# Manufacturing Bankruptcy – The assault on pensions

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Pension theft: imported from Detroit? In giving the state-appointed Detroit Emergency Manager Kevyn Orr the green light to take the city into bankruptcy, U.S. Bankruptcy Judge Steven Rhodes' December 3 ruling opens up a national offensive to loot public sector workers' pension and health care benefits.

Within a week *Forbes* magazine, aimed at audiences who don't rely on public sector pensions for their secure retirement, published an article proclaiming "a silver lining" to be found in the ruling. The author, Martin Fridson, believes this teaches public sector unions that it will be safer to negotiate 401(k)-type plans, which "belong" to the worker and would not figure into future municipal bankruptcies. He does not mention, of course, that such plans typically pay significantly less than the traditional defined-benefit pension plan.

The same day as Rhodes' bankruptcy ruling, the Illinois legislature cut cost-of-living raises on that state's plan. As in Michigan, Illinois public pension rights are guaranteed under the state constitution. No matter, according to Judge Rhodes' ruling. They're on the chopping block, along with all of Detroit's material assets. The pillage is on. And the implications are staggering not only for Detroiters but nationally, as the Detroit bankruptcy ruling is considered to mark new legal precedents in previously uncharted legal territory.

To understand the politics behind Detroit's manufactured bankruptcy, one has to unpack the essence of capitalism. It is capital's expropriation of assets — land, nature's resources and workers' capacity to produce — that produces wealth. There's also a clear policy of Michigan's elites: After so many years of corporate downsizing and relocation, after so many years of renovating Detroit's downtown at the expense of the neighborhoods, their "solution" is deepening austerity and abandonment for much of the city's African-American, working-class majority.

### Trending Downward

It used to be that 40% of all U.S. workers received pensions. Although corporations have cut that figure in half over the last 30 years, more than 80% of all public sector workers still have defined-benefit pensions. Studies have shown that these workers make less than private-sector workers, but in this era of neoliberalism, it's the public sector workers who are on the hot seat.

The attack on pensions, which began in the corporate sector, is spreading now to a full assault on public workers. Teachers and other municipal workers are demonized as lazy and overpaid. Since proportionately more African Americans and women are public sector workers, the racism and sexism that infects our culture is an additional factor in viewing these workers as "undeserving."

State pension funds currently top $2.6 trillion. In 15 of those states, public employees do not receive Social Security so they are entirely dependent on pensions and their own savings in their retirement. These include California, Illinois, Massachusetts, Ohio and Texas. In Detroit, uniformed (fire and police) workers aren't in the Social Security program.

When the economy heated up in the 1990s, states were advised that they didn't need to contribute to the pension funds; high interest rates alone were enough. Since accounting standards for public sector pensions are lax, officials were able and delighted to act on that advice! Then, when the bubble burst, many states skipped their contributions as a way to balance their budgets.

As a result, two-thirds of state pensions are now considered underfunded, meaning that they do not have enough money to cover all the long-run claims of their work force. Supposedly Illinois is about 67% funded while New Jersey is at 33% and Massachusetts stands at 27%.

*Percentage of state pensions being funded by state.*

This underfunding, the result of bad advice by high-paid financial advisors and banks and indolence of state legislatures, also seems to be a convenient setup for the next stage of making working people pay. In April 2013 Moody's, one of the biggest rating companies, changed the way they evaluate pension assets. Instead of using a formula to smooth out market price fluctuations over a three- to five-year span, they will only count the current market value.

Another important change that Moody's instituted is to assume a yearly interest rate on investments of 4.5% rather than the 7-8% (admittedly, wildly overoptimistic in the post-2008 Great Recession climate, but historically reasonable) that had been used. In a recent article Dean Baker pointed out that over a 20-year period the difference would result in a 40% decline in value. (See Dean Baker's "The Financial Health of Public Pensions," 5/3/13 at http://www.cepr.net/index.php/blogs/cepr-blog/today-the-financial-health-of-public-pensions.)

**Next Stage for Detroit**

The pensions that the city owes to 30,000 retirees and the thousands of active city workers now have no greater standing than any other "unsecured" creditor. "Unsecured" means that there is no stream of revenue, such as a tax or fee, dedicated to paying the debt. Of course, city workers for decades have contributed a percentage of their earnings, and the city has put in money toward these funds. Currently the two city pension boards control more than $5 billion worth of investments. But in bankruptcy those funds are effectively up for grabs and their boards subject to dismissal by Emergency Manager Orr.

The bankruptcy process, Judge Rhodes ruled, will proceed without interruption. Next, Orr will develop a "plan of adjustment" by early 2014 and reopen negotiations with those "unsecured" creditors, including workers, who are expected to take a haircut. In reducing those obligations, Orr would supposedly free up that money to rebuild the city's deteriorating infrastructure. However $62 million has already been spent to pay multiple "consultants" for their restructuring proposals, including Orr's own former law firm Jones Day.

The big question for the shock-doctrine restructurers may be how far pensions can be cut for retired city workers — many of whom barely get by as it is — without running the risk of a political or social explosion. That may be an underlying reason why Rhodes announced that he would not necessarily rubberstamp Orr's plan.

The suggestion Orr has floated is that pensions would be tiered, with some receiving close to their current payment (an average of $19,600 for city workers and $30,000 for police and fire). For the current work force, at least those who become "vested" with three years seniority, their retirement contributions would be transferred to individual 401(k)-type plans, with limited city contributions. These workers, who have already taken a 20% pay cut and contribute 20% to their health care benefits, would be free to add to their account — if they can afford it! — and could expect a retirement benefit between 25% and 50% of their pay.

What then might happen to the pension boards, which are made up of officials and elected union representatives? The Emergency Manager's claim that the pensions are underfunded opens the door to seize and turn them over to the State Treasurer. According to the Emergency Manager law (PA 436) rushed through the legislature and signed by governor Rick Snyder — after a referendum vote in the November 2012 election voided the previous version, PA4 — if pension funds fall below 80% of the total obligation, the EM has the go-ahead to snatch them up. Since his appointment by the Governor in March 2013, Orr conveniently skipped the city's 2013 contribution.

The police and fire pension board maintains that it is funded at 96%, while the city pension board's funding stands at 78%. Orr asserts that both funds are significantly less healthy, and given that he used a different formula for evaluating the funds, it's understandable how he came to such a dire conclusion. Yet one might wonder why long-term debt features so prominently in the discussion. After all, most homeowners have a longterm debt (their mortgage) but don't count the total amount owed when they are figuring up their yearly cash flow.

The banks — who have stiffed the city with huge fees, variable interest rates and taken advantage of lowered bond ratings to jack up the interest, to say nothing of foreclosing on thousands of financially distressed Detroit homeowners — aren't penalized to pay for their role in creating the mess. Quite the contrary, they're first in line for repayment, under the pretext that their loans are properly "secured" through pledged tax revenues.

**A Way Out?**

Demos, a public policy think tank, released a report authored by Wallace Turbeville, who examined the city's finances and concluded that its problem stems from a decline in revenue, not from obligations to the so-called legacy costs. He points out that the $18 billion debt that Orr maintains is the city's albatross includes both "secured" debts — such as the $5.8 billion Water and Sewerage Department debt, which is covered by the fees charged to the three million users throughout southeastern Michigan — as well as pension and health care costs. He suggests these obligations are overstated and in any case irrelevant to solving the city's cash flow problem.

Chapter 9 allows for municipal bankruptcy when it is unable to pay its debts as they come due. According to Orr's bankruptcy filing, the deficit is $198 million for fiscal 2014.

Certainly with the city's longterm decline in jobs and infrastructure, Detroit is continuing to lose population — a 53% decline in employment and a 25% population decline between 2000-12.

What has Michigan done to help its largest city? Since 2011 alone the state has cut $67 million a year in revenue sharing to Detroit. (About $24 million is the result of the decline in population, but

that still leaves $43 million that the city should have received.) It has done nothing to make sure commuters who work in private sector jobs in Detroit pay non-resident income taxes, costing the city an estimated $30-45 million annually.

Both Democratic and Republican governors have taken over the school system, resulting in closing 200 schools, approving for-profit charters and driving the system into debt. Governor Snyder keeps telling Detroiters that he is only “trying to help” as he appoints Emergency Managers to both the city and the school system. At the same time, Snyder has enthusiastically supported Mike Ilitch’s proposed downtown sports arena, offering to contribute some $300 million in state funds.

Meanwhile, Detroit cut operating expenses by nearly 38% between 2008 and 2013 — mostly by laying off 2,350 workers, cutting pay and reducing benefits. Pension contributions were relatively flat during this period while healthcare contributions increased 3.25% per year, less than the national average of 4%. City workers protesting the bankruptcy speak from experience when they say that they have already been fleeced.

One reason for Detroit’s fiscal debacle is the downturn in the stock market at the time the housing bubble burst. When mayor Kwame Kilpatrick entered into a bargain with Wall Street in 2005-06 via Certificates of Participation instead of general bonds, they wined and dined him. These certificates were essentially a gamble that variable interest rates would go up, making them more valuable for the city. Once the Federal Reserve, in response to the economic crisis, set rates near zero, the city (like many homeowners) went underwater, its credit rating downgraded.

This is the way the scam worked in Detroit: The city was deliberately underfunded and the infrastructure took a hit, then city officials listened to various financial advisers and borrowed recklessly from the banks — racking up huge fees and agreeing to risky variable rates. Now the deficit is overstated by the trickery of combining short- and long-term obligations, and public sector workers take the fall.

Detroit’s bankruptcy is manufactured and manipulated, but the crisis is real. The fact is that neither Detroit, nor any other municipality or state in the same sinking boat, can cut, slash and burn a way to a viable future. The way out is not to destroy the safety net, but to expand it. With retirement savings next to impossible for more and more families, Social Security needs to be substantially increased. Health care needs to be guaranteed by a “single payer” system of Medicare for all.

Can we free the resources now wasted on military and prison spending, and massive corporate subsidies, to rebuild our cities and turn to production for human need and a sustainable environment? The answer: Yes we can; but no, capitalism won’t.

**The Editors of *Against the Current*** , December 19, 2013

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* http://www.solidarity-us.org/site/node/4056