The Long View

By Eric Werker and Benjamin Kennedy
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Just what does it mean for a city to go bankrupt?

Bankruptcies are so commonly associated with firms and individuals that we tend to use the same mental models to evaluate Detroit's bankruptcy filing as we do a firm like Circuit City. The Associated Press declared that "Motown Goes Bust," and most commentary described the bankruptcy as yet another nail in the coffin of a city in decline. On the surface, the Motor City does look like Circuit City. Both entities have failed to compete, with management mistakes, in a sector doomed by trends beyond their control. And Circuit City's dark and empty big box stores, like Detroit's boarded-up houses and overgrown factories, remind us of the failings and offer a sense of finality.

That's a neat and tidy narrative to attach to America's largest municipal bankruptcy, but it may be wrong. To be sure, this is an extraordinary moment in the annals of American municipal finance, with serious near-term implications for municipal bond markets and other underfunded pension systems. Detroit's Chapter 9 bankruptcy case will be precedent setting in a variety of ways. But the real story here may not be what happens in the near-term at all. This is where cities differ from firms.

Cities almost never die. A bankrupt firm's assets can be sliced up and repackaged and sold off to partially repay the firm's creditors, and once that process is complete, the entity becomes dissolved. But cities—with some incredible exceptions that prove the rule, like Atlantis or Pompeii—cannot just be dissolved. Places recover from all sorts of catastrophes including natural disasters and wars. Along the spectrum of catastrophic events, a fiscal crisis is not the worst of these; in fact, a fiscal crisis is often an essential ingredient of recovery. Detroit has a precedent in Pittsburgh and a variety of other cities and jurisdictions that have seen their trajectory fundamentally shift in the wake of precipitous economic and fiscal decline.

Long before the American automobile industry was in crisis, American steel producers began to lose out to foreign competition. In the Pittsburgh region, which is to steel what Detroit is to the automobile, primary metals employment dropped by three quarters in the 1980s. Some 150,000 jobs disappeared, devastating the region's population of 2.2 million. But Pittsburgh had a second act (or third, counting the city's reversal from untenable air and water pollution levels in the 1940s).

Pittsburgh's recovery offers a potential model for Detroit. It went on to become a technology hub, anchored in the computer science and robotics coming out of Carnegie Mellon University. It also became a medical hub, driven by the brisk expansion of the University of Pittsburgh Medical Center. The education centers of Carnegie Mellon and Pitt attracted students from all over the world, and the city helped to retain them through its new economy sectors and affordable home prices.

Philanthropy, seeded by the steel fortunes, played a major role in funding education, culture, and historical preservation projects. City and state government, combined with self-organized private-sector players, played their part by funding technology as well as sticks-and-bricks real estate projects and brownfield redevelopments. In spite of this, Pittsburgh almost went bankrupt. It fell under state receivership in 2004 due to rising pension obligations, and the state of Pennsylvania has had oversight of Pittsburgh's fiscal policy since then. It still has trouble with pension obligations, but by 2009 it was rated America's most livable city by the Economist Intelligence Unit.

Countries, like cities, have gone through their own bankruptcies on the path to recovery. Liberia, a small country in West Africa where one of us advises, did the sovereign equivalent of bankruptcy as part of its post-civil war reconstruction. When Liberia emerged from a decade-and-a-half of war, fiscal obligations were several times higher than income. Its new leaders were able to restructure the country's commercial debt (to three cents on the dollar) and negotiate most of its official debt to be forgiven.

Liberia is not yet in the clear, but it is politically stable, its economy is rapidly growing, and its citizens are returning to lives enhanced by a more egalitarian power structure. Without the fiscal fresh start, investments in infrastructure and human capital would be impossible. Scores of other countries have also undergone debt relief, and it's probably not a coincidence that eight of the twenty fastest-growing countries in the world recently underwent this process.

Every place's recovery has its own unique features, since places, as congregations of people, have an organic quality. Ultimately, places, even if fiscally bankrupt, have assets that cannot be stripped, and these are the assets that must power their recovery. People are enormously resilient, and the permanence of place only serves to stoke this common trait.

So what does this mean for how we think about Detroit? It means we should be taking the long view. Detroit doesn't have to turn things around in a year or even five years. And it doesn't have to reclaim the place it once held among America's largest urban economies. It simply needs to be a better Detroit for current and future residents.

The good news is that Detroit's private-sector leadership already seems to understand what it will take to build back the city over the next several decades. Much of what we see if we look beyond the fiscal calamity in Detroit resembles the essential characteristics of the Pittsburgh recovery. Philanthropic and corporate leadership are working collectively to strengthen the core of the city through physical redevelopment. Medical and educational institutions are doubling down on their commitment to the city. Dynamic entrepreneurs and artists are giving life to a new narrative for the future. Long-time residents are staying in the city, stabilizing neighborhoods house by house. Seen in this context, Detroit's bankruptcy is more prologue than epilogue.

This isn't just good news for Detroit. It's good news for every place around the world that might otherwise be written off because of its fiscal straits.

The economist John Maynard Keynes was right about the ultimate mortality of human beings ("In the long run, we are all dead," he once said), but when it comes to places, it may be precisely the opposite.

Eric Werker is an associate professor of the Harvard Business School. Benjamin Kennedy is a senior program officer at The Kresge Foundation and a 2009 Harvard MBA. *This piece was one of three published under the heading* Detroit Files for Bankruptcy: HBS Faculty Weigh In *at the Harvard Business School's Working Knowledge website.*