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Pinching Pensions to Keep Wall Street Fat and Happy

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The debate over public pensions shows clearly the contempt that the elites have for ordinary workers. While elites routinely preach the sanctity of contract when it works to benefit the rich and powerful, they are happy to treat the contracts that provide workers with pensions as worthless scraps of paper.

We see this attitude on display currently in the Detroit bankruptcy proceedings. It is even more clearly on display in efforts by Chicago Mayor Rahm Emanuel to default on the city's pension obligations.

The basic story in both cases is that the contracts that workers had labored under are being laughed at by the elites because they find it inconvenient to carry through with the terms. In the case of Detroit, public sector workers face the loss of much of their pension as a result of the city's effort to declare bankruptcy.

These workers could be forgiven for laboring under the illusion that they would see the pensions for which they worked. These obligations were actually guaranteed under the state's constitution.

But Detroit's emergency manager, Kevin Orr, thinks a constitutional guarantee is just a joke that you tell people to trick them into working. Even though the City of Detroit is legally a creation of the state of Michigan, Orr believes that he can ignore the state constitution and pursue a federal bankruptcy that could have workers' pension cut by as much as 90 percent.

As bad as the story is in Detroit, there is the reality that the city really does face an economic crisis. Its population has shrunk more than 60 percent from its heyday in the 1950s. At the national level, Detroit has been the victim of policies designed to weaken U.S. manufacturing to the benefit of finance, like an over-valued dollar. At the state level, it has suffered from an urban policy that invited middle class people to escape from Detroit's social and fiscal problems by stepping over the city line.

Chicago presents a qualitatively different picture. It is a vibrant city with a diversified economy. While large chunks of Detroit have been nearly abandoned, developers are moving to build on long abandoned railroad yards and factory sites in Chicago. In Detroit, paying for pensions or anything else without outside assistance poses a real problem. In Chicago, the cost of the city's pensions is an inconvenience.

While media like to play the scary number game -- $20 billion in unfunded pension liabilities -- this comes to about to about 0.5 percent of the city's GDP over the next 30 years, the time period in which the shortfall would have to be made up. The city could of course raise this much revenue, but the current mayor Rahm Emanuel thinks it would too inconvenient. And hey, these are just contracts with workers, not obligations to people who really matter.

Emanuel's cavalier attitude toward contracts with the city's workers apparently does not apply to its other contracts, for example its deal with Morgan Stanley to lease its parking meters for 75 years. The city arguably received less than half the market price for this long-term lease, but Emanuel apparently thinks the city can still afford to honor its contract with the huge Wall Street bank.

Contracts with Wall Street types always seem to draw more respect than contracts with workers. Folks may recall that when AIG was bankrupt and effectively a ward of the government, we were told by the Obama administration (where Emanuel was then chief of staff), that it had to pay out $165 million in bonuses to its senior staff. Many of the AIG employees, who had taken the company into bankruptcy, pocketed hundreds of thousands of dollars from these bonuses.

By contrast, the pensions for Detroit's retirees average just over $18,000 a year. That means many AIG executives got a larger bonus from their bankrupt company in 2009 than Detroit workers will collect over their whole retirement. (Chicago's average pension is somewhat higher at $33,500, but workers do not get Social Security, an important fact left out of most reporting.)

The other notable instance where we have gotten lectures recently about the sanctity of contracts has been with underwater mortgages. Most lenders have been very reluctant to do write-downs, even though it is unlikely that they will ever collect the full amount from these mortgages.

Several cities, most importantly Richmond, Calif., are making plans to seize underwater mortgages through the use of eminent domain. This would then allow them to issue new mortgages to homeowners based on the current market value of their house.

It is important to remember that in such cases the holders of the mortgages are still entitled to the fair market value and can sue in court if they don't consider the city's offer fair. Nonetheless, we are still getting lectures about sanctity of contract. In fact, the federally controlled purchasers, Fannie Mae, Freddie Mac, and the Federal Housing Authority have openly threatened to use their dominance in the secondary mortgage market to punish any city that goes this route.

So there is a clear lesson on morality in modern America. Contracts are sacred when respecting them works to the benefit of the rich and powerful. Contracts that imply obligations to workers, like pension commitments, are a joke. Got that?