both in the process of making policy and in the implementation of those adopted policies.

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FINANCIAL EMERGENCY. A legal condition more severe than fiscal stress, but not so severe as to cause municipalities to declare bankruptcy or default on contractual obligations to repay borrowed funds. A financial emergency assumes that a municipality will take appropriate corrective action to prevent bankruptcy or defaults.

A financial emergency is more serious than fiscal stress. A government under fiscal stress faces budget cuts, revenue increases, and changes in how it carries out its core responsibilities. Although many municipalities have dealt with bouts of fiscal stress, few have confronted a true financial emergency (Advisory Commission on Intergovernmental Relations 1973, 1985).

For our purposes, a financial emergency is a legal condition. In the United States, federal law provides a legal avenue for municipalities to use for declaring bankruptcy, if permitted by state law. An example is the wealthy area of Orange County, California. It filed for legal bankruptcy on 6 December 1994 because of poorly conceived investment practices. Federal law prescribes the resolution of a bankruptcy.

The second condition deals with a *default* of contractual provisions to repay borrowed funds (see entry for **defaults, municipal**). In 1979, Cleveland, Ohio, defaulted when it could not repay one-year loans backed by the full faith and credit taxing power of the city. For bonds backed by dedicated project revenues, indentures accompanying the bonds clarify the legal rights and responsibilities of bondholders.

Under the third condition, state laws specify the terms of a financial emergency. It is the third definition reviewed here. Specifically, this entry uses the state of Ohio's fiscal emergency law to illustrate how a state can respond to municipal fiscal inadequacy. Other state experiences provide useful comparisons.

In Ohio, there are six legal criteria, and failure of any single one requires the state to declare the municipality in a condition of fiscal emergency. The first two tests represent failures to meet obligations to other parties: a default in payment to debt holders, and the failure to issue a payroll to employees when due. Four others represent the lack of adequate fiscal controls, including insufficient cash to meet current obligations, excessive deficits, excessive past due accounts payable, and excessive unvoted debt. More specifically, Chapter 118 of the *Ohio Revised Code* specifies that any one of the following constitutes a fiscal emergency condition of a municipal corporation:

1. a default for more than 30 days;
2. failure for lack of funds to make all payroll payments to municipal employees within 30 days of when payment is due;
3. an increase in the municipality's minimum tax levy, affecting the levy of another political unit;
4. overdue accounts payable of the general fund from the preceding fiscal year exceeding one-twelfth of the general fund budget, or overdue accounts payable from all funds exceeding one-twelfth of the revenues for the general fund and special funds;
5. an aggregate deficit in all deficit accounts, less cash balances, which can be used to meet the deficits, exceeding one-twelfth of the year's general fund budget and receipts to the deficit funds for that year;
6. the amount in the unsegregated treasury is insufficient to meet the purposes of the general fund and special funds and the deficiency exceeds one-twelfth of the total amount received into the treasury during the year.

A municipality may fail certain tests at year-end, but correct its fiscal behavior in time to avoid entangling itself in the legal control. For example, existence of any year-end condition in tests four, five, or six is not a fiscal emergency if the condition no longer exists at the time of the fiscal emergency audit. It might appear that the best time to assess a city's fiscal emergency status is at the time of a regular year-end financial audit, but fiscal problems may emerge earlier in the year. Ohio law requires calculations at the prior year-end and at the time of the fiscal emergency audit. So, if the municipality had corrected its behavior by the later date, the fact that it had an earlier failure is not sufficient to justify invoking the law's remedial powers.

Although the state fiscal emergency conditions clarify unacceptable local fiscal behavior, the law is indifferent on the cause(s). The emergency could be due to long-term economic deterioration or to the inattention of local officials to make a debt payment on schedule. Regardless, the fiscal emergency law is a remedial action to restore a municipality's fiscal integrity.

State Response

Why does a state assume a special burden when one of its local governments runs into financial trouble? A state cannot afford a market perception that it allows its local governments to follow a callous approach to fiscal stewardship. The market associates the state with its local governments. For this and other reasons, some states have found it in their interest to take steps to deal with local fiscal problems. The states of New York, Ohio, and Pennsylvania created state control boards for particular municipalities. In calling for a control board for Yonkers, New York, the state legislature said:

> [I]t is hereby found and declared that a financial emergency and an emergency period exists in the city of Yonkers.... To end this disaster, to bring the emergency under control and to respond to the overriding state concern ...., the state must undertake an extraordinary exercise of its police and emergency powers under the state constitution, and exercise controls and supervision over the financial affairs of the city ..., but in a manner intended to preserve the ability of city officials to determine programs and expenditure priorities within available financial resources (see Mackey 1993).

The nature of the state's response can vary. State action can follow a continuum, from very formal to extremely informal responses. Examples from Ohio, New Jersey, New York, and Florida help illustrate possible responses.

In Ohio, the independently elected state auditor has the initial responsibility to certify that a particular municipality has a fiscal emergency. The state auditor may initiate a review based upon problems identified through its regular audit program and its ongoing monitoring of general events in municipal governance. There are provisions for others (e.g., the mayor, governor, or presiding officer of the city council) to request that the state auditor conduct a fiscal emergency analysis of a municipality. In seven out of the first fifteen fiscal emergencies in Ohio, local officials submitted a request. In the other cases, municipalities were reluctant recipients of a state initiative.

Upon the state auditor's determination that a fiscal emergency condition exists in Ohio, the governor has the responsibility to appoint a Financial Planning and Supervision Commission (FPSC) for the specified municipality. The FPSC consists of seven members, including the state treasurer, the director of the state's Office of Budget and Management, the mayor, the presiding officer of the municipal council, and three "citizen" members. The governor selects the citizen members from a list submitted by the mayor and presiding officer of the municipality's legislative authority. These three members must have an understanding of financial matters and at least five years of experience in the private sector, must live or work in the municipality, and must not have held elective office within the past five years.

Each FPSC is an agency and instrumentality of the state, which pays the bills. A major decision of each FPSC is to appoint a firm of certified public accountants to serve as that municipality's "financial supervisor."

The duties and powers of the FPSC are expansive. The FPSC is a supervisory body in both name and purpose. All financial matters of the municipality require FPSC review and approval. The FPSC reviews the city's budgets, tax levy ordinances, and appropriation measures. It approves the purpose and amount of any debt obligation. It also serves as an adviser on the structure and terms of debt obligations, on methods to increase revenues, and ways to reduce costs.

The municipality has certain responsibilities under the terms of its fiscal emergency status. Each municipality must prepare a balanced budget and financial plan and then meet the stated timetable. Municipalities must contend with the FPSC monitoring its revenues and expenditures monthly to ensure that expenditures remain less than receipts. The financial plan must show that the municipality plans to deal with the areas of fiscal inadequacy that triggered the law's remedial provisions. Although armed with the power to approve or disapprove the financial plan, the FPSC cannot dictate action. Thus the municipality retains budgetary and financial priorities within approved fiscal parameters.

Florida has similar inadequacy tests to those found in Ohio, but the governor has broad discretion in designing a response to a local problem. The law allows the Florida governor's office to work out an informal solution to a community's financial hardship. This is instead of invoking gubernatorial power to establish a formal financial control commission.

New Jersey also has similar fiscal inadequacy tests, but the discretion resides in a board, not the governor. Similar to Florida, New Jersey deploys a technical assistance team to help a threatened community isolate its financial problems and set up minimal fiscal practices.

In Pennsylvania, the head of the Department of Community Affairs appoints a department employee, or a consultant, as the "coordinator" for the subject municipality. However, a special amendment passed in 1991 established Philadelphia's fiscal control board.

The state of New York has followed a different legal path by using a case-by-case approach. A specialized state

law dictated the state response to each particular financial emergency. Yonkers and New York City had their fiscal oversight boards established in the 1970s. More recently, Troy faced similar treatment in 1994. For Yonkers, the cycle of creation and cancellation of a control board occurred twice. New York City operated under the strict prereview conditions of a Financial Control Board until 1986, when the city's own success led to significant curtailment of the monitor's responsibilities as provided under its original enabling law (Gross 1986). New York City's control board (before 1987) had five primary responsibilities, namely,

1. to review and approve or disapprove the city's annual submission of a four-year financial plan;
2. to review and report on city operations and make recommendations for cost reduction and service improvement;
3. to review and approve or disapprove contracts or other obligations that require the payment of funds or the incurring of costs;
4. to review and approve or disapprove the terms of each proposed long-term and short-term borrowing by the city; and
5. to the extent it deems necessary or appropriate, to establish procedures for disbursement of moneys.

A state control board imposes financial discipline on the municipality. This can go as far as to include steps on what the city will do, how it will do it, and when it will be done. Since fiscal emergency laws typically limit elected city officials to a minority voting position, enhanced state control comes at the expense of local discretion.

Making a city live within its resources is attractive public policy. At a minimum, control boards can foster improved financial management capabilities. Independent control boards bolster the ability of local politicians to deflect various spending interests. In addition, a control board can help diffuse external voter and taxpayer opposition to revenue enhancements or severe service cuts.

As a buffer between the state and its local government, a control board can make life easier for both. This allows the state to avoid having to control local affairs from the state capitol. Local home rule is upset when the state supervises local affairs. The loss is not as great, however, if the state avoids assumption of responsibility for service levels, budget allocations, and local taxation decisions. Merely supervising local efforts to comply with state law and the local government's own financial plan gives the state leverage to remedy problems, but avoids the actual setting of allocation decisions. In this respect, a control board operates by holding local officials accountable for local decisions.

In Ohio, a control board's power to ensure compliance with state law emanates from the enabling legislation. Local officials who willfully violate a valid control board order are subject to legal penalties. Even if never invoked, the presence of such sanctions provides a threat to foster local compliance with the state's fiscal supervision.

Control Board Operations

A key element in a control board's work is the caliber of its daily relationship to the municipality. The municipality may acknowledge the legal role of the board, but the added layer of reporting and oversight confounds local decisionmaking channels.

A control board carries out its responsibilities through its staff. Three methods have evolved; namely, a separate professional staff, state agency management, and contractors. The two New York state experiences illustrate the professional staff method. New Jersey and Pennsylvania, however, rely on specialized state agencies to help smaller municipalities. In contrast, local control boards in Ohio typically engage the services of a certified public accounting (CPA) firm to serve as the city's "fiscal supervisor."

To do its work, a control board requires extensive access to reports, documents, and financial records. In response, the municipality has to devote staff time to gather and compile the requested information. This is compounded when the control board wants information on a given topic within a period that the city administration finds too difficult or confining. Meeting the deadlines avoids possible sanctions, however.

Municipalities subject to financial emergency oversight must do certain things. Ohio law, for example, requires that the municipality present to its FPSC an initial financial plan within 120 days of the state's certification of an emergency condition. Board action on approval of the financial plan, its modifications, and in the issuance of debt also represent formal roles of the board.

Just as critical to its formal role, the board and its staff (whether full-time public employees or an accounting firm under contract) develop an informal relationship with the municipality and its administration. In many Ohio municipalities, this translated into the fiscal supervisor, a CPA firm, helping the city improve its financial system so the city could ultimately comply with the control board's demands.

Influence on Taxing and Spending

If the state supervision is to ensure financial discipline, then the intervention should have an impact on budget balancing. In Ohio and New York, for example, financial emergency declarations require that municipalities prepare a multiyear financial plan for approval by the control board. These plans allow local decisionmakers to decide

service allocations, but within revenue estimates and spending plans monitored by the control board.

On the matter of taxing (and revenue generation), the control board serves in several capacities. The board can require the city to begin more effective collective systems, especially in dealing with accounts receivables. Since several Ohio governments had difficulty determining expected receipts and revenues, basic improvements in the administration of existing fees and taxes resulted in more timely receipt of funds.

In neither Ohio nor New York, for example, were state supervision boards extended the power to begin a new tax on local citizens. State lawmakers are understandably reluctant to bear the burden for having a state-declared and administered fiscal emergency result in a mandated tax increase. Thus the laws make local officials propose those actions.

Control boards force troubled municipalities to live within existing resources. In one example, the Yonkers, New York, control board reduced the administration's estimate of estimated revenues, forcing the city to make service cuts instead (Volk and Grumet 1979). In Ohio, a subject municipality has to submit a three-year financial plan to its control board. The plan must include the city's proposals for eliminating all fiscal emergency conditions and deficits, paying all overdue bills, restoring misused fund moneys, balancing the budget, and regaining the ability to market long-term general obligation bonds. Also included is a timetable for realization of the plan elements, and steps to prevent any new fiscal emergency from arising in the future. In Ohio, failure to submit a timely financial plan results in automatic spending restrictions in the general fund. The spending ceiling is 85 percent of general fund expenditures for that month in the preceding year. New York City's board monitors threats to the board-approved city expenditure plan (Bailey 1984; New York State Financial Control Board 1992). Fiscal discipline, as imposed by control boards, usually means living within resource limits, not enlarging the taxing authority.

Control boards help local governments develop adequate financial practices. Such practices may prevent future fiscal problems from escalating into another emergency. This requires an improvement in the local jurisdiction's internal capacity to detect dangerous fiscal trends. The entity must have an accounting system and financial procedures that provide timely but adequate data for financial decisionmaking. Just by its presence, a control board shows that the governmental entity failed minimum standards in the past.

Under the Ohio law, covered municipalities must develop "an effective financial accounting and reporting system" to help it carry out and comply with the financial plan. This ensures that the entity will install minimal standards. To end state supervision, a municipality must have met the objectives of its financial plan, corrected and eliminated all fiscal emergency conditions, avoided any additional failures, and showed a reasonable expectation of finishing the conversion to an adequate financial accounting system within two years. Thus, before a municipality can emerge from under a state control board, it has to prove certain basic financial management abilities.

Special Financing

Since a financial emergency renders most governmental entities unable to enter the financial markets for funds, they often need special financing opportunities. In New York City, the Municipal Assistance Corporation (MAC) provided the city with long-term access to the financial markets well before the city could again issue debt. As an intermediary between the state and the city, MAC issued debt obligations. The collateral for these MAC bonds was a repayment stream of revenues due the city from the state, funneled instead through MAC. An intercept mechanism similar to this is a frequent design. For Troy, New York, the fiscal oversight law allowed the city to issue bonds to make up several years of budget deficits.

Unlike New York City, the Ohio municipal financial emergency law does not provide for new long-term financing options. Instead, the law allows short-term borrowing from the state treasurer, which, in turn, receives security for payment from anticipated property taxes or other revenue sources. The law also created an intermediate-term method of borrowing (up to eight years) to settle past due accounts, restore misspent restricted funds, and eliminate deficit balances. Short-term borrowing helped Cleveland, Ohio, deal with its liquidity problems.

Other states, such as Pennsylvania and New Jersey, provide special grants and loans to distressed local governments. These programs, combined with technical assistance, seek to remedy the fiscal problem.

Policy Choices

When a state establishes active supervision over a local government that has failed that state's fiscal adequacy standards, the state codifies both incentives and disincentives for local fiscal management. This section reviews five policy concerns.

A fiscal emergency law should give municipalities a strong economic incentive to avoid falling under its provisions. A state must strive to keep from making a bad situation even worse. Still, those municipalities that fail minimum fiscal standards should not be able to gain advantages over other municipalities that have struggled successfully for years to maintain their fiscal affairs in order. Uncondi-

tional grants of money do little to punish or change local behavior.

Municipalities should have an economic incentive to end quickly their coverage under the law. Prolongation of a fiscal emergency should not be in the state's interests. In Ohio, the state pays the bill for the control board. Thus municipalities have little fiscal incentive to end the control period.

Laws should allow the state to use a flexible response for municipal fiscal distress. Requiring the state to create costly control boards, with hired or contracted staff, may be overkill. Sometimes the municipality may need little more than strong state pressure to correct a problem, interim aid in drafting effective fiscal plans, or assistance in installing fiscal controls.

The law should allow a flexible definition for judging fiscal inadequacy. The tests for detecting a fiscal emergency incorporate some arbitrary hurdles. An Ohio municipality that does not pay its entire payroll on time is in trouble. If a municipality pays the payroll from the cash-rich enterprise fund and not from the cash-short general fund, it fails a fiscal test. In four additional tests the Ohio law specifies that 30 days (one-twelfth of a year) have to elapse before certain fiscal practices are considered to yield fiscal emergency. The rationale for a one-month window is unclear.

Fiscal emergency laws should encourage the state, and other municipalities, to learn from those municipalities that fail the fiscal tests. The state should have an interest in distributing the results of its remedial actions to discourage other municipalities from neglecting the norms of fiscal adequacy. States may find it cheaper to promote effective fiscal procedures than to "clean up" after a bankruptcy, default, or fiscal emergency.

W. Bartley Hildreth

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FINANCIAL INDICATORS. Any financial measures that are used to evaluate the financial performance of government activities.

Origin and Subsequent History

When a governmental unit is established, it is generally the initial intent that the revenues be sufficient to cover the expenditures. Consequently, the key financial measure is a balanced budget. In other words, one dollar in estimated revenue equals one dollar in appropriations. However, the wants of any political body may exceed the desire of its constituents to pay. Through debates and public hearings, the elected or appointed officials reach consensus regarding the level of expenditures relative to the revenue to be generated.

Over time, as the governmental unit becomes larger and more sophisticated, debt is incurred to construct buildings, highways, and so on. Consequently, it becomes more difficult to determine the financial performance of the governmental unit. The level of debt incurred, and the subsequent repayment of principal and interest, are critical factors in determining the funds available to meet current operational needs.

To evaluate the extent to which units in the public sector can incur debt, bond rating agencies have been established. These agencies generally include four broad areas of concern covering established sectors of credit: economic, debt, administrative, and fiscal. Economic factors are used to ascertain the strength of the tax structure and the overall debt burden for repayment of debt. The stability of the administrative unit is evaluated along with an examination of fiscal performance versus the budget (Standard and Poor's 1989).

Underlying Theoretical Framework

The basic framework within which a governmental unit attempts to operate is referred to as intergenerational equity. Each generation is expected to pay for the services that it receives and the cost of these services should *not* be passed on to future generations.

The means by which financial measures are used to determine whether each generation is paying for services received is dependent upon the type of accounting method. The accounting methods are referred to as cash, modified accrual, or full accrual. The cash basis of accounting only recognizes the cash received and cash disbursed. Since this method is subject to manipulation and does not attempt to implement the concept of intergenerational equity, it is strongly discouraged.

The modified accrual basis of accounting is an attempt to move toward charging the costs of services to the

DEFAULTS, MUNICIPAL. Failure to repay debt. Borrowing money carries an obligation to repay the funds, often with interest during the interim. A default occurs when any debt repayment condition fails to be honored. Individuals and organizations usually find it best to avoid defaulting on a debt obligation. There is a point where the benefits of default outweigh the costs, and bankruptcy laws deal with this situation. In the United States, federal law lets individuals, corporations, and municipalities seek court protection from creditors, under certain conditions. Given that default is always a possibility, investors must exercise caution in entering into loans. Furthermore, investors must maintain vigillance throughout the duration of the loan. At their peril, investors can rely too much upon credit ratings to provide a summary assessment as to the probability of nonpayment of a debt. Borrowers with sterling reputations and credit ratings have defaulted.

Generally, default is the failure to repay the principal amount borrowed and/or the scheduled interest payments, by the stated due date. A delay of only a day is a default under most loan agreements, although the delay may impose a negligible economic impact on bondholders. A different burden arises when nonpayment of principal or interest extends over weeks, months, or years.

Failure to follow agreed-upon procedures, not just economic nonpayment, also is a default. In return for capital, borrowers agree to detailed legal obligations, duties, and responsibilities. Default, then, means an omission or failure to keep a promise or meet an obligation. Structural provisions of municipal bonds provide illustrative examples. General obligation bonds, backed by the full faith and credit of the issuing political jurisdiction, typically do not require additional legal covenants. Revenue bonds, however, do need legal specifications since the pledge is so precise. An indenture is the document that contains specific covenants binding the debtor to particular practices and policies. Typical covenants include pledges to: transfer and retain a specified stock of funds in certain restricted accounts; maintain levels of property and casualty insurance; revise rates to levels sufficient to cover yearly operation and maintenance expenses and over a year of debt service; restrict additional debt that dilutes security interests; and many other features designed to protect the assets covering the bondholders' claims. A violation of any single covenant is an event of default allowing "the bondholders or their representative (indenture trustee) to take appropriate action, including the institution of the remedies set forth in the indenture" (Spiotto 1993, sec.13.42).

Indenture agreements provide trustees with several remedies to apply as needed. Trustees can gain legal control over the project to protect bondholders' interests. The ultimate remedy, however, is to accelerate as due and payable all outstanding bonds. Yet, investors prefer to use the threat of remedies, instead of their actual imposition. Few investors, if any, want to assume operational responsibility for a project. They prefer to have their principal and interest paid as agreed. Indentures help anticipate repayment problems by forcing problems to the forefront before the bondholders incur economic loss.

A technical default is an inexact term referring to a noneconomic default. These defaults represent a violation of procedural covenants, not a loss of timely principal and interest payments. There is a linkage, however. A technical default "ripens into an Event of Default after notice has been given to the issuer for the commencement of the grace period and, after a lapse of time, the default remains uncured" (Spiotto 1993, sec. 13.42).

Spiotto (1993) isolates three default phases. The first phase involves gathering information on the reasons for the default. Also, it helps to take steps to correct any defected security for the debt. For example, in 1983 the Washington Public Power Supply System (WPPSS) defaulted on $2.25 billion of municipal bonds used to finance two nuclear power plants. The precipitating factor in the largest municipal default in history was state court action. The court invalidated power sales agreements requiring several public utilities to take electricity from WPPSS nuclear plants, at WPPSS prices, or pay even without taking power (termed "take or pay" contracts). These agreements offered the security upon which WPPSS borrowed money to build the electric generation power facilities. As a direct result of the court's action, the WPPSS financial plan collapsed, leading to a default on the associated bonds. As the WPPSS case shows, actions that impair the security of bonds increase the probability of default. In contrast, action taken to correct the defective security improves the odds of avoiding a default. However, correcting defective features at this late stage of a project's financial history may not be easy.

The second phase involves attempts to work out of the default. The goal is for bondholders and the debt issuer to resolve their differences. A workout occurs "when the parties agree that their financial interests are best served by restructuring the borrower's debt and reorganizing its operation" (General Accounting Office 1984, p. 39). An example is the mayor who kept all the parties to a troubled waste-to-energy enterprise talking, instead of litigating, while restructuring the project's finances (Hildreth 1994).

The third stage occurs when there is a workout failure. In this last phase, bondholders' assert their rights to obtain payment. This includes calling the bonds due and payable immediately (acceleration of payments using the full force of litigation to uphold their interests). Litigation often follows, with suboptimal resolution for all parties. In the WPPSS example, years of litigation and settlements yielded bondholders less than the desired returns.

Municipal securities default, but at a lower dollar amount than corporate bonds, despite the much larger size of the municipal market. Defaults in the municipal securi-

ties market, however, raise questions well beyond the local community. A municipal bond default tests the interests of bondholders and the state and federal governments. Bondholders are many and often scattered (in an economically random process) around the country. This makes bondholders the constituents of many public officials, who try to respond to public pressure. In addition, a municipal bond issuer is either a state government or a state-created political entity (for example, a municipality, county, or statutory agency), thus justifying state monitoring and fiscal control (see **financial emergency**).

The legal status of the municipal market rests with the federal government. Congress has the power to eliminate the tax-exempt securities market (*South Carolina v. Baker*, 1988). As the search intensifies for more U.S. income tax receipts to aid in the federal deficit reduction effort, the tax expenditures associated with the tax-exempt market are enticing targets (Carter and Hildreth 1992). Therefore, financial emergencies and defaults give Congress and the president ammunition for imposing tighter federal supervision over municipal securities.

Disclosure is central to federal securities law and the functioning of efficient capital markets. Yet, federal securities regulation is weaker for the municipal market than for corporate bonds. In a theme reminiscent of its earlier report on New York City's debt problems, the U.S. Securities and Exchange Commission's report on circumstances surrounding the WPPSS default noted systematic disclosure problems in the municipal securities industry and deficient disclosures to WPPSS investors (U.S. Securities and Exchange Commission 1977 and 1988). The WPPSS report questioned whether the bond disclosure documents adequately revealed significant facts regarding the projects. Without adequate disclosure, investors are unable to make an intelligent decision regarding the probability of repayment. Thus, defaults have encouraged federal securities regulators to assert tighter regulation over the municipal securities market (U.S. Securities and Exchange Commission 1993).

Municipal debt defaults are the culmination of legal, economic, political, managerial, and financial problems (see generally Hillhouse 1936; Hemple 1971; Advisory Commission on Intergovernmental Relations 1973 and 1985). Although the court's invalidation of the power sales agreements was the legal event that precipitated the WPPSS default, the original energy demand estimates were unrealistic, the political pressures to keep low power rates were high and growing, project schedules were too hard to maintain, and the escalating project costs occurred in a high interest rate environment (see Jones 1984; Myhra 1984). In Cleveland, the city defaulted on the repayment of short-term notes (not bonds). While the Cleveland default occurred during a highly charged political debate between the mayor and the local banks holding the notes, the city faced significant underlying managerial and financial problems (see Swanstron 1985). Municipal defaults, therefore, reflect underlying problems that, left unresolved, can impose a burdern on investors.

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DEFERENCE PRINCIPLE. A court doctrine used by judges to yield or defer to the judgment of agency administrators (experts). The deference principle is a basic doctrine in administrative law. It is rooted in the separation of powers doctrine and in plain common sense. In

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