Chapter 5
Financial Conditions, Financial Sustainability, and Intergenerational Equity in Local Governments:
A Literature Review

Francesca Citro
University of Salerno, Italy

Giovanna Lucianelli
University of Rome "Tor Vergata", Italy

Serena Santis
University of Salerno, Italy

ABSTRACT

The chapter offers a necessary summary of the key concepts of financial conditions, financial sustainability, and intergenerational equity in local governments through a close examination of different approaches. Focusing on a narrative literature review approach, the chapter has two main aims: first, to provide evidence on how to define the terms of theoretical and practical underpinnings to represent financial conditions in local governments in order to clarify the distinctive feature of financial conditions with a particular focus on the specific measures for budgetary solvency: sustainability, flexibility, and vulnerability; second, taking into account that the link between financial sustainability and intergenerational equity seems to be under-investigated, the authors discuss what the conditions for achieving financial health are while ensuring intergenerational equity with reference to the level of citizens' quality of life.

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INTRODUCTION

Currently, the current global financial crisis is one of the main reasons for the critical situations in many countries, at both national and local levels.

Moreover, the increased amount of attention being given to financial budgeting over recent years demonstrates that public administrations have to learn more about how to measure the financial condition, what strategies can be implemented in order to achieve financial health and how the expected results of these strategies can be represented.

This paper starts by considering that a local government is in good financial condition if it is able to provide public services without damaging its ability to face future obligations (GASB, 1987). On the contrary, local governments (LGs) in poor financial health are unable to deal with their financial obligations and still provide public services, resulting in the quality/quantity of these services often becoming damaged (Raphael, Renwick, Brown, & Rootman, 2010).

However, the level of financial condition is not easy to represent since it cannot be readily measured with a single performance indicator, but determined by different measures and indicators, which are directly observable.

There is extensive literature on how to determine appropriate and suitable financial condition indicators by using financial ratios (e.g., Andrews, 2015; Drew & Dollery, 2014), cost-revenue analysis (e.g., Lohri et al. 2014), or other drivers such as the cost of restoring infrastructure assets to a satisfactory condition (Jones & Walker, 2007).

Some authors (Groves, Godsey, & Shulman, 1981) have represented financial condition by referring to four levels: cash solvency, budgetary solvency, long-run solvency and service-level solvency. Others (Greenberg & Hiller, 1995; Zafra-Gómez, López-Hernández, & Hernández-Bastida, 2006), along with the Canadian Institute of Chartered Accountants (CICA, 1997; CICA, 2009) have proposed three indicators for measuring budgetary solvency: the level of sustainability, flexibility and vulnerability.

These three features have been previously used by researchers and public advisors to represent the financial condition of governments (e.g., Ammar, Duncombe, Jump, & Wright, 2005; Clark, 2015; Cuadrado-Ballesteros, Mordán, & García-Sánchez, 2014; García-Sánchez, Mordán, & Prado-Lorenzo, 2012; García-Sánchez, Mordán, & Cuadrado-Ballesteros, 2014; Kioko, 2013; Lopez-Hernández, Zafra-Gómez, & Ortíz-Rodríguez, 2012; Zafra-Gómez, López-Hernández, & Hernández-Bastida, 2009a; Zafra-Gómez, López-Hernández, & Hernández-Bastida, 2009b; Zafra-Gómez, López-Hernández, & Hernández-Bastida, 2009c).

However, in recent years, the international financial crisis has led financial sustainability to become a relevant concept in public entities, with it being even