Manipulation of Economic Figures: Lies used to Justify Detroit Bankruptcy

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A report issued Wednesday by the New York City-based liberal think tank Demos is a devastating refutation of the arguments used by Emergency Manager Kevyn Orr to throw the city of Detroit into bankruptcy.

The Demos report charges that the financial numbers used by Orr and other advocates of bankruptcy were grossly inflated, and that the real causes of Detroit's cash flow shortfall were parasitic loans and other financial schemes pushed on the city by the banks and other powerful creditors.

Data assembled in the report adds to the already overwhelming evidence that the city of Detroit's July 19 Chapter 9 bankruptcy filing was not driven by economic necessity but by political considerations.

Taking into account the Demos findings, it is more obvious than ever that Orr filed for Chapter 9 as part of a strategy to use the bankruptcy courts to gut the pensions of 21,000 retired municipal workers, privatize services and sell off public assets, including the artwork of the Detroit Institute of Arts. The aim is to pay off the same financial institutions chiefly responsible for the city's crisis and, more generally, the economic crisis that erupted in 2008.

US Judge Steven Rhodes is expected to rule soon on whether the city is eligible for bankruptcy.

The entire political and media establishment in Detroit and around the country have repeated without the slightest challenge the claims by Orr and his co-conspirators that the city is in inescapable financial distress, caused above all by unfunded pension obligations and other "legacy costs". The Demos report shows that the surge in legacy costs used by to justify the filing "was driven heavily by the city's complex financial deals, not retiree benefits."

The real causes of the city's cash flow problems are not the pensions and benefits owed to workers, but the massive decline in revenue that has taken place under conditions of deindustrialization, mass unemployment, the growth of poverty and huge tax giveaways to corporations.

"Contrary to widely held belief, Detroit does not have a spending problem," the report states. "Since the onset of the Great Recession, the city's total expenses have actually decreased by $356.3 million... although its financial expenses have gone up."

Summing up its main conclusions, Demos writes, “The City of Detroit’s bankruptcy was driven by a severe decline in revenues (and, importantly, not an increase in obligations to fund pensions.) Depopulation and long-term unemployment caused Detroit’s property and income tax revenues to plummet. The state of Michigan exacerbated the problems by slashing revenue it shared with the city. The city’s overall expenses have declined over the last five years, although its financial expenses have increased. In addition, Wall Street sold risky financial instruments to the city, which now threaten the resolution of this crisis.”

The report points to the disastrous social conditions in the wake of the 2008 crash as a primary factor behind the collapse in city revenue. “The number of employed Detroit residents fell by 53 percent from 2000 to 2012. But half of that decline occurred in the single year of 2008 as the Great Recession took hold. There is one inescapable fact: The most significant proximate cause of the cash flow cliff off of which the city fell was the Great Recession.”

Moreover, Detroit lost hundreds of millions of dollars in state revenue sharing as Republican Governor Rick Snyder and his Democratic predecessor—two-term governor Jennifer Granholm—cut more than $700 million in transfer payments from the state government in Lansing to the city. From 2008 to 2013, as the impact of the crisis hit hardest, annual revenue sharing fell 27 percent, from $249.6 million to $182.8 million.

Although the Democratic Party-aligned think tank mentions it only tangentially, federal aid from the Obama administration—particularly in areas of anti-poverty, public education, Head Start and other programs—has also been slashed precipitously since 2009. In addition, the White House and Congress cut funding to cash-strapped states, which in turn reduced funding to cities.

The city’s revenue stream was also depleted by massive tax concessions to powerful corporations. The more than $20 million per year awards to companies included gifts to DTE Energy, Comerica Bank, Quicken Loans, Compuware, the Farbman Group and Detroit Medical Center, the report shows.

The report argues that Orr’s frequently cited figure of $18 billion for the city’s deficit is, from a legal standpoint, irrelevant to a municipal bankruptcy, which is based strictly on immediate cash flow considerations and not on speculative estimates of long-term solvency.

“That figure is irrelevant to an analysis of Detroit’s insolvency and bankruptcy filing, highly inflated, and in large part, simply inaccurate,” the report claimed. “In reality, the city needs to address its cash flow shortfall, which the emergency manager pegs at only $198 million, although that number too may be inflated because it is based on extraordinarily aggressive assumptions of the contributions the city needs to make to its pension funds.”

As Demos notes, far from excessive, irresponsible spending on services, Detroit’s fiscal policy in the wake of the 2008 crash was characterized by brutal cuts in operating expenses. “Between FY 2008 and FY 2013, the city drastically cut operating expenses by $419.1 million. This was accomplished in large part by laying off more than 2,350 workers, cutting worker pay, and reducing future healthcare and future benefit accruals for workers… The city reduced salary expenses by 30 percent between FY 2008 and FY 2013. Total operating expenses have been reduced by nearly 38 percent during that same time.”

While city operating expenditures fell sharply, however, debt servicing and other financing

costs shot up. The city entered into complex financial arrangements, including interest rate swap agreements, which produced vast sums for Wall Street but amplified the city's financial woes. By entering these financial arrangements—first started in the mid-2000s under Democratic Mayor Kwame Kilpatrick—the city effectively placed large bets that interest rates would continue to rise on its outstanding debt. When the Federal Reserve slashed interest rates in the wake of the 2008 crash, the city lost out massively and found itself completely at the mercy of the creditors, who were suddenly able to demand staggering "termination" fees to "unwind" the swap deals.

The case of the Detroit Water and Sewerage Department illustrates the scale of these losses. For fiscal years 2011 and 2012, the city took on more than $1.16 billion in debt to pay for expenses related to the DWSD. Nearly half of this debt total, $547 million, went to cover "swap termination payments" imposed on the city after its credit was downgraded. Orr is now pushing for the city to accept a proposed $350 million loan from the international finance house Barclays to pay off the debts incurred to Bank of America/ Merrill Lynch and UBS as a result of these swaps.

In other words, the debt burden of the city will be exacerbated—and the cuts against the working class made deeper—in order to pay off the criminal and semi-criminal elements that swindled the city into the swaps. "A strong case can be made that the banks that sold these swaps may have breached their ethical, and possibly legal, obligations to the city in executing these deals," Demos reported.

The so-called "legacy costs" are constantly cited by the corporate-owned press in their attempts to portray pensioners and health care recipients as unaffordable burdens on the city's finances. But according to the report, the bulk of the increase in legacy costs from 2008 to 2013 was due to financial expenses payable to the banks, which rose by $38.5 million, while actual benefit costs rose by only $24.3 million.

The Demos report, while presenting damning evidence of the conspiracy behind the Detroit bankruptcy, does not challenge the basic political framework of the assault on the working class. It concludes with a series of recommendations for Orr, including proposals for increases in revenue through unspecified means. The think-tank has ties to sections of the Democratic Party as well as the unions, which have opposed the bankruptcy from the standpoint of insisting that the unions should have been brought on board in imposing concessions on the working class and selling off city assets.

While the Demos report was a lead article in the *Guardian* in the UK, it was ignored by virtually all of the major US media outlets, including the *New York Times* and *Washington Post*, and barely reported in Detroit itself. The *Detroit Free Press* criticized the report, saying it shifted the blame to "outsiders," when the real problem was an "unwillingness to face fiscal realities, a devotion to expensive benefits, excessive pension bonuses" and a failure to make "tough decisions."

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