
The Pension Grand Bargain: A New Reform Model for Cities.

Academics and attorneys specializing in municipal finance are expressing doubts about a public pension overhaul proposal being touted by the Manhattan Institute, which suggests the "grand bargain" model pioneered during Detroit's bankruptcy could be used to remedy the significant retirement liabilities crippling the rust belt cities of Chicago, St. Louis, Cleveland and Buffalo.

In addition, scholars studying public philanthropy dismissed the Manhattan Institute's assertions that regional and national foundations would be willing to serve as a "piggy bank" for cities' public-sector pension debts.

The Manhattan Institute report, released May 3, observed that Detroit's solution was particularly innovative. It used substantial contributions from private foundations to leverage much broader contributions from state government, corporations, public employees and retirees to sweep away a significant portion of the city's liabilities. The report pointed to sufficient philanthropic assets in Chicago, St. Louis, Cleveland and Buffalo to achieve the same result.

But Christopher Berry, director of the Center for Municipal Finance at the University of Chicago's Harris School of Public Policy, told Bloomberg BNA that the Manhattan Institute's analysis represents a fundamental misunderstanding of Detroit's experience.

Berry said the pension component of Detroit's grand bargain included some new funds from outside sources and cuts in benefits for participants, but it also made some long-term bets on the city's capacity to recover. In this regard, the plan gave Detroit permission to lighten its pension contributions for 10 years while it focused on economic recovery. In theory, he said, the city will have sufficient economic strength to ramp up its pension contributions in 2023.

Despite these good intentions, Berry said it's unclear what Detroit's pension hole will look like when the bills come due, or whether the city will be in any position to make good on its obligations. The notion that this uncertain model should be extended to neighboring rust belt cities is problematic. Moreover, it is unclear how Detroit's grand bargain could be layered on cities operating outside the crucible of bankruptcy.

"The grand bargain was a way out of bankruptcy. It wasn't a grand solution to the pension problem," Berry said. "We will only know if this was a solution to the pension problem when those pension payments are due and the city starts paying them."

Hole Is Getting Bigger

James Spiotto, managing director of the municipal finance consulting firm Chapman Strategic Advisors LLC, told Bloomberg BNA that the initial reviews of Detroit's pension systems since the approval of the bankruptcy plan in 2014 aren't encouraging.

"The problem is the hole is getting bigger," said Spiotto, a frequent speaker on municipal bankruptcy. "The projections say they are not earning what they thought they'd earn. They have losses and the benefit costs are different. So they could end up with a significantly larger unfunded problem in 2023. Sometimes, this grand bargain is better referred to as a grand bet."

The Manhattan Institute's premise that philanthropic organizations should play a role in resolving Chicago's $20 billion pension crisis was quickly dismissed by the John D. and Catherine T. MacArthur Foundation.

"Unlike what came together for Detroit in its bankruptcy case, a long-term solution to the fiscal challenges in Chicago will require significant political compromise and legislative action that demonstrably are not possible in the context of the current intransigent stalemate in our state capital," Valerie Chang, the MacArthur Foundation's managing director of programs, told Bloomberg BNA.

"We do not believe it is the role of local philanthropies to address budgetary shortfalls created by representative government at the local and state levels making choices about how to spend scarce resources," Chang said.

Made in Detroit

The Manhattan Institute's report, "[The Pension Grand Bargain: A New Reform Model for Cities]()," notes that Detroit's efforts to emerge from bankruptcy were stymied by a "crippling overhang" of retirement obligations. Fearing that the crisis would eventually force the court to sell off the city's beloved art collection at fire-sale prices, a consortium of philanthropic organizations came together to break the impasse.

The consortium pledged $366 million to address Detroit's pension liability and leveraged similar commitments from private corporations and the state of Michigan. In addition, public-sector unions representing Detroit employees and retirees agreed to forgo a portion of their retirement benefits as a contribution toward long-term solvency (25 PBD, 2/6/15). This "grand bargain gambit" eventually won the support of the bankruptcy court and, the report contends, placed Detroit on a sustainable path.

While other rust belt cities struggling with crushing pension obligations, declining municipal services and escalating property taxes don't find themselves in the clutches of bankruptcy, the Manhattan Institute said "Detroit has pioneered a model worthy of imitation."

"This paper finds that philanthropic assets in the aforementioned cities are more than sufficient to support a Detroit-style grand bargain—if paired with contributions proportionally equivalent to those made by other Detroit stakeholders (corporations, government, and labor)—to reduce such cities' pension debt, as well as to improve municipal services and/or reduce taxes," the report concluded.

The report includes a rough financial analysis suggesting how a proportionally equivalent version of the Detroit model could be applied in each of the four rust belt cities.

For instance, the Manhattan Institute points to a $19.4 billion unfunded pension liability in Chicago. That shortfall could be slashed to approximately $7.5 billion with a $1.8 billion contribution from the MacArthur Foundation, the Robert R. McCormick Foundation and others; a $1.3 billion contribution from state and local government; and an $8.8 billion contribution from labor in the form of benefit adjustments.

'Incredibly Unrealistic.'

Vasyl Markus, director of special projects at the Chicago-based Center for Tax and Budget

Accountability, told Bloomberg BNA that the Manhattan Institute’s analysis might make sense for Detroit but not the four other cities.

Markus, who specializes in municipal pension issues, said the major players managing the Detroit crisis understood that the city was dealing with a depleted property tax base that offered little hope of generating the revenue needed to make good on its broader obligations. The same can’t be said of Chicago, which continues to have a viable commercial, industrial and residential tax base but does not have the political will to fully leverage it.

Markus said Cleveland, St. Louis and Buffalo are also in much better positions than Detroit to generate tax revenue to solve their problems. Even in the context of bankruptcy, he said, it would be hard to imagine a court concluding one of the four cities simply didn’t have the tools to pay down its debts.

“This report is incredibly unrealistic,” he said. “This struck me very much as a comparison between an orange and a rotten apple, particularly when you think about a comparison of Chicago and Detroit.”

‘Bad Public Policy.’

The University of Chicago’s Berry warned that the grand bargain model is simply “bad public policy,” sending elected officials, public employees and unions the signal that private foundations will always bail them out.

“What message are you sending?” he said. “This does nothing to address the underlying incentives. The incentives involve politicians and employees kicking the can down the road and passing benefits that are invisible to voters now. Until we change those incentives, nothing is going to change.”

James Ferris, director of the University of Southern California’s Center on Philanthropy and Public Policy, told Bloomberg BNA that the grand bargain was particular to the difficult circumstances Detroit faced and might not work in other communities. He added that the unusual role played by private foundations overlapped with their commitments to Detroit and their missions to preserve a prized art collection. The notion that foundations might respond in a similar fashion in other cities is “misguided.”

“There are a lot of forces at play behind the grand bargain,” Ferris said. “To view it as simply a model for foundations/philanthropy bailing out a city and their pension obligations is naive and misguided. Philanthropy is not a piggy bank.”

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