The Philadelphia Inquirer

Avoiding Detroit's crash

Once a boomtown, the Motor City now is a sad warning. But Phila. and others don't have to follow in its path.

 By Mark Zandi, July 28, 2013

Is Detroit's bankruptcy an omen or an anomaly? Will other American cities, such as Philadelphia, eventually go down the same dark financial road? Or is the Motor City's financial crisis an isolated event?
Detroit's story is a cautionary tale. The city's economy soared with the advent of the automobile a century ago, making companies such as Ford and General Motors the Apple and Google of their day. The population ballooned, rising to nearly two million after World War II.

A city that big requires lots of government services, including schools, police, fire, sanitation, and social services. Government jobs paid well and offered hefty health and retirement benefits. Indeed, city workers were willing to forgo some pay increases in exchange for better benefits. City leaders were happy to oblige, saving cash while passing the retirement and health costs on to future taxpayers. Everyone assumed the strategy would work because Detroit's economic future was bright and its population would surely continue to grow.

But prospects dimmed for U.S. automakers, and Detroit, as gasoline prices soared and foreign competition grew fierce in the 1970s and 1980s. U.S. automakers fought back by cutting prices and offering car buyers cheap financing, but failed to innovate and produce cars Americans actually wanted. Moreover, the carmakers had promised their workers overly generous pension and health benefits. When the Great Recession struck, only a federal bailout saved two major U.S. automakers from extinction.

Hundreds of thousands of jobs have been lost over the decades, and Detroit has hemorrhaged people. Many left to work in newer auto plants in Kentucky, Georgia, or other states. Others moved to the cheaper, cleaner, and safer suburbs. The city is a blighted shadow of its former self, with closer to 700,000 residents living amid tens of thousands of abandoned homes and buildings.

All this would have been devastating even for a well-managed city, but Detroit's leaders were myopic. Ironically, they were also hamstrung by leaders of the auto industry - the city's largest taxpayers, philanthropists, and political contributors - who had little interest in attracting other industries to diversify the city's economy.

Elements of Detroit's story are all too familiar. Across the country, many municipalities have seriously underfunded pension and health plans. It is not difficult to construct scenarios in which they won't be able to meet their obligations to tomorrow's retired workers. The problem will become especially acute in the next decade, as the bulk of the baby-boom generation retires. Many strapped municipalities will have no way out but bankruptcy. Indeed, a wave of municipal bankruptcies could be at the center of the next serious financial crisis and recession.

But it doesn't have to be this way. Since the problem is clear and at least a few years off, it can be addressed now. The best course is for cities to grow and diversify their economies. On this point there is reason to be somewhat optimistic, particularly about Philadelphia. The region's economy has a demographic tailwind, from aging baby boomers who are already using more health-care services. Philadelphia is home to some of the nation's largest and most highly respected health-care firms. The pharmaceutical, hospital, biotechnology, medical instrument, and medical software industries are well-represented in our area.

Also, the large baby-boom echo generation - the boomers' kids - are in their 20s and increasingly seeking to improve their economic prospects through education. Few American cities have as many world-class institutions of higher education as Philadelphia.

Philadelphia's economy is also among the nation's most diversified. It depends not on a particular industry or company but on myriad industries and midsize companies. This means the economy is less likely to boom - when one industry is up another is likely to be down - but it also means the Philadelphia economy will not suffer the same downdraft as Detroit's.

However, Philadelphia's leaders must do more to ensure bankruptcy is not in the city's future. It is critical that city and suburbs work together to attract new businesses and industries. A fragmented region, competing with itself for growth, will lose out to highly organized and committed cities in other parts of the United States, and increasingly from overseas. We compete against places, from Austin, Texas, to Singapore, where civic and business leaders speak with a unified voice.

We also need to speak louder if we want to be heard. Philadelphia's quiet Quaker culture has its merits, but it won't create the buzz necessary to attract and keep the best and brightest. They are the essential raw ingredients for entrepreneurship and innovation, which are ultimately the fountain of jobs and wealth.

Even if Philadelphia succeeds in ramping up growth, avoiding bankruptcy will likely require difficult choices by both public employees and taxpayers. The city will need to contribute more to its pension and health plans, and the plans will need to be rightsized to reflect the financial realities of today's workplace and the likely lower returns on investments that fund payments to future retirees.

Philadelphia is not Detroit, and Detroit's bankruptcy doesn't have to be an omen. But only action will make this so.

Mark Zandi is chief economist of Moody's Analytics. He can be reached via help@economy.com.

http://www.philly.com/philly/news/20130728_Avoiding_Detroit_s_crash.html