 2007; Black, 1999; Clapp et al., 2008; Davidoff and Leigh, 2008; Dougherty et al., 2009; Fack and Grenet, 2010; Gibbons and Machin, 2006, 2003; Gibbons et al., 2009) and other school quality measures (Black and Machin, 2011; Figlio and Maurice, 2004; Fiva and Kirkeboen, 2010; Kane et al., 2003; Nguyen-Hoang and Yinger, 2011; Zahirovic-Herbert and Turnbull, 2009) into housing prices, less is known about the relationship between housing prices and the quality of other public services offered by local governments. The literature has found positive associations between housing prices and expenditures on police and fire services (Kreft, 2007) and garbage collection (Reiff and Barbosa, 2005). Areas with lower crime (Bishop and Murphy, 2011; Gibbons and Machin, 2008), access to public transportation (Gibbons and Machin, 2008, 2005), and parks and recreational opportunities (Anderson and West, 2006; Bolitzer and Netusil, 2000; Dahlberg and Fredriksson, 2001) have also been found to be positively valued in the housing market.

3. Institutional details

3.1. Local governance structures

Municipalities in Ohio consist of 251 cities and 681 villages. The sole distinction between cities and villages is the size of the population, with a municipality classified as a city if it has more than five thousand residents in the last census.² Municipalities in Ohio have full home rule powers, with the ability to adopt charters, ordinances, and resolutions and are able to choose their own form of governance structure. The two most common forms of governance structure are mayor-council and council-manager. In the traditional mayor-council governance structure, the mayor is elected separately from the city council and has significant authority over administrative and budgetary decisions. The city council members are also elected officials and do hold some legislative powers, with the degree of power depending on whether the mayor has weak or strong powers. The council-manager governance structure involves an elected city council that oversees general administration, policy, and budget decisions. The council appoints a professional city manager to carry out the day-to-day administrative operations of the municipality. In Ohio, 852 municipalities have a mayor-council governance structure and 80 have a council-manager structure.

² There are two exceptions. First, a municipality with at least five thousand registered voters is a city. Second, a municipality with more than five thousand residents is considered a village if the population falls below five thousand after netting out-of-town students and prisoners.

Download English Version:

<https://daneshyari.com/en/article/5103723>

Download Persian Version:

<https://daneshyari.com/article/5103723>

[Daneshyari.com](https://daneshyari.com)