Lesson from Detroit's Bankruptcy

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In mid-July of 2013, the City of Detroit, well-known as the world's automotive center, filed for bankruptcy to the local court. No one has ever thought previously that the city once was an example of the development model for cities in the United States filed for bankruptcy due to inability to pay all its financial obligations to its creditors. The collapsed of Detroit is considered as one of the largest bankruptcy for the cities in the United States so far. With total debt amounted to USD18.5 billion, City of Detroit was in the position it could no longer be able to pay its debts. Of the total debt, USD1 billion was the debt on the general obligation bonds, and USD5.3 billion in debt on revenue bond guaranteed by the proceeds from drinking water over the drainage system (Revenue Bond). Detroit's biggest debt was the funds for retiree health coverage (Medicare), reaching USD9.2 billion. Each year, City of Detroit is obliged to pay its debts of more than 38 % of the total annual budget. Detroit's annual budget in 2013 was close to USD3.1 billion, so that every year it should set aside significant fund from its budget to pay its debt as much as USD1.2 billion. The enormous amount needed to pay its debt has limited city's capacity to finance its public services.

Detroit's bankruptcy most likely was caused by several factors: First was the decline in the performance of its automotive industry. Since 1950, many migrant workers from other cities in the United States came to Detroit to work in the automotive industry. The big automotive companies during that golden time in Detroit such as Ford, Chrysler and General Motor Company were competing to recruit employees. When cars from Japan's and European's manufacturers began to enter American market, automotive industry in US started to decline. The biggest problem for the City of Detroit was that it has not been able to find another industry that could substitute the automotive industry as a driver for the city economy.

The second major cause was attributed to a decline in the Detroit's population. For every city, population is a driving force for City development. Bigger population will contribute to the higher income for the government through taxes and fees. City of Detroit's population dropped roughly 26% in 2012 compared to 2011. In 1950 the population of Detroit reached nearly 2 million people, but in 2012, the number of population in Detroit was only about 700,000 people, compared to the population of Bandung, which was more than 2 million people in 2012. With that small in population, City of Detroit was certainly difficult to get enough income from tax revenue to fund public services. The consequence of this low revenue, City of Detroit must do a massive efficiency. In 2012, only about 60% of the city lights were functioning, security services dropped dramatically and the number of crimes increased. High unemployment rate gave even more burden to the city. In 2012, its unemployment rate was standing at 18%, higher than national average.

The third possible cause was the failure of the City of Detroit to manage its finances, especially in balancing city's revenues and its expenditures. The obligations to finance its retirees and public health insurance (Medicaid) became one of the main factors inability Detroit City to finance public services. When City's revenue declined but the obligation to pay retiree healthcare sustainably increasing, Detroit's fiscal condition would be eroded.

Valuable lessons for local governments in Indonesia

Currently, borrowing for regional development or for operational expenses is not common for local governments in Indonesia. Foreign debt and bond are still dominated by the central government. However, a rapid regional development will need huge funding to finance the projects and sooner or later local governments need to explore other source of funding for their development. Municipal Bonds and other borrowing scheme are some of funding sources. Bankruptcy of City Detroit can be a very valuable lesson that local governments must always be careful in managing their finances, especially if the regional government decided to make loans or issue municipal bonds. There are some important lessons that can be learned from bankruptcy case:

1. **A Good financial management is an absolute requirement in order to avoid bankruptcy**. From budget preparation process, to revenue and expenditure Management, to

preparation of cash flow and capital investment to debt management must be managed and supervised very prudently. Without good financial management, it would be difficult for regional governments to provide good public service. Financial management system will be well managed if it is supported by a very high qualified personnel. Therefore, training and capacity building of public employees are absolutely necessary.

2. **Dependency on one major industry sector.** One of major causes of the decline in Detroit's economic was due to dependence on the automotive industry. The dependency to this industry was really high for city of Detroit. For years automotive industry was a major industry for city of Detroit's economy, but the city failed to nurture other industries to support Detroit economy when auto industry experienced the decline. In Indonesia, some cities are very dependent on one major industry such as oil and gas, or agricultural products. For local governments having oil and gas industry as major contributor to the economy, they should be able to exploit this oil and gas industry's contribution to start developing other sectors as a supplement or a substitute if a contribution of oil and gas industry started to decline. Local Governments, on the other hand, should be very active and creative in creating new alternative industries to foster regional business so that local economy is not relying heavily on one sector only.

3. **Regional Government should be more prudent and careful in making decision to borrow money**. Borrow money to cover the operational expenditure is extremely unwise. Routine or operational expenditures should be financed by local or regional revenue. Local governments should have capacity to make budget in accordance to its financial capacity. Borrowing should be used to finance activities or projects producing revenue. Regarding the regional borrowing to finance regional projects that generate revenue has been set in Government Regulation No. 30 of 2011 regarding regional borrowing.

4. **Properly manage and empower local residents.** Population is an important element and valuable capital for the government. Number of population will directly relate to the revenue potential of the region because large population means higher tax revenues and higher levels of consumption. Taxes and consumption can drive the local economy. Because the existing population is very important, it is also important that residents should be empowered and well managed. Providing good employment and good infrastructure is an absolute importance for Government Authorities to handle. Should Local Governments failed in empowering their people, bigger population can lead to serious social problems instead. Unemployment, crime, as well as the provision of health facilities and housing are critical issues that need to be taken care of by Local Authorities.

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