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Detroit Bankruptcy: Wall Street, Lost Revenues Forced Decline, But City Pensioners to Pay the Costs

A federal judge has approved Detroit's bid to qualify for bankruptcy, putting the city on a path to financial recovery — but threatening the livelihoods of thousands of city workers. In a landmark decision that could harm retiree benefits nationwide, Federal Judge Steven Rhodes ruled that federal bankruptcy law can override state laws that protect public pensions. That clears the way for Detroit to make major cuts to the health and retirement benefits of city employees. The city faces about $18 billion in debt, of which $3.5 billion is pension obligations. Detroit's emergency manager, Kevyn Orr, has told public unions to brace for "significant cuts," but has not laid out details. Workers' pensions in Detroit average around $19,000 per year. By the new year, Orr will present a "plan of adjustment" in bankruptcy court that will clarify how much pensions will be cut. The plan may also include a "fire sale" of city assets that could result in public utilities and the Detroit Institute of Arts collection being bartered off to private bidders. Detroit's bankruptcy filing marks a grim milestone in the decline of what was once the country's fourth-largest city, known as the Motor City, the birthplace of the middle class. We are joined by Wallace Turbeville, senior fellow at Demos and former Goldman Sachs executive who has just authored the new report, "The Detroit Bankruptcy." Turbeville argues that Detroit's problems stem not from its liabilities but from a decline in public revenues and involvement in harmful Wall Street schemes.

TRANSCRIPT

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NERMEEN SHAIKH: We begin with Detroit, which has become the largest-ever U.S. municipality to qualify for bankruptcy. On Tuesday, Federal Judge Steven Rhodes ruled the city meets every criteria for insolvency, including failure to honor its debt obligations and inability to provide the bare minimum services to its 680,000 residents. This is Detroit's mayor, Dave Bing, responding to the ruling.

> **MAYOR DAVE BING:** Let me just say that the judge has spoken, and I do think it's a tough day for all of us here in Detroit. I believe, since I came to office with the crisis that we had, this was inevitable. I don't think anybody necessarily wanted to go in this direction, but now that we are here, it's more important that we work together as opposed to continuing to fight each other.

AMY GOODMAN: That was Detroit Mayor Dave Bing. The bankruptcy ruling puts tens of thousands of retired city workers' pensions at risk, overriding protections in the state constitution. The city faces about $18 billion in debt, of which $3.5 billion is pension obligations. Detroit's emergency manager, Kevyn Orr, has told public unions to brace for significant cuts but has not laid out details. General workers' pensions in Detroit average around $19,000 per year. Orr welcomed Tuesday's bankruptcy ruling.

> **KEVYN ORR:** We are gratified with the court's ruling today regarding the city's eligibility to pursue a plan of adjustment under Chapter 9 of the federal bankruptcy code. While we are very pleased, we remain very concerned about the need to adjust the city's debt, to improve its level of services for its citizens, and to also prepare for the city to exit this receivership in a fashion that restores democracy to the city.

NERMEEN SHAIKH: That was Detroit's emergency manager, Kevyn Orr. By the new year, Orr will present a, quote, "plan of adjustment" in bankruptcy court that will clarify how much pensions will be cut. The plan may also include a "fire sale" of city assets that could result in public utilities and the Detroit Institute of Arts collection being bartered off to private bidders. Detroit's bankruptcy filing marks a grim milestone in the decline of what was once the country's fourth-largest city, known as the Motor City, the birthplace of the middle class.

Opponents of Detroit declaring bankruptcy say the city failed to engage in good-faith negotiations with retirees and municipality workers. Emails from before Orr's appointment reportedly suggest that bankruptcy was a foregone conclusion. The local chapter of the American Federation of State, County and Municipal Employees, or AFSCME, has already appealed the bankruptcy ruling in a bid to protect its union members' pensions and benefits.

AMY GOODMAN: Meanwhile, a new study says Detroit's emergency manager may be exaggerating claims of an $18 billion debt while misplacing blame for the city's fiscal woes. The progressive think tank Demos says Detroit's problems stem not from its liabilities, from a decline, in fact, in public revenues and involvement in harmful Wall Street schemes.

To talk more about the crisis, we're joined by the Demos report author, Wallace Turbeville, senior fellow at Demos and author of the report, "The Detroit Bankruptcy." He's formerly a vice president at Goldman Sachs in the municipal finance department.

And in Detroit we're joined by Edward McNeil, who worked for the city of Detroit for 25 years as an arborist. He retired in '98 and now works for AFSCME Council 25 in Michigan, one of the union representatives currently bargaining for the rights of Detroit's employees and retirees.

We welcome you both, Wallace Turbeville and Edward McNeil, to *Democracy Now!* Wallace Turbeville, can you explain to us what is it—who is responsible, who is responsible for Detroit's woes?

WALLACE TURBEVILLE: Detroit has several kinds of woes. Detroit has had some deep structural problems for many years: a declining population, a job market that's been particularly susceptible to downturns in the economy, and a real decline in housing. Those structural issues have been going on for a long time. The other thing that's happened—they're related, but they're different—is that it ran out of cash, ran out of cash this year. And when you talk about insolvencies of municipalities, bankruptcies of municipalities, it's all about running out of cash. So they need to fix very important structural problems. They also need to get their checkbook balanced so that they're actually—have money coming in that's—that it covers the money that has to go out on an annual basis. So, that part is—what we find in the report is that part of it, the cash part of it, is overwhelmingly a function of a tremendous downturn in the revenues of the city, in the tax base of the city, and, importantly, money that the state collects in taxes and turns back to the city in terms of revenue sharing. That was a critical part of the problem.

AMY GOODMAN: The way the corporate media is portraying this, they say, you know, politicians, Republican and Democrat, they cave to unions, and so over the many, many years around the issue of pensions, for example, you know, they give in, in union negotiations, and so the unions are bringing this city down, Detroit known as a union city. You found something very different.

WALLACE TURBEVILLE: Oh, absolutely. First of all, something that happened five, 10 years ago, I'm not even—I don't even comment on that. This is a battle of ideas and of words—the $18 billion number, bringing up things that happened years ago and saying it was a function of bad management and that's what's the problem now. No, the problem now: They're out of cash. Those are two different things completely. But the point is that the facts don't show, as we sit here today and as we look at the last five years, that any of that's true. Thirty—the city cut—has cut its operating budget by 38 percent in the last five years in response to the Great Recession. So, the benefits—in the report we talk about the healthcare benefits, are very comparable to other cities. And if you—we've got that all laid out; anybody who wants to go look can think of their own health insurance and whether it's comparable. It is. The issue of pensions, $19,000 a year for non-uniformed employees, I have to ask: Does anybody think that's excessive? The figure is $30,000 for uniformed employees. If you look at—

AMY GOODMAN: Police, firefighters.

WALLACE TURBEVILLE: Police and fire. If you look at that compared with, you know, every other city in the United States, it's on the low end. So, there is no demonstrable evidence that this cash crisis has been caused by the expense side of the ledger, leaving aside some of the financial deals.

NERMEEN SHAIKH: So what is it, Wallace, about a municipal bankruptcy that people should understand? First of all, how often is it the case that cities in the U.S. run out of money? And what brought Detroit to this point? And why is it that debt is being talked about rather than annual revenue?

WALLACE TURBEVILLE: OK, let me do the last part first, why is debt being talked about, and let's get that out of the way. $18 billion is a fantasy number. And I can explain—I can start the explanation by just saying one of the components of that is $5.8 billion of water and sewage revenue bonds. Those revenue bonds are for a system that's not just Detroit; it serves 40 percent of the population of the state of Michigan. That's three million people. Detroit is 700,000 people. The emergency manager added that into the list. It has Detroit on the cover sheet. I mean, that's what it says: Detroit. But the—that's not debt of the city, and it isn't paid from the budget of the city, and it's for this broader enterprise. So, just as an example, the $18 billion number is a fantasy.

But, more importantly and more sort of centrally, the idea of some gross debt number being important is just not true. Municipalities have historically gone bankrupt infrequently. It's getting more frequent because the recession. This is the backwash from the recession. And as property values crashed, property taxes, which are a fundamental revenue base for cities, went down, but there was a time period where that decline occurred. That didn't happen all at once. Property values went down. Reassessments occur over time. Eventually, it hurts the cities. Cities—cities are all about cash—cash in, cash out. Now, a lot of debt can cause you to have to pay a lot of debt service, meaning your annual payment, but if you think about what happens to people, as long as you can pay your mortgage, you're in good shape, and especially with municipalities who can tax and have access to states, and they have taxing power. It's all about having the cash to go forward. So what's happened to Detroit is, they've had a tremendous decline, a 20 percent decline in tax revenues since the Great Recession, and, again, this really unfortunate and possibly planned cutting of the state revenue sharing at the worst possible moment.

NERMEEN SHAIKH: But why is it—why focus on the $18 billion of debt, because it's not obvious what declaring bankruptcy—who stands to gain from declaring bankruptcy?

WALLACE TURBEVILLE: Oh, why focus on the $18 billion, I think that's a marketing issue. I think—

NERMEEN SHAIKH: Marketing to what end?

WALLACE TURBEVILLE: Well, the emergency manager wants things to sound as dire as possible, because he was appointed by the state over—against the will of the people.

AMY GOODMAN: Now, explain what that emergency manager is and how he got chosen.

WALLACE TURBEVILLE: OK. The state of Michigan adopted a law. The state of Michigan—what happened is that the Legislature and governor became very right-wing in 2010 when there was a big sweep election. So what they did was they adopted a law that said that the governor could appoint an emergency manager for a city and basically become a dictator in that city for the duration of any financial crisis. And so that's what's happened. Mr. Orr is a—is the emergency manager. He's a partner at a law firm called Jones Day. Jones Day is a Cleveland-based law firm. It's been around for a thousand years. I've worked for them myself many times. Jones Day was also appointed a special counsel to the city. So I think it's fair to say that not so much—

NERMEEN SHAIKH: Wasn't that a conflict of interest?

WALLACE TURBEVILLE: Well, it's been argued as such, especially since some of the financial deals that were done, Bank of America was a central part of those financial deals, and Jones Day represents Bank of America. So, to resolve their contract—their conflict, they've been paid $16 million, so to—in this representation. So I think it's fair to say that Jones Day is running Detroit. But Jones Day is running Detroit at the behest of the governor, Governor Snyder, who has an animosity towards Detroit for a number of reasons, I would say, and would like to see—would like to see the politics adjusted.

AMY GOODMAN: Explain why.

WALLACE TURBEVILLE: Well, Michigan went the way of the tea party. And Michigan has—you know, Detroit is the only large city, but there are other cities around it, which are largely old industrial cities and African-American cities, for the most part, and Democratic. So, there is this tension between the urban centers, which are—that have a lot of influence from trade unions, and the Republican rest of the state. So, it's—from a political standpoint, it serves the interest of Governor Snyder and his party to actually undercut the role of trade unions, because they're the ones that are institutions opposed to his political viewpoint.

The bankruptcy judge yesterday said—one of the issues that was raised was that basically the bankruptcy was a—the fix was in for it. In other words, the state did it as part of a plan that would restructure the politics. And the judge said, yes, there was evidence of that, actually, but, he said, not enough to actually make a ruling. Well, I don't have—I don't have to adhere to rules of evidence from the court. I'm more of the view that if it quacks like a duck and walks like a duck, it's a duck. And if you watch the series of events, first the emergency manager statute that gave him the right to create a dictator in a city—and they've done that in several cities now—by the way, that was pulled back by referendum, so the people of the state of Michigan voted to eliminate that statute, then the state Legislature came back and re-enacted it, basically. So, it's not a—it's not a popular statute. But, anyway, the idea is, have the power to create the emergency manager, create a situation where Detroit has a very hard time keeping its revenues up during this recessionary period, when every—when it's being starved of cash because of property taxes and income taxes and all the rest. Then, at the last minute, cut revenue sharing, and it's starting to look like the whole idea was to push Detroit over the edge in order to have this bankruptcy to restructure.

NERMEEN SHAIKH: But one of the things that your report, the Demos report, "The Detroit Bankruptcy," of which you're the author, points out is that the financial crisis in Detroit was exacerbated by complicated Wall Street deals that put its ability to pay its expenses at even greater risk. So could you explain what the role of Wall Street was in making the crisis worse?

WALLACE TURBEVILLE: Yes. The—in 2005 and 2006, the city, like many cities and states around the country, felt compelled to issue debt to put money into its pension fund. The idea is you borrow the money, you put it in the pension fund, and, let's say, you can hold it for 30 years and invest it in the stock market; the interest on the debt that you take out is less than the earnings you're going to get on shares of stock. Whether that's wise or not, I won't comment, but it's been done. It was done many, many places. So, they issued $1.6 billion of debt. For half of that, they did it in combination with a derivative. Derivative, you might recall, was the large reason for the financial crisis in 2008. AIG comes to mind, if everybody remembers that, $180 billion in losses that drove the largest insurance company in the world out of business, or at least into receivership and into bailout. So what happened was they talked the city of Detroit into doing this derivative. And the way it worked is, for half, or $800 million, of this financing, it's as if you took out a mortgage, borrowed money, and you paid your principal to one bank and the interest to the other bank.

On this interest part of the deal, they had a term in it that if Detroit was nicked just one credit rating down, the bank could ask for all of the interest for 25 years that was to become due—they could ask for it now. Now, the city of Detroit had been—I worked in the city of Detroit as a banker at Goldman in 1990 to keep them from getting downgraded, and we successfully managed that, to do the financing to do that. City of Detroit has been on the edge of investment grade, non-investment grade for decades. So, to do that transaction in 2005 and 2006 and include a term which says all of your interest for 20 years is due now if you get downgraded was just imprudent beyond imagination. I've never seen anything like it. And indeed, of course, that's what happened. And so, one of the major issues under discussion right now is that the banks have come and said, "I want my interest now." And the question is whether that's going to be adjusted by the bankruptcy court, whether it's negotiated some other way. Right now the emergency manager has shown no inclination to negotiate that as strongly as I think it should be, frankly.

AMY GOODMAN: Wallace Turbeville, what are the recommendations of your report?

WALLACE TURBEVILLE: I have the happy role of not having to actually implement anything, so I can think widely about what should be done. I think one of the things—right now they have a cash shortfall, according to the emergency manager, of about $200 million a year. First of all, I think that's inflated. As part of the whole thing of that $18 billion pushing up how dire things are, the emergency manager inflated what the unfunded part of the pension liability is—that is, the future liabilities to pay pensions to people—what do you have to put aside to cover that, what the city has to put aside. And then—so you get a number like that, and you say, "How many years do you pay it off?" And so, what the emergency manager has done is calculated a number that's very, very large, using assumptions that are not typical, and then said, "Pay it off really quick," which means that the cash demand on the city is very, very high. That's a little bit like the whole $18 billion thing—make it as bad as possible. So, one thing is to address the pension liability issue and the funding of it in a way that actually is practical and would work, that would reduce the $200 million gap.

The second thing is to collect taxes better. They have a serious problem of so-called reverse commuter income taxes, meaning people who live inside the city of Detroit, work outside, they're supposed to pay income taxes, but they don't properly track that, that you're actually making money outside the city. That's easily tracked. You just get on the database for federal income taxes. That's an important thing.

But I think, most importantly, that what should happen, and what should have happened before this bankruptcy was ever filed, is that the state of Michigan has to recognize that they are both responsible at a certain level and also it's in their interest—it's in the interest of the entire state to increase the revenues of the city of Detroit over a period of time. So, revenues have to be pumped up.

AMY GOODMAN: Well, Wallace Turbeville, I want to thank you very much for being with us. And we're sorry we weren't able to go to Detroit; our guest there didn't show up. But we will, of course, continue to follow this issue. Wallace Turbeville is senior fellow at Demos and author of the report, "The Detroit Bankruptcy." He was formerly a vice president at Goldman Sachs in the municipal finance department.

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