Chapter 8

What Is Known and What Should Be Known About Factors Affecting Financial Sustainability in the Public Sector: A Literature Review

Silvia Gardini
University of Bologna, Italy

Giuseppe Grossi
Nord University, Norway

ABSTRACT

The international literature suggests that the causes of weak financial sustainability of public organizations depend on both external and internal conditions. Whereas the external conditions are related to demographic and socio-economic factors, the internal conditions are associated with the political and managerial settings, and thus, the latter could be addressed by the local government with the aim to maintain financial sustainability over the long term. Based on a literature review, the authors explain the most consolidated trend of such variables with respect to the impact of those variables on financial sustainability, and simultaneously, they reveal a disproportion in what the literature has most recently analyzed. Ultimately, the authors highlight the need for further research regarding the managerial factors and additional cross-country comparisons of the roles of both external and internal conditions.

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INTRODUCTION

Every economic entity can achieve its corporate goals from a going-concern perspective only if the entity is financially sustainable. Since the objective of a public entity is to deliver public services to meet the needs of the community, the failure to do so under a condition of efficiency would damage the primary purpose of the public entity. Furthermore, this circumstance could prevent citizens from receiving essential public services, such as public health, education, safety, waste collection, local public transport, water, and energy supply, and thus undermine their quality of life (Cuadrado-Ballesteros, Mordan, & Garcia-Sanchez, 2014).

As a result, in the last 40 years, the international literature (Brown 1993; Klhoa, Weisert, & Kleine, 2005a; Zafra-Gomez, Lopez-Hernandez, & Hernandez-Bastida, 2009a, Garcia-Sanchez, Cuadrado-Ballesteros, Frias-Aceituno, & Mordan, 2012a), regulators, institutions and standard setters in most jurisdictions worldwide (CICA, 2007; IFAC 2013; EU 2015) have focused on creating models that monitor and measure financial health and predict financial crises at the local government level.

This interest originates from the ongoing financial crisis that involved various cities in financial default in the US between the 1970s and the 1990s (i.e., Cleveland and New York in the 1970s; Miami, Pittsburgh, and Philadelphia in the 1990s) and, later, from the spending reviews and austerity policies that many EU countries imposed on their local governments following the international crisis of sovereign debt that began in 2008.

At the same time, many studies have been conducted with the aim to identify the factors undermining the financial sustainability of local governments and provide theoretical and empirical evidence based on the socio-economic environments where the local governments operate (Navarro-Galera, Lara-Rubio, Buenida-Carrillo, & Rayo-Canton, 2017; Zafra-Gomez, Lopez-Hernandez, & Hernandez-Bastida, 2009c). Although the literature on this topic is extensive, the analysis of key aspects of a more managerial nature is either completely lacking or fragmented and understudied.

Accordingly, the purpose of the chapter is to provide an in-depth analysis of what almost four decades of literature has recognized as factors affecting the financial sustainability of local governments. Through a literature review, the authors provide clarity regarding what is known to date and provide insights on what should be known according to the identified gaps in the extant literature.

Due to the widespread attention garnered by the international debate on this issue, together with the highlighted fragmentation of the investigated factors, which often leads to inconsistent results, the chapter proposes a specific literature review with respect to the factors affecting the financial sustainability of local governments. In this regard, this research should be considered a significant contribution that will benefit a full range of stakeholders, such as public managers, policy makers, and
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