Stockton bankruptcy signals attack on US pensions

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The recent bankruptcy filing by the city of Stockton, California will likely entail the ending of contributions to retired city workers' health care plans. The move is part of a growing trend among US municipalities, states, and private corporations to tear up contractual agreements with retired workers.

Stockton will request court approval for its plan to immediately reduce its obligations to retiree health care plans and eliminate payments entirely by July 2013. The city council is also imposing deep cuts to existing workers' benefits, eliminating all benefits for workers with less than 10 years' service, and further gutting city services as part of its bankruptcy.

Stockton is filing for protection from its creditors under Chapter 9 of the US bankruptcy code. In essence, it is insisting that retired workers—whose pension and health care benefits were contractual promises for decades of labor—be treated as creditors who have lost out on an investment. The unfunded liability for retiree health care benefits is reportedly $417 million.

It is common in recent US history for major corporations to dump their obligations to retired workers in bankruptcy, then reemerge in some new form to reap profits for investors. Among those that have done so in recent years are Hawker Beechcraft, General Motors and Chrysler (in deals orchestrated by the Obama administration), Texaco, Worldcom, LTV, Continental Airlines, Federated Department Stores and Greyhound.

In corporate bankruptcies, a semi-government entity called the Pension Benefit Guaranty Corporation guarantees pensions up to a certain annual limit, currently capped for the highest-paid pensioners at $4,300 per month for those retiring last year. As of 2010, the PBGC provided pensions for 1.5 million workers whose private pension plans failed in corporate bankruptcies.

The PBGC does not guarantee the retirement plans of government workers. That is the responsibility of state governments. Numerous states, including Michigan and Illinois, have put in place laws that allow the state government to impose outside financial control over struggling cities. This is already the case in Detroit, which is effectively ruled by a state-imposed financial commission.

Yet due to the economic crisis, states are cutting the amount of money they share with local governments, even as demand for social services rises. The stage is being set for a massive assault on the pensions and health care of retired government workers.

Last year, the city of Central Falls, Rhode Island successfully used bankruptcy court to cut its pension payments to retirees. Attacking the pensions of retired workers, according to University of Pennsylvania law professor David Skeel, "had previously been the third rail." He added, "But after Central Falls, it's unclear if it's so much of a third rail anymore."

Now the Stockton bankruptcy, whose court proceedings began on Friday and will not be completed for months, may prove a tipping point.

At a packed June 26 meeting of the Stockton City Council, retired city workers spoke about cuts in their medical benefits. Retirees broke down in tears after the city approved changes to their medical benefits.

"Some people will be devastated," said retired fire chief Gary Gillis. "There are those who have such severe medical problems that they will not be taken up by any medical company. This plan appears to be a sledgehammer or a machete."

"For me, bankruptcy might as well be a life sentence," said retired police officer Gary Jones, who has lived with a brain tumor for more than a decade.

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Jones said he would no longer be able to afford chemotherapy and other treatments.

Stockton, with a population of nearly 300,000, is the largest municipal bankruptcy in US history and the 13th government entity in the US to seek protection from its creditors in the last year.

As is the case with the sovereign debt crisis in Europe, the attack on American pensioners is being pressed by the finance industry—the same banks, hedge funds, and ratings agencies that drove the world economy to collapse in 2008. In the words of a recent Reuters article, “Investors in the $3.7 trillion municipal bond market are focused on whether states, counties, cities and towns can afford the pension benefits granted public workers.”

A report issued last week by credit rating agency Moody’s—which is also playing a critical role in the attacks on European workers’ living conditions—estimates that US states and localities amassed more than $2 trillion in unfunded pension liabilities. Last year, Northwestern University finance professor Joshua Rauh provided an even higher estimate of $3 trillion in unfunded pension liabilities, and warned that six large cities and seven states will be unable to meet their obligations by the end of the decade.

Moody’s is now in the midst of altering how it rates bonds based on pension liabilities. “The negative impact of the modifications—which will start taking effect in the fall—will hit local governments such as counties, cities and towns, as well as school districts, most heavily,” according to Reuters.

The ratings downgrades to state and municipal bonds will result in investors demanding higher bond yields, causing pension liabilities to increase sharply. This, in turn, will result in further cuts to pension plans and public services, layoffs and more bankruptcies.

The move by Moody’s is also expected to end so-called “asset-smoothing,” which allows government entities to spread losses out over an extended number of years. This practice was part and parcel of deliberate policies pursued by states and localities to underfund pensions, effectively borrowing against retirement obligations to workers in order to fund tax cuts for the wealthy and big business.

State and local workers are among the last sections of the American workforce to enjoy decent retirement packages. Only 18 percent of workers now have defined benefit plans, whereas as three decades ago perhaps two thirds did, according to analyst Jack Rasmus.

Knives are being sharpened. The *Washington Post*, citing the recent example of Vallejo, California, which went into bankruptcy in 2008, wrote in May that while default used to be a “last resort” for cities, “that attitude has started to change as more cities have found themselves facing fiscal catastrophe; bankruptcy offers an opportunity to start over with a clean slate.” The *Post* called Vallejo “a model for cities in an age of austerity.”

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