Detroit borrows $1.2 billion from Wall Street

US cities face crushing debt burden

D'Artagnan Collier, Jerry White
19 April 2005

One of the central features of the current US economy is the trillions of dollars of debt being accumulated by corporations, consumers and all levels of the government. While it is barely mentioned in the mass media, major US cities have accrued an enormous debt burden to finance their day-to-day operations.

With the cutback in federal aid, the loss of state revenue-sharing and the massive tax breaks provided by city officials to attract corporate investment, municipal governments have turned towards Wall Street for a short-term solution to their budget woes. The municipal bond market—now valued at $1.9 trillion—has become one of the most lucrative businesses for investment banks, brokerage firms and their army of lobbyists and consultants.

This process has resulted in a windfall of profits for wealthy investors, who have gained unprecedented access to the public treasury. In order to pay off their debt obligations, financially-strapped cities have been forced to cut funding for infrastructure repairs, education and other vitally-needed public services, and sell off municipally-owned utilities and other assets to raise cash.

The latest example is the city of Detroit. Long beset by problems associated with the decline of the US auto industry that have turned the Motor City into the poorest big city in the US, the city has faced almost perennial budget deficits. Earlier this year, Democratic Mayor Kwame Kilpatrick announced a budget-cutting plan to reduce the city's $350 million deficit that included the elimination of nearly 1,000 city workers' jobs, cutting wages and benefits and ending 24-hour-a-day bus service. On April 12, Kilpatrick announced further cuts, including the virtual elimination of all subsidies for the arts, zoos and other "non-essential" programs, as well as cutbacks in firefighting and EMT services.

Kilpatrick also proposed to float $1.2 billion in municipal bonds to finance the city's under-funded pension plan and other budget shortfalls. The city council, which first opposed the deal, unanimously voted to approve it after the mayor announced he would lay off 2,000 city workers if the bond deal didn't pass. So far, 3,000 city workers have been dismissed in the last three years.

In essence the city is using the hard-earned pensions of current and future retirees, as well as other public assets, like the city-owned water treatment plant, as collateral to guarantee Wall Street repayment of its loan, plus millions in interest payments. At the end of 2004, the Detroit retirement system had assets totaling $2.5 billion, according to the pension board. At the same time the Kilpatrick administration is continuing to cede unprecedented authority to wealthy investors to dictate the city's fiscal policy, including reducing retiree benefits.

During a four-hour City Council meeting, a fiscal analyst from the Wall Street rating company Standard & Poor told council members that "pension boards would have to resist demands for better retiree benefits and distribution of excess profits" in order for the bond deal to succeed.

When a city council member expressed concern over what would happen if the city defaulted on its loan, while still remaining obligated to pay retirees their money, the mayor arrogantly responded, "So what," according to a report in the *Michigan Citizen*. The mayor insisted, "We've already told Wall Street we would use the pension obligation certificates to close the gap in our budget."

For almost a year, the Kilpatrick administration worked with UBS Financial Services to sell the bond proposal. The middleman who laid the groundwork between the city government and the investment bank was none other than Dennis Archer, the former mayor of Detroit. During his eight years in office, the Democratic mayor handed over hundreds of millions of dollars in tax breaks to corporations and contributed to the financial crisis that working people in Detroit are now paying for.

At the end of 2004, the city of Detroit was scheduled to pay almost a billion dollars on bonds, notes and debts. Of that nearly $366 million was for interest payments alone. Kilpatrick claims the new bonds will save about $13 million a year because of lower interest rates during the 15-year life of the bond certificates.

Detroit is following the pattern set by municipal governments in New Orleans, Pittsburgh and other major cities throughout the US. Cities and states have to pay a fixed rate of interest on the bonds, and are essentially betting they can earn a higher rate of return by investing their pension funds in the stock market.

The losses on pension investments over recent years have put municipal governments in the red, not only to cover the cost of their pension obligations but also the interest payments on the newly-purchased bonds. According to an October 2003 analysis from the advocacy group Global Action on Aging, many cash-strapped cities have been lured into stocks and commercial money markets with promises of high returns on their pension investments, which have never panned out.

In New Orleans, for example, a bond deal finalized in late 2000 ended up costing the city $270 million. “We were thinking that we were going to make money on it,” said, Suzy Mague, fiscal officer for the New Orleans city council. Mague said PaineWebber claimed New Orleans would probably have to pay about 8.2 percent on the bonds and could expect to earn 10.7 percent a year, on average, by investing the proceeds, mostly in stocks.

This rosy scenario was based on the returns from 1983 to 1999, a period that saw the greatest bull market in history. When the market fell sharply, instead of earning 10.7 percent on their pension investments, New Orleans suffered losses of about 3 percent a year. For its role in the bond sale PaineWebber, which later merged with UBS, collected a $3 million fee.

Pittsburgh, which like Detroit has suffered the erosion of its industrial base, owes $1.68 billion in total debt. Between now and 2011 the city has to pay at least $82.8 million annually—or nearly 20 percent of its yearly budget—toward the debt, assuming it doesn’t borrow more. In the late 1990s the city sold $404 million in bonds to cover its pension obligations and other debts. Placed under financial receivership, Pittsburgh sold off its water and sewer operations to a private water company in 2001 to help pay off its debt to Wall Street.

In January, Wall Street upgraded Detroit’s credit rating from a negative to stable outlook. The message to big business is: now is a good time to invest in Detroit at the expense of its low-income and working class citizens!

The Kilpatrick administration is currently considering selling off Detroit’s water system and lighting utility to private corporations. The city took a step in this direction, when it hired Victor Mercado from the British-based water conglomerate Thames Water North America to run the Detroit water department and began the shut-off of water supplies to tens of thousands of poor people who failed to pay their bills.

The mayor recently closed the century-old aquarium on Belle Isle Park, the 983-acre island park designed by the creators of New York’s Central Park. Further mass layoffs in the future are almost certain, given the relentless demands placed upon the city government by Wall Street bond investors.

Demands for austerity measures and the wholesale selloff of public assets are familiar for Third World countries facing the dictates of the International Monetary Fund and World Bank. Now almost every large US city is being subjugated to the same predatory lending practices and austerity measures as the less developed countries.

The historical precedent for the restructuring plans being imposed on US cities by Wall Street was set in 1975 when New York, the country’s largest city, was on the verge of financial collapse. At the insistence of Wall Street, the Municipal Assistance Corporation—formed by the state government and representatives of big business—the city government laid off thousands of city employees, implemented wage freezes, increased subway fares, and abolished free college tuition for students at the City University of New York.

Today Democratic-controlled city governments, like the Kilpatrick administration in Detroit, are gambling with the pension funds of workers and selling off public assets, much in the same way as the Bush administration proposes to privatize Social Security. In both cases the fate of retirees and the welfare of the general public are being put in the hands of billionaire financial speculators.