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Motown's Mental Breakdown

As unions and the city council resist reform, bankruptcy looms

REVIEW & OUTLOOK

The political gospel according to Democrats is that the auto bailout saved Detroit. If only it were so. Alas, costly labor agreements have driven Motown like GM and Chrysler to disrepair. Perhaps the only fix now is to let Detroit go bankrupt.

Michigan lawmakers have kept Detroit on life support for the past six months and may need to do so indefinitely barring a miraculous economic recovery. The city will run out of cash this month unless the state releases $30 million in bond proceeds, which are being held in escrow under a consent agreement that council members reluctantly approved in April. The rescue package ties $137 million in state aid to reforms and lets Mayor Dave Bing redo labor contracts.

The city has already drawn $40 million from the state drip and may soon be cut off since council members last month rejected a contract for a legal firm to advise the mayor, a condition of further aid. The council cashiered the contract because the legal firm Miller Canfield helped craft the agreement, which the unions virulently oppose.

While the council is digging Detroit's grave, Mr. Bing is performing triage. The Democratic mayor has slashed wages across the board by 10%; increased health premiums and co-pays; reduced current-worker pensions and suspended retirees' 2.25% cost-of-living raises. This quadruple bypass operation will save about $60 million this year, but the city will still likely end the fiscal year next June $50 million in the red.

Meanwhile, third-party actuaries are pegging the city's retirement liabilities at $11 billion, nearly twice as much as the city has estimated. Detroit will spend $160 million this year and $135 million in 2013 on retiree benefits even after Mr. Bing's labor reforms are phased in. Some of the problem is demographic and has been exacerbated by defined-benefit pensions that let workers retire in their 40s. Many retirees living into their 80s are drawing benefits for nearly twice as long as they work.

The mayor has also floated raising the retirement age and moving new hires to 401(k)-style plans as the state did in 1997. He's even put the nuclear option—freezing pensions for all workers—on the table. Federal law requires private employers to do this if their pension funds become insolvent, but there are no such diktats for local governments.

Another idea is outsourcing operations to private companies. According to the Mackinac Center for Public Policy, the city could save about $110 million annually by contracting out its bus system, garbage collection and water management. Selling its electrical system to an investor-owned utility could raise $300 million to $500 million. Unions oppose all of the above.

Abandoned, blighted school for sale in Detroit, Michigan

Egged on by the city council, the unions have also sued to block the consent agreement and the mayor's labor reforms. State courts threw out their lawsuits this summer, but the unions hope that voters' November repeal of a state emergency manager law, which provides the framework for the consent agreement, will also void the reforms.

In any event, Gov. Rick Snyder and Republican lawmakers are rewriting the nullified law to assist other insolvent cities. One option is to allow distressed municipalities to file for Chapter 9 bankruptcy without state authorization, which is currently required. Some Detroit council members are importuning the state to let the city go bankrupt so they can escape the strictures of the consent agreement. But a bankruptcy judge is unlikely to be more lenient than the mayor.

And make no mistake, Detroit is on its deathbed. Its unemployment rate is nearly twice as high as its surrounding metropolitan region. It has the highest violent crime rate of any major city in part because its police force has been stripped to pay for retirement bills while two-thirds of its street lights are broken. Its schools are among America's worst. The city has lost a quarter of its population over the last decade, and its abandoned lots cover more acreage than Paris.

If the council wants to bolt from its state rehab program, the only way to rescue Detroit may be through an orderly bankruptcy (i.e., not politically negotiated) that restructures its $2.5 billion in general fund-backed debt and $11 billion in retirement obligations. Detroit would be the largest city to date to file for bankruptcy. Its restructuring could drag on for several years, slash pensions for many retirees and impair the city's ability to borrow for decades.

But at the very least, it would provide an instructive lesson for other chronically insolvent cities like Chicago and Los Angeles that have delayed reforms because they believe they're too big to fail.