How Grand a Bargain?
A Distributional Analysis of the Detroit Bankruptcy

A THESIS

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Table of Contents

Glossary

Preface and Acknowledgements

Introduction

- Research Design 2
- Overview of Chapters 3

Chapter 1: Literature Review

- Inequality and Economic Distribution in the U.S. 4
- Political Economy of Local Governments 8
- Municipal Bankruptcy in Legal Theory 10
- Judicial Decision Making 11

Chapter 2: Detroit’s Fiscal Crisis 14

Chapter 3: Timeline of Detroit’s Bankruptcy 23

Chapter 4: “Whether Bankruptcy and Which” 30

- Theoretical Approach 30
- The Politics of Choosing Bankruptcy 33
- Regional Deals 46
- Financial Settlements 56
- Professional Fees 60
- Conclusion 61

Chapter 5: Comparative Cases 62

- New York City 62
- Orange County 70
- Conclusion 75

Conclusion 77

Appendix A 80

Appendix B 81

Bibliography 82
## Glossary

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFL-CIO</td>
<td>American Federation of Labor and Congress of Industrial Organizations</td>
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<td>AFSCME</td>
<td>American Federation of State, County, and Municipal Employees</td>
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<td>ASF</td>
<td>Annuity Savings Fund</td>
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<td>BOA-ML</td>
<td>Bank of America Merrill Lynch</td>
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<td>COLA</td>
<td>Cost of Living Adjustments</td>
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<td>COP</td>
<td>Certificate of Participation</td>
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<td>DIA</td>
<td>Detroit Institute of Arts</td>
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<td>DREM</td>
<td>Detroiters Resisting Emergency Management</td>
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<td>DWSD</td>
<td>Detroit Water and Sewerage Department</td>
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<td>FECB</td>
<td>Financial Emergency Control Board</td>
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<td>FGIC</td>
<td>Financial Guarantee Insurance Company</td>
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<td>FHA</td>
<td>Federal Housing Administration</td>
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<td>FOIA</td>
<td>Freedom of Information Act</td>
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<td>GASB</td>
<td>Governmental Accounting Standards Board</td>
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<td>GLWA</td>
<td>Great Lakes Water Authority</td>
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<td>GRS</td>
<td>General Retirement System</td>
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<td>MAC</td>
<td>Municipal Assistance Corporation</td>
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<td>NAACP</td>
<td>National Association for the Advancement of Colored People</td>
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<tr>
<td>OPEB</td>
<td>Other Post Employment Benefits</td>
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<tr>
<td>PFRS</td>
<td>Police and Fire Retirement System</td>
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<td>UAW</td>
<td>United Auto Workers</td>
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<td>WRAP</td>
<td>Water Residential Assistance Program</td>
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Preface and Acknowledgements

This thesis encapsulates two of the most important aspects of my University of Michigan experience. As a Politics, Philosophy and Economics major, I have devoted much of my college career to studying the interaction between economics and political science, particularly as it leads to the unequal distribution of resources in our society. I have also spent a considerable amount of time in the past four years working and living in the City of Detroit. As I watched the city’s bankruptcy unfold, I began to wonder how this case related to the concepts that so engaged me in my coursework. In pursuing this curiosity in my thesis, I have both grown as a student and gained a deeper understanding of a city that means a great deal to me.

I owe thanks to a number of people for their support during my thesis process. I would first like to thank the Gerstein family for their generous stipend, which allowed me to access crucial sources during my research. I would also like to thank the individuals whom I interviewed for this thesis, including the Hon. Gerald E. Rosen, Mike Mulholland, and Gretchen Whitmer, for their invaluable insights.

I am enormously grateful to my parents, who proofread draft after draft of this thesis, and who are a constant source of wisdom and support in my life. I would like to thank my thesis cohort for their help on my project and camaraderie throughout the year. Professor Andrei Markovits deserves huge thanks not only for his guidance and encouragement, but for allowing our cohort to learn from one another during this process. I would also like to thank Professor Mika LaVaque-Manty for his mentorship and for providing me with an incredible introduction to social science research. Finally, I would like to express my deep thanks to my advisor, Professor Robert Mickey. Not only was his course on the politics of inequality the most important of my college career, but since that time he has continually challenged me to become a better student, scholar, and citizen.
Introduction

On December 9, 2015, a consortium of news agencies held a public forum to commemorate the one-year anniversary of Detroit’s exit from the largest municipal bankruptcy case in United States history. The program included presentations from Michigan Governor Rick Snyder, Bankruptcy Judge Steven Rhodes, and the city’s newly elected Mayor, Mike Duggan.

What promised to be an opportunity to hear “key players” discuss the city’s post-bankruptcy progress was cut short when protestors began to overwhelm the speakers. Organizers called out from the audience as Snyder and Rhodes took the stage, expressing anger over the cuts to municipal workers’ retiree benefits that resulted from the bankruptcy, and denouncing the state’s use of emergency management in Detroit.

Cries of “liar” punctured a previously upbeat and congratulatory reflection on the bankruptcy case. One protester carried a sign that read, “We Have Been Ripped Off.” Another shouted at the Governor, “Why is it never a ‘Rick Snyder,’ never the rich people who have to pay? It’s always taken out of poor people’s hands.”¹

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Detroit is a city known for images of abandonment and ruin. For years, it has served as a national symbol of industrial decline, economic disinvestment, and depopulation. The city’s deteriorating condition is understood often as the product (or victim) of a new global economy, portending the demise of the American industrial worker. Predictably, photographs of crumbling manufacturing plants and empty sidewalks accompanied news headlines announcing that Detroit had filed for bankruptcy protection.

Perhaps for this reason, the city’s bankruptcy declaration produced little shock in most observers, local or national. The common narrative for the bankruptcy celebrated city and state

leaders for their fortitude in finally accepting the reality of the city’s fiscal crisis, and praised judges for the case’s speed and efficiency. The academic literature on municipal bankruptcy reinforces this deterministic view of Detroit’s case, in that legal theorists understand bankruptcy as a process that is predominantly controlled and modeled by economic phenomena. Specifically, the dominant legal approach conceptualizes bankruptcy as an exercise in economic efficiency that maximizes the collective welfare of creditors.

However, this interpretation of Detroit’s bankruptcy saga as acting out some sort of economic or fiscal destiny overlooks many of the questions and tensions evident at the bankruptcy’s one-year anniversary event. Was bankruptcy an inevitable outcome for Detroit, as Snyder began to suggest in his presentation? Who benefitted from the bankruptcy, who ‘had to pay,’ and how were these winners and losers determined? What role did politics play in shaping these outcomes? These are the questions I seek to answer in my thesis, and in doing so provide a new conceptual approach to municipal bankruptcy as a political, as well as economic, phenomenon.

**Research Design**

I began my research by familiarizing myself with the timeline of Detroit’s fiscal crisis and bankruptcy. I then identified pivotal moments in the story - when the city made a fateful choice, but could have plausibly taken another path - as anchors for my counterfactual analysis. These included the city’s decision to declare bankruptcy, as well as the settlement of a number of deals that allowed the bankruptcy to move forward. I used legal documents and transcripts from the case, along with press reporting and other government materials, to understand how the Detroit bankruptcy as we have come to know it emerged and also to analyze distributive implications of these outcomes. Finally, I chose to illuminate further the Detroit episode by comparing it alongside two other cases of local fiscal distress - New York City in 1975 and Orange County in 1994. Each had several important features in common with Detroit yet arrived at significantly different outcomes.
Overview of Chapters

In Chapter 1 I will review the literature on inequality and distribution in the United States, the political economy of cities, municipal bankruptcy, and judicial decision-making. Chapter 2 will provide an overview of how Detroit’s fiscal crisis emerged over the past decades, with particular consideration given to the political dynamics that contributed to Detroit’s economic decline. This chapter also includes an introduction to the city’s precarious pre-bankruptcy finances, from its pension funds to its borrowing patterns. I will continue this story in Chapter 3, which describes the city’s course from fiscal crisis to and through bankruptcy.

Once I have familiarized the reader with my case, I will provide a distributional analysis of the Detroit’s bankruptcy. In particular, I will analyze the distributional consequences of crucial political conflicts and their resolution during the bankruptcy process. Chapter 4 will begin with an analysis of the decision, by state and city officials, to declare bankruptcy in response to the city’s fiscal crisis. I will then analyze the deals produced during bankruptcy, including the so-called “grand bargain,” the formation of the Great Lakes Water Authority, and the city’s settlements with its various financial creditors. Finally, in Chapter 5, I will use New York City’s 1975 fiscal crisis and Orange County’s 1994 bankruptcy to provide a comparative study of the Detroit case that both emphasizes and expands my analysis from Chapter 4.
Chapter 1: Literature Review

In this chapter, I will review three areas of scholarly research that contextualize my own work. The first section includes a discussion of recent scholarship on the politics of economic distribution and inequality at the national level. I then move to the literature on the political economy of cities, focusing in particular on the dynamics that affect local budgets. Finally, I will conclude with an overview of the legal scholarship on municipal bankruptcy and judicial decision making.

Inequality and Economic Distribution in the U.S.

Coinciding with the steady rise in economic inequality since the 1980s, there is a growing body of academic work addressing the failure of the American political system to redistribute wealth and income on a federal level. Public choice models of political behavior support the intuition that economic inequality of the kind currently observed in the U.S., characterized by a widening gap between the rich and the rest of the country, will prompt an increasing redistribution of resources by majoritarian democratic governments. Downs’ model predicts that vote-maximizing politicians in two-party systems have rational incentives to align their party platforms with the preferences of the median voter, and that policy outcomes in these systems should therefore reflect the median voter’s preferences.\(^2\) Applying Downs’ model to redistributive policies in particular, Meltzer and Richard theorize that a majoritarian democracy will generate redistribution whenever the mean income is greater than the median income (that is, the income of the median voter).\(^3\) This model would suggest that inequality and the demand for redistribution are positively linked, and that higher levels of inequality should lead to a greater level of redistribution.

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There are two major challenges to the public choice model of redistribution that attempt to explain why the American political reality diverges from theoretical predictions. One sub-genre of the literature on redistribution in the United States questions the model’s assumption that people who are disadvantaged by inequality will necessarily prefer redistributive policies. On the contrary, recent empirical studies suggest that inequality tends to promote fiscal conservatism. A study by Kelly and Enns models the effect of inequality on preferences while controlling for other theoretically relevant variables, ultimately finding that all classes in the United States become more conservative as the level of inequality increases. Lupu and Pontusson, in a similar study, find that the structure of inequality is more relevant than the level of inequality, but nevertheless corroborate the negative correlation between inequality and support for redistribution. Luttig confirms the results of both Kelly-Enns and Lupu-Pontusson, arguing that both the absolute level and the changing structure of inequality have promoted conservatism.

There is also a significant body of literature which seeks to explain the results of these empirical studies and to understand American policy preferences. One explanation put forth by Kearns et al, for example, looks at the residential and spatial determinants of public support for redistribution. The researchers ask whether where someone lives is associated with their attitudes on inequality and income redistribution. They find that people with higher incomes showed greater support for redistribution when they lived in areas that were more deprived, had a higher density, and were more ethnically mixed. Patterns of residence, therefore, can be said to reinforce patterns of income and wealth inequalities through public opinion.

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Alesina and Glaesan argue the history of race and racism in the United States is a key determinant of American attitudes towards redistribution. In their discussion of race, Alesina and Glaesan argue that the historic overlap between race and class in the United States has made it easier for politicians to stigmatize the poor as inherently “different” or “lesser” in order to avoid redistributive policies. Jacobs and Helms, like Alesina and Glaesan, focus on race in the United States in their explanation for the lack of redistribution. Specifically, through analyzing "historically contingent" changes in the progressivity of United States income tax code, they find that civil rights activity leads to redistributive tax policies, but social problems blamed on the underclass – such as riots or crime – reduce the progressivity of the tax code.

Other authors, such as Bartels, speculate that problems of information and voter competency are at fault. Bartels uses Bush Era Tax Cuts as a case study of the “irrationality” of American voters, focusing in particular on the disconnect between voters’ ideological values relating to the economy and their support for this specific tax policy, as well as the general latitude such disconnects afford political elites. Why is it, he asks, that middle and lower class voters who oppose inequality and believe the wealthy are not taxed enough supported the Bush Tax Cuts - which many of the same voters acknowledged would disproportionately benefit the wealthy? Bartels’ solution – that “the appealing notion of popular sovereignty is both psychologically unrealistic and logically incoherent” – is two-part: first, many voters simply ignored the issue; second, those who had an opinion based their views on their own tax cut over their larger economic interest and values. Bartels concludes that public opinion is not an impetus for redistributive policies, but rather a political resource to be shaped.

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There is a second set of criticisms of the public choice approach to redistribution which questions whether the traditional median voter model is a useful representation of the American political system. An article by Brady, Verba, and Schlozman uses survey data on electoral participation through voting, campaign work, and campaign contributions to adapt Downs’ portrait of the median voter.\(^{11}\) They find that the Downsian Model is predictive when the median voter is defined by relative political participation, as well as ideology. This is due to the practical necessities of running and funding campaigns which encourage candidates to be more responsive to those voters who are more likely to volunteer their time or donate. Rational politicians, therefore, attempt to woo voters who are more politically active, as well as the ideological centrist, and thus do not converge precisely on the ideologically median voter, but preference more active citizens. Because income levels are higher for participators than for the general population, they argue, politicians will favor policies that are minimally redistributive.

Hacker and Pierson argue that prevailing political theories focus too narrowly on tax policy and the median voter; they instead advocate an analysis focused on organized group influence on the “market conditioning” policies of the government through lobbying efforts.\(^{12}\) Hacker and Pierson rely on the concept of political "drift" and its role in this process. They define drift as the failure of politicians to update policies due to pressure from political interest groups, despite the recognition that the effect of these policies has changed substantially due to shifts in surrounding economic or social contexts, "drifting" away from their original intent. Encouraging political drift, they argue, is a key way American legislative institutions are shaped in ways that give unequal influence to business interests, resist redistribution, and allow inequality to rise.

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A study by Gilens and Page builds on Hacker and Pierson’s thesis, testing the policy influence of different actors in the American system with a single statistical model, using multivariate analysis to demonstrate that economic elites and organized groups representing business interests have significant independent influence on American policy, while average citizens and their mass-based interest groups have little to none. Gilens and Page look at key variables for 1,779 policy issues, relating group preference on different policies to the success rate of said policies (whether or not the proposed policy change occurred in four years). This relationship is expressed through a "predictor," which measures the influence of group preference on outcome on a scale of 0 to 1; for average citizens, this number was 0.05, whereas for business interest groups it was 0.43 and for economic elites it was 0.78. Based on this evidence, Gilens and Page conclude that both economic elites and organized interest groups play a substantial part in affecting US policy, whereas the general public has little to no independent influence.

**Political Economy of Cities**

The body of work described thus far holds important insights into the political factors that shape economic distribution in America; however, it focuses exclusively on federal policy. Studies of redistribution at the local level account for not only the role of electoral systems in shaping fiscal policy (as modeled by Downs and Meltzer and Richards) but also for the effect of voter and taxpayer mobility on these outcomes. As Tiebout first theorized in 1956, the ease with which residents can move between cities (at least relative to international mobility) should lead to preference-based sorting of residents and efficiency-producing competition among cities.

According to the Tiebout model, local redistribution will theoretically create a problem of adverse selection wherein wealthy individuals leave the municipality and are replaced by poorer

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residents, shrinking the overall funds available for redistribution.\textsuperscript{15} Peterson extends Tiebout’s argument to the business sector as well, demonstrating that analogous dynamics affect the movement of firms and capital from cities, with serious implications for a local tax revenue and employment.\textsuperscript{16} Thus, local governments are heavily reliant on state and federal levels of government for redistributive policies and transfers. Cities as economic entities are therefore deeply vulnerable and responsive not only to the preferences of residents and interest groups, but also to the policies enacted at higher levels of government.

Kantor and David argue that the municipal budgetary arena, specifically, is used as a means to generate political stability and dissuade relocation of residents and business. Their analysis suggest that city budgets should be expected to transform significantly in response to changing constraints (both exogenous and endogenous) in urban political and economic development.\textsuperscript{17} This responsiveness, they argue, accounts for the recent volatility in city budgeting, characterized by fiscal crises, illegal deficits, severe retrenchment, and emergency bailouts.

Peck builds on Kantor and David’s analytic framework, looking at how the exogenous factor of the 2008 financial crisis was translated into a state crisis, especially at the urban scale.\textsuperscript{18} He describes a rise in ‘austerity politics,’ defined as a sustained federal effort to socialize, rescale, and ‘dump’ costs of the economic crisis onto states and cities, remaking the landscapes of urban politics. In particular, Peck identifies a key tension causing strain on states and cities: that the commitment to public services in the United States is almost entirely delivered at the state or local level, while a neoliberal platform at the federal level pushes restraints on social spending and developing government employment, devolving budgets, and deferring to market

conditions. This creates, he argues, cyclical financial distress. Budget crises trickle down while at the same time balanced-budget requirements are placed on states and cities, localizing budget pressure. In response, most local bodies are forced to reduce services and retrench public-sector workers. Ultimately, he argues, this system is self-perpetuating because deficit conditions systematically favor anti-state forces.

Other scholars focus on endogenous forces within cities, examining how the political pressure exerted by interest groups generates budgetary instability. Many focus on the threat of underfunded pensions as an engine of the fiscal crises facing many local political bodies.\(^\text{19}\) Kelley, for example, uses three models to examine the problem of underfunded pensions: the ubiquitous Downsian Model, the theory of “capture” by special interest groups, and a hybrid of the two.\(^\text{20}\) Using data from the Public Pension Database on pension liabilities and assets, he compares these points to voter data (income, age) and interest statistics (public union percent of voting population). The median voter, he speculates, would want to push the costs to the future, and the "special interests" - the public sector unions - would want to maximize the short-term compensation packages. Kelley ultimately finds that the combined model provides the strongest explanation, suggesting both voter preferences and interest groups affect outcomes.

**Municipal Bankruptcy in Legal Theory**

In thinking about the relevant phenomena covered thus far - public opinion, interest groups, institutions, and fiscal federalism - it is useful to consider how these factors interact as a city moves from fiscal crisis to bankruptcy. Gillette argues that distressed municipalities take a strategic approach to the two options available to them: either to receive a bailout from central

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government (state or federal) or declare bankruptcy. Central governments, he reasons, will try to avoid the negative externalities resulting from one municipality’s bankruptcy within the regional economy, and will therefore step in to bail out distressed cities, often attaching some form of oversight or “repayment” agreement to these bailouts. Gillette argues that city officials who understand the central government’s fear of bankruptcy “contagion” could theoretically threaten bankruptcy to negotiate more favorable conditions to their bailouts.

Moringiello understands the decision to declare municipal bankruptcy not as strategic behavior but rather as the bringing together of two sovereigns, the state and the federal government, to accomplish something that neither could accomplish on its own: developing a plan to adjust debts that is binding to all creditors. Moringiello argues that bankruptcy is a “wake-up call” to state officials to address deficiencies in their municipal distress intervention policies. He argues that recent bankruptcy filings in the U.S. challenge the conventional wisdom that municipal bankruptcy is poorly tailored to the rehabilitation needs of cities, arguing that approaches like Gillette’s are flawed because they looked at state intervention in municipal affairs and bankruptcy as freestanding alternatives rather than complementary components of a comprehensive recovery plan.

**Judicial Decision Making**

Because bankruptcy judges are often granted significant power in shaping bankruptcy outcomes, a brief discussion of judicial decision making is relevant. Much of this literature uses either a “behavioral” model to assess the impact of judges’ personal attributes and backgrounds on their decision making, or an “attitudinal” model to argue that it is the judge’s ideology which

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influences their choices. Collins builds from this attitudinal framework, exploring how a judge’s ideology combines with external political factors to produce outcomes. Using evidence from amicus curiae briefs, he propose a new “Legal Persuasion Model,” which predicts that a judge will be influenced by the ideological content of legal briefs in a case irrespective of his or her own political proclivity.

Rather than studying judges as individuals, the decision-making scholarship on bankruptcy proceedings in particular has largely attempted to analyze the welfare considerations implicit in bankruptcy law, which judges are presumed to embody. Jackson and Scott, for example, propose a model that is both descriptive and normative, which suggests that the various objectives which shape the distributional goals of bankruptcy are consistent with the goal of maximizing expected creditor group welfare. In order to do this, judges must understand distributional effects of bankruptcy as a "bankruptcy tax" imposed upon creditors in the collective proceedings, which must be fixed and horizontally equitable to avoid collective action problems. Korobkin disputes Jackson and Scott’s welfare-based theory of bankruptcy, arguing that bankruptcy law does not merely exist for the purpose of maximizing the economic welfare of creditors as a group. Rather, he argues, it is a response to a crisis of diverse human values that cannot be reduced to the objectivity and certainty of economic models. Korobkin proposes that bankruptcy decision making be understood as analogous to individual decision making about a person’s life in that the normative and deliberative constraints of bankruptcy law allow judges to make rational decisions within the complex context of the case.

In this chapter, I have reviewed scholarly work related to my case, moving from research focused on the dynamics of national inequality and economic distribution to a discussion of local government fiscal crises. I have also provided an introduction to the legal theory on municipal bankruptcy and judicial decision making. In Chapter 4, I will return to my discussion of bankruptcy theory, situating my distributional analysis within this literature. Before I revisit that discussion, I will first introduce my case in greater detail in Chapter 2 and provide an overview of Detroit’s fiscal crisis and bankruptcy in Chapter 3.
Chapter 2: Detroit’s Fiscal Crisis

“It is, indeed, a momentous day,” Judge Rhodes told the courtroom on December 3, 2013, as he announced his decision to allow Detroit to enter bankruptcy protection. Rhodes continued, “we have here a judicial finding that this once proud and prosperous city can’t pay its debts. It’s insolvent.”

In order to contextualize my analysis of the response to Detroit’s fiscal crisis, I will first briefly address the question of how this crisis came to be. Specifically, in this chapter I will present the politics and policies that led to Detroit’s declines and brought a “once proud and prosperous city” to the point where it could no longer pay its debts, let alone provide basic city services to its citizens.

Historians trace the origins of Detroit’s economic decline - which in turn precipitated its fiscal crisis - to prewar years, when racial discrimination in housing and employment created a precarious foundation upon which the city grew rapidly. Discrimination in the housing market forced new black migrants of the Great Migration into the city's worst and most congested housing stock. Not long after, the Federal Housing Administration (FHA) developed mortgage-backing policies that entrenched patterns of segregation by funneling federal investment in homeownership into homogeneous white neighborhoods. By the 1940s, the segregation machine of Detroit, codified in federal policy and reinforced by organized racial discrimination among realtors and homeowners, insured that residential integration was met

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28 Ibid.
30 Sugrue, Origins of the Urban Crisis, 34-55.
with patterns of declining home values and neighborhood demographic turnover. Black Detroiters also faced obstacles in the labor market, where they were confined to the worst, lowest paying industrial jobs.

Over the course of the following decades, twin forces of deindustrialization and suburbanization began to transform intra-city inequality into regional inequality. The process of Northern urban deindustrialization began during World War Two, when the federal government invested considerably in industrial growth outside city centers, believing suburban areas to be less vulnerable to enemy attacks. Sunbelt politicians worked to maintain this trend as they gained power in the postwar years, steering government investment in industry toward their states and away from northern cities like Detroit.

Private manufacturers soon followed suit, relocating to areas, such as the South or suburbs, with lower wages and more favorable labor relations. At the same time, the automation of manufacturing processes eliminated many of the jobs to which black workers were confined. However, as a result of persistent housing discrimination in the suburbs, these workers were not able to follow remaining employment as it began to relocate outside of the city. The residential exclusion of black residents from areas of economic growth and prosperity continued to shape inequality in the metro-Detroit region for the remainder of the century.

In the late 1950s and early 1960s, the city’s cross-racial alliance of liberal political and labor leaders sought to make Detroit a center of “Great Society” social policy. However, Detroit’s economic destabilization soon translated into increased political fragmentation. Despite its enthusiasm for liberal policy reform, the coalition ultimately failed to change institutional structures of racial oppression. Discrimination in employment and housing, as well

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31 Galster, Driving Detroit, 136-166.
32 Sugrue, Origins of the Urban Crisis, 91-123.
33 Galster, Driving Detroit, 2012, 51.
34 Sugrue, Origins of the Urban Crisis, 2014, 140.
as issues of police brutality, remained unresolved. As a result, rising racial tension within the city percolated until the violent rebellions of 1967.

The 1967 rebellion accelerated the process of “white flight” in Detroit, further signaling the collapse of the city’s cross-racial liberal coalition. Black liberal leaders, however, retained much of their political power, and continued to build a solid electorate among the city’s black middle class in the midst of white migration from the city. The election of Detroit’s first black mayor, Coleman A. Young, in 1973 - just six years after the rebellion - represented a major victory for black political power in the city.

Mayor Young’s legacy within the metro-Detroit region is ambiguous. He is often criticized, for example, for his tendency to make inflammatory comments directed at the suburbs, which deepened political cleavages between the increasingly black city and its increasingly white metropolitan surroundings. (These comments were certainly matched by incendiary remarks from suburban political leaders, such as Dearborn Mayor Orville Hubbard and Oakland County executive Brooks Patterson.)

It is also true that Detroit continued to experience trends of job loss and deindustrialization during Young’s tenure, producing deep economic decline. Technological advancements in transportation and communication further spurred the movement of manufacturing industries from cities like Detroit, contributing to the decline in income and property values in the city. Between 1977 and 1982, for example, the city experienced a 21% loss in industrial operations. On a regional scale, manufacturing jobs were replaced with

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38 Thompson, *Whose Detroit?*, 192-216.
42 Rich, *Coleman Young and Detroit Politics*, 129.
suburban service-sector employment, but residential segregation proved a geographical obstacle between Detroiters and these jobs.

Mayor Young attempted to counter Detroit’s manufacturing downturn by encouraging corporate investment in the city’s central business district. At this point, government-business coordination had deteriorated from a relatively stable coalition in the 1940s-1960s into a “vendor regime.” Under this system, business interests proposed economic development projects which the city administration made concessions to facilitate. Due to Detroit’s vulnerable economic position, these projects usually came at a cost to the city in terms of land write-downs as well as tax abatements and incentives.

Despite the economic challenges his administration faced, Mayor Young managed to maintain a balanced budget throughout much of his tenure through a combination of budget cuts and government downsizing. When the nationwide recession of the late 1970s pushed the city to the edge of fiscal crisis in 1981, Young successfully addressed the nearly $132.6 million deficit through a series of political maneuvers. Most notably, he convinced Detroit residents to vote for a local income tax increase and negotiated a wage decrease from fifty two of the city’s fifty-seven unions. Young’s management of the situation allowed the city to maintain its independence from external financial control.

In the decades after Young left office, Detroit’s finances suffered from a combination of dwindling revenue and increased spending obligations. These fiscal stresses evolved in part from the economic trends that continued to affect Detroit, including poor employment conditions and a shrinking population. However, political decisions, in both local and state government, also worsened Detroit’s financial position.

Funds from each of Detroit’s major sources of tax revenue - property, income, utility user, and casino-wagering taxes - all declined steadily from the late 1990s through the 2010s as

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44 Rich, Coleman Young and Detroit Politics, 246.
the city’s economy deteriorated.Detroit also lost a significant amount of revenue due to continued cuts in the state’s revenue sharing program. These cuts were partly according to the state’s revenue sharing algorithm, which decreased funds with Detroit’s population, yet much of the reduction was discretionary.

In 1998, then-Mayor Dennis Archer attempted to plug this leak in the city’s revenue stream through a “handshake deal” with Governor John Engler. According to the deal, Detroit would reduce its income tax in exchange for a guaranteed $339 million in revenue sharing payments from the state. Despite this agreement, the state nevertheless continued to cut funds to the city throughout the following decades. By some estimates, this deal cost Detroit as much as $728 million by 2013 - $220 million in owed revenue sharing payments and $508 in lost income tax revenue.

Detroit’s finances also suffered from the legacy costs of the city’s retiree benefit obligations and other promised post-employment benefits (OPEB). The city operated two retirement systems funds: the General Retirement System (GRS) and the Police and Fire Retirement System (PFRS). Per these systems, each municipal employee automatically transferred a portion of their earnings toward retirement income and benefits via a common pool investment fund. Both of Detroit’s retirement systems were designed in the mid-20th century and promised retirees “defined benefit plans,” which guaranteed retirees a certain level of benefits regardless of the financial status of the retirement fund. This meant that the city was obligated to make regular contributions to the fund, as well as manage investment decisions,

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49 Legacy costs are expenses resulting from defined-benefit retirement plans (explained below).
assume market risk, and make up any differences that arose when the fund was insufficient to pay retiree benefits.\textsuperscript{50}

When an employer fails to make financial contributions to its retirement fund to close gaps between the fund’s balance and promised benefits, the retirement system is considered “underfunded.” Detroit found itself in this position often throughout the second half of the 20th century. Underfunding was a frequent issue for Detroit in part because, as the city’s population dwindled and its workforce shrank, the ratio of employees paying into the fund versus retirees claiming benefits became less and less favorable.\textsuperscript{51} Larger, national economic trends also played a role in exacerbating Detroit’s underfunding problem. For instance, fluctuations in the stock market affected the stability of public retirement funds like Detroit’s, which held considerable investment portfolios.\textsuperscript{52}

Certain specific features of Detroit’s retirement systems and the way they were managed also contributed to underfunding. For example, until 2011, retirees were able to exchange annuity payments from the fund for one lump-sum payment, which drained the system significantly in the short-run.\textsuperscript{53} During the 2000s, the funds engaged in a number of risky, ultimately costly investments. The funds’ chief legal counsel and former trustees were eventually indicted in March of 2013 on charges of bribery and conspiracy involving more than $200 million in investments for Detroit’s two retirement funds.\textsuperscript{54}

By the time Detroit declared bankruptcy in 2013, Emergency Manager Kevyn Orr reported that the city’s retirement systems had accumulated $3.5 billion in underfunded

\textsuperscript{50} Chung, “Government Budgets,” 2014.
\textsuperscript{52} Chung, “Government Budgets,” 2014.
pension liabilities. However, the larger source of Detroit’s retiree-related debt was not the pensions but growing OPEB costs, particularly health care. By 2013, the city estimated these debts numbered $6.4 billion. There are two reasons why Detroit’s OPEB debts eclipsed its pension obligations. First, the Governmental Accounting Standards Board (GASB) does not require local governments to fund their OPEB shortfalls the way they do pension shortfalls. This has led many cities like Detroit to allow underfunding liabilities from OPEB expenses to outpace those associated with pensions. Second, the costs of healthcare in the United States rose steadily from the 1960s onward, growing the amount that Detroit was required to pay towards retiree health care.

In this context, it is unsurprising that the city began to run chronic deficits, which city officials responded to by selling municipal bonds. These bonds took two forms: general obligation and revenue bonds. The city used its taxing power or “good faith and credit” to back general obligation bonds, which were regulated by laws designed to limit local governments from accumulating large amounts of debt. Revenues from particular projects or special funds, such as the Detroit Water and Sewerage Department (DWSD), served as collateral for Detroit’s revenue bonds.

Under the mayoral leadership of Kwame Kilpatrick, Detroit also employed more unusual methods of borrowing, including the quasi-legal “swaps and COPS” deal of 2005. To address accrued liabilities and pension debt, the city generated a revenue stream supported by service contracts between itself and nonprofit “shell” corporations associated with each of the two retirement systems. Municipal bond insurance firms, namely Syncora Holdings AG and Financial Guarantee Insurance Co. (FGIC), purchased Certificates of Participation (COPs) in the

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56 Ibid.
revenue stream in exchange for paying $1.4 billion to fully fund the city’s pensions. This complicated transaction allowed the city to circumvent legal limits on municipal borrowing and source additional money to pay its pension obligations.

The second component of the deal involved Detroit’s “swaps bet.” Two banks, UBS and Bank of America Merrill Lynch (BOA-ML), agreed to convert floating interest rates on some of the new COP debt to a fixed interest rate. Per this agreement, Detroit paid a fixed rate to UBS and BOA-ML, and in exchange the banks paid Detroit the variable rates.\(^{59}\) By taking this deal, the city effectively bet that interest rates would rise or stay above the fixed amount. Riskier still, Detroit agreed to a stipulation that gave the banks the ability to demand the entire projected future value of the swaps deal in “termination payments” should the city’s credit rating fall even one level.

Detroit’s problems, both economic and financial, became even more severe during and immediately after the Great Recession of 2008. Interest rates fell significantly due to efforts by the Federal Reserve to offset the effects of the recession, and it soon became clear that the city had lost its swaps wager as its debts to the UBS and BOA-ML crept into the hundreds of millions. Mayor Ken Cockrel, Jr. negotiated a new deal in 2009 to avoid triggering the automatic termination of the swaps when the city’s credit rating fell. Cockrel pledged casino tax revenue as collateral on the swaps debt,\(^{60}\) which converted the swaps into “secured” obligations that could not be altered through financial restructuring or bankruptcy.\(^{61}\)

Detroit’s economic position during these years was similarly unfavorable. Between 2008 and 2010, unemployment in Detroit effectively doubled, and property taxes decreased by 19.7% as a result of plummeting value assessments.\(^{62}\) The recession also cut into key income tax

revenues and fee revenues from city-operated utilities.\textsuperscript{63} And, while Detroit’s resources declined rapidly during this time, the city had virtually no borrowing options owing both to its poor credit rating and to the fact that it had run up against many state-imposed limits of local government borrowing.\textsuperscript{64} In the end, the city found itself with no choice but to further reduce spending on already diminished city services.

By 2013, Judge Rhodes summarized Detroit’s situation with a grim set of statistics. The city’s population was less than 700,000 - a 63\% drop from its postwar peak and a 26\% drop since 2000. Detroit’s violent crime rate was five times the national average and its unemployment rate came in at over 18\%. In 2013, the average emergency response time for the Police Department was 58 minutes, compared to a national average of 11 minutes. Approximately 40\% of the city’s streetlights did not work. The city had accumulated as much as $18 billion in debt, owed to more than 100,000 creditors.\textsuperscript{65} However, while these statistics are certainly jarring, they do not in themselves explain how Detroit came to declare bankruptcy. The next chapter provides an introduction to my answer to this question, as well as an overview of the city’s bankruptcy proceedings.

\textsuperscript{63} Turbeville, “Detroit Bankruptcy,” 2013.
\textsuperscript{64} Pew Charitable Trusts, “Detroit Profile,” 2013.
\textsuperscript{65} In re City of Detroit, Docket No. 1945.
Chapter 3: Timeline of Detroit’s Bankruptcy

In the previous chapter, I explained how Detroit’s fiscal crisis came to be; here, I provide an overview of how that crisis resulted in bankruptcy. This chapter also includes an overview of the bankruptcy itself, from the initial filing to the confirmation of the final Plan of Adjustment. In Chapter 4, I will return to the most important events in greater detail - my intention here is to provide the reader with a sense of where those events fit into the overall saga of Detroit’s bankruptcy.

The story of how, in 2013, Detroit’s economic and financial trajectory arrived at bankruptcy is closely tied with the development of the State of Michigan’s institution of emergency management. Michigan’s emergency manager laws first appeared in 1990, under the leadership of Governor James Blanchard (D).\(^{67}\) The original law, known as the “Local Government Fiscal Responsibility Act,” allowed the State to intervene in the governing affairs of municipalities and school districts facing financial crises by appointing an emergency financial manager. These managers assumed many of the financial decision-making powers typically held by elected officials. Both Democratic and Republican governors appointed emergency financial managers throughout the 1990s and 2010s.

Early in Governor Snyder’s first term, the Michigan legislature replaced the original emergency manager law with Public Act 4 of 2011, which expanded the position considerably. Under this law, state-appointed managers had powers that in many ways assumed and exceeded the role of elected officials.\(^{68}\) The most controversial of these included the ability to adopt new local legislation, the right to remove elected and appointed officials from office, and the legal authority to alter and void union contracts.

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\(^{66}\) See Appendix A for a list version.

\(^{67}\) In re City of Detroit, Docket No. 1945.

In November of the same year, Governor Snyder announced that he would appoint a ten member panel to assess Detroit’s financial situation. This announcement attracted particular attention because Public Act 4 named the formation of such a “review team” as the preliminary step in the emergency management process. City leaders, including then-Mayor Dave Bing and Council President Charles Pough responded that they were optimistic that the city’s financial problems could be addressed through negotiations with unions to make “structural reforms” in health care and pensions, as well as wage reductions.

Following the financial review team’s determination that the city was in a state of financial emergency, Detroit officials approved a “Financial Stability Agreement” in 2012. This agreement, which City Council approved by a slim 5-4 majority, handed over operating and budgeting control to a state-appointed review board, but allowed local officials to retain their other powers.

Later that year, the American Federation of State, County and Municipal Employees (AFSCME) successfully led an effort to repeal Public Act 4 through a statewide voter referendum. The AFSCME consortium represented several public sector unions whose pension plans would soon be labeled key elements of the city’s fiscal crisis. In December of 2012, the Republican-dominated State Legislature enacted another law that essentially re-instituted the most controversial elements of Public Act 4, including giving emergency managers powers of legislation and contract alteration.

In March of 2013, just months after signing this new law into effect, Governor Snyder placed Detroit under emergency management and selected Kevyn Orr, a top bankruptcy lawyer, to serve as manager. Workers, retirees, and the city’s two pension funds responded by filing

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multiple lawsuits to block the state government from authorizing a bankruptcy in Detroit.\textsuperscript{73} Orr himself made early remarks that he would try to avoid bankruptcy through “good faith” negotiations with creditors. However, just days after the media began reporting tensions in these negotiations, Orr filed for chapter 9 bankruptcy protection on behalf of the city on July 18th, 2013.\textsuperscript{74}

The United States Bankruptcy Court quickly appointed Judge Rhodes to adjudicate the case, and in September Rhodes began the city’s eligibility hearings. In order to be considered eligible for chapter 9 bankruptcy protection, a city must meet at least three of the following four requirements: (1) the city must have an agreement on a plan from creditors holding at least a majority in amount of claims under each class on which the municipality intends to impair debt; (2) the city must have attempted to negotiate in “good faith” with creditors, but failed to reach an agreement; (3) this failure - that is, the inability of the city to negotiate with creditors - must be because such negotiations are impracticable; and (4) the city must reasonably believe that a creditor will try to obtain a “preferential payment” of municipal assets through aggressive bargaining.\textsuperscript{75}

During eligibility hearings, Detroit’s unions objected to the city’s chapter 9 filing on the grounds that Orr had not genuinely pursued good faith negotiations with their representatives, and had instead predetermined the city would file bankruptcy. A number of additional challenges arose during this period on the legality of altering union negotiations under bankruptcy. Perhaps the most important of these challenges came from Michigan Attorney General Bill Schuette, who made official statements during the hearings that Michigan’s


constitution protected the integrity of union contracts, which could not legally be “diminished or impaired” by the bankruptcy process.\(^ {76} \)

In the midst of Detroit’s eligibility hearings, Orr pursued an agreement with UBS and BOA-ML to settle the city’s interest rate swaps debt from 2005. This included an estimated $350-400 million payment from the city and promised future tax revenue flows from Detroit’s casinos, which represented 20% of the city’s total revenue.\(^ {77} \) Judge Rhodes rejected this iteration of the deal between Detroit and UBS/BOA-ML on the grounds that it gave too generous compensation to the banks given that the 2005 swaps were potentially illegal.\(^ {78} \)

In December of 2013, Judge Rhodes ruled Detroit eligible for chapter 9 bankruptcy, and opined that the city had made “good faith” efforts to negotiate with creditors prior to filing for bankruptcy protection. Perhaps most importantly, Rhodes argued that retirement obligations could be altered in federal bankruptcy court.

In the same months as the city edged towards bankruptcy, controversy emerged around the prospect of the city’s selling artwork from the Detroit Institute of Arts (DIA) to repay creditors. Although Schuette testified during the eligibility hearings that DIA works were legally protected from such sales, several creditor groups began to organize around the prospect of liquidation.\(^ {79} \) Orr and his legal team contracted the international auction house Christie’s Appraisals to assess the value of the collections, which it placed somewhere between $452 and $866 million.\(^ {80} \) Once Judge Gerald Rosen was named lead mediator for Detroit’s case, he began meetings with various philanthropies and foundations to try to solicit money to protect the artwork.

\(^ {77} \) Turbeville, “Detroit Bankruptcy,” 16.
\(^ {78} \) Nathan Boney, “Rhodes Halts Trial over Swaps Deal, Orders City to Renegotiate with Banks,” \textit{Detroit Free Press}, December 18, 2013.
In January of 2014, Judge Rosen announced his “grand bargain,” an agreement that protected DIA artwork from liquidation in exchange for a multi-million dollar contribution to retiree pension funds. This contribution included $100 million from private DIA donors, $330 million from philanthropic foundations, and $350 million from the State. The city then transferred the artwork to a charitable trust, where it would be shielded from creditors.

The next month, Detroit released the first version of its “Plan of Adjustment” of debts, which the city would continue to revise in the following months as it negotiated with its many creditors. According to federal bankruptcy code, any municipality’s Plan of Adjustment must (1) divide creditors into classes in a way that is fair and equitable; (2) specify which classes are and are not impaired by the plan; and (3) treat all claims in a class equally unless particular claimants agree to less-favorable treatment.

The city divided its debt into seventeen classes of claims. The court considered six of these classes to be secured claims, which could not be altered or restructured during bankruptcy. Most of these claims were secured by the fact that the city had pledged specific revenue sources as collateral when it assumed the debt. For example, the vast majority of the city’s secured debt ($5.8 billion) came from bonds taken out against DWSD revenue. Mayor Kockrel “secured” the interest rate swap claims when he pledged casino revenue against these debts in 2009, but challenges to the legality of the swap deals allowed the city to pursue restructuring negotiations nonetheless.

The remaining eleven classes of claims were unsecured, backed only by the general revenue and “good faith” of the city. These claims could be altered during the bankruptcy, so the case largely revolved around negotiating settlements from unsecured creditors. The largest, most expensive unsecured claims included the COPs debt and pension obligations. Syncora

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82 Dabney et al, Municipalities in Peril, 20.
83 For a full list of these classes and their treatment under the final Plan of Adjustment, see Appendix B.
Guarantee and FGIC held $1.47 billion in unsecured debt associated with COPs. The city treated the pension obligations as three different classes: Police and Fire Retirement System pensions, General Retirement System pensions, and retiree health care benefits (which, unlike the first two classes, involved only retirees).

In April, UBS and BOA-ML agreed to a much smaller settlement on the 2005 swaps debt, this time accepting $85 million from the city.\(^8^4\) Between April and June of 2014, pension fund representatives, retirees, and works agreed to a 4.5% cut for general pensioners and no cut for police and fire pensioners but with a reduction of “cost of living adjustments” from 2.25% to 1%.\(^8^5\) These figures compared favorably to the offer reportedly made by Orr to retirees in the days leading up to bankruptcy filing, which could have been possibly as low as ten cents on the dollar.\(^8^6\)

During these same months, the city also settled with unlimited tax general obligation bond insurance companies Assured, Ambac and National Public Finance Guarantee, paying off 74% of their debt and redistributing 26% to low-income pensioners.\(^8^7\) In May, the United Auto Workers (UAW) agreed to raise funds to help offset retiree health care cuts.\(^8^8\) This unusual contribution was a concession to Michigan Speaker of the House Jase Bolger (R - 63rd District), who had - in what Minority Leader Gretchen Whitmer (D - 23rd District) called a “crass political move”\(^8^9\) - demanded private sector unions contribute to the grand bargain.

Just days after the Plan of Adjustment confirmation trial began on September 2nd of 2014, Detroit and Wayne, Oakland, and Macomb counties reached a deal to create a regional

\(^8^4\) Steven Raphael and Steven Church, “Detroit Allowed to Pay UBS, BofA $85 Million to End Swaps,” Bloomberg, April 11, 2013.
\(^8^7\) Chad Halcom, “Detroit Agrees to Pay Bondholders 74% on $388M Claim in Bankruptcy,” Crain’s Detroit, April 9, 2014.
\(^8^9\) Gretchen Whitmer, interview by author, March 21, 2016.
water system, known as the Great Lakes Water Authority (GLWA). This agreement allowed Detroit to refinance massive amounts of debt associated with the DWSD (which would merge with the regional system) and will provide billions to the city over the next four decades to fix its water infrastructure.\textsuperscript{90} Almost simultaneously, the city reached a settlement with the bond insurance company Syncora, which included a 20-year lease extension on the Detroit-Windsor Tunnel.\textsuperscript{91} Detroit made a similar deal with FGIC, wherein the city promised FGIC purchasing rights to the former Joe Louis Arena site.\textsuperscript{92}

The confirmation trial closed on October 27th, less than two months after it began. Judge Rhodes approved the city’s Eighth Amended Plan of Adjustment on November 7th, ruling that the plan was both fair and financially feasible and calling the outcome “miraculous.”\textsuperscript{93} Now that I have provided a timeline of Detroit’s journey to and through bankruptcy, in the next chapter, I will return to a few of the key events to perform my distributional analysis.

\textsuperscript{91} \textit{Crain’s Detroit}, “Detroit Reaches Key Agreement with Bond Insurer Syncora,” September 10, 2014.\
\textsuperscript{92} Matt Helms, “Terms of Detroit’s Settlements with FGIC, Syncora,” \textit{Detroit Free Press}, October 17, 2014.\
Chapter 4: Whether Bankruptcy and Which

Theoretical Approach

The primary objective of my thesis is to analyze and explain the distributional effects of the Detroit bankruptcy in a political context. A case study of this nature does not currently exist in the literature on municipal bankruptcies, and theoretical work on the political nature of chapter 9 is similarly sparse. For this reason, I will begin this chapter with an overview of what I believe this sort of distributional analysis should entail.

The core question of my analysis asks “cui bono?” - who benefits? Specifically, I seek to identify the winners and losers of Detroit’s bankruptcy and understand how this particular outcome came to be. Actors may “win” in comparison to one another and in comparison to themselves in some alternative state of events. Therefore, a distributional analysis of bankruptcy must explain the positions of relevant actors in relation to each other and in relation to what their positions might have been if the city’s fiscal crisis had unfolded without bankruptcy, or if the bankruptcy had been negotiated in a different way.

From a purely economic standpoint, the “relevant actors” in this case include only those groups that competed directly for resources during the bankruptcy process. This description applies most obviously to Detroit’s creditors. In game theory, bankruptcy is fundamentally understood as the process by which a debtor’s assets are divided up among its creditors, whose combined claims sum to more than the total amount of those assets. In this way, bankruptcy is a zero-sum game in which creditors can only gain at the expense of one another. This understanding of bankruptcy as a Pareto efficient system informs the dominant approach to the topic in legal theory. In “Bankrupt Politics and the Politics of Bankruptcy,” Adam Levitin argues...
that most legal theorists conceptualize bankruptcy as an exercise in economic efficiency designed to maximize collective creditor welfare.\(^{95}\)

It is important to distinguish here between private bankruptcy, with which most bankruptcy theory is concerned, and municipal bankruptcy. While Chapter 11 allows for the total liquidation of debtor assets for distribution among creditors, municipal bankruptcy code is explicitly designed to protect financially-distressed cities from liquidation. In practice, this means that the city may decide when to sell its assets, balancing the abatement of debt through the liquidation of assets with long-term considerations of the future value of those assets for the city. For this reason, the city - or, more specifically, officials acting as agents of city residents - would also be considered a competitor in this zero-sum game.

However, this purely economic approach is flawed because it fails to acknowledge that public bankruptcies are just as much political events as economic ones. More specifically, the dominant legal approach is poorly suited for municipal bankruptcies because it does not address the idea that distributional decisions in these cases are also political decisions. Therefore, rather than conceptualizing municipal bankruptcy as some sort of economic contract, we should understand it as a set of bargains and compromises between competing groups that unfold according to what Levitin calls “the political economics of loss allocation.”\(^{96}\)

This theory applies not only to the outcome of a municipal bankruptcy case, but also to the very decision to use bankruptcy as a tool to address fiscal distress. Levitin notes that bankruptcy is a significantly different distributional process from legislation, governed by its own set rules and norms.\(^{97}\) For one, chapter 9 gives judges and creditors, rather than voters and legislators, the power to make decisions regarding the distribution of city funds. Municipal bankruptcies also allow for alterations to collective bargaining agreements that are not typically


\(^{96}\) Ibid, 1454.

\(^{97}\) Ibid, 1452.
available to local elected officials. In assessing the political aspect of public bankruptcies we should consider that bankruptcy, as an alternative to legislative processes, may be preferable for certain interest groups.

In this chapter, I illustrate these ideas more fully by using Detroit as a case study of the political economy of bankruptcy. Specifically, I will explain the distributive consequences of Detroit’s bankruptcy as political outcomes. This approach has two conceptual implications. First, my analysis will consider all groups and individuals who influenced the bankruptcy process, from the city’s 2013 fiscal crisis through the final Plan of Adjustment. This includes interest groups such as the city’s various creditors, city and state residents, and labor unions. It also includes officials who governed the process at various stages, including city, state, and federal elected officials, federal judges and mediators, and contracted lawyers and consultants.

Second, “winning and losing” must be understood in a political-economic context. By this I mean that the interests and positions of all of the actors in this case were determined by the interplay between electoral and resource-driven motivations. Economic gain and political ambition are both important factors in explaining interests and behavior, and for assessing who benefited from Detroit’s bankruptcy saga.

This chapter consists of three different sections, each presenting a distributional analysis of a different aspect of the case. The first explores the city’s progression, between 2011 and 2013, from fiscal crisis to bankruptcy. The second section looks at the regional deals that emerged during the bankruptcy trial, specifically the grand bargain over DIA artwork and the formation of the GLWA. Finally, the third section studies the concessions made by the different financial creditors in approving the Plan of Adjustment.

At each of these stages of the case, I compare what happened in Detroit to counterfactual scenarios in which either the city did not declare bankruptcy or in which its bankruptcy

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98 For the purposes of this thesis, treating residents at either the state or the city level as a group is somewhat of an analytical abstraction. In discussing the economic and political positions of these groups, I rely on averages rather than performing an analysis of how the different strata within these groups fared.
unfolded differently. Given that there are, in theory, an infinite number such states, it is important to identify which are the most plausible and salient.\textsuperscript{99} For the first stage of my analysis, the relevant counterfactuals are the bailouts that various officials, experts, and organizations proposed as alternatives to Detroit’s bankruptcy. In the second and third sections, I will compare the consequences of the city’s actual bankruptcy outcome to those that could have existed were certain key deals not reached.

\textbf{The Politics of Choosing Bankruptcy}

There is little dispute that by 2013, Detroit required some sort of financial intervention. As discussed in previous sections, municipal services in Detroit were drastically reduced by 2013 due to repeated budget downsizing and the city’s steadily declining revenues. This crisis existed in two time-frames: immediate and long-term. Detroit needed to both address the looming threat of cash-flow insolvency as well as reverse structural trends that threatened the city’s solvency in the future.

Emergency manager Kevyn Orr claimed the city would face a $198 million annual cash flow shortfall by fiscal year 2014 in his proposal to creditors.\textsuperscript{100} This amount included the city’s debt service, meaning that Detroit needed an annual revenue increase of around $198 million to avoid defaulting on its loans. In order to maintain long-term solvency, Detroit would also need to find a way to close the gap between its revenue and spending into the future.

Despite the severity of the city’s fiscal crisis, public opinion polls from 2013 demonstrate that most Detroiters believed alternatives to bankruptcy existed. When asked in a survey, “do you think it was necessary for Kevyn Orr to begin bankruptcy proceedings to resolve the financial crisis in the City of Detroit,” 60% responded yes, while only 24% believed bankruptcy

\textsuperscript{100} City of Detroit, “Proposal to Creditors,” page 7.
was necessary.\textsuperscript{101} Local officials and organizations reflected this opinion, calling upon the federal and state governments to help Detroit secure the funds it needed to avoid bankruptcy.

**Proposed Federal Bailout**

Many in Detroit looked to the federal government to help address the city’s fiscal crisis. Former U.S. Representative Hansen Clarke (D - MI 13th District) was one prominent supporter of this option. In a 2012 editorial piece for the *Huffington Post*, Hansen wrote:

As Motown inches ever closer toward an emergency manager takeover or chapter 9 bankruptcy, city, state, and federal leaders would be wise to remember a key lesson of the New York’s post-1970s economic miracle: that well-designed federal assistance can be both fiscally responsible and potentially transformative for a city in need.\textsuperscript{102}

In the same piece, Hansen proposed that Congress help Detroit regain short-term solvency by extending a Recovery Act program that reimbursed distressed cities for a portion of their interest payments. To address Detroit’s long-term issues, Hansen suggested Congress then use measures such as “reduced capital gains rates” to incentivize long-term investments in Detroit. Clarke reportedly spoke directly to President Obama about other forms of federal aid, such as department-specific grants to improve city services.\textsuperscript{103}

The possibility of assistance from the federal government seemed unlikely when, in July of 2013, Republicans in Congress introduced multiple amendments aimed at eliminating the possibility of a bailout for Detroit. Senator Lindsey Graham (R-SC) proposed an amendment to a general spending bill that would bar the use of federal funds to buy or guarantee municipal obligations from cities at risk of defaulting and prohibit the federal government from issuing lines of credit to distressed municipalities.\textsuperscript{104} Other Republican Senators, including Ron

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\textsuperscript{104} Lisa Lambert, “‘No Bailout:’ Senators Look to Pre-Empt U.S. Aid to Detroit,” *Reuters*, July 25, 2013.
Johnson (R-WI) and John Cornyn (R-TX), introduced similar amendments to a Housing and Urban Development bill that year.105

While both amendments were ultimately unsuccessful, they certainly reflected the preferences of important members of Congress regarding a federal bailout for Detroit. A review of Obama’s statements from his first campaign onwards reveal that he avoided mention of federal assistance to Detroit, even while praising his 2009 bailout of the city’s auto industry. By 2013, an unnamed member of the Obama Administration told the New York Times that the chances that Congress would pass any legislation for Detroit were “somewhere between zero and zero.”106 Thus, Detroit never received assistance from the federal government to address the city’s short-term insolvency and keep appointed officials from pursuing bankruptcy. In the end, the Obama Administration waited until September of 2013, two months after the city had filed for bankruptcy, to provide Detroit with a $300 million aid package to help with quality of life programs like blight demolition and transportation.107

Proposed State Bailout

According to former State Senate minority leader Gretchen Whitmer, the Michigan legislature debated the issue of a Detroit bailout “annually”108 when Democrats and labor unions called for the state to honor the 1998 handshake deal between Archer and Engler. Whitmer believed the Democratic position on this issue failed to gain traction due to the party’s dwindling political power in the legislature. However, appeals to restore revenue sharing to Detroit nevertheless took on particular urgency as the state assumed financial control of the city.

In 2012, Detroit’s lead attorney, Corporation Counsel Krystal Crittendon, filed a lawsuit against the State of Michigan’s Treasury Department in an effort to block the Consent Agreement between Detroit and the state. In her suit, Crittendon claimed that the state owed

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107 Ibid.
108 Gretchen Whitmer.
Detroit $244 million in reduced revenue sharing from the Archer-Engler agreement.\textsuperscript{109} (The Ingham County Circuit Court eventually dismissed the suit on the grounds that these debts were not legally binding.)\textsuperscript{110} The Detroit branch of the NAACP echoed Crittendon’s argument, calling for the state to restore revenue sharing to $270 million by May of 2013. Chapter President Reverend Dr. Wendell Anthony wrote to Snyder: “We well understand that Detroit and other municipalities across the state are experiencing financial hardship. But a major part of Detroit’s budget problems are the direct result of state policies that have drained the city budget of revenues.”\textsuperscript{111}

In November 2013, Wallace Turbeville, a senior fellow at Demos think tank and former vice president of Goldman Sachs, published a similar recommendation for addressing Detroit’s fiscal crisis. Turbeville recommended that Orr avoid bankruptcy by closing the state’s immediate cash flow shortfall. Orr could do this, Turbeville wrote, by asking the state to restore discretionary revenue sharing, helping the city to collect unpaid taxes, and contributing other funds “on an emergency basis.”\textsuperscript{112} This, he suggested, would provide short term relief while the state collaborated with the city on economic improvement projects to grow Detroit’s tax base.

Detroiters Resisting Emergency Management (DREM) cited Turbeville’s report in their proposed “People’s Plan for Restructuring Toward a Sustainable Detroit,” endorsed by over thirty local community organizations and churches. The DREM Plan argued that “budget concerns must emphasize eliminating the budget shortfall of $198 million rather than continually targeting the questionable figures relied on by the emergency manager to justify his actions based on inflated long term debt.”\textsuperscript{113} Like Turbeville, Anthony, and Crittendon, DREM called for the state to do this by increasing revenue sharing, though it did not specifically say by

\textsuperscript{110} Maynard, “A Fragile Bargain.”
\textsuperscript{111} NAACP, “Revenue Recommendations for the city of Detroit,” May 13, 2013.
\textsuperscript{112} Turbeville, “Detroit Bankruptcy,” 6.
how much. The DREM plan also called on the Michigan Legislature to enforce a reverse commuter tax that would require automatic payroll deductions for Detroiters working outside the city, rather than relying on these commuters to surrender the tax themselves. DREM projected $40-50 million additional revenues from this legislation, but a 2009 study commissioned by then-Mayor Dave Bing estimated that it could yield as much as $142 million.114

**Choosing Bankruptcy**

The crucial question in determining if Detroit had financially feasible alternatives to bankruptcy is whether or not the long-term, structural challenges facing Detroit included its pension and OPEB obligations. Proponents of state and federal bailouts identified these challenges as the economic and fiscal trends that contributed to Detroit’s declining revenues. They believed their proposed alternatives were viable because they included, along with immediate aid to address the city’s short-term insolvency, plans to change Detroit’s economic momentum and help the city capture revenue going forward. In contrast, Republican politicians and the experts they appointed and hired argued that these alternatives were not feasible because they could not address the structural problem of the retirement systems. They pointed to huge amounts of debt associated with pension and OPEB obligations that could only be legally115 restructured through bankruptcy.

Michigan State Treasurer Andy Dillon made this argument on a local Detroit radio station in 2012. Dillon first acknowledged that the state had failed to uphold its end of the 1998 deal between Engler and Archer, estimating, as Crittendon did in her lawsuit, “if you add up the last revenue sharing it totals up to $224 million.”116 But Dillon quickly rejected the possibility of the state turning over this money to Detroit, saying, “So while that would be nice if it would get

114 Bill Bradley, “Detroit Losing Money from Reverse Commuter’s Who Don’t Pay Income Taxes,” *Next city*, August 15, 2013. The state suggested it would help Detroit pursue this legislation in its 2012 Consent Agreement with the city, but the proposal was put aside during the bankruptcy process. An “Income Tax Deduction Bill” along these lines was eventually passed by the state in 2015, post-bankruptcy.
115 There were, of course, legal challenges to the use of bankruptcy to adjust pension debt. These were avoided in the case of Detroit, as discussed in further detail in subsequent pages.
us through this year and probably next year it won’t solve the systemic structural problems the city has.” He specifically labeled the pensions and OPEB as the “structural problem,” saying “I think the review team will find [the retirement system] unsustainable and that, to me, is a big problem.”

Snyder’s administration continued to reiterate this argument over the course of the following year. When Representative Clarke publically called on Snyder to wait to appoint an emergency manager until after he could explore the possibility of federal aid to Detroit, Snyder responded to the press: “We’re happy for him to pursue any type of federal money he can, but if there isn’t [sic] structural changes, the city will be in the same situation down the road.” On Face the Nation in 2013, Snyder told the host: “I don’t view [a bailout] as the right answer. The right answer is, bankruptcy is there to help deal with the debt question.”

Politicians at the national level echoed these comments. In a guest column in USA Today, Senator Ron Johnson explained his proposal to block federal aid to Detroit, writing:

> Detroit's failure is rooted in an unholy alliance between politicians and public sector unions. Its 47 municipal unions spent their members' dues to elect public officials who then “negotiated” with those same unions for overly generous contracts that resulted in bankruptcy ... Federal bankruptcy court is the proper venue for settling these debts and obligations that taxpayers cannot afford.

Johnson continued his call for bankruptcy in another public statement, saying: “What must not happen is a federal bailout that spares Detroit from making the needed reforms that the bankruptcy process may require.”

At the state and federal level, Republicans rejected the idea of assisting Detroit based on the argument that proposed alternatives could not address the issue of the city’s pension and

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117 Meloni, “A Major Twist.”
119 Rick Snyder, interview by Bob Schieffer on Face the Nation, July 21, 2013.
121 Lambert, “’No Bailout.”
OPEB debt, which threatened Detroit’s long term solvency and fiscal stability. Because this threat could only be addressed through bankruptcy, Chapter 9 was the city’s only option, and Detroit had no choice but to file for bankruptcy.

This narrative places considerable importance on the size of the city’s retiree obligations, which needed to appear both high and drastically underfunded to support the conclusion that bankruptcy was inevitable. In his “Proposal to Creditors,” Orr reported that the present value of the city’s liabilities from the GRS and PFRS amounted to $9.2 billion: $5.7 billion from health care, $3.5 from pensions.\footnote{City of Detroit, “Proposal to Creditors,” 23.} This represented over half of city’s total debt, which Orr reported to be about $18 billion. Perhaps more significantly, it was roughly 80% of the city’s reported total unsecured debt, the kind of debt that can be diminished or restructured during bankruptcy. Not only did the media widely circulate these figures, but Judge Rhodes referred to them when he declared Detroit bankrupt in his written “Statement Regarding Eligibility.”

It is unclear, however, how exactly Orr generated these numbers in his proposal. At one point, Orr writes “Further analysis by the city using more realistic assumptions (including by reducing the discount rate by one percentage point) suggests that pension UAAL\footnote{UAAL stands for “Underfunded Actuarial Accrued Liabilities.”} will be approximately $3.5 billion as of June 30, 2013,” but never specifies what these assumptions are. Similarly, Orr states that “As of the most recent valuation (June 30, 2011), OPEB unfunded liabilities totaled $5.7 billion and are expected to grow absent restructuring,” but does not provide the details or origins of this valuation.\footnote{City of Detroit, “Proposal to Creditors,” 23.}

When questioned by lawyers representing various retiree groups during Detroit’s eligibility hearing, Orr testified that he based his assessments of retirement liabilities on reports from Milliman Inc., an actuarial and consulting firm based in Seattle. Neither Orr nor Rhodes included Milliman’s actuarial studies in their written statements on Detroit’s financial condition, and these reports were only made public through Freedom of Information Action (FOIA)
requests from the *Detroit Free Press*. In the FOIA-ed studies, addressed to a partner at Orr’s law firm, Milliman actuaries included the disclaimer: “Our projection is suitable for explaining emerging trends in costs and liabilities, but is significantly less robust than a projection based on a full valuation.”

In addition to Milliman’s own reservations concerning the paucity of their work, independent reports called further attention to the unorthodox methodology used to calculate pension liabilities. Rachel Barkley, a municipal credit analyst with Morningstar investment firm, released an analysis of the Milliman studies in August of 2013, soon after the *Free Press* made them public. In her report, Barkley pointed to three questionable aspects of the studies: the assumed rate of return, amortization period, and asset valuation method.

Barkley noted that the assumed rate of return on pension fund investments used by Milliman varied between 6.3 and 7.5%, well below the most common rate of return used by pension funds in the U.S., 8%. Turbeville, in his report on the bankruptcy, brought up the fact that Milliman itself assumed a 7.65% rate of return in the firm’s separate assessments of over 100 other pension funds. Mike Mulholland, former president of the Detroit AFSCME chapter, recalled that during bankruptcy negotiations with union leaders, Orr used the rate of as a bargaining tool, rather than treating it as an actuarial fact. According to Mulholland, deciding on a rate of return “wasn’t math, it was politics.”

Barkley also commented that Milliman’s assumed amortization period appears to deviate from actuarial standards. A pension fund’s “amortization period” is the allotted time period the fund has to pay off its debt in fixed payments. Milliman cut the period in half, from the standard

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125 Glenn Bowen and Katherine Warren, email correspondence with Evan Miller, “Re: DGRS Simple 10-Year Projection of Freeze Plan and No Future COLA” and “Re: PFRS Simple 10-Year Projection of Freeze Plan and No Future COLA,” June 4, 2013. Numbers from these reports are result in smaller projected 2013 liabilities than Orr eventually reported, suggesting he used even more restricted actuarial assumptions.


127 Mike Mulholland, interview by author, March 17, 2016.
of 30 years to 15 years, significantly increasing the overall pension debt amount. Finally, both Turbeville and Barkley noted Milliman’s reduced use of “smoothing” to measure the value of the pension funds’ assets. Smoothing refers to the standard practice of using “actuarial value assessments” of fund assets, rather than market value assessments. This is typically done to account for short-term fluctuations in the stock and bond market. Barkley wrote that while the Milliman report appeared to have used some smoothing, Orr likely removed it entirely in his calculations for the Proposal to Creditors, using the market value of GRS and PFRS assets instead. Due to the fact that the economy was still recovering from the recession, this methodological choice reduced the estimated value of the assets and made the funds’ net liabilities appear much larger. According to Barkley, this probably also accounted for the difference between the Milliman calculations and the figures that appear in Orr’s proposal. Taken together, Barkley wrote, Orr’s practices “clearly fall outside of industry norms.”

The origin of Orr’s $5.7 billion estimate on Detroit’s retiree healthcare liabilities is also unclear. Though Orr does not provide citations for these figures or include calculations, Turbeville guessed his source may have been a 2013 Pew Study “A Widening Gap in Cities.”

The Pew study, Turbeville wrote, notably assumed much larger increases in healthcare costs than were born by recent historic trends.

It is very likely that the retirement systems were more fully funded, and liabilities were significantly smaller, than Orr suggested. This means that retiree benefit agreements were not the structural time bomb that Snyder and others portrayed them to be. Thus, Detroit most likely did not need to reduce its retiree benefits to achieve long-term financial stability, and therefore bankruptcy was not the city’s only option. If there were financial alternatives, how did Detroit arrive at bankruptcy? Most likely, the retirement systems were used as an excuse to avoid pursuing the politically non-viable option of assistance to Detroit.

Republicans, many of whom vocally opposed aiding Detroit, exerted considerable influence on both the state and national stage in 2012-2013. In Michigan, Republicans held a majority in both the Michigan State Senate and House of Representatives from 2011 onward. Snyder himself had few electoral incentives to oppose his own party to appeal to Detroit voters with a state bailout. Though Detroit represented a substantial Michigan electorate in terms of population, the city aligned historically with the Democratic Party. In 2010, for example, 93.7% of Detroit voters had supported Snyder’s Democratic opponent, Virg Bernero.\textsuperscript{130} Though a very slim majority of Democratic voters at a national level approved of assistance to Detroit,\textsuperscript{131} Obama’s silence regarding a federal bailout suggests this was not enough to incentivize him to oppose Republicans on this issue.

The state and federal political context made proposed alternatives politically unrealistic, rather than financially unrealistic. Orr appeared to have accepted this as given even before he assumed his appointment as Detroit’s emergency manager. FOIA requests revealed email exchanges between Orr and his colleagues at the Jones Day law firm in which he anticipated the reaction to a potential Detroit bankruptcy, predicting “the Reps [sic] would rail against any further federal bailouts ... plus, if the feds did anything for Detroit, a number of other municipalities would have their hands out at a time when no one’s in the mood to dole out federal largess.”\textsuperscript{132}

A generous assumption is that officials at the state or national level were primarily concerned with the wellbeing of the residents of Detroit. Knowing that bailout options were not politically viable, they instead played up the issue of the pensions so the city could pursue bankruptcy, where at least its debt could be restructured to free up some of the city’s very limited revenue. A less generous interpretation, suggested by some observers, is that officials


\textsuperscript{131} Quinnipiac University, “American Voters Back ‘Stand Your Ground,’ Quinnipiac University National Poll Finds; Obama Tops Republicans on the Economy,” news release, August 2, 2013.

\textsuperscript{132} Kevyn Orr, email correspondence with Heather Lennox in “Re: Fwd: D,” January 31, 2013.
were also motivated by a larger, overarching desire to cut public pensions and benefits. According to this theory, Detroit’s bankruptcy was part of a larger political agenda - the city was used to set a precedent for the rest of the state to cut pensions and benefits and make it easier for Republicans to perform on their promise of low taxes and reduced spending.

During closing arguments for the bankruptcy eligibility hearing, lawyers for Detroit’s municipal unions presented a version of this interpretation for the court. Sharon Levine from AFSCME noted, “we don’t see valuations. We don’t see appraisals. We don’t see actuarial reports. We don’t see any expert reports with regard to the shortfall - alleged shortfall in the vested pension benefits or otherwise. And we have heard that that’s for strategic reasons.”

Thomas Ciantra from the UAW was more explicit about what exactly these “strategic reasons” were: “What they have done is used the Chapter 9 process, used the threat of Chapter 9, to – to put the pension benefits at play.” Turbeville made a similar indictment of Orr in an opinion piece for the Huffington Post in which he postulated that Orr “may have seen his mission to include damaging the public employee unions forever by fundamentally altering the retirement system.”

There is evidence to substantiate the claim that state officials viewed impairing retiree benefits as an independent goal. First, the FOIA-ed emails containing Milliman’s reports on the city’s pension systems were addressed to a lawyer at Jones Day. This suggests the Snyder Administration apparently solicited the services of a bankruptcy law firm prior to receiving any sort of detailed study of the systems pension fund liabilities. Not only was a Jones Day a law firm with a leading bankruptcy practice, it was a firm that, in 2010, circulated a White Paper recommending states and cities use bankruptcy to adjust their pension obligations. In this

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133 In re City of Detroit, Case No. 13-53846 (Bankruptcy E.D. Mich. 2013), Docket No. 1719: Eligibility Trial Closing Arguments, page 89.
134 Ibid, 163.
136 Bowen and Warren, email correspondence with (Jones Day partner) Evan Miller.
Chapter 9 of the Bankruptcy Code offers many tools and strategies to a struggling municipality that are not available under otherwise applicable state law. In fact, seeking chapter 9 protection may be the only alternative for some municipalities facing unprecedented budget shortfalls and excessively burdensome pension and other obligations.\textsuperscript{137}

Finally, the fact that Snyder chose not to pursue a bankruptcy with contingencies to protect retirees further bolstered this interpretation. During his testimony at the eligibility hearings, lawyers representing Detroit’s retirees questioned Snyder regarding a correspondence between the Governor and his chief legal advisor, Mike Gadola. In the document, Gadola urged Snyder to authorize Detroit’s bankruptcy with contingencies that the pensions and OPEB not be altered, as was permitted in Michigan’s laws regarding municipal bankruptcy.

Ronald King [attorney for GRS and PFRS]: “And why is it that you chose not to put a contingency in the July 18th authorization related to accrued pension benefits?”

Governor Snyder: “I made a decision not to put a contingency with respect to any conditions because my concern was is this is an extremely difficult process; that we’re in a crisis mode; and that we have serious issues here. And I felt it could be an issue causing more delays, concern, complexity to a very complex case to begin with ... I thought it was a good opportunity to get people that are the appropriate people to make decisions that then I can help support the city in the implementation.”\textsuperscript{138}

In other words, Snyder declined to take steps to protect the retirees because he believed bankruptcy was the appropriate forum for addressing the future of Detroit’s retirement systems.

This interpretation is consistent with the pre-existing dynamics between Snyder and organized labor in Michigan. In the 2010 gubernatorial election, labor overwhelmingly...
supported Snyder’s Democratic opponent.\textsuperscript{139} The relationship became particularly strained after Snyder signed Right to Work legislation in 2012.\textsuperscript{140} American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) President Richard Trumka warned that the new law would “diminish the voice of every working man and woman in Michigan,” and called Snyder “a puppet of extreme donors.”\textsuperscript{141} The idea that Snyder used Detroit’s fiscal crisis as an opportunity to further challenge public sector unions is congruous with current trends in national politics, as the presidential candidacy of Wisconsin Governor Scott Walker demonstrated.\textsuperscript{142} Similarly, recent scholarship finds that Republicans in many states used post-recession municipal budgetary problems to justify laws that have weakened or eliminated public sector unions.\textsuperscript{143}

**Distributive Consequences of Choosing Bankruptcy**

Republicans leaders rejected proposed state and federal bailouts for Detroit based on the argument that the city’s fiscal crisis was primarily the result of its under-funded, overly-generous retirement systems, which could only be addressed through bankruptcy. However, I have argued that a closer look at the debt figures used to make this argument reveals that Detroit’s retirement systems were more fiscally stable than suggested and that proposed alternatives to bankruptcy were therefore financially viable. Instead, it was the political context at the state and federal level that foreclosed on the feasibility of a bailout for Detroit. Further, I have argued that Republicans in Michigan used Detroit’s fiscal crisis as an opportunity to weaken labor’s position in the state.

\textsuperscript{140} This law prohibited unions and employers from reaching deals that would require non member employees to join unions or to pay union dues.
\textsuperscript{142} Patrick Marley and Jason Stein, More than They Bargained For: Scott Walker, Unions, and the Fight for Wisconsin (Madison: University of Wisconsin Press, 2013).
Thomas Ciantra, a lawyer for the UAW, told the court in his closing argument, “No one, I think, can deny that there is a fiscal problem here. No one can deny that there is a need for reinvestment. The question is, who is going to pay for that.”

By choosing bankruptcy over bailouts, officials made it so that the retired workers, and not the state or federal government, had to “pay” by accepting cuts to their retirement benefits. This choice shifted the cost of addressing Detroit’s fiscal crisis to a low income sector of the population. Further, municipal unions and retiree associations now had to negotiate to protect what would have been secured incomes outside bankruptcy. As I will discuss in the following section, this made municipal unions vulnerable to demands from Republicans, which could further weaken their position relative to the state in the future.

Regional Deals

Grand Bargain

Once Judge Rhodes ruled that Detroit was eligible for Chapter 9 protection, court-appointed mediators began the process of negotiating with creditors and the city to determine which municipal assets would be available for distribution among creditors. According to Judge Gerald Rosen, the lead mediator for the case, it became clear that the DIA artwork was the city’s only real asset and, besides tax revenue, its only means of paying creditors. At that point, Rosen looked at the case and saw two competing interests: public artwork and pensions. This tension took on additional significance because the museum was tied in many ways to the region’s white, suburban elite. (In Rosen’s words, the board of the DIA was a “who’s-who” of Southeast Michigan.) Detroit retirees and employees, on the other hand, were mostly black...

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144 In re City of Detroit, Docket No. 1719, 161.
145 In 2013, average annual incomes for Detroit retirees ($19,000 for civilian workers and $30,607 for police and firefighters) fell below the average household income in Michigan ($48,273) and the nation ($52,250). See Melanie Hicken, “Detroit Pension Cuts Hit Civilian Workers the Hardest,” CNN, June 2, 2014 for retiree incomes and census.gov for Michigan and U.S. incomes.
147 Ibid.
and working class. The Judge worried that the prospect of liquidating the DIA artwork had the potential to create a “civil war” in the region around historical issues of race and class.

According to Rosen, the idea for the deal that would eventually be known as the “grand bargain” came from a suggestion by one of the GRS lawyers that the state buy the artwork. When Governor Snyder and his advisors initially rejected the idea, Rosen turned to local and national philanthropic foundation. Beginning with the Ford Foundation, these organizations made multi-million dollar pledges to protect the artwork. The museum itself solicited private donations from its own network to contribute to fundraising efforts.

In the end, the combined funds totaled $366 million from the foundations and $100 million from the “DIA Direct Funders,” to be contributed over the course of a 20-year period. The legal agreement approved by the Court, funds from these two sources would go to the city’s two Retirement Systems and could not be subject to claims by the city’s other creditors. The pledges from the foundations also contained requirements for “stakeholder participation,” meaning the donations were contingent upon the state itself contributing the bargain. In Rosen’s estimation, once this money was “on the line,” Snyder felt that he could not walk away. The Governor eventually agreed to a $350 million contributed, payable over 20 years, to the GRS and PFRS “for the benefit of Holders of Pension Claims.”

In exchange for the combined $816 million in funds for the retirement systems, the city agreed to transfer all of its rights to and ownership of the DIA collection to the nonprofit “DIA Corporation” as trustee. The artwork would be held by this charitable trust in perpetuity for “the primary benefit of the residents of the city and the Counties and the citizens of the State.”

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148 Rosen interview.
150 Ibid, 57.
**Distributive Consequences of the Grand Bargain**

The immediate effects of the deal benefitted the retirees, and, to some extent, Detroit residents. Rosen described this goal of the grand bargain in his official press release regarding foundation contributions:

> It bears emphasis that the foundations’ agreement to participate is specifically conditioned upon all of their funds being committed to the twin goals of helping the city’s recovery from bankruptcy by assisting the funding of the retirees’ pensions and preserving the DIA’s art collection as part of an overall balanced settlement of disputes in the bankruptcy.\(^{151}\)

Essentially, the bargain gave retirees the value of Detroit’s only asset while still allowing the residents to enjoy that asset.

However, it should be noted that some commentators have overstated the extent to which the grand bargain benefited Detroit residents by “saving”\(^{152}\) the DIA. After the bankruptcy case ended, Judge Rhodes made it clear that he had never believed it legally possible for the city to sell DIA collections to repay creditors.\(^{153}\) Given that Rhodes had the ultimate power to approve or reject the city’s Plan of Adjustment, it therefore seems unlikely the art would have been sold had the grand bargain not transpired. Rosen recalled asking Rhodes not to disclose his opinion on the artwork so that he could use the DIA as an asset during mediations.\(^{154}\) Thus, a more accurate interpretation of the grand bargain is that it the DIA provided a mechanism to the court to secure foundation, donor, and state funds for retirees exclusively, avoiding the city’s other creditors.

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153 Steven Rhodes statement during “The Detroit Grand Bargain” panel discussion at the University of Michigan Ford School of Public Policy, October 21, 2015. Attorney General Bill Schuette took the same position (see Bill Schuette, “Conveyance or Transfer of Detroit Institute of Arts Collection,” Attorney General Opinion No. 7272).
154 Rosen interview.
Syncora Guarantee, one of the firms that backed the COPs deal in 2005, objected to the bargain for exactly this reason. Specifically, Syncora based its complaint on the fact that bankruptcy law required that both Syncora and the retiree classes, as unsecured creditors, receive equal treatment in the case:

The Grand Bargain was orchestrated to maximize recoveries for politically favored, insider creditors while protecting the Museum Assets from all other creditors and the city itself ... A plan born from collusion and unfairness ... quasi-political maneuver by Judge Rosen ... to pick winners and losers in the bankruptcy (pensioners and mostly suburban patrons of the art versus other creditors) while simultaneously transferring the Museum Assets beyond the reach of all present and future creditors other than the chosen winners.¹⁵⁵

Syncora’s complaint captures another aspect of the bargain: the deal represented a transfer of money to retirees, not only from foundations, donors, and the state, but also from the city’s other creditors. Syncora and Detroit’s other unsecured creditors believed they were legally entitled to some return on their loans to the city. Therefore, excluding these creditors from the bargain and giving the entirety of the city’s only assets to the retirees effectively took money from the former and gave it to the later.

The immediate consequences of the deal appear to favor Detroit residents and retirees at the expense of the foundations, donors, and state and (unwillingly) the other creditors. However, certain conditions attached to the state’s contribution complicate the idea that the grand bargain was a “win” for the retirees. First, as stated in the final Plan of Adjustment, the state’s participation in the grand bargain was conditional upon

active support of the Plan, by a release of and covenant not to sue the State from, and an agreement not to support in any way the litigation described in subsection (f) of this Section by, the city, the Retiree Committee, the Retirement Systems and certain unions and retiree associations.

“Subsection (f)” includes:

Cessation of all litigation ... including the cessation of funding of any litigation initiated by any other party, as it relates to the city, (i) challenging PA 436 or any actions taken pursuant to PA 436 or (ii) seeking to enforce Article IX, Section 24 of the Michigan Constitution.\(^{156}\) This meant that not only did retirees have to vote to approve the Plan, but that the city, retirees, and various labor organizations involved in Detroit's bankruptcy had to agree to drop all legal challenges to Public Act for 436 (the most recent emergency manager law) and the use of bankruptcy to override the Michigan constitution.

For retirees, agreeing to the grand bargain meant accepting significant cuts to their pensions and benefits. Per the Plan of Adjustment,\(^{157}\) Police and Fire Department retirees received no reduction in accrued pension benefits, but a 45% reduction in cost of living adjustments (COLA). GRS retirees experienced a 4.5% reduction in accrued pension benefit amount, the complete elimination of COLA, and the “clawback” of $190 million in annuities from a supplemental retirement program within the GRS.\(^{158}\) Both groups received a 25% reduction in OPEB. Interestingly, both systems were required by the Plan to use a 6.75% rate of investment return assumption (compared to the standard 8%) until 2023.

Accepting the bargain also meant that retirees had to forgo the option to challenge these cuts based on protections given to collective bargaining agreements in the Michigan constitution. Attorney General Bill Schuette gave the retirees grounds for such objections by asserting that the pension and benefits were protected in Michigan under Article IX, Section 24 of the state’s constitution (the section named specifically in the state’s conditions).\(^{159}\) When the retiree classes agreed to the grand bargain, Schuette wrote that the pensioners had waived this

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\(^{156}\) *In re City of Detroit*, Docket No. 8045, 56.

\(^{157}\) Ibid, 38-44.

\(^{158}\) Technically, this meant that certain GRS retirees had to return payments they received by participating in an Annuity Savings Fund (ASF). The ASF allowed city employees to invest a portion of their salaries in a defined contribution retirement account. Between 2003 and 2013, the city diverted funds from GRS pension funds to ASF, which was potentially illegal and contributed to underfunding in many of those years.

constitutional right. Schuette’s office wrote in a press release, “In keeping with past filings, Schuette noted that honoring the pensioners' vote on the proposed Plan of Adjustment is consistent with existing legal precedent allowing certain rights to be subject to negotiation.”

The significance of the retiree group’s decision to accept the bargain became clear after Detroit exited bankruptcy and a group of dissenting retirees appealed the case. This appeal went before U.S. District Court. Judge Bernard Friedman who rejected it on the grounds that it would “unravel the Grand Bargain” and cause

(1) the State to commence measures to recover the State’s contribution and (2) the DIA Funding Parties to withhold hundreds of millions of dollars in funding not yet disbursed to the city. Simply put, unimpeiring GRS Pension Claims would not only threaten the success of the Plan, it would cast the city into a renewed financial emergency.

Retirees and their representative unions agreed to the grand bargain because they believed it was the best possible outcome they could expect. Shirley Lightsey, then-president of the Detroit Retired City Employees Association, captured this sense of resignation when she told retirees, “You can’t eat principles and uncertainty doesn’t pay the bills.” Mulholland recalled that the statewide chapter of AFSCME (Detroit’s largest union) “didn’t think they could win anything in bankruptcy,” and pressured local chapters to accept the deal without protest. Democrats in the state legislature, having heard from their Detroit and retiree constituents that neither group could afford to reject the deal, voted to approve the state’s contribution.

In many ways, Republican officials were probably the biggest winners of the grand bargain. Their added conditions to the deal, which Rosen recalled as crucial to the state’s

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161 In re Lucida Darrah v city of Detroit, Case No. 15-cv-10036, Docket No. 53: Judge Friedman Opinion and Order Granting Appellee’s Motion to Dismiss Appeal, page 17.
162 Mulholland interview.
163 Whitmer interview.
participation,\footnote{Rosen interview.} eliminated the possibility of the pensioners either derailing the Plan of Adjustment approval process or asking another court to hold the state responsible for the retirement system debt. Further, the fact that many municipal unions gave up their ability to challenge the state’s use of emergency management and bankruptcy to diminish collective bargaining agreements will likely make it much easier for the state to repeat what was done in Detroit elsewhere in Michigan. This is particularly relevant for the eleven other cities in Michigan currently under emergency management.\footnote{Michigan Department of Treasury, “Emergency Management Information,” michigan.gov.} Randy Richardville, the Majority Leader of the Michigan State Senate at the time, recalled his role as a leader of the bipartisan effort to win legislative approval for the state’s contribution to the grand bargain: “I looked at [the contribution] as an investment.”\footnote{Randy Richardville during “Grand Bargain” panel discussion.}

\textbf{The Great Lakes Water Authority}

Perhaps the most important aspect of Detroit’s pre-bankruptcy finances, besides the DIA, was the city’s water and sewerage department. In 2013, DWSD was one of the largest municipal water and sewerage systems in the country. DWSD provided services to Detroit as well as many other cities in an eight-county area, covering 1,079 square miles.\footnote{City of Detroit, “Proposal to Creditors,” 37.} There was also an enormous amount of secured debt tied to DWSD, as the city had repeatedly backed its borrowing by using revenues from the department as collateral. Because the city could not impair these secured debts during bankruptcy, Orr proposed privatization as an alternative means of addressing DWSD liabilities. When initiatives to monetize DWSD failed, the city turned instead to the prospect of “regionalizing” the water and sewerage system.\footnote{Great Lakes Water Authority, “Memorandum of Understanding Regarding the Formation of the Great Lakes Water Authority,” September 9, 2014.}
According to Rosen, it was newly elected Mayor Duggan who came up with the idea of addressing DWSD debt by “trading governance for money.”\textsuperscript{170} This formed the backbone of the agreement among Detroit and Oakland, Wayne, and Macomb counties to transform DWSD operations into the GLWA. Per this agreement, Detroit continues to own the whole water and sewerage system but will lease infrastructure outside city limits to the Authority for the next 40 years. In return, the GLWA pays Detroit $50 million a year, earmarked for improvements to the city’s water infrastructure. This lease payment technically comes from “common-to-all” GLWA revenues, meaning suburban cities pay an estimated two-thirds of the lease and Detroit one-third.\textsuperscript{171} Most importantly, the GLWA assumed all remaining, post-bankruptcy DWSD debt.\textsuperscript{172}

The GLWA governing board now consists of two appointees from Detroit, one appointee each from Oakland, Macomb and Wayne counties, and one from the Governor. This represents a change in majority power - previously, Detroit had four votes on the DWSD board and the suburbs had three.\textsuperscript{173} This board manages suburban and “common-to-all” operations, which include approving utility rates and issuing debt. Though DWSD controls its own water and sewerage system within Detroit, the city is still technically a wholesale customer of the GLWA and is required to pay its water and sewerage invoices to the Authority. Approximately 500 DWSD employees stayed within the city’s department, and 900 became employees of the GLWA.\textsuperscript{174}

The initial Memorandum of Understanding for the GLWA also included plans to develop a regional assistance programs for low-income residents in Southeast Michigan. The Water Residence Assistance Program (WRAP), developed in the midst of controversial water shutoffs that brought international scrutiny to DWSD operations in 2014-5,\textsuperscript{175} is funded with 0.5% of the

\textsuperscript{170} Rosen interview.
\textsuperscript{171} Oakland County, “GLWA Responses to Major Concerns,” news release, July 24, 2015.
\textsuperscript{172} GLWA, “Memorandum of Understanding,” 2.
\textsuperscript{173} Oakland County, “Responses to Major Concerns.”
\textsuperscript{174} GLWA, “Memorandum of Understanding,” 6.
\textsuperscript{175} Laura Gottesdiener, “UN ‘Shocked’ by Detroit’s Mass Water Shut-Offs,” \textit{Al-Jazeera}, October 20, 2014.
GLWA base operating revenues.\textsuperscript{176} This program will be available for customers at or below 150\% of the Federal Poverty Guidelines for their previous month’s income whose water account status is at least 30 days past due. WRAP covers one-third of the cost of the average monthly bill of these customers, freezes overdue amounts, and places utility shutoff holds on their client accounts. Eligible customers also receive one-time payments of up to $1,000 for approved, minor water-related plumbing repairs on their properties.\textsuperscript{177}

**Distributional Consequences of the Great Lakes Water Authority**

There are three important distributive components of the GLWA deal. The first is the creation of WRAP, which represents a method of distributing throughout the region the cost of assisting low-income Detroit residents with their utility bills. Prior to the creation of the GLWA, Detroit relied a combination of borrowing and, more recently, non-profit assistance or service shutoffs to address the issue of unpaid utility accounts.\textsuperscript{178} Detroit’s concentration of low-income residents at risk of falling behind on their bills made it difficult for the DWSD to cover the cost of its operations within the city, let alone provide assistance to these residents. As stated above, revenue from all of the GLWA's wholesale customers will now fund WRAP, incorporating wealthier areas of the metro-Detroit region into an assistance program. Without the GLWA deal, this regionally redistributive system likely would not have occurred.

Second, the city will receive an estimated $33 million (two-thirds of the $50 million GLWA lease) from the suburbs annually to use for capital improvements to its water and sewerage operations. These updates to DWSD’s facilities are also intended to lower the department’s operational expenses so as to reduce utility rates for Detroiters in the future. In Judge Rosen’s words, the city receives this money in exchange for governance of the regional

\textsuperscript{178} Anna Clark, “Living Without Water in Detroit,” *Next City*, July 3, 2014.
system. There is no real economic cost to the city in this exchange, however, because operational control of DWSD came with responsibility for the systems massive debt. At the time officials reached the GLWA deal, DWSD operated at a yearly loss of around $200 million per year - a burden that the GLWA largely absorbed. Most likely, the suburbs agreed to this with the understanding that once this debt was no longer associated with the Detroit, it could be refinanced and utility rates in the suburbs would decrease.

A third, and significantly less discussed feature of the GLWA is what Mulholland called the “convoluted and twisted tale” of the water and sewerage employees. In its Memorandum of Understanding with DWSD, the GLWA promised to honor collective bargaining agreements between DWSD and the employees that transitioned from one entity to the other. However, in the fall of 2015, the GLWA required these employees to reapply for their positions, assigning them to different unions that did not have collective bargaining agreements with DWSD. The GLWA then offered either privatized or defined-contribution retirement plans, which the employees viewed as considerably less favorable than the defined-benefit plans they had previously had as part of Detroit’s GRS. Thus, while the transition in governance between DWSD and the GLWA came at no cost to the city, it did result in a loss of retirement benefits for many workers, beyond what they would have otherwise experienced in bankruptcy.

Observers applauded the grand bargain and GLWA as rare instances of collaboration between the city and its suburbs, government officials and private foundations, Republicans and

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179 Rosen interview.
182 Mulholland interview.
Democrats. Many pointed to the fact that the GLWA will provide Detroit residents with benefits in the form of WRAP and possibly lower future water rates, or that the grand bargain secured $816 million for retirees. However, these deals came at significant costs to Detroit retirees and current workers, who experienced cuts to their retirement benefits, as well as to municipal unions, which likely gave up significant future bargaining power to the state.

**Financial Settlements**

Other than the retirees, the two most important classes of creditors in the bankruptcy consisted of the financial service industries that had backed the city’s COPs and swaps transactions from the mid-2000s. Not only were these claims large - over $1.7 billion, combined - but they were also legally complex and defended persistently by the creditors.

**Interest Rate Swaps**

Detroit’s 2005 swaps deal consisted, first, of UBS and BOA-ML synthetically converting interest rates on the city’s COP debt. This arrangement eventually put Detroit in greater debt when interest rates fell and the city was locked into paying the banks higher rate than the banks were paying in return. The swap deal also included stipulations for “automatic termination” payments if the city’s credit rating fell. Detroit put its casino revenue up as collateral to avoid these payments when rating agencies downgraded its bonds to “junk” status in 2009.

Despite the fact that the claims were technically secured by casino revenues, Judge Rhodes opined that there was significant evidence that the deals were illegal, and ordered the banks to settle for a portion of their overall debt. Rhodes and others questioned the legality of the swaps deals on the grounds that the original agreement pushed Detroit over its legal borrowing limit, and the 2009 patch-up deal was an unauthorized use of gaming revenues under

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Michigan law. Believing the city to be “reasonably likely”\textsuperscript{188} to win a potential lawsuit against UBS and BOA-ML, he rejected two proposed deals between the city and UBS and BOA-ML, finding that both were too generous to the banks.

The banks eventually agreed to a much smaller settlement in April of 2014, accepting $85 million ($42.5 million each) from the city. Rhodes ruled that this amount was appropriate given that a lawsuit against the banks would likely be expensive, drawn out, and without guarantee of success.\textsuperscript{189} Eighty-five million, Rhodes opined, was a fair price for the city to pay to avoid litigation yet still shed a significant amount of debt. Specifically, the settlement reflected the value, to the city, of avoiding expensive and potentially drawn out litigation against the banks.

\textit{Certificates of Participation}

In 2005, Detroit funded its pension obligations with $1.4 billion from Syncora and FGIC. In exchanged, the firms received certificates funded by service contracts between the city and shell “service corporations” associated with its two retirement systems. Because this debt was both unsecured and subject to legal scrutiny, the city proposed considerable cuts to the COPs claims in both Orr’s Proposal to Creditors and in early versions of the Plan of Adjustment. Syncora and FGIC responded by pursuing numerous legal challenges to the bankruptcy process at every step. These included objections from Syncora to both the grand bargain and final Plan of Adjustment, and a lawsuit from FGIC claiming the city had fraudulently led the firm into the COP transaction.\textsuperscript{190}

According to bankruptcy code, Rhodes could have forced the Plan of Adjustment concessions on FGIC and Syncora once the other creditors had voted to approve the plan.\textsuperscript{191} But with legal challenges outstanding, the firms still held over Detroit the threat of expensive

\textsuperscript{188} In re City of Detroit, Docket No. 2521, 18-19.
\textsuperscript{189} In re City of Detroit, Case No. 13-53846 (Bankruptcy E.D. Mich. 2013), Docket No. 3399: Judge Rhodes Approving BOA-ML, UBS Settlement, page 11.
\textsuperscript{190} Reuters, “Bond Insurer Claims Fraud in Detroit Pension Debt Lawsuit,” August 14, 2014.
\textsuperscript{191} Dabney et al, Municipalities in Peril: The ABI Guide to Chapter 9, 26.
litigation and a protracted approval process. Mediators and lawyers for the city therefore continued to pursue settlements with both Syncora and FGIC, eventually reaching agreements in the fall of 2014.

Per these agreements, Syncora and FGIC both withdrew all litigation against the city and accepted an 87% cut on the COP debt. Detroit, too, dropped its lawsuit questioning the legality of the COPs deal. Syncora received a 26-year extension of its lease on the Detroit portion of the Detroit-Windsor tunnel and a 30-year lease for a parking garage located downtown. FGIC, for their part, received an option to develop the riverfront property site of the former Joe Louis hockey arena. These real estate and property agreements came with a number of development benefits for the city. Syncora must make $13 million in capital improvements to the garage, and that FGIC had to begin work on a “mixed-use” development within 36 months, covering the cost of all construction and onsite improvements.192

**Distributive Consequences of Financial Creditor Settlements**

By repeatedly demanding that Orr renegotiate to achieve a more favorable deal with BOA-ML and UBS, Rhodes redirected millions ($315 million, specifically) towards the city and its other creditors that would have otherwise gone to the banks. “Hasty and imprudent financial decision-making ... [has] already caused great harm to the city's creditors and to its citizens” Rhodes told the courtroom after rejecting the second settlement, adding, “one goal of this Chapter 9 case is to end these practices so that the city can truly recover.”193

It is more difficult to say how Detroit fared in these settlements compared to the alternative scenario in which the city decided to sue these financial creditors. On the one hand, the city gave up two substantial properties to the creditors in the settlements - the parking garage and the site of the hockey arena. James Doak, an expert from Miller Buckfire restructuring firm, testified during the bankruptcy approval hearings this particular garage

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192 *In re City of Detroit*, Docket No. 8045.
cleared only half a million dollars a year. Over 30 years, this represents $15 million in foregone revenues for the city.\textsuperscript{194} However, on net Detroit only lost about $2 million on the garage deal, given that Syncora will put about $13 million in capital improvements into the city-owned property. The cost of giving up the arena property also appears to have been low. Orr testified that this site had either no value or negative value because the costs of marketing the property - demolishing the arena structure and conducting environmental remediation - exceeded what the city could sell it for in the market.\textsuperscript{195}

Detroit also made a concession in extending Syncora’s tunnel lease in terms of not being able to competitively market the lease for an additional 20 years. This would represent a cost to the city if Syncora was not paying a competitive price. Yet, because the city had limited information on the financial and structural aspects of the tunnel - information that would be essential to market a lease - the answer to this question is unclear.\textsuperscript{196} Finally, by agreeing to these deals with FGIC and Syncora, Detroit gave up its opportunity to void the entirety of the COPs debt. The exact cost of this is unclear and depends upon the speculative probability of Detroit winning a lawsuit against the firms.

The ways in which Detroit benefited from these deals are also unclear. The city will likely experience some tax revenue benefits from the FGIC development, though the exact size of these benefits is unknown at present. The city also avoided the legal fees that might have been involved in the lawsuits (and countersuits) between Detroit and these creditors. However, because it is impossible to determine these costs, this size of this benefit is similarly uncertain.

In sum, it is difficult to perform a distributional analysis of the city’s deals with these creditors because the counterfactual comparison requires a number of imprecise speculations,

\textsuperscript{195} \textit{In re City of Detroit}, Docket No. 1502, 136.
\textsuperscript{196} \textit{In re City of Detroit}, Docket No. 8089, 124. It should be noted that Detroit lacked this information because Syncora, which had acquired the tunnel by absorbing the prior lease-holding company, refused to turn it over.
particularly regarding the cost and outcome of foregone litigation. In the next chapter, I will use the Orange County bankruptcy, which provides a real-life example of a municipality that sued financial firms outright, to add to this analysis.

**Professional Fees**

Before concluding this chapter, I will briefly address the role that consultants and attorneys hired to advise Detroit played in producing the outcomes discussed thus far. Detroit’s was not only the largest bankruptcy case in US history, but also the most expensive.\(^{197}\) The city spent over $170 million on lawyer and restructuring fees, $164.91 million of which came from its general fund (the rest was funded by the State).\(^{198}\) Jones Day was Detroit’s most expensive professional service, receiving $57.9 million from the city. These fees represent a significant short-term stress on the city’s budget because they must be paid immediately.

Given that these firms clearly benefited from the bankruptcy, it is important to consider the role they played in pushing officials to pursue this option for the city. Emails admitted as exhibits in the city’s eligibility hearing suggested that both Jones Day and Miller Buckfire offered gratuitous services to the state in the years leading up to the bankruptcy. Their recommendations during this time period included advice for how to pass a new emergency manager law that would be “referendum proof” and allow the city to enter bankruptcy.\(^{199}\)

When pressed on this issue during his testimony at the eligibility hearing, Governor Snyder himself speculated, “I perceived it as they were more presenting information to potentially get themselves hired for an engagement most likely ... but not necessarily by the state or by the city. I’m not going to speculate on who.”\(^{200}\) These professional legal and consulting firms - particularly Jones Day - had a vested interest in the state’s pursuing a bankruptcy for

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199 In re City of Detroit, Docket No. 1719, 147.
200 In re City of Detroit, Docket No. 1502, 129-130.
Detroit, and guided officials in that direction through the specific information and expertise they shared.

**Conclusion**

In this chapter, I have analyzed the distributional consequences of this case as political outcomes in their own right. I have shown that not only was the very choice to file for bankruptcy a political one, but that the deals produced during the bankruptcy negotiations were reflections and consequences of individual and partisan agendas. In the next chapter, I will add to this analysis by comparing Detroit to two other local governments, New York City and Orange County, that experienced similar fiscal crises. Specifically, I ask: why did New York City receive federal and state bailouts when Detroit did not? Why did Orange County sue its financial lenders, but Detroit did not? And, did these variations result in different distributive outcomes between the three cases?
Chapter Five: Comparative Cases

In the previous chapter I used counterfactuals to analyze the distributional implications of the Detroit bankruptcy. The two cases that I will now compare provide real-world illustrations of some of these counterfactual scenarios.201 New York City, which experienced an enormous fiscal crisis in the 1970s, is an example of a municipality that barely avoided bankruptcy in part because it received bailouts from New York State and, eventually, the federal government. The 1994 Orange County bankruptcy, the third biggest in U.S. history, helps to illustrate Detroit’s treatment of the finance industry lenders. An examination of how these two cases resembled and differed from Detroit corroborates my distributional analysis in the previous chapter. These comparisons also begin my discussion of the broader significance of Detroit’s bankruptcy, which I will return to in my conclusion.

New York City

New York City’s Fiscal Crisis

New York City experienced many of the same economic and demographic trends during the postwar decades as did Detroit and these placed similar strains on its budget. The city’s manufacturing sector, which had attracted waves of migrants to New York for more than a century, began to relocate to the suburbs and other regions of the United States. Unemployment increased steadily by 2% each year in the 1950s and then by 7% each year in the 1960s.202 The exodus of jobs from New York City also coincided with a growing demographic divide between city and suburban residents. From the 1950s through the 1970s, New York’s suburbs became increasingly middle class and white, while the city became comparatively poorer, with growing

201 Because municipal bankruptcies - particularly on the scale of Detroit’s - are so rare in the United States, it is not possible to find examples for all of the counterfactual scenarios discussed in chapter four.
black and Puerto Rican populations. As in Detroit, racially discriminatory zoning laws and FHA policies actively shaped these residential patterns.

The concentration of rising unemployment and poverty in the city increased demand for social welfare expenditures at the same time as local revenues decreased. This trend was particularly acute for New York, as it provided a much larger share of social services to its citizens than was common nationally, among other cities. Further, because New York City was both a city and a county, funding for public services like hospitals and schools was contained to New York and not shared by other local communities.

New York City certainly possessed an advantage over Detroit in that it retained a large and varied economy despite deindustrialization. However, business leaders successfully pressured city politicians not to increase taxes on the private sector, warning that this would drive capital from the city. Mayor electoral coalitions, beginning with Robert Wagner in the 1950s and 60s, became increasingly dependent on racial minorities, who pressed for more municipal services. This made it politically difficult for the city’s leaders to either reduce spending or increase taxes, even in the face of regular budget deficits.

Instead, New York City officials fell into the pattern of borrowing to pay for current operating expenses. As the city’s budgetary shortfalls persisted year after year, it soon had to borrow to cover its debt payments as well. This strategy began to unravel when many of the banks that bought or insured New York’s bonds started to doubt the city’s ability to repay its debts. Having suffered significant losses during the early 1970s, firms on Wall Street and

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elsewhere became less willing to risk lending to the city.\textsuperscript{208} By 1975, the banks had shut New York out of the securities market completely. Unable to borrow funds, the city had no way to cover its operating budget, yet alone the debt repayments that were about to come due. The city faced a cash flow shortfall of $12.96 billion in 1975.\textsuperscript{209}

**State Bailout**

Though New York City’s fiscal crisis was considerably larger in magnitude than Detroit’s, the political context at the state level allowed for assistance to New York where it did not for Detroit. Perhaps the most crucial difference in state response was in the behavior of the two governors. Democratic New York Governor Hugh Carey quickly advanced New York City approximately $800 million so that it would not default on the debts that had to be repaid in April of 1975.\textsuperscript{210} Carey knew a New York City default would significantly impaired the state’s credit rating and thus viewed bankruptcy as a non-option.\textsuperscript{211}

Carey then created the Municipal Assistance Corporation (MAC) to address the city’s crisis by retiring short-term debts and converting them to long-term obligations with lower interest rates. To encourage confidence from the banks, Carey extended the state’s credit to the MAC bonds. When July sales for these new bonds proved poor - largely because the banks believed New York had not reformed its unsustainable spending patterns - Carey took more drastic action to prevent the city from defaulting.

In September, Carey proposed the omnibus Financial Emergency Act. Per this Act, the state took control of all budget operations in the city for the near future, under the auspices of the Financial Emergency Control Board (FECB). In exchange for cuts to New York City’s workforce and services, the state provided the city with $2.3 billion in aid.\textsuperscript{212} Union officials, recognizing that a bankruptcy would put their collective bargaining agreements with the city in

\begin{flushleft}
\textsuperscript{208} Shefter, *Political Crisis/Fiscal Crisis*, 109.  
\textsuperscript{209} Ibid, 128.  
\textsuperscript{210} Lachman and Polner, *The Man Who Saved New York*, 103.  
\textsuperscript{211} Shefter, *Political Crisis/Fiscal Crisis*, 132.  
\textsuperscript{212} Ibid, 134.
\end{flushleft}
jeopardy, agreed to invest up to 40% of their pension fund assets in MAC bonds.\textsuperscript{213} Many of the city’s banks responded favorably to the FECB and began to purchase MAC bonds as well.\textsuperscript{214}

Governor Carey’s efforts were not without political opposition from Republican factions of the New York State electorate and legislature who instead pushed for a New York City bankruptcy. According to Carey biographers Seymour Lachman and Robert Polner, many legislators upstate “made no secret of their distaste for the big city - a drain on the rest of the state, in their eyes - and who felt just as adamantly that Carey should force its leaders to finally feel the consequences of years of financial profligacy.”\textsuperscript{215} Republican state senate majority leader Warren Anderson opposed Carey’s proposal for an additional $200 million in state aid, saying that New York City leaders “must stop delivering more services than [they] can afford to give.”\textsuperscript{216}

Carey nonetheless worked to avoid bankruptcy, not only because it would have tested the state’s fiscal stability, but because the city’s municipal unions and voters were electorally vital for him. Carey received a substantial majority of city votes in the 1974 gubernatorial elections, as well an overwhelming endorsement from labor unions.\textsuperscript{217} For Carey, forcing the city to declare bankruptcy would have been, in the words of Lachman and Polner, “akin to cutting his own political throat.”\textsuperscript{218} The Democratic majority in the state assembly that supported Carey’s efforts in New York City shared his political allegiances.

This was very different from Governor Snyder’s relationship with either Detroit’s electorate or public sector unions in Michigan, both of which were (and remain) key cogs in the state Democratic party. Where it was in Carey’s strategic interest to help New York City avoid bankruptcy, it was in Snyder’s interest to do the opposite for Detroit. The political differences

\textsuperscript{213} Lachman and Polner, \textit{The Man Who Saved New York}, 165. Coleman Young also used this technique to address Detroit’s fiscal crisis in 1981.
\textsuperscript{214} It should be noted that New York City had an advantage over Detroit in that many of the banks from whom the city borrowed money were local. This meant New York bankers likely had a greater interest in the city’s stability and functioning compared to Detroit’s creditors, who were much more removed.
\textsuperscript{216} Ibid, 111.
\textsuperscript{217} Shefter, \textit{Political Crisis/Fiscal Crisis}, 131.
\textsuperscript{218} Lachman and Polner, \textit{The Man Who Saved New York}, 93.
between New York State in 1975 and Michigan in 2013 led to markedly disparate state-level responses to these two municipal fiscal crises.

In 1975, not only did New York City’s municipal unions have more political allies in the state government than did Detroit’s, but these organizations existed in an era that was generally more favorable to public sector unions. By 2013, Republicans had successfully challenged public sector unions in multiple states, as described in the previous chapter. The decline in private sector union density facilitated these attacks, as the shrinking of sympathetic, private sector union membership weakened electoral support for public sector unions. Mike Mulholland recalled that for years AFSCME leaders approached negotiations in Michigan expecting to fight against cuts rather than champion wage increases, asking themselves, “how bad is it going to be this time?”

Federal Bailout

In the early months of New York City’s fiscal crisis, both Carey and Mayor Abe Beame unsuccessfully appealed to Republican President Gerald Ford to back the city’s bonds temporarily. This would have provided the city with short term relief, allowing it to re-enter the securities market before increasing local taxes for the next year. Ford responded that the city should find a way to help itself, preferably by reducing expenditures. In a public letter to Beame, the President wrote:

A ninety day Federal guarantee by itself would provide no real solution [to the crisis] but would merely postpone, for that period, coming to grips with the problem. For a sound judgment to be made on this problem by all concerned, there must be presented a plan on how the City would balance its budget. This, given the amount involved to accomplish that balance, would require an evaluation of what the City can do through curtailment of

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220 Mulholland interview.
less essential services and subsidies and what activities the City can transfer under existing state laws to New York State.\textsuperscript{221}

Carey nonetheless redoubled his efforts to secure federal assistance when, in the fall of 1975, it became clear that the city would soon default on its debts despite the efforts of the MAC and FECM. Ford did not yield, instead vowing to veto any bailout to the city and proposed a new Chapter in federal bankruptcy code that would make it easier for the city to declare bankruptcy. In a speech the press summarized with the famous headline “Ford to City: Drop Dead,” the President chastised New York for “massive growth of the city’s debt [and] extraordinary increases in public employee contracts.”\textsuperscript{222}

Other conservative voices echoed Ford’s comments, naming labor power and social spending as the source of New York’s woes. The \textit{Wall Street Journal}, for example, published an editorial piece in September of 1975 which argued, “the fiscal agony of New York has gone on so long that the only hope for a responsible and reasonably straightforward resolution is a voluntary bankruptcy ... [the city] desperately needs a rearrangement of its debts and obligations, including labor contracts and pension plans.”\textsuperscript{223} In one meeting between city, state, and federal officials, Vice President Nelson Rockefeller pointed to New York State comptroller Arthur Levitt and suggested he bail out the city using money from the state’s pension funds.\textsuperscript{224}

These statements demonstrate why Republicans opposed bailouts for both New York City and Detroit. In both cases, conservatives argued that providing federal assistance would not address the structural issues facing the cities. And, in both cases, they named public sector employees - their contracts and their pensions - as a key source of fiscal instability. In New York City’s case, Republicans also lay blame on what they deemed to be overly generous social

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{222} Lachman and Polner, \textit{The Man Who Saved New York}, 156.
\item \textsuperscript{223} Ibid, 129.
\item \textsuperscript{224} Ibid, 150.
\end{enumerate}
\end{footnotesize}
spending, articulating a call for government downsizing that would become stronger still in the next decade.

Had the political climate at the national level remained the same, New York City might have declared bankruptcy. As it was, domestic and foreign observers became increasingly wary of a New York City bankruptcy as the city inched closer and closer to default. West German Chancellor Helmut Schmidt warned that New York City’s collapse would have “a domino effect, striking other world financial centers such as Zurich and Frankfurt.”225 A study by the Joint Economic Committee of Congress found that if the city defaulted, it would delay national recovery from the recent recession by increasing unemployment by 300,000 nationally and by reducing the gross national product by as much as 1% in 1976.226 In early November 1975, a Harris poll estimated 69% of the American public supported assistance for New York if it did not come at an expense to taxpayers outside the city.227

The changing public sentiment towards New York made Ford’s hardline position on a bailout a political liability as he prepared to run against Jimmy Carter in the 1976 general election.228 This became all the more clear to Ford and others from the intensely negative reaction Ford received to the “Drop Dead” headline.229 By November 26, 1975, Ford acquiesced and called on Congress to approve new legislation giving New York City $2.3 billion in direct federal loans.230

Though public opinion forced Ford to concede on the issue of a federal assistance, he was nevertheless able to use the bailout as an opportunity to force a more fiscally conservative budget on New York City. As a condition to the bailout, the city accepted significant retrenchment in the form of labor cuts, increased fees for city services, fewer low rent housing

226 New York City’s Financial Crisis, Joint Economic Committee, 56.
230 Ibid, 164.
subsidies, and the elimination of free higher education at the city’s public universities.\textsuperscript{231} Thus, Ford was able to appease his conservative constituencies on the issue of ‘profligate’ social spending, even as he altered course on the bailout.

Detroit experienced no such political turnaround at the national level, largely because neither public opinion nor public spending provided opportunities for compromise with Republicans. Detroit certainly never occupied New York’s position as an international economic and financial center. However, even in the 1970s, Detroit had significantly more national influence than it had by 2013.\textsuperscript{232} When asked if the Obama administration was concerned about the effects that Detroit’s bankruptcy could have on the national economy, Press Secretary Jay Carney responded, “I don’t have anything concrete to say about that. We’re concerned, obviously, about the citizens of Detroit.”\textsuperscript{233} International observers were even less perturbed about the potential spillover effects of the bankruptcy, as they had virtually no economic stakes in the city’s financial stability.

Similarly, Detroit could not realistically offer spending cuts as a concession to Republicans in return for federal aid because, in short, there was almost nothing left to cut. For comparison, in 1975, New York’s labor costs were $889 per capita and its total spending $346 per capita, whereas Detroit spent only $346 per capita on labor and $370 per capita on all public expenditures.\textsuperscript{234} Detroit’s spending continued to decline after the 1970s, until its city services sunk to the level of dysfunction and deprivation described in previous chapters. In the Detroit case, Republican officials focused primarily on the issue of retiree benefits, which could only be addressed through bankruptcy.

\textsuperscript{231} Shefter, \textit{Political Crisis/Fiscal Crisis}, 135.

\textsuperscript{232} Aaron Wildavsky, \textit{A Comparative Theory of the Budgeting Process} (Oxford: Transaction Publishers, 1986). On page 208, Wildavsky describes the “Detroit made mini-machine” within the Carter Administration which Coleman Young used to protect the city’s interest.


\textsuperscript{234} Shefter, \textit{Political Crisis/Fiscal Crisis}, 135.
Because New York City managed to avoid bankruptcy, its municipal unions were able to preserve the institution of collective bargaining and protect the principle that contractual gains and retirement obligations were inviolable. Though these unions did concede to state and federally mandated austerity measures, they were able to regain many benefits during subsequent negotiations in the late 1970s and early 1980s. In Detroit, not only did retirees lose billions of dollars in retirement benefits, but conditions attached to the bankruptcy settlement hamstrung organized labor in Michigan from preventing future challenges to collective bargaining.

Orange County

Orange County’s Fiscal Crisis

In the mid-to-late twentieth century, Orange County, California experienced the inverse trajectory of urban areas like Detroit and New York City. The County grew rapidly from suburbanization in these years, gaining 2 million residents between 1940 and 1990. The local economy expanded considerably beginning in the 1980s, with employment growth outpacing the population at times. The median household income in Orange County was $46,000 in 1994, more than 50% above the national average at that time.

Mark Baldassare argues that Orange County “was not the usual bankruptcy scenario of a troubled central city with declining revenues and rising expenditures ... [the county’s] downfall was the result of an overwhelming desire to live beyond their means by increasing their local revenues.” Notably, this increase in local revenue that Baldassare refers to here did not come from taxes, but from risky financial speculation.

235 Shefter, Political Crisis/Fiscal Crisis, 140.
237 Ibid, 39.
238 Ibid, 88.
Orange County’s political environment included a fiscally conservative electorate and a Republican-dominated local government whose politicians ran on platforms of maintaining middle-class services without raising taxes. When a regional recession in the early 1990s led to a slight decline in local revenue, officials sought to compensate for the county’s losses without compromising on taxes or services. Orange County treasurer Robert Citron provided the county with a way to do just this. Citron first used the funds in the Orange County Investment Pool, about $7.6 billion in contributions from local governments and districts, as collateral to borrow an additional $13 billion from Wall Street firms. He then used the combined funds to invest in derivatives and other exotic and unstable financial instruments.

This is where Orange County’s experience began to overlap with Detroit’s - in the use of risky financial techniques to circumvent barriers in the local budget. Citron relied heavily on floating interest securities, which, much like Detroit’s swaps deal, effectively bet on the direction of interest rates. His strategy worked well when interest rates were low, decreasing the investment pool’s total debts and increasing the value of its long term investments. In the early 1990s, when interest rates were indeed low, the Orange County Investment Pool generated interest payments that grew local revenues without increasing taxes. But when the Federal Reserve increased interest rates in 1994, Citron’s entire system began to collapse.

Baldassare attributes the crisis in part to the “weak” structure of Orange County’s government, which allowed elected officials like Citron limited oversight but significant autonomy. The county’s Board of Supervisors, auditor-controller, and other administrators had little knowledge of the specifics of Citron’s risky financial techniques. Indeed, the crisis first came to light only because local business leaders urged elected officials to look into the rumors.

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240 Ibid, 90.
241 Both Detroit and Orange County ran up against state-imposed local borrowing limits. Orange County also faced the voter-imposed limit of maintaining low tax rates.
they heard from Wall Street of the county’s collapse. In November of 1994, the County commissioned an independent evaluation of the investment pool by an outside consultant who reported a $1.5 billion loss on investments.244

Local officials quickly assembled a “crisis team” to address the situation. It first sought loans from Wall Street investors to cover the pool’s losses, but investors refused to offer the county assistance. The team then tried to liquidate the pool’s risky investments, but found no buyers. As a last resort, county officials asked the Securities and Exchange Commission to freeze the investment pool, but the commission denied their request. On December 6, 1994, the first bank seized on the collateral it held in the investment pool.245 The county Board of Supervisors filed for bankruptcy hours later, in a strategic effort to prevent a run on the $7.6 billion in local funds held as collateral by the banks.

Less than a month passed between when county leaders received official reports on the magnitude of the county’s losses and when they declared bankruptcy. This left precious little time for the county to appeal to higher levels of government for assistance. The weak, decentralized nature of Orange County’s government made organizing for this task even more difficult. In an investigation on the bankruptcy by California’s State Senate Special Committee on Local Government Interventions, county leaders and state officials pointed fingers at one another for failing to respond to the crisis in time.246

Bankruptcy

There are many dissimilarities in how Orange County and Detroit each arrived at bankruptcy, from the source and pace of the fiscal crisis to the role of the state government. As mentioned, what is common to both cases is the use of complex financial mechanisms to maneuver around state-imposed limits on borrowing. However, the treatment of these financial services firms was notably different in Orange County’s bankruptcy. Unlike Detroit, Orange

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244 Baldassare, When Government Fails, 108.
245 Ibid, 111.
246 Ibid, 121.
County did not treat these firms as creditors, but instead sued them to help repay local government investors in the Orange County Investment Pool.

After an early settlement fell through in June of 1995, members of the Orange County Business Council, lawyers, and officials negotiated a new Plan of Adjustment. This time, pool participants would no longer hold the county responsible for the $861 million it still owed them after the liquidation of pool assets. Instead, they would remove this debt from Orange County and wait for the repayment of their funds through lawsuits against Wall Street firms. The local government creditors approved this plan, and Orange County emerged from bankruptcy on July 12, 1996.

By February of 2000, Orange County had won a number of these lawsuits and disbursed $865 million in settlements to the local government creditor. This included a $400 million settlement from Merrill Lynch (BOA-ML), the division of Bank of America involved in Detroit’s swaps deal. In the early 1990s, BOA-ML sold Citron roughly two-thirds of the securities used to grow the investment pool. Orange County claimed that because Citron had no right to enter into these agreements, as they exceeded the municipal debt level set by the California constitution, BOA-ML should be held responsible for any losses it incurred on so-called “reverse repayment” agreements.

In addition to suing the banks that provided Citron with risky securities, Orange County also took action against a number of firms that contributed to the county’s fiscal crisis in other ways. The county won a $45 settlement from against the law firm that served as Citron’s bond advisor, a $75 million settlement from the auditing firm KPMG for failing to warn the county of

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its risky investments, and a $140,000 settlement against Standard and Poor’s for “erroneous evaluation” of the county’s credit rating.\footnote{Pollack and Wayne, “Merrill Lynch to Pay California County.”}

Thus, Orange County provides an example of what might have happened in the Detroit bankruptcy had Orr and the city’s legal advisors decided to sue certain firms outright instead of treating them as creditors. Syncora, FGIC, BOA-ML, and UBS all held claims that Judge Rhodes deemed legally questionable based on the same argument that Orange County used to sue BOA-ML and others: that their involvement in municipal finances was illegal because it allowed local officials to subvert state imposed limits on borrowing. However, Orr and his legal team nonetheless treated these firms as creditors throughout the bankruptcy process, from the Proposal to Creditors to the Plan of Adjustment.

The discrepancy in the treatment of financial services firms in these two cases is especially curious considering that the same attorney, Bruce Bennett, served as chief legal counsel to both Detroit and Orange County. In 1995, the \textit{New York Times} published a profile calling Bennett “Orange County’s artful dodger,” describing his many “bold moves” in the case.\footnote{Leslie Wayne, “Orange County’s Artful Dodger; The Creative Bankruptcy Tactics of Bruce Bennett,” \textit{New York Times}, August 4, 1995.} The \textit{Times} noted in particular that Bennett shocked many in the financial community by questioning whether securities (like COPs or interest swaps) should be treated like bonds.

Bennett became a partner at Jones Day in 2012, and by the time he came to represent Detroit in 2013, he had apparently lost much of his desire to “shake up the municipal bond market.”\footnote{Ibid.}

It is unclear why Bennett, Orr, and Detroit’s other advisors did not follow the precedent set by Orange County in their treatment of finance firms. Joseph Fichera, a Wall Street financial advisor, noted that between 1994 and 2014, “most advisors and bankers have persuaded governments that the market would penalize them if they sued a banker.”\footnote{Joseph S. Fichera, “Were Detroit’s Swaps Unfair?,” \textit{Bloomberg View}, January 27, 2014.} Others have alleged
that Jones Day’s representation of Detroit represented a conflict of interest, in that some of Detroit’s financial lenders, including BOA-ML and UBS, were also its clients.\textsuperscript{254}

Whatever the reason, Detroit’s decision to treat these firms as creditors likely cost the city millions. According to the final Plan of Adjustment, Detroit repaid these creditors 13-24\% of their claims and offered additional sweeteners to secure settlements (upwards of $270 million, in total). Orange County, on the other hand, extracted multi-million dollar settlements without any conciliatory payments to the firms.

This decision was largely justified as an alternative to litigation by the fact that Detroit avoided the legal fees associated with potential lawsuits. Though not a perfect comparison, Orange County paid its attorneys less than $50 million to litigate the county’s numerous suits.\textsuperscript{255} Adjusted for inflation, this is approximately the same amount the City of Detroit paid Jones Day for its services during the bankruptcy. This amount is also less than the $270 million Detroit paid to Syncora, FGIC, BOA-ML, and UBS. Though comparisons between these two cases on this issue are largely speculative, it appears that by taking more aggressive action against its financial creditors (and hiring less expensive legal counsel) Detroit might have avoided paying these firms millions in taxpayer money and city property.

**Conclusion**

In this chapter I compared Detroit to two other distressed local governments in recent history to test the robustness of my distributional analysis of Detroit’s bankruptcy in chapter 4. I used cases that were significantly similar to Detroit, yet differed along certain key conditions discussed in chapter 4, to demonstrate that these variables produced disparate outcomes. New York City faced a larger fiscal crisis than Detroit’s, but in a different political context. The fact


\textsuperscript{255} Shelby Grad, “County Legal Fees in Bankruptcy Suits $10.7 Million So Far,” *Los Angeles Times*, December 31, 1997. The County set aside $50 million in its Plan of Adjustment to pursue various lawsuits. In a press conference, Thomas W. Hayes, who oversaw the county’s litigation efforts, said he had enough money to pursue “each and every lawsuit” and stay within that budget.
that New York received multiple bailouts further supports my argument from chapter 4 that Detroit’s bankruptcy was a political outcome and not an inevitable result of its fiscal crisis. Orange County and Detroit engaged in the same risky financial wagers, yet Orange County extracted significantly more money from the financial services firms who facilitated those gambles. This difference adds to my previous analysis of Detroit’s bankruptcy settlements, suggesting that the city may have been better off had it sued those financial firms outright. The Orange County case also serves to emphasize my point that Detroit’s attorneys and consultants exerted considerable influence over the outcome of the bankruptcy.

Finally, comparisons between Detroit and both New York City and Orange County demonstrate the shifting political and economic climate of the U.S. As discussed at different points in this chapter, after the 1970s and even the 1990s, public and private sector unionism weakened across the country as the influence of the financial sector grew. This period effect contributed to distributive outcomes that disadvantaged retirees and Detroiters. Governor Carey foreshadowed this shift when he warned Ford that if he allowed New York to go bankrupt, “every municipality in this ... nation will become vulnerable to this political/financial pincer and more and more, New York City and other cities will have public and social policy decided in bank boardrooms.”

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Conclusion

In the final days of the bankruptcy trial, Judge Rhodes allowed Estella Ball, a Detroit retiree, to present her personal objection to the Plan of Adjustment. Speaking before the court, she argued:

Now, through [the bankruptcy] process, Governor Snyder and Mr. Orr wish to negate all of [the pensioners’] hard work and earned benefits by blaming the city for the failure of the country, the state, and the schemes of the financial institutions and the lawyers who set up the schemings. Now they want to put it on the backs of the retirees, ignoring and rewriting city laws, state laws, and the Constitution of the United States in an unprecedent[ed] grab of power by the State of Michigan officials. If they do it to us in Detroit, they will do it to anyone in this country.257

Ms. Ball’s eloquent statement captures two aspects of Detroit’s bankruptcy that I will discuss in my conclusion. The first is the issue of distributive justice. In Chapters 4 and 5, I found that Detroit’s bankruptcy largely shifted the cost of addressing the city’s fiscal crisis onto Detroit retirees and residents. Now that I have established “who paid,” I turn to the question of who should have paid.

As I alluded to in my introduction, Detroit’s decline is often discussed as having an aura of economic inevitability. However, Chapter 2 demonstrated that government and group actions were largely responsible for the city’s downturn. Mid-century policies at the federal and local levels intentionally created racial segregation in the metro-Detroit area and lay the foundation for Detroit’s economic and fiscal crisis. More recently, the State of Michigan exacerbated Detroit’s budgetary challenges by cutting revenue sharing to the city, weakening a redistributive mechanism that had provided Detroit with access to capital just beyond city limits. These cuts effectively pulled the rug out from under the feet of city officials as they tried to maintain fiscal stability. Perhaps the final blow came from Wall Street, which took advantage of Detroit’s

vulnerability by peddling highly risky financial mechanisms to a city that desperately needed revenue and could not afford to say no.

All of these entities - from Lansing to Wall Street - should have borne their share of addressing a crisis they helped to create by draining the city of its resources. Yet, Republicans shifted much of the blame for the fiscal crisis onto Detroit residents and retirees. They labeled Detroit a burden to the state’s finances and chastised municipal retirees for their ‘overly generous’ pensions and benefits. And so these groups came to pay for a crisis they had, for the most part, played little role in creating.

This is troubling not only because it seems profoundly unfair, but also because Detroit’s retired employees and residents were not, by and large, well-off to begin with. In the bankruptcy, many pensioners had to give up significant portions of their already small annual incomes - money they had earned through years of work and on which they had come to rely. Aging retirees have seen their healthcare benefits drastically reduced at a time when their medical costs are likely increasing. Further, resources that Detroit could have used for much-needed improvements to city services will instead go to the city’s predatory Wall Street lenders and to the lawyers and consultants who profited considerably from steering the city into bankruptcy. For these reasons, I believe that Detroit’s bankruptcy resulted in an unjust distribution of the city’s resources.

The second concern that Ball’s statement raises is: what does Detroit’s bankruptcy mean for the rest of Michigan and for the nation? Eleven other cities in Michigan are already under emergency management, and the agreements reached in Detroit’s bankruptcy will most likely make it easier for the state to continue to use these managers to push Republicans’ fiscal and political agenda on these and other cities.

On a national level, many local governments in the U.S. are struggling to maintain fiscal stability, especially in the wake of the Great Recession. Public sector retiree obligations have received particular attention for this issue, often targeted as unwieldy burdens that local and
state governments must shed. Although the use of Chapter 9 is limited by state authorization and eligibility requirements, neither should be viewed as absolute. Both federal bankruptcy code and state authorization statutes have been and could continue to be adjusted by elected officials. The variability of public bankruptcy in the U.S. is perhaps best demonstrated by the current debate over whether states should be allowed to go bankrupt. It is therefore certainly possible that bankruptcy will become an increasingly common phenomenon among local and even state governments.

Finally, I believe that Detroit’s bankruptcy represents a new age of local government in the U.S. which reflects the current dynamics of American inequality, particularly the decline of labor power and the rise of the financial sector’s influence. The Detroit case demonstrates that local government fiscal policy and bankruptcy represent yet another arena in which the country’s wealthy elite may take advantage of the poor and working class. In this context, the saying “so goes Detroit, so goes the nation” takes on a disturbing meaning in Ms. Ball’s final warning: “If they do it to us in Detroit, they will do it to anyone in this country.”
Appendix A: City of Detroit Bankruptcy Timeline

May 15, 1990 - Michigan’s original emergency management law effective
March 16, 2011 - Public Act 4 expands emergency manager powers
November 10, 2011 - Snyder appoints financial review commission for Detroit
April 4, 2012 - Detroit officials approve a “Financial Stability Agreement” with the state
November 7, 2012 - Voters repeal Public Act 4
December 28, 2012 - Snyder approves Public Act 436
March 14, 2013 - Orr is appointed emergency manager of Detroit
July 18, 2013 - Orr files for bankruptcy on behalf of Detroit
August 2013 - Christie’s Appraisals assesses value of DIA artwork
December 3, 2013 - Rhodes rules Detroit eligible for bankruptcy
January 13, 2014 - Rosen announces his plan for the “grand bargain”
February 21, 2014 - City proposes an initial version of its “Plan of Adjustment”
April 8, 2014 - City settles with UTGO insurance companies
April 11, 2014 - Rhodes approves $85 million settlement with Bank of America and UBS
April 25, 2014 - Retiree committee agrees to support revised Plan of Adjustment
May 21, 2014 - UAW agrees to raise funds to help offset retiree health care cuts
September 2, 2014 - Plan of Adjustment confirmation trial begins
September 9, 2014 - City and surrounding counties announce GLWA deal
September 15, 2014 - Syncora settles with the city
October 16, 2014 - FGIC settles with the city
November 7, 2014 - Rhodes approves the Eighth Amended Plan of Adjustment
## Appendix B: City of Detroit Bankruptcy Claims and Treatments

<table>
<thead>
<tr>
<th>Class</th>
<th>Name</th>
<th>Claim*</th>
<th>Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Secured Claims</td>
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<tr>
<td>1A-C</td>
<td>All DWSD Bond Claims</td>
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<td>2A-F</td>
<td>Secured General Obligation Bonds, 2010-2012</td>
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<td>Unimpaired</td>
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<tr>
<td>3-4,6</td>
<td>Other Secured Claims</td>
<td>$95.8</td>
<td>Unimpaired</td>
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<tr>
<td>5</td>
<td>COP Swap Claims</td>
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<td></td>
<td></td>
<td></td>
<td>Unsecured Claims</td>
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<tr>
<td>7</td>
<td>Limited Tax General Obligation Bond Claims</td>
<td>$163.5</td>
<td>41% recovery</td>
</tr>
<tr>
<td>8</td>
<td>Unlimited Tax General Obligation Bond Claims</td>
<td>$388</td>
<td>74% recovery</td>
</tr>
</tbody>
</table>
| 9     | COP Claims | $1,430 | - FGIC: 13% recovery, real estate  
- Syncora: 13% recovery, real estate, tunnel lease |
| 10    | PFRS Pension Claims | $1,660 | - No reduction in accrued pension benefit amount  
- 45% reduction in COLA |
| 11    | GRS Pension Claims | $1,700 | - 4.5% reduction in accrued pension benefit amount  
- Elimination of COLA  
- “Clawback” on annuities ($387 million) |
| 12    | OPEB Claims | $5,700 | $4.3 billion: $2.2 billion for PRFS retirees and $2.1 billion for GRS retirees. |
| 13    | Downtown Development Authority Claims | $33.6 | $3.69 million |
| 14    | Other Unsecured Claims | -- | $16.48 million |
| 15    | Convenience Claims | -- | 25% recovery |
| 16    | Subordinated Claims | -- | 0% recovery |
| 17    | Indirect 36th District Court Claims | $6 | 33% recovery |

* In millions
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