

# **Public financial risk management – a comparative perspective of U.S. and Austrian local governments**

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## **Introduction**

For several years, governments all over the world have been experiencing the effects of a global financial and economic crisis that has found its preliminary peak in the sovereign debt crisis beginning in 2010 (Kickert et al. 2013). Severe cutbacks in spending as well as public services have followed and the recovery phase still persists in wide areas. Although posing a serious shock, these developments provide also windows of opportunity for structural changes in governmental entities and often have led to public management reforms. Similar chances have been taken by governments in the crisis years of the 1980ies, where New Public Management and a more managerial approach in public sector activities had entered the governmental stage and were here to stay for decades in public management practice as well as research (Hood 1991, Bovaird and Loeffler 2003).

Not only have the actions of public leaders been impacted by the global financial crisis, the phenomenon has also caught academic interest and has dominated discourses, contributions and publications in the economic, public policy, public administration, and financial management field for years. Scholars have investigated various aspects, the crisis' causes and its development over time, its impact on distinct sectors or the economy as a whole, social cohesion and governmental responses (e.g. Chor and Manova 2012, Shiller 2012, Kickert et al. 2013). Different instruments have been used in pursuit of adequate responses to the two-edged sword of coping with austerity while initiating economic recovery (Pandey 2010), ranging from regulations to economic and currency policy approaches to more management-oriented

solutions like the implementation of early warning systems, risk management strategies and risk mitigation instruments like debt brakes (e.g. Rose and Spiegel 2009, Hein and Truger 2014, Mayer and Stähler 2013).

However, two relatively blind spots appear in academic research. First, most contributions focus on the national, e.g. the central government level. Although subnational levels – states, regional and local levels, have been affected similarly by the financial crisis and the following economic recession and stagnation (see e.g. local government debt figures from 2008-2011, OECD 2013), they have received far less attention. Arguably, the impact has been experienced with delay (Kickert et al. 2013) and to a certain extent has been ‘cushioned’ by upper governmental levels. However, austerity-induced service cuts are especially visible at the ‘nearest-to-citizen-level’ of local government (Torres et al. 2006) which carries out main public service tasks. This makes it a crucial research object for investigations on public financial (risk) management.

Second, since it has been concluded that the financial crisis was partly caused from a naïve belief that risk had been virtually eliminated (FCIC 2011), issues of risk management have played a significant role in economic and financial and banking contributions, but to a lesser extent in the public administration area. Relatively little is still known about governmental risk management in general, and only a few studies have explored the concept of risk and risk management at subnational levels (e.g. Woods 2009, Collier and Woods 2011, Vinnari and Skaerbaek 2014, Assenova et al. 2015).

This article is a contribution to addressing this imbalance. It adds to the knowledge in the field of risk management as well as to the (comparative) research on management in local government in turbulent times. Drawing on evidence from five U.S. and five Austrian local government case studies, we explore the definition of risk and applied risk strategies, the

approach to and responsibilities in risk management, and its relationship with financial management in local government from a comparative perspective. The study is set in the context of the aftermath of the global financial crisis, where governmental entities all over the world had to cope with serious financial problems resulting from rising debt levels and drops in their revenues (see Pollitt 2010, Peters 2011, Peters et al. 2011, Kickert 2012, Lodge and Hood 2012). This provides a rare opportunity to investigate these entities' awareness and reaction in highly turbulent times of high uncertainty, risks and vulnerability.

Our aim is to understand the conceptualization of risk and approaches to risk management of local governments that have recently experienced fiscal stress during the aftermath of the global financial crisis. Taking a comparative approach, we explore these aspects in the two country contexts of the U.S. and Austria. Since it has been argued that there is a relationship between early warning and organizational performance during turbulent times (Boyne and Meier 2009), we are furthermore interested in a possible relationship between the conceptualization of risk and approaches to risk management and strategies in coping with fiscal stress.

The article is organized as follows. It begins with a consideration of the concept of risk management in general and its emergence in the public sector. Subsequently, we provide a literature review on the global financial crisis and fiscal stress in local government. The data and methods section provides the case selection process. Next, the ten cases are described and analyzed to draw a picture of risk and risk management in local governments. We put forward propositions about the relationship between different approaches toward risk and risk management in local governments and their strategies in coping with the global financial crisis and the resulting fiscal stress.

## **Risk and Risk Management**

Risk management has been a long-standing issue in the fields of health and safety and in different industries such as the insurance, chemical, and space industry and has been also investigated in management and organization perspective for several decades (e.g. Gallagher 1956, Renn 1998, Subramaniam et al. 2011). Apart from fields with a 'narrow' focus such as finance where risk has been clearly defined and operationalized for measurement (Frenkel et al. 2005, Bhimani 2009, Soin and Collier 2013) however, this extensive research on risk in organizations has not produced a widely accepted definition of the term itself, and several perspectives on risk can be identified (Aven 2012). In broad terms, risk is referred to as the possibility of danger, loss, injury or other adverse consequences. Some authors, especially in the business management area, have pointed to the dual character of risks, which can produce either losses or gains, in other words, can pose either threats or opportunities to an organization (see Borghesi and Gaudenzi 2013). The negative connotation as adverse events or the realization potential of negative consequences however prevails (Rowe 1977, Hopkin 2012). In practice as well as literature, risk and uncertainty are sometimes used interchangeably, or both used to refer to the same phenomenon, e.g. 'risk as the effect of uncertainty on achieving objectives' (ISO 2009). However, the terms are inherently different and for the purpose of risk management have to be treated separately. Following the classic work by Knight (1921), risk is concerned with events where probabilities can be assigned, whereas uncertainty defines situations in which probabilities are unknown (Chenhall 2003, Subramaniam et al. 2011). The different perspectives on risk, i.e. if risk is regarded as expected value loss, probability of an (un)desirable event, (objective) uncertainty, or the result of probability and consequences, strongly influences the way risk is analyzed and how it is managed (Aven 2012).

With several crises and scandals in recent economic history, it has been argued that the public perception of risk has led to a shift from the focus on technological, environmental, health and

safety risks to ‘operational risks’, ‘strategic risk’ and ‘reputational risk’ (Beasley et al. 2005, Power 2008), and that it has accelerated the development of enterprise risk management, integrating strategic, financial, hazard and operational risk, in organizational settings (Power 2008, Hutter and Jones 2007, Soin and Collier 2013). The increased number of contributions in literature is an evidence for the growing interest in the concept (see also Power 2009).

Risk management is seen as the set of principles, frameworks and actions taken by individuals or organizations in an effort to manage events which could harm the organizational value or prevent the achievement of organizational objectives (Cummins et al. 1998, ISO 2009, Hoyt and Liebenberg 2011, Arena et al. 2011). Actions in addressing these events include risk identification, risk measurement/assessment, risk strategy, and monitoring and reporting (Hopkin 2012, Borghesi and Gaudenzi 2013, Drennan et al. 2015). These ‘generic’ risk management phases have inspired a number of contributions where such systems are seen as neutral and fulfilling a particular organizational function (ISO 2009, Vinnari and Skaerbaek 2014). This rather normative view on risk management suggests that there are universal solutions which can be implemented in the organization and, with adjustment to organizational and institutional factors, provide optimal management of risks. In the post-global financial crisis phase however, as the risk management systems in place seemingly have failed, practitioners and academia have increasingly criticized this approach (e.g. Miller et al. 2008, Shimpi et al. 2008, Taleb et al. 2009, Beasley et al. 2010). Particularly in the public management field a risk management system is perceived as an umbrella term for diverse risk management techniques and arrangements which are adjusted to organizational needs, thus being dependent on different factors (Power 2008, Mikes and Kaplan 2013, Woods 2009).

Although similarities of the concept of risk management in private and public organizations can be observed, differences in the method and context (Schiller and Prpich 2013) are acknowledged especially when it comes to organizational value or organizational objectives,

the different stakeholders and accountability requirements, and the nature of risks. It has been argued that many public sector organizations are not affected by the risk of bankruptcy or liquidation (e.g. Drennan et al. 2015) – several examples in the last years (e.g. Detroit, the sovereign debt crisis in Greece) however have proven the risk of bankruptcy as real in the public sector. A general distinction between the public and private sector in risk management is pointed out in the risk strategy. The public sector is described as engaging in less risk-taking activity as the public tolerance to risk is decreasing (Drennan et al. 2015). This argument is supported by a recent study by Eckerd (2014), where citizens tend to view risk as best avoided.

The scarce empirical studies on risk management approaches in public sector entities placed their analyses in large public sector organizations (e.g. Palermo 2014), or in large local governments with employee numbers comparable to large stock-listed companies (500 to 55,000) and population figures ranging between 80,000 and 1,000,000 (Woods 2009, Collier and Woods 2011, Vinnari and Skaerbaek 2014, Assenova et al. 2015<sup>1</sup>). The studies show contrasting views on risk management, varying from an absence of risk mitigation strategies (Assenova et a. 2015) to the existence of basic risk management structures across organizations and across countries with distinct facets resulting from policy, institutional environment, information and communication technology, organizational size and resource dependencies (Woods 2009, Collier and Woods 2011). Furthermore, while its goal was to reduce (external) uncertainties, the implementation of risk management itself has been found to lead to uncertainties regarding legal aspects and available resources with operational managers (Vinnari and Skaerbaek 2014), and business experience and relational skills still have been described as the major tools of ‘risk champions’ (Palermo 2014).

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<sup>1</sup> Assenova et al. 2015 investigate risk mitigation in five Scottish councils, which are not indicated, however the average population of Scottish councils is 193,164, just three of which are under 50,000.

Although the comparative study in England and Australia by Collier and Woods (2011) claims to have explored the adoption of risk management in large as well as small local governments, the two entities labelled ‘small’ show population figures of 180,000 (England) and 90,000, (Australia) respectively, and thus provide no possibilities for comparison in country contexts characterized by small local governments. Small local governments, already under-represented in many areas of public management research (see Ho 2003, Rivenbark and Kelly 2006, Previtali and Bof 2009), have not been included in empirical investigations of risk management yet. Our study therefore aims to provide insights into the definition of risk by crucial actors in local government administration, risk strategies (e.g. mitigation, acceptance), responsibility for risk management and its relationship with financial management in small local governments.

#### *Factors influencing risk management in organizations*

In their critical view on the discipline of risk management, Mikes and Kaplan (2013) identify three literature research streams with two underlying research interests: (1) studies aiming at explaining the adoption of risk management, or configurations of context variables and the scope of risk management implementation and its impact on organizational performance; and (2) studies exploring the risk management implementation processes and practices which advance them, aimed at understanding risk management and its various forms in the organizations themselves. The latter develop grounded theories (e.g. Schermann et al. 2012), while different theoretical approaches are applied to explore the factors leading to risk management adoption, the concept itself, and its effectiveness - ranging from institutional theory (Palermo 2014), contingency theory (Woods 2009, Collier and Woods 2013), actor-network theory (Vinnari and Skaerbaek 2014), or combinations of organizational, political and

social theories in search for a more informed management control theory (e.g. Mikes 2009, Huber and Scheytt 2013).

A variety of external and internal factors have been investigated in contingency-informed empirical studies on risk management. Organizational size for instance has been shown to influence risk management (Beasley et al. 2005, Paape and Spekle 2012) while organizational growth offered mixed results (Gordon et al. 2009, Paape and Spekle 2012). Organizational culture and overall resistance to change are highly related to the approach and the concept, particularly if risk management is seen as the formalization of what is already done (Kleffner et al. 2003). The presence of a risk manager as a distinct position supported the adoption (Kleffner et al. 2003) as well as the design of risk management (Beasley et al. 2005, Paape and Spekle 2012), and support by the chief executive officer and chief financial officer (Beasley et al. 2005) as well as the board (Beasley et al. 2005, Kleffner et al. 2003) with its oversight function have been shown to play a significant role. Analyses of the role of auditors in risk management adoption offered mixed results (Beasley et al. 2005, Paape and Spekle 2012), however the focus in the respective studies was the ‘quality’ of the auditor, referring to as renowned audit firms. Numerous authors have investigated the factor of organizational performance and its influence on risk taking and vice versa (e.g. Singh 1986, Mone et al. 1998, Latham and Braun 2009), and as some scholars have argued that organizations in decline reduce risk-taking (Cameron 1983, Abrahamson 1991) others conclude that low performance drives risk-taking, and this, in turn, has a negative influence on future performance (Singh 1986, Wiseman and Bromiley 1996, Bromiley 2001). These studies however do not address the question if the negative influence of risk-taking persists also if the organizations implement adequate risk management. In a wide sense, there are some indications that the implementation of risk management is associated with higher performance (see Gordon et al. 2009, Hoyt and Liebenberg 2011).

One study found national differences in the level of adoption and implementation of risk management (Beasley et al. 2005), which the authors however treated as a proxy for the regulatory environment. Later studies identified the regulatory environment created by the set of obligatory rules as well as non-binding standards in risk management approaches as an important contextual variable in business as well as public sector organizations (Chenhall 2003, Collier et al. 2006, Woods 2009, Paape and Spekle 2012). In her study with UK local governments, Woods (2009) showed that existing standards and guidelines by national audit and professional public finance and local authority institutions play a significant role in local government risk management, although these institutions considered their role as providing guidance rather than specific requirements.

### **The financial crisis and local government fiscal stress**

The global financial crisis experienced between 2007 and 2009, and its different manifestations as the credit, banking, economic, sovereign debt and Euro-crisis are described as the worst since the Great Depression in the 1930ies (Ciro 2012, Arestis and Karakitsos 2013). Although the world has experienced different other shocks of wide economic impact such as the oil crisis in the 1970ies, the equity market crash of 1987, and the internet bubble in the late 1990ies and early 2000s, the latest crisis is unique in the speed at which particularly the Western world experienced ‘a catastrophic series of interrelated events’ (Ciro 2012). Industrial production and GDP rates in numerous countries dropped in the years 2008 and 2009 to an extent that had crowded out prior GDP growth. The International Monetary Fund described this development as the ‘Great Recession’, which in the U.S. has become the commonly used term to refer to the financial crisis and its aftermath.

Several triggers and causes of the financial crisis are discussed in literature, ranging from the U.S. and international housing bubble, the global credit freeze, systemic market failure, sovereign debt, opaque financial markets and the deregulation of financial markets (Ciro 2012, Chaston 2013). Considering the latter, the role of risk management and risk oversight, or rather deficiencies thereof have been acknowledged to play a significant role in the causes of the financial crisis (Beasley et al. 2010, Mikes and Kaplan 2013). Furthermore, it has been argued that a prolonged period of low interest rates fuelled excessive consumer borrowing and led to adverse developments in the sub-prime mortgage lending, thereby creating a housing bubble in the U.S. The U.S. are therefore described as the epicentre of the crisis, which, through different catalysts, e.g. the aggressive build-up of debt in many developed economies, spread to financial markets globally (Ciro 2012). Policy responses by central banks, such as the reduction of key interest rates by the Federal Reserve and the European Central Bank during 2008–2009 helped alleviate further contagion. The extensive economic impact of the crisis however caused the U.S. and European central governments to cut public spending in order to reduce their deficits (Chaston 2013). This had a significant impact on the financial condition of sub-national governmental entities. Local governments which often depend on transfer payments from upper levels of government to a substantial extent, experienced severe fiscal stress as a result of the financial crisis.

From a short-term perspective, fiscal stress can be defined as the ability to make payments in a timely manner. In the long-term, fiscal stress is expressed as a gap between a local government's tax base or revenues relative to its expenditures and commitments (Kloha et al. 2005, CBO 2010). Fiscal stress is identified when (1) revenues decrease while at the same time a compensating decrease in the demand for services and thereby the expenditures do not decrease to a comparable extent, (2) demand for services increases but available resources do not increase or are constrained or capped, (3) when a higher level of government imposes an

increase in local governments services without providing the necessary funding to compensate for the increased service responsibility (Chapman 2003). It is argued that local government fiscal stress is caused either by a weak or transitional economy, years of unsustainable and negligent budget management, or by a single shock (CBO 2010, Gross 2011). Several U.S. cities in fiscal stress serve as examples of the negligent budget management argument. Especially in cases with a substantial population and a relatively higher average income of their citizens, serious financial decline and crises were not rooted in socio-economic deficits, but rather caused by a combination of political fragmentation, lack of fiscal discipline and controls, incompetence, illegal activities and bad financial decisions (Hendrick 2011, p. 2). The same might be true also for some Austrian cities reported in the media, where derivative financial instruments and foreign currency loans led to fiscal stress and initiated a discussion about risk management and control systems in local government. While certain scandals and economic causes for fiscal stress can be identified in both countries, the financial crisis posed a substantial shock to the financial health of local governments in both countries investigated in the study. In the following, we describe the organization and financing of local governments in both countries to give an overview of the level of autonomy and constraints that affect the local governments' ability to generate revenues (Chapman 2003).

### *Local governments in Austria*

Austrian local governments receive their funds to a major part out of constitutional federal government revenue shares (Finanzverfassungsgesetz 1948 BGBl. 18/1993), which account for 40 per cent of total local government revenues. Another important source are own revenues, which on average make up another 45 per cent, about half of which are service fees in business activities like e.g. water and sewer or waste, and other municipal fees. The other half are local

government taxes, where the municipal tax and the property tax are the most relevant. The property tax is basically a land value tax, where the tax base differs from actual market value. The municipal tax is a payroll tax paid by businesses based on the number of employees and the wages.

The revenue shares system is not only a vertical redistribution, but horizontally provides for equalization within local governments, mainly through a leverage based on population figures. Local governments with more inhabitants thereby receive a higher weighted share of revenues. However, small local governments with population figures up to 1,000 (a quarter of Austrian local governments) receive additional revenue equalization to account for lower economies of scale in administration, and fiscally weak municipalities are supported based on a percentage of their financial demand. A glance at the different types of municipalities shows several other types of fiscal ‘discrimination’: for larger cities (population figures of 50,000 plus) due to a higher percentage of employment in the public sector and subsequent lower municipal tax revenues, smaller cities with a broader spectrum of administrative functions (e.g. state capitals), and residential municipalities, as municipal taxes are raised in the municipality where business headquarters are located (Bröthaler et al. 2002).

Austrian local governments are organized as the ‘strong mayor’ form (see Mouritzen and Svava 2002). The government consists of an elected local council and a mayor. Although both share policy-making, the mayor has almost complete administrative authority, ranging from representation of the local government and management of the administrative office, to preparation and execution of the budget. As the legislative body, the city council has to approve the budget and policy decisions. Officers of the administration, such as department heads and the chief executive officer are appointed by the mayor. The chief executive officer has a strong advisory function to the mayor in legal, financial and organizational terms (Saliterer and Korac 2013) and thus impacts strategic decisions in the local government.

Austria's local level consists of 2,354 cities and smaller municipalities. Unlike in the U.S., there are no special purpose units such as school districts as autonomous local governments. Local governments can create associations to carry out their services, e.g. elderly care, to share operational costs, these units however are assigned to the municipalities and mainly have no separate governance structures. Local governments have two main areas of responsibility: the management of their autonomous policy and the execution of tasks imposed upon them by upper levels of government. Among core administrative services, local governments provide a wide range of 'tangible' services: water and sewage, waste collection, kindergarten, elderly care, energy supply, local roads and works, recreation facilities, and libraries (Saliterer and Korac 2013). Police departments are under federal responsibility, some municipalities however historically have installed an own city police which still is in operation. Fire departments in most capitals are professional and thereby provided by the cities themselves, or voluntary and thus provided by non-profit organizations.

Political oversight of local governments is carried out by the local councils while the nine Austrian state governments ('*Länder*') have the administrative oversight authority, carried out through special departments. For cities with population figures above 10,000, the national audit office carries out financial audits of the budget and financial statements. As only 0.03 per cent of local governments fall into this classification, the national audit office has criticized that reliable information about the financial condition of Austrian local governments is non-existent, the adequacy of transfer payments cannot be analyzed, and missing benchmark possibilities hinder an effective oversight by local councils (Rechnungshof 2012).

Developments in the financial condition of cities in the U.S. and several bankruptcy cases reported in the media led to an increased discussion of bankruptcy possibilities for Austrian local governments. The legislation is unclear in this context: on the one hand, it has been argued that local governments cannot file for bankruptcy, as this would lead to their liquidation and

their existence was ensured by the Austrian constitution. On the other hand, the constitution theoretically allows local government bankruptcy, but with several restrictions. A local government can file for bankruptcy only if their assets are regarded as sufficient to meet certain obligations, which would provide a basis for their further existence. The state can dismiss the local council and appoint so-called ‘commissioners’ to take up the function of governing the municipality (Held 2009). In recent history, one small Austrian local government filed for bankruptcy in 2008 after a scandal of assumingly illegal activities of the mayor, and there have been several cases of bankruptcy due to unsustainable budget management, with higher occurrence in one Austrian state.

#### *Local governments in the U.S.*

The main financial sources for U.S. local governments are own revenues from property tax, sales tax, personal income tax, user fees and charges. The volume of intergovernmental transfers however makes them further important sources of revenue for local governments (Ebel et al. 2012). About 4 per cent of total local revenues are from federal government, and 34 per cent from state government payments (Fisher 2010). The level of revenues and expenditures and their structure however differs significantly between the sub-national government units. In Michigan, at least 41.6 per cent of spending in every annual budget must be allocated for local governments (Gross 2011). The sales tax revenues are distributed to local governments based on a percentage and weight factor according to the population and unit type (city, village, township). On the own revenue side, more than 93 per cent of Michigan’s local governments’ tax revenues is derived from property taxes, which is about 20 per cent higher than the U.S. average (Tax Policy Center 2013).

U.S. local governments are able to issue own debt obligations as municipal bonds. However, except in three states, the amount of debt issued is limited by the state government via constitution or statutory provisions (Spiotto 2008). The basis for municipal bonds is either their 'full faith and credit', which means that the local government guarantees for the debt with its general funds (general obligation bonds) where the bond holders have the right to establish a tax levy, or the revenue to be collected through investments or the improvement, e.g. a toll road, airport etc. (revenue bonds) (Spiotto 2013). As the confidence of the municipal bond market is seen as essential for their financing, local governments depend heavily on rating agencies. In Europe, there is no equivalent for the U.S. municipal bond market (Arezki et al. 2011), although also European and Austrian local governments are affected by agencies' ratings when they opt for ratings in order to achieve favourable credit terms with their banks.

The U.S. sub-national level consists of 50 states and nearly 90,000 local governments with a variety of political and fiscal arrangements. The local level is divided between general purpose governments, school districts, and special purpose governments. The latter provide urban services such as water, sanitation, and fire protection, are less politically visible and not directly accountable to voters, whereas school districts are mainly independent bodies governed by an elected board. General purpose governments are counties that are subdivisions of the state, and municipalities (cities, towns, villages, townships) that are self-governed (Ebel and Petersen 2012). Municipalities cover a spectrum of services of public interest, such as leaf and snow removal, streets and roads, economic development, parks and recreation, and libraries; water, sewer, electric, waste and recycling if not provided through special purpose units; and police (municipal police departments with police chiefs reporting to the city manager in the council-manager form of government) and fire services (through own fire departments, contractual agreements, or a volunteer fire department where fire fighters receive no pay), and emergency medical services (often in conjunction with a fire or police department).

Municipalities can take different forms of government: the *weak mayor-council* form, where an elected mayor is the head of government but their power is limited by the council, a *strong mayor-council* form, where the elected mayor has a strong executive function, the *council-manager form*, where the council sets policy, a city manager who is in charge of organizational direction and execution of policy, and usually a directly elected mayor as a facilitative leader with no independent power, and the less common systems of the *commission* and *town meeting* (Mouritzen and Svara 2002, Ebel and Petersen 2012). The state of Michigan consists of 83 counties, 1,240 townships, 275 cities, 258 villages, about 600 school districts, and 300 special districts (Michigan Manual 2010). The dominating form of government in its cities is the council-manager form.

The U.S. constitution grants certain independence and power to the states and local government. Local governments are created by the states, which is why the state is the supervisory and oversight authority for its local governments. However, the state takes a hands-off-position in the structure and processes of local government as long as certain fundamental tasks are carried out, e.g. collection of property taxes, elections (CRC 2000). This ‘home rule’ ensures that local governments frame, adopt and amend their own charters and allows a higher structural, functional, personnel and financial autonomy (see e.g. Fairlie 1910, Ebel and Petersen 2012). In order to prevent or alleviate fiscal emergencies and to ensure the ongoing operation of its local governments, the state of Michigan, which has a strong home rule tradition, has introduced several policies (see CRC 2000) that have led to limitations of the local financial autonomy.

In times of serious fiscal stress, state governments as the oversight authorities can allow local governments to adjust taxes, or can opt to directly overseeing a municipality, sometimes by implementing a financial control board or so-called ‘emergency financial managers’ (CBO 2010, Michigan Department of Treasury 2012, Kasdan 2014). In Michigan, the emergency financial manager has broad powers to operate and restructure the municipality by rejecting,

modifying, or renegotiating obligations (Spiotto 2013). The federal government, which has no supervisory relationship to local governments as it would intrude the states sovereignty (United States Courts, CBO 2010), can encourage local government actions to tackle the fiscal stress, and more rarely it can assist the local government with funds (CBO 2010). The state however will ensure that its local governments retain the financial independence without the necessary interference of the federal government (Spiotto 2008, 2013). More interesting however is the existence of a distinct law that enables local governments to default on their debt and file for bankruptcy - the 'Chapter 9' (United States Courts, Lewis 1994, CBO 2010). The primary purpose of the bankruptcy code is to allow the municipality to continue operating while it adjusts or refinances creditor claims, since it is acknowledged that a municipality cannot continue to function when liquidating its assets to satisfy creditors (Spiotto 2013).

#### *Fiscal stress in U.S. and Austrian local governments*

During a recession in the early 1990ies, U.S. local governments had to adjust to a diminished growth in property values resulting from slowly stagnating real estate values. This phase has proven short, as from 1993 the economy recovered and local governments entered a phase of economic growth. In 2001 however, a stock-market downturn struck the national economy and led to reduced revenues for the local level. The U.S. National League of Cities described the period between 2001 and 2004 as years of municipal fiscal recession and stress (Pagano and Hoene 2006a, Ebel et al. 2012). In 2006, while city managers' financial outlook was mainly positive, the financial condition of cities had been described as stabilized, but not fully recovered from the post-2001 recession period (Pagano and Hoene 2006b).

The financial crisis affected U.S. local government revenues in different ways: through the eroding property-tax base, increased unemployment and lower consumer spending, reduced

state aid, and restricted access to credit (Ebel and Petersen 2012). From an upper governmental level perspective, U.S. local governments have been regarded as experiencing less fiscal stress from the great recession than state governments. This estimation was based on the argument that local governments rely to a substantial amount on property taxes, which were seen as a relatively stable source of revenues (CBO 2010). Although an administrative lag of about three years between changes in housing values and changes in property taxes revenues is acknowledged (Lutz 2008, Chernick et al. 2011), in the aftermath of the great recession, Lutz and colleagues (Lutz et al. 2011) still argued that it was unlikely that property tax values will fall sharply. Other scholars at the same time were more critical of the local government financial situation (e.g. Scorsone and Plerhoples 2010), and the far-reaching bullwhip effect of the drop in housing values and thus the erosion of property taxes supported this more pessimistic but true view (see FCIC 2011).

In the years 2008 to 2011, U.S. cities reported negative impacts on cities' fiscal condition by the declining economic situation, downturns in housing, low consumer spending and unemployment, leading to severe fiscal stress. Major challenges for local governments were decreasing state and federal aid and long-term infrastructure needs which had occurred due to deferred investment in austerity times, on the one hand. On the other hand, employee wages and pension and health care obligations as contingent liabilities made up for the bigger part of future financial burden (NLC 2014). Chief financial officers repeatedly as well as increasingly gave a negative estimation of the ability to meet fiscal needs in the near future compared to the prior year (Pagano and Hoene 2008; Hoene and Pagano 2009, 2010, 2011). In 2012, the prolonged effects of the economic recession still challenged the cities' fiscal condition, but the outlook was more positive (Pagano et al. 2012, Ivacko et al. 2012). In 2013 and 2014, they reported a slightly improving situation. However, this has to be considered in a perspective relative to the obviously negative projections in the years before. For the first time since 2006,

general fund reserves had been increasing in 2013, but were considered stagnating in 2014 while expenditures were slightly increasing.

The developments in the years of and after the financial crisis brought two basic financial challenges for Michigan cities: first, the recession had negative effects on the state budget due to losses in sales taxes. This led to cuts and reductions in non-constitutional<sup>2</sup> revenue sharing programs between the state and the local governments in order to stabilize the state's fiscal condition and to avoid state 'bankruptcy' (Kellogg 2014). As a consequence, local governments have been confronted with a significant reduction of a revenue source that accounts for a third of their overall budget. Second, the financial crisis had severe negative impact on property value thus on the local governments' most important revenue source. In general, the taxable value (TV), which is the base for tax calculation, is dependent on the so-called 'state equalized value' (SEV). The SEV is 50 per cent of the 'true cash value' – i.e. the true market value of the property (Tax Tribunal 2014). This mechanism enables adjustments to decreasing property values but also increases in the tax base once the market recovers. Two major legal regulations in Michigan however constrain the increase in taxable value and thereby the recovery of local government revenues: the *Headlee Amendment* of 1978 and *Proposal A* of 1994 (Michigan Const. Art. IX esc. 6, 25-34, Ballard 2010). These property tax limitations have been introduced during the economic boom in the 1990ies and early 2000s, where annual property values had increased rapidly. The 'roll back' mechanism of these regulations impacts the tax collection in local governments in the way that overall property taxes do not increase by a percentage greater than the consumer price index (CPI) or 5 per cent, whichever is less. Since property values dropped drastically following the collapse of the housing bubble, this revenue source eroded. The effect

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<sup>2</sup> Constitutional revenue sharing is protected under Article IX, Section 10 of the Michigan Constitution and therefore is fixed at 15.00 per cent of gross collections of the state sales tax collected at a 4.00 per cent rate, which is redistributed to cities on a per capita basis. Non-constitutional, statutory revenue sharing is subject to annual appraisal (Gielczyk 2013).

of the cap at this stage is that it restricts the local governments' ability to recover for years to come. One possible way to accelerate the local financial recovery is to override the amendment. However, this has to be approved by the voters. Citizens thereby basically impose a higher tax burden on themselves, which is why the override is very uncommon in practice. In 2014, four out of 48 cities with a population between 10,000 and 25,000 inhabitants implemented a Headlee override.

In the years before the global financial crisis, Austrian municipalities experienced significant reductions of intergovernmental transfer payments in the course of Austria's EU-membership and the required fiscal consolidation to meet the Maastricht criteria (see e.g. Buiter et al. 1993) in mid-1990ies. These losses in payments are perceived to have affected the municipal budgets in a sustainable negative way. Furthermore, the last years were dominated by devolvement of public tasks to local governments without adequate compensation, e.g. free kindergarten, and by higher payments from local governments to states as the governmental level responsible for inpatient health care and social welfare (KDZ 2014).

While national governments in the EU experienced the impact of the financial crisis already in its early years, local governments seemed affected only to a certain extent. Initially, credit conditions were favourable for local governments, as they were more credible borrowers than other actors in the turbulent economic times. When the trust in the financial market however diminished further, risk premiums in credits led to more expensive and less available borrowing for the local level. This development has been observed carefully by the Austrian Association of Cities, pointing to possible problems arising from leasing constructs and derivatives. In 2008, the association suggested to postpone loans and use interim funding, and to apply variable interest rates, as interest rates were expected to drop in 2009. Furthermore, it was acknowledged that the good economic situation in the years before the crisis had led to relatively high revenue shares for local governments, and that these were expected to decrease in 2009 and 2010

(Städtebund 2009). The worsening economic situation as a result of the financial crisis and its effect on employment were crucial for local governments. Lay-offs and temporary employment in the business sector led to noticeable reductions of municipal taxes and higher expenditures in social services. In this phase, it was already expected that local governments would respond to the fiscal stress by postponing investments.

While the financial crisis and its impact received academic interest in the area of finance and national policy, the challenges and implications for public management on the local level remained largely unexplored. Media repeatedly indicated fiscal stress in Austrian local governments from 2008 to 2010, and the Austrian parliament recognized that the crisis still was not over in the local level by 2013. The revenue and expenditure data supported this view. In the period from 2007 to 2013, municipal revenues in Austria increased by 2.9 per cent, expenditures however exceeded by 0.4 per cent, with a substantial negative impact in the crisis peak years 2009 and 2010. While transfer payments from the central to the local level increased, payments from the municipalities to the states did too, crowding out the reallocation for local governments, inhibiting investments, and increasing the local debt level (KDZ 2014, Biwald and Rossmann 2012). The local governments were in need of a reform of local government taxes and fees, as their financial autonomy was seen as unsatisfying. In particular, the Austrian Association of Cities called for an adjustment of the transfer system according to public tasks, an increase in land value tax and land purchase tax and the possibility for local governments to collect infrastructure investment fees (Städtebund 2014).

### **The role of risk management in coping with fiscal stress**

In our investigation of risk and risk management in local governments and its relationship with strategies in coping with financial stress, we largely build on contingency theory following prior

literature suggesting that external factors are significant predictors of internal organizational design, internal structures and processes (Burns and Stalker 1961, Lawrence and Lorsch 1967, Hage and Aiken 1967, Van de Ven and Drazin 1984, Donaldson 2001). This premise has been investigated in different areas of organizational and management studies, such as management control and management accounting (e.g. Govindarajan and Gupta 1992, Otley 1992, Chenhall 2003), strategy and strategic management (e.g. Hofer 1975, Delery and Doty 1996), performance management (e.g. Child 1975, Hoque and James 2000, Taylor and Taylor 2014), and innovation (e.g. Gopalakrishnan and Damanpour 1994, Mone et al. 1998), and has served as a theoretical lens in literature on risk management in the field of management accounting and control (e.g. Chenhall 2003, Mikes 2009, Woods 2009, Soin and Collier 2013). We follow these frameworks and explore how contextual and organizational factors shape the conceptualization of risk and approaches to risk management in local governments in two different contexts. In order to account for a possible impact of the national context, we compare local governments that show similar characteristics concerning the contextual factors *size, form of government*, and *structural and functional responsibility*. These factors and their parameters in the analyzed cities are explained in more detail in the case selection and description section. To account for differences in the local government context, we include the *contextual factors* of *financial autonomy* (Wolman et al. 2008, Hendrick 2011) and the *regulatory environment* (Beasley et al. 2005, Woods 2009, Paape and Spekle 2012) in the analysis. As *organizational factors*, we include different measures of *financial health* and *strategy and goals* (Kloha et al. 2005, Walker and Jones 2006, Carmeli 2007, Wang et al. 2007, Zafra-Gomez et al. 2009, Overmans and Nordegraaf 2010, Hendrick 2011). Furthermore, we investigate the *conceptualization of risk*, *responsibility* for risk management, *risk strategies*, and *risk awareness* in local government.

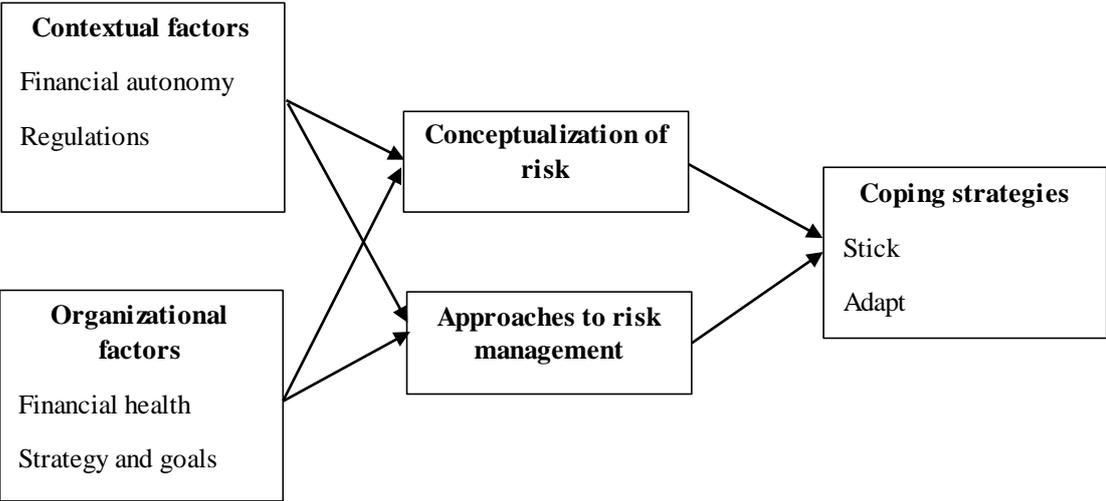
As pointed out above, the financial crisis had severe impact on local governments' munificence. Considering the above mentioned drop in revenues, the amplitude of changes in the financial condition of local governments can be described as large. While some critical voices have warned about the shock to local government financial condition resulting from the financial crisis, the impact was a surprise to several actors. Such unpredictable changes to the environment of public organizations are in the center of interest in the research stream on turbulence (Aldrich 1979, Goodstein and Boeker 1991, Haleblian and Finkelstein 1993, Castrogiovanni 2002, Boyne and Meier 2009), which defines turbulence as an unpredictable change in the munificence and complexity to the environment of the local government (see Boyne and Meier 2009). In order to react to turbulence, organizations can choose two alternative strategies: '*stick*' to the organizational design, i.e. structure and processes, or '*twist*' – adapt to the change by reconfiguring resources (Bettis and Hitt 1995, Boyne and Meier 2009). It is argued that stable organizations can buffer turbulence. Subsequently, financially stable local governments (with good financial health) will choose to *stick* to their structure and processes and thereby survive the financial crisis. This approach supports the theory of structural inertia (Hannan and Freeman 1984). The contingency approach however suggests that local governments will reconfigure their resources in order to cope with the turbulence caused by financial crisis.

In their analysis of turbulence, structural change and performance in local governments, Boyne and Meier (2009), from a long-term perspective, supported the contingency view as they conclude that coping mechanisms be taken to avoid or minimize turbulence effects. On the one hand, they identified that proactive networking with key environmental actors had a positive impact on performance. On the other hand, they suggested that environmental scanning and early warning as a complementary structural change strategy be used to detect changes to munificence or complexity of an organization in advance, as organizations could thereby alter

their procedures to minimize the impact of lower munificence. Following the concepts in performance management we argue however that information gathered through early signalling is a necessary but not sufficient factor for organizational performance (Bouckaert and Van Dooren 2003). In order to affect performance and regain the status of financial health as of before the financial crisis, local government actors must act upon the information, meaning that they have to select the mix of instruments to cope with fiscal stress. Subsequently, the way risk and risk management are understood and implemented will influence the awareness of turbulence and thus influence local government strategies to cope with financial shocks and fiscal stress.

Local governments can respond to fiscal stress in different ways: (1) decreasing spending, (2) increasing taxes and fees, (3) shifting the timing of payments, and (4) borrowing (see e.g. CBO 2010, Scorsone and Plerhoples 2010, Chernick et al. 2011). A decrease in spending is achieved by staff reductions, delays in payments to (employee pension and health care) funds, postponing capital investments, or deferring maintenance. Especially the last approaches bear however the potential of higher future costs for the local governments, when infrastructure, facilities or assets in an inferior state cannot be repaired or refurbished but has to be replaced. Increases in taxes and fees are common, however the extent of increases in taxes, assessments and also fees can be limited by state or federal law (CBO 2010, European Commission 2012, Jimenez 2013.). Furthermore, different preferences for the ways of coping with fiscal stress exist in practice. An empirical study with Wisconsin local governments found that delayed capital expenditures, delays in routine maintenance, targeted budget cuts, and refinancing of outstanding debt are the most agreed instruments in coping with financial stress. Increasing short-term debt, across the board budget cuts, discouraging population growth (in order to contain service demand), and laying off workers were regarded as the least favorable instruments (Maher and Deller 2007). The mix and the scope of instruments to regain financial health hence varies and depends on

different factors. As outlined above, we suggest that the ways of coping with fiscal stress will be influenced by the approach to and conceptualization of risk and risk management. In particular, we suggest that the conceptualization of risk (as uncertainty, as threat or opportunity), and the approach to risk management influence the strategy chosen to cope with fiscal stress. We therefore include local governments’ *coping strategies* as the final part in our framework. The conceptual model of our study is presented in Figure 1.



[Figure 1]

**Data and Methods**

The main goal of this study is to understand how contextual and organizational factors affect the conceptualization of risk and approaches to risk management in local government and whether the latter influence strategies of coping with fiscal stress. This research conducts a comparative case study of local governments in Michigan, U.S. and Austria in order to explore whether these aspects differ between national contexts. We use a contingency-theory laden conceptual framework to allow a more structured analysis within and across the cases (Weick 1979, Harrison 2002) and follow the inductive theory-building approach in the analysis

(Eisenhardt 1989, Yin 2003). The study is thus designed to test as well as to build theory (Howard and Morgenroth 1968, Woodside 2010). Since research on risk management in local government is narrow and the scarce empirical studies report a variety of factors influencing the concept, the inductive approach helps generate valuable insights, allows identifying left-out variables, and the development of new theories and hypotheses (Eisenhardt 1989, George and Bennett 2004).

This study used a purposive sampling strategy (Patton 2015). We selected local governments within the population range of 10,000 to 25,000 in order to include a reasonably comparable sample of Michigan and Austrian cities in the study. In Michigan, this accounted for 48 cases, and in the Austrian context for 53 cities to be included for further analysis. The population range has been selected for two reasons: the characteristics local governments show in the two countries, and the institutions responsible for audit and oversight. Up to 10,000 inhabitants, the municipalities are classified as villages, towns or townships. Each of the types shows distinct functions and responsibilities, which however are comparable to Austrian municipalities only to a certain extent. From a public administration view, the city type with population figures above 10,000 shows similar functions and responsibilities in service provision. Austrian local governments with more than 10,000 inhabitants are subject to audit by two institutions - the respective department in the state administration and the national audit office, whereas smaller municipalities are not accountable to the latter. In Michigan, the financial audit and oversight of municipalities is carried out by the external auditors of the financial statements, and the department of treasury of the state of Michigan. Following the principles of purposive sampling, we distinguish between cases with different levels of fiscal stress. Fiscal stress in this study is indicated in the cities' per capita deficit and per capita long-term debt figures, both over a five-year period (see Hendrick 2011). In the selection process, we distinguish between cities with

higher as well as lower deficit and long-term debt than the group average, and thereby facilitate a counterfactual analysis of the cases.

We used quantitative and qualitative methods to investigate the cases. Quantitative data was used in the case selection process, to measure different variables, and to complement and confirm/disconfirm qualitative data (Woodside 2010). We included data from the municipal comprehensive annual financial reports between 2008 and 2012 for Austria, and 2009 and 2013 for Michigan, each representing the latest five years available. The qualitative analysis consisted of document analysis and semi-structured interviews as the cornerstone of case study research (Yin 2003), but triangulation of data was used to provide stronger ‘substantiation of constructs and hypotheses’ (Eisenhardt 1989). The interviews included open-ended questions on different factors according to the contingency theory-laden conceptual model, but were not designed to operationalize any one theory (Woodside 2010). The respondents were chief executive officers (CEOs) or city managers, and chief financial officers (CFOs) or financial directors of the local governments. Due to their positions and responsibilities in local government administration and management, these actors were regarded as the right addressees for the purpose of the study. Two researchers carried out the interviews on-site and in two cases via phone, with one leading the discussion based on the interview protocol and the other taking notes and asking additional questions (Eisenhardt 1989). The interviews lasted about 45 minutes, and except for one were tape-recorded, transcribed and used for qualitative content analysis. The non-recorded interview was transcribed on the basis of the two researchers’ notes and a synthesis of notes from memory.

During the interviews, we asked chief executive officers and chief financial officers about their tenure and time in their current position, previous experiences in the public, non-profit and private sector, and about their main responsibilities, to put their perception into context. The questions for respondent groups included their perception of local government financial

autonomy, regulations regarding risk management, the relationship with the audit and oversight authorities, the local government's financial health (in general, the debt level, and changes of the financial condition and debt), and strategy and goals (mid- or long-term strategy, financial and non-financial mid- or long-term goals). Questions on risk management have been developed out of a literature review on risk management, financial management, financial condition and management control literature. We asked the respondents to define risk and risk management, whether there was a relationship between risk and innovation, and about the relationship between risk management and financial management. Further questions included their opinion about responsibility for risk management in general, the person currently responsible for risk management in the local government, the awareness of risks and shocks, and risk strategies. We do not apply measures for distinct instruments of the 'financial toolbox' (Hendrick 2011) to measure strategies of coping with fiscal stress, in order to capture a more open description of the strategies applied and to avoid suggestion of ordinal scales. Instead, we asked an open question of how the city had reacted to financial crises and shocks in the past. We use a proxy to identify whether the local government chose a 'stick' or 'adapt' strategy in coping with fiscal stress. Providing eleven terms which were a mix of terms for rather forward-looking and bouncing back approaches, we asked the respondents to (1) select the terms which in their opinion described financially resilient local governments, and (2) if those terms described their city. Additional information on financial autonomy, audit and oversight authorities' responsibility and function, and regulatory requirements regarding local government risk management was derived from literature and collected through document analysis of the respective organizations' reports, codes, and websites.

In the first step of the case analysis, full transcripts of the interviews were created and data were coded into the categories and factors according to the proposed conceptual model (Yin 2003). Second, we created subcategories using classifications derived from literature, e.g. for the

conceptualization of risk and the risk management strategies. The coding scheme was developed jointly and was applied in the analysis of one U.S. and one Austrian case to confirm applicability and consistency. Both researchers conducted the coding of all cases, and also acted as auditors for the other researcher's coding, respectively. If the data collected through interviews were inconsistent between the respondent groups (e.g. current person responsible for risk management) or with quantitative data (e.g. the city's financial condition), we reconciled differences with additional sources of quantitative and qualitative data. The case analysis comprised an iterative process of comparing the findings from the cases with the conceptual model and identifying different concepts of risk and patterns of risk management implementation across the cases.

## **Results**

Our goal was first to understand the conceptualization of risk and approaches to risk management in local government, how these are shaped by contextual and organizational factors, and whether the latter differ in the national contexts; and second, if there was a relationship between the conceptualization of risk and approaches to risk management and strategies in coping with fiscal stress. The comparative case study provided insights into different aspects of and approaches to risk management, the magnitude and quality of the crisis' impact and the strategies and fiscal responses local governments have applied to cope with the resulting fiscal stress.

### *Contextual factors*

In both contexts, local governments identify the issue of low autonomy regarding their revenue sources in general. Especially for Michigan, restrictions to raising revenues are a main

hindering factor in mitigation of risks, in being prepared for financial crises and shocks, as well as in searching for possibilities to recover once a shock has hit the organization. Austrian cases describe their autonomy also as very low and identify this as ‘a system failure’. There are no regulations regarding the form and system of financial risk management in local governments.

In Austria, the government has to abide by the Maastricht criteria, which has direct implications for the deficit and debt of local governments, but often is described as a game of matching statistical indicators without practical relevance. Some local governments report that meanwhile, meaning after the event of the financial crisis, laws have been passed which restrict or prohibit derivative financial instruments and foreign currency loans. Similar to limits to liabilities and deficit rules, this is however dependent on the state where local governments are located, with some state governments issuing strict regulations while others remain vague on the issue. However, most local governments have internal standards regarding signing authority or risk management in their externalized entities. The Austrian stability pact (see European Commission 2012, p. 79) is described as ‘a nice idea’, but its implementation and execution of sanctions is described as lagging. Also in the U.S. there are no rules and regulations for the financial risk management of local governments. The analyzed Michigan municipalities report some regulations by the state government regarding law suits, insurances, requirements for investments, and limits on debt as well as financial instruments.

Almost all cases report the main audit and supervisory institution or organization being the state government. Their relationship to the latter covers a wide spectrum from being ‘difficult’, ‘demanding’, ‘painful’ to ‘helpful’ and ‘supporting’. Similarly, representatives of the oversight institutions on the one hand are described as ‘stubborn’, ‘unfair’, ‘inflexible’, ‘unrealistic’, ‘bureaucratic’, or ‘slow’; and as ‘thorough and accurate’, ‘competent’, ‘customer-friendly’, ‘fair’, ‘unobtrusive’, ‘cooperative’ and ‘professional’ on the other hand. While we expected this relationship to be dependent on the financial health of the respective local government, this

does not seem to be the case. Some cases which are in bad financial health describe their relationship as demanding but in a supportive way, whereas well-off local governments often describe the relationship as burdensome. In the Michigan cases, respondents referred to mainly the same oversight institution so that differing perceptions might not be a result of describing different organizations. We assume that the perception of wiggle room in funding and the local government leaders' experience play a role here, but the question of which factors exactly affect the relationship has to be clarified in future studies.

The within-case analyses revealed overarching contextual issues posing additional threats which materialized once the impact of the crisis hit local government finances. In addition to the financial shock perceived by the local governments resulting in the aftermath of the global financial crisis, in retrospective, a slow-burning financial crisis can be identified in Austria. The main development reported to have worsened the local government financial condition is the devolution of responsibility for service provision from upper levels of government to the municipalities. This has been carried out with either none, or with inadequate compensation for the increased financial burden. Local government actors argue that the compensation does not reflect the true costs, and that state and federal funds are paid with an excessive time lag, which raises uncertainty in budget planning and imposes a funding gap on local governments. This adverse effect of service decentralization on local government finances is a long acknowledged challenge in public management literature (e.g. Maher and Deller 2007, Krane 2004).

As for the U.S. context, pension and health care obligations as contingent liabilities place a burden on cities throughout the country, and in the analyzed Michigan cities in particular. In the past decades, local governments have negotiated generous pension and health care benefits. This approach was used in competing for the workforce while not burdening the present budget with higher wages. As the number of retirees increases, the legacy costs now take a major part of the general fund revenues (see also Kellogg 2014). These obligations mainly are not part of

the balance sheets and are shown only in footnotes. Furthermore, federal and state laws generally do not require local governments to make annual contributions to the employees' pension and health care funds (CBO 2010). Finding themselves in the catch-22 situation of the financial crisis aftermath, the industry-related economic situation, and the deteriorating property values, payments to these funds are often delayed in order to avoid cuts in services. As so-called 'legacy costs', these liabilities will likely affect the cities' financial condition in a substantive and negative way in the next few years.

### *Organizational factors*

We assumed that two factors play a role in the way risk is conceptualized in local governments and how risk management functions within the organizations – financial health and organizational strategy and goals. However, the across-case analyses revealed no relationship in this regard. Whether local governments were robust or not, showed high, medium or low debt levels, and diversified and stable revenue bases or not was irrelevant to these aspects. Their financial health however played a significant role in to what extent the crisis has hit them and the scope of measures they had to take to cope with the crisis, ranging from entirely buffering the crisis and cuts only in voluntary services to deferring investment, massive personnel cuts, revenue increases, selling of assets, but also to restructuring in the way services are delivered. The extent of formalization of the local government strategy and the main goals for the organization also do not seem to have an effect on risk management. In Austrian local governments, the strategy is set mainly in medium-term financial planning, which is however an obligatory planning tool required by the state governments. Two of the five Michigan cases show also medium-term financial planning, but in this context, the way strategies and goals are

defined seems mainly to be dependent on the financial health of the local government and planning capacities by the respective leaders themselves.

### *Conceptualization of risk*

The term risk has been defined differently by the local governments analyzed, and often also the concepts of what is meant by 'risk' differed within the cases. While in the Michigan cases at least one respondent defined risk as either a threat or an opportunity, one Austrian case completely conceptualized risk as a threat that has to be avoided at all cost. In general however, chief financial officers were more likely to define risk in terms of threat and were slightly more conservative when asked about whether their local government was taking risks, reporting that no risks were taken. Austrian respondents especially mentioned that their local government did not take financial risks, referring to speculation on the stock market. Half of the cases mentioned risk as something uncertain and unforeseeable. When asked about the relationship between risk and innovation, respondents recognizing such a relationship referred to an innovation always bearing the risk for failure. Only few respondents mentioned risk-taking being important in order to be innovative. The predominant strategies in dealing with risks were risk avoidance and risk mitigation, where chief financial officers tend to avoid risks, and chief administrative officers tend to manage risks while using cost-benefit-analyses and carefully assessing possible risks. This distinction of strategies seems to mirror the respective conceptualizations of the term risk and the way risk-taking of the local government is defined. Only one case reported that its main strategy in dealing with risks was transferring risks to insurance companies. This was also the only case mentioning safety as the main risk for the local government. However, no significant history of safety issues could be identified for this local government.

### *Approaches to (financial) risk management*

Similar to the different conceptualizations of risks, we identified also different approaches to risk management. Some respondents referred to risk management as actions of assessing and analyzing risks, controlling them, and preparing counter-strategies, while others understood risk management as actions of inhibiting risk-taking, avoiding risks and averting loss, and making sure that the negative part of risk never materialized. A few respondents referred also to insurance or scenarios of possible outcomes as well as to absorbing unforeseeable things, while only one leader provided an accurate generic description of risk management. In almost all cases, financial management and risk management are seen as tightly coupled, since financial management makes sure that public money is spent for the public purpose. Also, ‘some risks can talk costs’ meaning that risks are visible in financial figures once they materialize, and conservative budgeting is seen as a way to avoid risks. The dominant approach however seems to be that the two functions should overlap and complement, but not obstruct each other. In all cases it has been argued that the local government itself should be responsible for (financial) risk management, which might be due to the missing rules and regulations by other bodies and the strong desire for more autonomy. The current responsibility for risk management in most cases was either with the chief financial officer or the chief administrative officer, with some respondents mentioning close interaction also with the mayor, the law department or auditors and banks. The respondents’ view on who was currently responsible matched in all but one case, where the chief financial officer and the chief administrative officer identified each other respectively as being responsible for risk management. This case was also one with high vulnerability and low perception of being able to control risks the local government is facing. Although risk management was not formalized in any of the cases, risk awareness, identification and assessment of risks seems to be present and implicitly carried out in each

local government. In some cases this had increased as a response and learning effect from the financial crisis.

### *Learning from crisis and coping strategies*

Organizations with learning-focused leaders may be more inclined to see opportunities arising from crises and utilize them for change in order to prosper (Brockner and James 2008, Edmondson and Cannon 2005, James et al. 2011). Responding to the call by James et al. (2011) to examine the origins and implications of such positive framing (p. 483), we explored the leaders' views on the crisis as a threat (negative framing) or as an opportunity (positive framing). In almost every case investigated, leaders experienced the impact of the global financial crisis, and those leaders mainly framed it as a threat to the local government. Here we detected also similar approaches to responding to threats, as leaders stressed that their investment strategies were 'conservative' or 'very conservative'. Only two local governments clearly identified opportunities arising from it. However, these two cases also indicated conservatism in their approaches. Here it seems that leaders conceptually differentiate between the fiscal responses to the crisis from the organizational or strategic ones. As the crisis experienced was a fiscal one, these local governments seem to have adopted or enhanced existing conservative approaches in investment, while at the same time recognizing the potential to introduce changes in the way of service delivery during the time of crisis and its aftermath.

Literature has argued that organizations that attribute causes for the crisis to external factors are less likely to learn from the crisis than organizations which identify internal factors leading to the crisis (Wooten and James 2008), and that organizations which learn from a crisis limit future exposure to the same problem (Sitkin 1992). In our cases, learning can be identified in cases

attributing causes for the crisis to internal as well as to external factors. This may however be largely due to the type of crisis. The study setting has been the aftermath of the financial crisis, a crisis that has its roots in and which affected an environment that is external to local governments. Wooten and James (2008) have however examined business crises that have been either rooted in core activities of the organizations or their immediate environment.

When it comes to the second argument of being prepared for future crises due to learning, leaders in one Michigan case have argued that the local government was prepared for further crises in a magnitude similar to the financial crisis. Indeed, the leaders' awareness of the local government's vulnerabilities and the attempts to tackle these support this statement. However, what distinguishes this case from the general findings is that there are no indicators of learning from the crisis itself. The causes for the situation are attributed to external factors, i.e. the funding system of local governments and the subsequent dependency on state government. In their previous careers, those leaders have experienced two prior crises. However, they neglect the local government's housing condition and thus their financial vulnerability arising from property values and rather address other vulnerabilities of the local government. The master plan to tackle vulnerabilities is currently in progress, and we cannot conclude if the local government will take adapting measures in the future. However, the survival of the latest crises through robustness suggest that for this local government, buffering will be the way to cope with crises in the future, too.

Nine out of the ten cases blame upper governmental levels for the magnitude with which the crisis hit their local governments, or for the slow recovery of their organizations due to little wiggle room in raising revenues, which was especially evident in Michigan cases. However, seven local governments also showed attempts of *adapting* in order to be better prepared for future shocks. The crisis was recognized as an opportunity to reorganize services and improve processes, and in two cases, the crisis led to changes in leadership, where individuals with

specific competencies, e.g. networking, profile building have been appointed. The across-case analysis revealed that one factor was present in every case where we had identified signals for learning from the crisis. When asked about terms which in their opinion describe resilient local governments, at least one of the respondents mentioned ‘being adaptive’ as a key attribute; in several cases, both respondents referred to adaptation.

The three cases where we could not identify learning from crisis all show signals for a *stick* strategy. On the one hand, these were robust local governments with a low debt level and a stable tax base or high financial reserves, where the leaders acknowledged the financial crisis as a major shock in the last years, but reported that their local governments have been able to absorb the crisis and that it did not have any impact on their organization at all. On the other hand, one case where we only identified blaming is a medium-robust local government with a high debt level. Currently suing the local government’s bank for losses which resulted from financial instruments the bank had promoted, this case seems to take a fatalist approach and attributes the fiscal stress to external factors only. This was also the local government where the two respondents identified each other respectively as the person responsible for risk management.

## **Discussion and conclusion**

From a central government level perspective, U.S. local governments seem to have a higher financial autonomy than Austrian municipalities. Sales and income taxes for instance are federal taxes in Austria, and local governments are entitled to collect only specific taxes up to a certain amount determined by the federal government (European Commission 2012). However, U.S. local governments have strong financial ties to the states, as sales taxes are collected by the state and those revenues are shared with their local governments. In both

national contexts, we find that this confines local governments in their response to the financial crisis. We have identified a myriad of conceptualizations of risk and approaches to risk management. This supports the description of risk management being an umbrella term for diverse risk management techniques and arrangements which are adjusted to organizational needs, and thus are dependent on different factors (Power 2008, Woods 2009, Mikes and Kaplan 2013). The contextual and organizational factors included in this study however showed no clear relationships with the way risk and risk management are understood in the local governments. We cannot draw conclusions on possible further factors that could influence the conceptualization of risk and approaches to risk management, e.g. organizational culture, resistance to change, support by political actors, the quality of auditors, and the vice-versa effect of organizational performance. Selecting local governments with a population between 10,000 and 25,000 inhabitants however allowed us to investigate entities with a similar organizational size. In this respect, we show that the conceptualization of risk and approaches to risk management vary also within a group of similar organizational size within as well as across different contexts.

Risk strategies however are similar throughout the cases and contexts. Although some respondents recognized that risks are part of the day-to-day business, the risk strategy of risk acceptance was not mentioned at all, partly since the local government works with public money, and it cannot take risks where the possibility of loss is high. This finding supports the above mentioned literature where the public sector is described as engaging in less risk-taking activity due to the low tolerance to risk by the public.

In general, U.S. governmental entities seem to have experienced financial crises and disasters that have received strong media attention more frequently (see Hendrick 2011). For Michigan cities alone, financial stress in the 1990ies, 2000s and in the great recession has led to a number of cities being under emergency financial management. Within the boundaries of their

permitted reactions to the fiscal stress, respondents in Michigan local governments showed more adaptive approaches and actively searched for solutions to gain revenues by simultaneously following the state's regulations and caps. Although uncommon for Michigan cities and unpopular to the voters in general, some cities manage to override the caps related to property tax. It seems that on the one hand, this is thanks to a well-functioning, well-informed city council. On the other hand, we believe that the information policy, prudence, and persuasion ability of administrative leaders is strongly connected with voter attitude toward an override.

The fiscal responses to the crisis were similar in all cases and correspond to the above mentioned fiscal responses described in literature. Depending on the level of impact by which the local governments were hit by the crisis however, they ranged from decreasing spending and deferring investments to moratoria on debt repayment i.e. shifting the timing of payments to increasing certain taxes and fees. No case reported however an increase in borrowing. This might result from the fact that debt levels rose during the peak of the financial crisis and that incurring more debt was not seen as a response to tackle the issue of debt. Based on our results we cannot identify a relationship between 'stick' and 'adapt' coping strategies and the range and the mixture of the 'fiscal toolbox' that local governments applied. The strategy chosen for the future path seems to rather determine the long-term organizational behaviour than short- to medium-term fiscal responses.

Respondents in both countries acknowledge and follow the rules and regulations that the local government cannot influence. However, local government in Michigan are more likely to adapt to the situation in case of fiscal stress. Our finding that leaders who use the term 'adaptive' in descriptions of resilient local governments also report adaptation efforts of their own

organization as a reaction to the crisis points to a significant influence of administrative leaders in the management and survivor of turbulent times. Here we assume an effect of leaders' individual factors, but the research design falls short in explanations of which traits or competences exactly lead to an adaptation orientation. We therefore invite scholars in the field to test the proactive adaptation theory within contingency theory in different county contexts, local government forms (e.g. strong mayor), and longitudinal studies. First, they could enhance our knowledge of the individual factor in local government financial risk management. Second, the findings would contribute to public management practice in the field of personnel acquisition and selection, training and development, and audit and oversight systems and processes.

In the present study, we have used interviews with chief administrative officers and chief financial officers as the main data source in exploring the conceptualization of risk and approaches to risk management in local government. However, future studies should include other perspectives, e.g. from upper governmental levels on the requirements toward a public financial risk management at the local level, and also regarding enabling and hindering factors of control and support in an audit and oversight relationship to the latter. Our investigation provides also the basis for a quantitative study, and we encourage such research designs in analyzing and refining the propositions resulting from the findings in the present study.

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