This article was published online on April 19, 2020
Final version July 28, 2020

Essays in

ECONOMIC & BUSINESS HISTORY

The Journal of the Economic & Business History Society

ISSN 0896-226X
LCC 79-91616
HC12.E2

"THE GRAND BARGAIN": DETROIT'S FINANCIAL FALL TO BANKRUPTCY AND RISE TO NEW POSSIBILITIES

This article is adapted from the keynote address to the 44th Annual Economic & Business History Conference delivered by John Naglick on June 7, 2019 in Detroit, Michigan.[1]

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The City of Detroit filed a petition for bankruptcy on July 18, 2013. At the time, it represented the largest municipal bankruptcy in American history. On November 12, 2014 a complex settlement agreement was accepted by the United States Bankruptcy Court. Causes leading to Detroit's bankruptcy traced back several decades. Yet, Detroit's emergence from bankruptcy only took about five hundred days. The problems leading to the City's

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[1] The views in this paper are solely the responsibility of the authors and should not be interpreted as reflecting the views of the City of Detroit, the Federal Reserve Bank of Chicago or the Board of Governors of the Federal Reserve System, or Walsh College.

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financial crisis are not unique to Detroit. Technological change, demographic shifts, faulty financial decisions and other variables that plagued Detroit are present in other American public entities. It is inevitable that there will be larger public bankruptcies in the future. The value of Detroit's story, however, is the example of how its financial crisis was resolved through the creative resolution process that involved the Court, the City and the wide circle of its financial stakeholders. Detroit's bankruptcy creates a valuable historical benchmark and its lessons can greatly impact how future public bankruptcies in the United States are resolved.

Detroit: The Motor City and Arsenal of Democracy

Detroit's civic history dates back to 1701, when Antoine Cadillac founded a French trading post along what is now the Detroit River (Richard White 2006, 146). Control transferred to Great Britain after the French and Indian War and to the United States after the Revolutionary War. Its location within the Great Lakes region provides convenient access to major water transportation systems and by the middle of the nineteenth century railroads enhanced commerce with other destinations within the United States. These conditions made Detroit an ideal location for the eventual growth and development of the American automotive industry

In 1908, Henry Ford's introduction of the first Model T automobile from his modest factory located in Detroit sparked the launch of the automotive industry. The vehicle's success soon prompted Ford to begin building the Rouge Complex in 1917. When construction was finally completed 11 years later, it became the largest manufacturing facility in the world. Significant consolidation took place within the American automotive industry during the 1920s. The largest three automotive manufacturers, Ford Motor, General Motors, and Chrysler Corporation, established a significant portion of their production facilities in or near Detroit, which quickly became the epicenter of the bourgeoning industry. In 1900, Detroit ranked as the thirteenth largest city in the United States, with a population of 286,000. By 1920, it was already the fourth largest American city with 993,000 inhabitants. During this twenty year interval, the city averaged a staggering six percent annual population growth rate. In 1930, Detroit had 1,569,000 residents and trailed only New York, Chicago and Philadelphia in population (United States Census Bureau 1998).

Detroit's ascendency strongly correlated with the growth of the American automotive industry. At the turn of the century, this infant industry's output was negligible, with production of approximately only 4,000 passenger units. By 1920 production had increased to more than 1.9 million vehicles and in 1929, just before the Great Crash, that figure increased to almost 4.5 million (Susan Carter, Scott Gartner, Michael Haines, Alan Olmstead, Richard Sutch, and Gavin Wright 2006, vol 4, 831).

The Great Depression in the 1930s impacted Detroit just as badly as the rest of the nation. However, the onset of World War Two accelerated economic recovery. Detroit quickly became known as "the Arsenal of Democracy," as automotive plants changed their production from cars to producing transportation vehicles and aircraft for the United States war effort.

In 1950, Detroit's population reached its peak at 1,850,000. However, significant change was underway, although it was by no means obvious at the time. The next six decades became a period of slow and steady urban decay. Some of the contributing factors were within the city's control while others were not. Detroit's municipal government employed policies that gave rise to racial tensions and there was evidence of increased levels of corruption at city hall. Simultaneously, post-war affluence prompted a significant emigration of residents to newly-built and more spacious housing in nearby suburbs. The tensions brought about by these trends were most strongly evident when an overzealous police force triggered Detroit's race riots of 1967.

Detroit's nadir occurred in 2013, when the city was forced into bankruptcy. This article seeks to identify the causes that led to bankruptcy, the rapid path to emerging bankruptcy that was a result of a "Grand Bargain", and chronicles recent developments that provide hope for Detroit's future. Detroit's story is an important one, as many American and global urban centers currently confront similar problems of deindustrialization and aging infrastructure.

Causes for Detroit's Bankruptcy

What makes Detroit's experience different in comparison to other major American cities that have experienced financial turmoil? A number of factors combined to make Detroit's experience unique. First, Detroit was a "one industry" automotive town, involved in a heavy manufacturing activity that was cyclical in nature, often leading to dramatic economic expansions and contractions. When automotive manufacturers started to move out of Detroit's city boundaries in favor of its suburbs during the 1950s, they removed a significant portion of Detroit's tax base. Further, Detroit was, and to a great extent still is, a highly segregated community. The City's urban neighborhoods were often impacted by artificial barriers in the form of redlining, where African Americans were effectively excluded from purchasing homes in white-dominated areas of the City. Other barriers included fencing, walls, and roadblocks that physically obstructed one ethnic neighborhood from another. While Detroit's 1967 racial uprising is well-chronicled, that year's riot harkened back to a long litany of previous racial disturbances that dated back to the mid-nineteenth century. One of the more notable uprisings occurred in 1943, and forced the US Army to restore order in the city, even as World War Two raged on (Detroit Historical Society).

Another added factor was the lack of collaboration and communication between Detroit and its surrounding metropolitan suburbs. Southeast Michigan never successfully developed any extensive public transportation system, relying on two separate operating bus systems for the city and the suburbs. This setup did not provide seamless connections for people to navigate easily within the Detroit area's large geographic footprint. Further, there were few alternatives for public transportation. Detroit did place electrified streetcars into service as early as 1892, but that system was closed down in 1956 (*Detroit News* 2017). Additionally, there was little collaboration between city government and the business community, in sharp contrast to similar circumstances in nearby regional cities like Cleveland and Pittsburgh. Detroit's meteoric rise during the first half of the twentieth century most certainly helped create a complacency within city hall. Over the course of many administrations, the municipal government trended towards an insular culture, one that fostered an environment very susceptible to corruption and prejudice. This created a growing distrust of city government that developed over several decades. The trend culminated with the imprisonment of former Mayor Kwame Kilpatrick in 2008 for obstruction of justice, forcing him to resign (National Public Radio 2008).[3] Unfortunately, in the latter half of the twentieth century the city never developed a master plan that outlined any overall future vision for the city.

A further factor working towards Detroit's descent was linked to demographic change. Living conditions became increasingly challenging as the city and its infrastructure aged. The loss of two-thirds of Detroit's peak population from 1950 created gaping geographical holes on the city map as once densely populated neighborhoods thinned out. As Detroit's large population expanded during the first half of the century, the city's borders grew to encompass 140 million square miles, large enough to house Boston, Manhattan, and San Francisco combined (Detroitography.com 2015). As millions of those square miles became vacant, properties were ignored, resulting in blight. This created a parallel problem of a dwindling tax base even as the city struggled to serve an infrastructure built for a population of two to three times its new size. Decreasing city revenues depleted public services, which manifested itself in the form of aging equipment, service delays, and a smaller and less skilled city-employed workforce. In an effort to boost sagging revenues, tax rates were raised, which further incentivized inhabitants to move out of the city and into the surrounding suburbs.

Coinciding with the population exodus, Detroit Public Schools also experienced a period of steep decline, becoming one of the worst performing school systems in the country (*EducationNext* 2015). The situation became so bad that the State of Michigan appointed a series of emergency managers to try to bring the district's finances back in order even as property tax revenues continued their fall and the city experienced its own deteriorating financial condition.

An issue further complicating Detroit's financial situation was a severe reduction in consumer spending within its city limits. The gradual migration of the metropolitan population from the city to suburbs, which

[3] Kilpatrick was convicted of 24 felony counts five years later and sentenced to 28 years in prison.

accelerated after the 1967 riots, greatly reduced commercial activity within the city, and consequently many ancillary and support businesses such as restaurants and hotels suffered or went out of business. Non-city residents rarely visited Detroit, save for a limited number of sports or concert events.

The philanthropic community was a potential channel of outside financial support that could enhance Detroit's quality of services and overall culture. Unfortunately, there were few civic institutions available to provide philanthropic support, and many prominent organizations that were likely sources of support were headquartered outside of Detroit. For example, the Ford Foundation was based in New York City. Detroit provided few significant civic institutions outside of the Detroit Institute of Arts.

Detroit's financial condition began to deteriorate seriously in the early 1970s. Prior to 1962, the city's revenues were solely tied to property taxes. Subsequently, an income tax was initiated in 1962, a utility tax in 1974 and a wagering tax from casino operations within the city in 1999. Despite adding new revenue sources, Detroit's total revenues (measured in 2013 dollars) fell from approximately $1.35 billion at its peak in 1972 to only $650 million in 2013. The largest cause for this negative trend was tied to plummeting property values. In 1958, the tax base (measured in 2013 dollars) was $45.2 billion. By 2013, the property tax base dropped to slightly less than $10.0 billion (City of Detroit annual financial reports).

Despite the precipitous drop in revenues, the city remained saddled with the high costs of services. The large geographic footprint of the city still required substantial police services and the increasing number of abandoned buildings necessitated substantial firefighting resources. Detroit did reduce employee head counts, but even as this process moved along the city remained liable for substantial pension obligations. The number of city employees decreased from 26,386 in 1960 to only 10,525 in 2013, but the number of corresponding pensioners increased from 10,629 to 21,113 during the same time period. In order to provide services, the city increasingly looked to debt capital markets to bridge a growing operating gap between tax revenues and operating costs. Outside debt (measured in 2013 dollars) rose from approximately $2.8 billion in 1990 to $4.3 billion in 2000 and $8.0 billion in 2013. In addition, Detroit in

2013 also had added accrued liabilities associated with pension and retiree health obligations bond interest of approximating $18.0 billion (City of Detroit annual financial reports).

In addition to declining revenues, Mayor Kwame Kilpatrick's administration made an ill-fated decision to enter the city into an interest rate swap contract in 2005 that essentially bet on interest rates increasing (Economic Policy Institute 2013). Unfortunately, Great Recession of 2008 led to aggressive Federal Reserve policies to keep interest rates low, causing Detroit to incur substantial added expenses due to the swap agreement. Further, the Great Recession prompted the bankruptcies of Chrysler and General Motors and the ripple impact of the resulting distress within the automotive industry contributed to a significant rise in Detroit's unemployment rate from 14.1 percent in 2005 to 25.0 percent in 2009 (State of Michigan, Department of Technology, Management and Budget 2015).

It became increasingly clear that the city's revenue streams were insufficient to offset both operating costs and bourgeoning debt obligations. The State of Michigan performed a financial review of Detroit's operation under its statutory powers in December 2011, and this resulted in a declaration of a financial emergency in March 2012. The city subsequently filed a separate financial plan with Michigan and the Detroit City Council voted to enter into a consent agreement requiring Detroit to satisfy a number of conditions in a reasonable amount of time before the financial emergency would be lifted. This process was certainly consistent with the previous experience of major American cities that had fallen into financial distress. However, in December 2012, Michigan ordered a second financial review of Detroit's operations, as it was deemed that the city was not making sufficient progress in meeting the original terms of the consent agreement.

The Tale of Other Cities

Several major US cities experienced financial distress during the period of Detroit's decline in. How did they avoid the same fate? New York City, Cleveland, Philadelphia, and the District of Columbia (DC) all experienced financial difficulties in the latter twentieth century. While each city dealt with unique circumstances, they also shared sufficient commonalities that allow for instructive comparison.

New York City's financial crisis reached its climax in April, 1975. That month, the State of New York advanced $400 million in revenue-sharing funds to the city ahead of the scheduled remittance scheduled for June (Robert Inman 1983). Private-sector banks refused to lend the city more money in May, forcing Mayor Abraham Beame to ask for additional state assistance (Inman 1983). Governor Hugh Carey responded by creating an advisory committee, the Municipal Assistance Corporation (MAC), to oversee New York's finances. The MAC was comprised of gubernatorial appointees authorized to sell bonds to meet New York City's financial needs. As part of their oversight, the MAC also demanded that the city reform by instituting wage freezes for, and layoffs of, city workers. In addition they required higher subway fares and higher tuition fees at city universities (Roger Dunstan 1995).

Governor Carey also created an Emergency Financial Control Board (EFCB) to oversee the City's budgeting practices. The EFCB required the City to submit a balanced budget within three years, as well as to build a three-year financial plan. The EFCB was also given the power to reject the City's financial plan, its budgets and any union contracts (Dunstan 1995).

Despite these efforts, New York City still required federal assistance later that year in order to avoid a financial default. That federal assistance came, but was conditioned on further increasing service fees, lowering work force levels, freezing wages, raising taxes, investing heavily in MAC securities, the resignation of certain government officials, a balanced budget within a three-year time frame, and a successful return to private-sector capital market access within three years. Eventually, New York City emerged from its financial crisis, allowing new Mayor Ed Koch to implement housing programs as well as support commercial building projects by the mid-1980s, which was key to persuading certain key businesses to retain a presence in the City. However, New York City's recovery was slow and the EFCB's oversight continued in place through 2000 (Dunstan 1995).

Cleveland encountered financial difficulty in 1978 when it refused to sell its MUNY electrical power system (Inman 1983, 16).[4] After the city defaulted on its municipal debt in December, 1978, incumbent Mayor Dennis Kucinich was defeated in the 1979 mayoral election by business-backed candidate and Ohio Lieutenant Governor, George Voinovich. Voinovich promised a greater role for Cleveland business leaders in local policies, which he delivered through the creation of multiple business and advocacy groups. The most prominent of these groups was Cleveland Tomorrow, which was patterned on Pittsburgh's Allegheny Conference (Pittsburgh began planning its urban transformation as far back as the 1940s), a group that focused on offering policy advice to make the city's manufacturing sector more competitive, increase entrepreneurship, and redevelop downtown Cleveland. Cleveland Tomorrow expanded its reach to include support for constructing the city's new baseball stadium / basketball arena complex as well as to raise money for Cleveland Public Schools in order to protect it from a potential state takeover. Eventually, the majority of these various advocacy groups united to form the Greater Cleveland Partnership, which focused most of its energies on reenergizing city neighborhoods, encouraging a larger role for regional foundations, and coordinating marketing and public relations efforts to promote Cleveland (Royce Hanson, Hal Wolman and David Connolly 2006, 7).

Meanwhile, after collaborating with city and regional groups, as well as neighborhood residents and stakeholders, the Cleveland City Planning Commission authored "The Connecting Cleveland 2020 Citywide Plan" to guide regional economic development for future decades (Cleveland City Planning Commission). The Citywide Plan is an expansion of Cleveland's "Civic Vision 2000 and Beyond" plan, which had been created in the 1990s and included both land-based and people-based strategies to revitalize the city.

Philadelphia's financial crisis festered for many years before reaching a crisis point in the early 1990s. The so-called "City of Brotherly Love" became the first US city to impose a municipal income tax in 1939. Philadelphia's income tax floated within a range of 1.0-1.5 percent until the 1960s when it began to increase, rising to 3.0 percent in 1970 and to

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[4] MUNY was a popular reference for the Cleveland Public Power Authority.

almost 5 percent by 1985. The city's increased income tax rate was a leading factor to motivate residents to migrate to suburban communities. In 1990-91 a structural budget deficit of $135 million was revealed and the outlook predicted even deeper budget deficits in future years. The city received short-term financial assistance from the Pennsylvania Intergovernmental Cooperation Authority (PICA). PICA successfully sold bonds on Philadelphia's behalf, but in return it required the city to adopt a five-year financial plan that was subject to its approval in order to gain access to capital markets and state funding. Mayor Ed Rendell and the city conformed to the five-year plan through privatizing selected services, and introducing more competitive bidding for city projects and freezing wages. These actions helped Philadelphia's recovery in the late-1990s. Philadelphia also lowered its commuter tax in 1995, converging city and suburban residents' respective tax burdens. Some estimates conclude that Philadelphia's decisions to increase its city income tax cost the city 207,000 jobs during the 30-year period from 1973 to 2003. Two separate tax commissions created in the 2000s concluded Philadelphia's tax system was outdated and badly needed reform (Theodore Crone 1990; Economy League of Greater Philadelphia 1999, 3; Inman 2003; *Philadelphia Enquirer* 2014).

DC experienced such poor financial performance that it found itself in a negative cash position in the mid-1990s. A variety of causes, including declining population, a lengthy and ineffective procurement process, questionable accounting procedures, and increased reliance on Medicaid helped lead to this crisis. By mid-1995, the District confronted a shortfall of $722 million. In response to this crisis, Congress passed legislation intended to provide greater oversight. It created the DC Financial Responsibility and Management Assistance Authority, a Presidential-appointed control board that had the authority to pass or reject any laws passed by the DC council. The board would exist and continue its oversight until DC met a number of conditions including four consecutive balanced budgets, four years of unqualified audit opinions, the repayment of all Treasury borrowings, and proof of the ability to meet all normal business obligations (The Civic Federation; US House of Representatives 1995, 12; Washington Post 1997).

The legislation also created an autonomous chief financial officer (CFO) position for DC. Once appointed, the CFO could only be removed by the control board and would enjoy independence from the mayor when determining revenue estimations, the financial impact of any legislation, and whether the budget was balanced. Congress amended the original 1995 legislation two years later in 1997, and it provided the control board with even greater oversight over DC operations, while simultaneously increasing federal funding contributions to the District (Washington City Paper 2000). The control board was finally dissolved in 2001 after DC posted its fourth consecutive balanced budget (The Civic Federation; Washington City Paper 2000).

In addition to the aforementioned four cities, other smaller urban centers also experienced financial stress, most notably Baltimore and New Orleans. Baltimore's population loss, while sizeable, was not as large proportionally compared to Detroit and did not leave the empty geographic footprint that Detroit encountered. After the widespread devastation from Hurricane Katrina, New Orleans entered into many public-private partnerships that were crucial to that city's rebound (Scott Cowen and Betsy Seifter 2014, 98).

Despite the economic and demographic trauma that all these American cities endured, none of them were driven to the fate of outright bankruptcy. Instead, through the help of other governmental entities and community-based organizations, they were nursed back to a better condition. Detroit was not as fortunate because its deficiencies, though often the very same causes that tormented its fellow cities, were so much more severe. Ultimately, the drastic loss of population and its related tax base, as well as essential municipal processes such as multi-year budgeting, collaboration, and clear, unified communication were missing from Detroit. The consequence was that Detroit was quickly and dramatically forced into declaring bankruptcy.

Detroit Bankruptcy Timeline

Detroit's bankruptcy episode lasted 17 months (*Detroit News* 2014). After the initial site visit audits by the State of Michigan in 2011 and 2012, an updated financial emergency was declared in February 2013. Governor Rick Snyder declared that "I have determined that a local government financial emergency exists with the City of Detroit because no satisfactory plan to resolve a serious financial problem exists." An emergency manager, Kevyn Orr, was appointed in March 2013 (Michigan Department of Treasury).

Orr's team immediately went into action. By May, they were able to submit a preliminary financial and operating plan. The following month, they published a creditor plan that proposed to offer some creditors as little as under ten cents on the dollar and to suspend any payments on unsecured debt. Ultimately, he recommended in July 2013 to Governor Snyder that Detroit enter bankruptcy protection (Michigan Department of Treasury).

Before Detroit's bankruptcy trial could begin, the city had to be deemed as eligible to enter bankruptcy protection. To be eligible to file for bankruptcy under Chapter 9 bankruptcy protection, a municipality had to be insolvent, desire to affect a plan to adjust such debts, and negotiate in good faith with creditors. Despite Detroit's rushed attempt at negotiations with pensioners, Judge Steven Rhodes, determined that the city was eligible for Chapter 9 bankruptcy protection in July 2013. One of Judge Rhodes's key statements in ruling that Detroit was eligible for bankruptcy was determining that state and local pension obligations could be altered in federal bankruptcy court, despite the explicit protection for pension benefits under the Michigan State Constitution (Melissa Jacoby 2014, 852; Governing.com 2013).

In order to emerge from bankruptcy, Detroit needed the presiding judge, the creditors, and the pensioners to mutually agree to a plan of adjustment. When Detroit first filed for bankruptcy, the majority of analysts assumed that Detroit's plan of adjustment would take years to formulate through an arduous process that involved arbitration, court proceedings, and other negotiations. It was a daunting task. The city had extremely large obligations to pensioners, bondholders and many smaller creditors.

In recognition of the many challenges, Judge Rhodes enlisted fellow Judge Gerald Rosen to mediate talks between affected parties that would hopefully resolve issues in a timely manner, thereby speeding up Detroit's actual bankruptcy trial. These efforts, taking place outside of the traditional legal process, collectively became known as the "Grand Bargain". In December 2013, the Court declared that Detroit was insolvent and therefore eligible to be classified as a Chapter 9 debtor, an action that helped to incentivize creditors to work towards a collective resolution with the city.

At the heart of the Grand Bargain was a significant issue regarding the artwork that the City of Detroit technically owned and housed at the Detroit Institute of Arts. The Institute's substantial and significant collection had been built up for over a century through donations and purchases. In what turned out to be a consequential legal oversight, the Institute had never been spun off to become an independent legal entity charged to hold its assets in trust for the citizens of the city. This could easily have been accomplished. Instead, Detroit's direct ownership of the Institute's assets created the scenario where these assets became a potential financial target for the City's creditors. An appraisal of the Institute's holdings valued its collection at approximately $1 billion. Under bankruptcy laws, these assets were eligible to be auctioned off in order to generate funds with which to satisfy Detroit's creditors.

A rally of civic pride provided the impetus towards resolving the issue. The solution was for various stakeholders to, in effect, purchase the collection, with the proceeds being passed onto the creditors in order to motivate them to drop their claims to the artwork. The purchasing coalition included a state legislature appropriation of $350 million, over a dozen non-profit and philanthropic organizations collectively contributing $366 million, and a coalition of Detroit's major employers collaborating on a donation of $100 million, totaling an $816 million settlement price (City of Detroit: Office of the Chief Financial Officer).

One other significant element within Detroit's plan of adjustment was the preferred treatment of pensioners over creditors. Judge Rhodes terminated Detroit's existing interest rate swap deals, which provided those financial creditors only 30 cents on the dollar. The bond insurers of Detroit's general obligation bonds agreed to receive 74 cents on the dollar.

These agreements created an opportunity to lessen the concessions that were needed from the city's pensioners. The City's pension obligations represented a significant challenge for Detroit and its creditors. The dwindling tax base was funding the retirements for a large retiree force that had been employed when the City had supported a much larger population. Further, the City's public safety needs, served by police and firefighters, was more a function of Detroit's large geographic area than of population, meaning that even as the City fell into distress these expenses were extremely difficult to reduce.

Former and current city employees were faced with the stark reality that they had little choice but to accept significant pension reductions. The alternative was to engage in lengthy and costly court litigation where the ultimate outcome was highly uncertain. Pensioners sought the safer route and overwhelmingly approved the plan of adjustment. These concessions ultimately resulted in a 4.5 percent decrease in pension benefits, instead of the 26 to 34 percent that had been initially feared (City of Detroit: Office of the Chief Financial Officer; Reuters News Agency 2014; *USA Today* 2014).

The Grand Bargain, combined with the slew of creditor and employee concessions, and the sale of certain city owned assets, allowed Detroit to exit bankruptcy protection on December 10, 2014, a mere 17 months after the initial filing. As part of the final settlement, Detroit achieved a $7.3 billion reduction to its liability obligations. The major sources were $5.5 billion from pensioners and $1.8 billion from bond debt creditors. An additional feature of the Bargain was a commitment to immediately earmark $1.7 billion to address critical short-term deferred maintenance issues, particularly associated with essential public safety issues (City of Detroit: Office of the Chief Financial Officer).

Post-Bankruptcy Detroit

In retrospect, did the Detroit's bankruptcy create conditions for fundamental positive changes in the city's financial condition? Were the issues that drove Detroit into bankruptcy addressed? In large part, Detroit's emergence incorporated many of the elements that helped the aforementioned cities to recover. However, the major difference was the Grand Bargain, which immediately and materially reset Detroit's financial condition. As a result, state financial oversight was withdrawn in April 2018 (*Chicago Tribune* 2018).

Detroit has enjoyed a modest increase in employment from 208,289 in 2010 to 226,431 in 2018. The city, as part of its bankruptcy emergence, also agreed to a number of financial reporting requirements, including a four-year roll forward budget, something the City had never done previously. In February, 2019 the city submitted its forecast, which showed a gradual increase in annual revenues from $1.08 billion in fiscal 2020 to $1.12 billion in fiscal 2023. The city is now poised to cover its annual operating costs and maintain a steady employee head count. As a result of these actions, Detroit's Moody's bond rating, which had fallen from B2 to Caa3 between March 2012 and June 2013, rebounded to an improved rating of Ba3 by May 2018 (City of Detroit: Office of the Chief Financial Officer; Detroit Revenue Estimating Conference Report 2019).

Certainly, some things have not substantially changed post-bankruptcy. Although the city has diversified economically, it remains heavily reliant on the automotive industry. However, in the wake of bankruptcy, some significant domestic automakers indicated a desire to invest in Detroit. Ford has announced plans to develop autonomous vehicles in the Corktown District at the site of the city's former passenger train depot. Fiat Chrysler is expanding its Jefferson North plant. Auto-supplier Waymo announced that it intends to build its autonomous vehicles in Detroit and another supplier, Flex-N-Gate, plans to build a new factory that will employ 750 workers. In addition, numerous technology sector stalwarts such as Google, Microsoft, and LinkedIn have opened local offices in Downtown Detroit post-bankruptcy.

A more qualitative post-bankruptcy outcome has been the relationship between the private business sector and the city government. Improved coordination between Detroit's largest investors, the Mayor's Office, and City Council has resulted in an increase in jobs that have been relocated to the central business district and its nearby neighborhoods. It should be noted, however, that the city has incentivized many of these new jobs through tax credits and subsidies (*Detroit Free Press* 2019). Nonetheless, these investments have rapidly changed Detroit's infrastructure and skyline. An example of these investments include the new Little Caesars Arena, which serves as the home arena for both the Detroit Red Wings hockey team the Detroit Pistons basketball team, as well as the venue for many concerts. Another is Ford's aforementioned purchase of the Michigan Central Train Station, a multi-story building that had stood blighted and vacant for over thirty years. The Rock Ventures family of companies, through their real estate investment arm, have acquired numerous older downtown Detroit properties and have invested significant resources into refurbishing and modernizing them (*Crain's Detroit Magazine* 2018).

Business leaders and government officials have also worked closely together to improve public services. A newly-formed regional lighting authority replaced old streetlights with new LED streetlights. A regional water and sewer department authority was created to improve the efficiency of its operations. Public services were improved as emergency responses took less time, new transit buses were purchased, and programs to address Detroit's aging housing stock and blight were introduced. The city's stakeholders further cooperated to create the Detroit Future City Plan, a document that looks to shape city policy over the next fifty years (*Detroit Free Press* 2015; Detroit Future City Plan; Detroithomeloans.org; *MLive.com* 2014).

City government has also worked hard to promote regeneration in its neighborhoods, where the majority of the population is located. In 2017, Mayor Mike Duggan and Detroit City Council signed off on initiatives to promote making Detroiter residents more employable. As an example, developers who receive state and local tax incentives for substantial construction work must have 51 percent of their workforce comprised of Detroit residents or pay a fine. Any penalty proceeds are channeled towards providing training to city residents in skilled trades. Any new residential construction project that receives material public assistance must allocate at least 20 percent of its capacity to affordable priced housing. Separately, the Detroit Regional Chamber of Commerce and the Michigan Education Excellence Foundation created the Detroit Promise which guarantees any Detroit high school student two years of free tuition to area community colleges or four free years to in-state college institutions subject to certain guidelines (City of Detroit 2016; *Detroit Free Press* 2017a, 2017b).[5]

Despite substantial progress on many fronts, Detroit continues to face many challenges. As part of the bankruptcy settlement, the city is obligated to resume substantial annual contributions to Detroit's pension

[5] Note that: substantial contracts are defined as $3 million and above; material public assistance is defined as $500,000 and above; and affordable housing is defined as applying to population earning 30 percent of the area median income or below. Mayor Duggan was elected in and took office in early 2014.

funds in 2024. This large obligation results from the relatively modest pension cuts to retirees combined with a significant pre-bankruptcy pension funding shortfall (Pew Charitable Trusts 2018, 9).

Other variables have also worsened. Detroit's tax burden remains high for residents. Revenue sharing from the state remains below 2000 levels. Detroit's school system remains one of the lowest-performing in the nation (*Detroit Free Press* 2018). The probability of a regional mass transit system has declined after a failed ballot measure in 2016 and an inability to get one on the ballot in 2018. More fundamentally, while the city's population loss has slowed, its decline continues.

Detroit's Demise: Root Causes and Structural Changes

The root underlying issues that led to Detroit's bankruptcy, as well as the travails of other major American cities, are closely tied to technological and demographic change. Detroit's growth in the early 1900s was directly tied to trends linked to the Second Industrial Revolution. The growth of the American automotive industry created a voracious need for labor in newly constructed factories. Detroit's surge in population was largely propelled by the surging "pull" of factory jobs in manufacturing plants, which encouraged migration from other areas of the country.

The rise of American manufacturing also created conditions for the rise of organized labor. By the mid-twentieth century, Detroit thrived economically and was plainly viewed as a "Union town." General Motors, Ford, Chrysler, American Motors and other automotive industry-related businesses were making handsome profits. The unions were able to negotiate contracts that were very beneficial to their membership. By the 1960s, the region was home to a thriving blue collar middle class. The successful rise of organized labor eventually seeped beyond just the automotive industry. Virtually all of Detroit's city employees were also unionized during the post-war era.

So long as the Detroit economy pumped out products that met global demand, was home base to profitable companies, and enjoyed a healthy population that was actively employed, the city thrived. However, even as early as 1950, there were signs that the days of prosperity that had erupted around 1920 were short-lived. By the 1970s the above conditions constituting the pillars of civic prosperity were beginning to weaken rapidly. By the dawn of the twenty-first century, all of these factors were trending in a negative direction. Importantly, most of these developments were outside of city government's control.

In the wake of World War Two, Detroit's automotive industry was effectively in a monopoly position, but this dominance proved to be short-lived. Europe and Japan had been devastated by the war, their manufacturing infrastructure shattered. However, they re-industrialized in the postwar decades and by the 1970s the American automakers were already fighting for their survival in an intensely global market. In 1961, the United States built 6.7 million total cars and trucks, representing 43.8 percent of the world's total automotive production. Over the following decades the American market share dropped to 32.0, 21.4 and 18.6 percent in the years 1971, 1981 and 1991, respectively. By 2000 the United States produced 12.8 million total cars and commercial vehicles, a significant number, but this represented just 21.7 percent of global production. The situation worsened during the period immediately before Detroit's bankruptcy. American automakers, impacted by the economic downturn in 2008, produced only 7.7 million total vehicles in 2010, constituting just 10.2 percent of global production. Although the most recent data for 2018 show that domestic production increased to 11.3 million units and global market share to 11.8 percent, the American automotive industry has not regained its previous relative dominance in the face of growing international competition (International Organization of Motor Vehicle Manufacturers; United States Bureau of Transportation Statistics).

By the early twenty-first century, the so-called "Big Three" American automotive manufacturers were in financial distress in the face of this global competition. General Motors lost $40 billion and $31 billion in 2007 and 2008, respectively. Ford lost $3 billion and $15 billion during the corresponding period. Chrysler had merged with Daimler-Benz in 1998 and sold to Cerberus, a private equity fund, in 2007. Neither transaction improved Chrysler's overall financial health. In 2009 the United States government intervened to prevent General Motors and Chrysler from collapsing (Austan Goolsbee and Alan Krueger 2015, 4, 10-12).

Detroit was also directly impacted by the affluence brought about from the boom years. As many of the automotive employees enjoyed improved standards of living as a result of their collective bargaining agreements, many chose to leave the crowded and older infrastructure of the city proper for the many nearby suburbs that were newly built shortly after World War Two. In some cases, their jobs moved with them as the automotive companies and their suppliers began closing older and obsolete facilities in the city and moving their operations to the suburbs as well. This exodus accelerated in the wake of the city's 1967 race riots. By the 2010 census, Detroit's resident population had dropped to 713,777, a staggering 61.4 percent decrease from its high point in 1950. The population was further estimated to be only 688,740 by 2013. The labor force participation rate in 2013 was 52.9 percent, the unemployment rate was 14.9 percent, and the number of residents living below the poverty line was 40.7 percent, all lagging behind national averages (United States Census Bureau 2018; State of Michigan, Department of Technology, Management and Budget 2015).

Conclusions

Detroit's bankruptcy and emergence represents an important milestone in the history of American governmental finance. Detroit's example of a short bankruptcy period and a financial "reset" creates a benchmark model for how a community-centered response driven through a broad coalition of both private-sector and public-sector stakeholders can generate future prospects for effective local and state government in the twenty-first century. However, to truly assess both challenges and opportunities, it is important to realize that all of the major economic and financial issues that Detroit, New York City, Cleveland, Philadelphia and Washington DC encountered over the past several decades represent only the symptoms, rather than underlying causes.

Detroit's financial woes, and ultimate bankruptcy were largely the consequence of the downward spiral driven by three significant factors. These were technology change and the related phenomenon of globalization, urban demographic change and migration, and the short-sighted fiscal mismanagement and leadership of the city.

Detroit's economic rise and prosperity were linked to industrialization. The city was the world's dominant automotive center between 1920 and the first decades of the postwar period. However, the newly rebuilt factories of Japan and Europe, which incorporated the latest manufacturing technologies and cheaper labor, proved formidable competitors. Increased global trade made it easier for foreign car companies to sell in the American market. Further, the advent of the Information Age, brought about by commercial application of computer technologies, directly impacted the automotive industry as computer-driven machine tooling revolutionized the manufacturing process and reduced the need for line workers. American automotive manufacturers, which remain an important component to Detroit's economy, have rebounded after the bailouts of 2009, but remain challenged in a highly competitive market. Although the automotive industry remains a critical part of Detroit's economy, Detroit's central business district has benefitted over the past decade from the migration of the Rock Connections family of companies, owned by Cleveland Cavaliers owner Dan Gilbert. The largest of these companies, Quicken Loans, had over 17,000 employees based in downtown Detroit as of 2019 (The Rock Connections Family of Companies).

Detroit lost critical population to the suburbs beginning in the 1950s. However, numerous loft and other urban renewal residential projects have drawn a new and young population into the core downtown area to live. Several new restaurants have opened in the downtown area, drawing visitors from the suburbs. Despite the progress in the central business district, the city's neighborhoods remain challenged as a result of aging infrastructure and abandoned properties.

Detroit also remains financially challenged. However, the bankruptcy episode has provided the city with a genuine opportunity to re-establish itself as a well-run municipality that attracts both residents and employers. The city government, which had unsuccessfully dealt with declining tax revenues, is on much firmer ground as a result of the State of Michigan's financial reporting and forecasting requirements. As an example, Detroit engaged in a significant project to reassess property values. The end result was that even though the value of the property tax base was reduced, financial markets were pleased with an improved process. Detroit's improved bond rating stands as testimony to improved perceptions of its financial condition.

A significant number of American cities share Detroit's attributes. Many of them, particularly in the American Midwest, grew rapidly as a result of the rise of American manufacturing during most of the twentieth century. The national transition to the Information Age brought about by computers has caused a shift in employment towards more service sector and fewer manufacturing jobs. These service sector jobs, particularly in technology and commerce, can often be quite lucrative. As a result, many people have left cities like Detroit and moved to other parts of the country where service jobs are plentiful, a reversal of the demographic trend that had enriched Detroit's labor market from the 1920s. The growing affluence of Americans has also generated a significant demographic shift of population from core cities to suburbs.

In the face of these trends, for many large American cities to remain viable and relevant, they need to adjust to economic circumstances that are far different than the previous century. While manufacturing will never completely disappear, major cities of the twenty-first century must become attractive to service sector companies and employees. The bankruptcy and the Grand Bargain relieved Detroit from past sins that it was simply not capable of working through. The rapidity of the process had the benefit of restoring confidence with the business sector and with capital markets. The city is now free to aggressively seek out public-private opportunities that will bring both jobs and residents to the city. That, in turn, will lead to increased ancillary services to service the growing population. Detroit's pre-bankruptcy situation and circumstances, unfortunately, are likely to happen to other large American cities in the near future. When that happens, civic and business leaders will be wise to look at Detroit's Grand Bargain as a model for restoring a city to financial health and creating a path to be reborn as a vibrant twenty-first century urban center.

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