Detroit's Bankruptcy Hastened by "13th Month" Checks Issued to Pensioners

When Kevyn Orr was appointed as Detroit's interim financial manager back in March, he launched an investigation into just how deep the city's financial hole really was. He should have waited until September when, after months of digging through records hidden from public view, the *Detroit Free Press* issued its own 6,000-word report.

Orr found catastrophe after catastrophe: computer systems that were woefully inadequate, accounting standards that were being violated and ignored, pension plans which greatly overestimated their expected returns, half of taxpayers owing real estate taxes who weren't paying them, street lights not working, ambulances not running, unemployment approaching 20 percent — his list went on.

Unfortunately, Orr's list wasn't complete. When the *Detroit Free Pres*s exposed the pension-plan shenanigans, even the *New York Times* took notice: The trustees of the two pension plans covering city workers had for nearly 25 years been illegally paying out "13th month" checks and other disbursements because they could do it with impunity. Those illegal checks, when added up over the years, along with the interest those funds could have earned had they remained in the plans where they belonged, amount today to more than $2 billion. While amounting to a fraction of the $18 billion shortfall Detroit is facing, such behavior is illustrative of the self-dealing, corruption, and denial of basic principles of fair play that have plagued Detroit for nearly six decades.

Here's how the game was played: A pension plan is designed around a number of vitally important assumptions — how much is contributed, how much those sums will earn until they are disbursed, and how long the beneficiaries will live. It's that "interest rate" assumption that lies near the root of Detroit's pension problems: The trustees chose to ignore reality and kept the assumption too high, thereby reducing the required contributions from the city and its current workers. When the plans' investments performed better than expected, the plans' trustees considered that a "windfall" event and, instead of leaving those funds invested against the inevitable day when those investments underperformed, gave the money away. It issued 13th month checks to its present retirees, usually at the end of the year, as well as giving this "free money" to its present workers.

So the corruption was two-fold: failure to understand (or deliberately ignoring) their responsibilities as trustees (they are supposed to be "trusted" after all), and their failure or ignorance about such "windfalls" and "free money." Interest-rate assumptions are based on the expected overall performance of the plans' assets: Some years will be ahead, some years will be behind, but on average — it is hoped, assumed — the plans will have sufficient assets to meet their obligations when the plans' beneficiaries retire.

One of the more egregious and vocal supporters and defenders of such corrupt and illegal behavior is Sandra Studzinksi, who served on Detroit's General Retirement System (GRS) board from 1996 to 2004. She told the *Detroit Free Press*:

> Things were always bad for employees. [Giving out these illegal checks] was a way to make up for lots of the years when there were no pension increases.

A spokeswoman for the GRS told the *New York Times* that it was "appropriate" for retirees to "benefit from market upturns" because — get ready — they had paid into the pension funds and so their own contributions had generated part of the investment gains. Besides, she added, "People were having a hard time, living hand-to-mouth, and we thought we would give them some extra."

Ignorance of how the real world works was evidenced by another pension trustee, John Riehl, who currently serves as the vice chairman of the GRS. He explained that sending out those illegal checks was necessary because:

> Many retirees relied on that check to pay their increased utility bills during the winter. Also remember that the money would go directly into the local economy.

Riehl overlooks, of course, the fact that the money *first came "directly" out of the local economy*. Ignorance isn't a crime, but stealing is. As Charles Moore, one of those working with Orr to determine the size, width, and depth of Detroit's fiscal hole, noted:

> [Board members took] GRS assets attributable to city contributions to fund [these] pensions … and reallocated those assets … thus effectively robbing GPS of precious funds….
>
> Hundreds of millions of dollars of plan assets intended to support the city's … pension arrangements were converted by GRS trustees to provide a windfall.

There were attempts in the past to rein in such egregious and illegal behavior, but the unions and the beneficiaries enjoying their 13th month checks were just too strong. When Dennis Archer took over as mayor of Detroit following Coleman Young's disastrous administration in January 1994, one of the first things he learned was how the union-controlled pension plans' trustees were disbursing these funds, and he tried to stop it. He proposed a new city charter which would have given Detroit's city council powers to override the pension plans' trustees. The voters passed, it but the unions and present pensioners took umbrage, sued Archer, and Archer (and the voters) lost in court.

So Archer tried a different tactic, called Proposal T, a ballot initiative to accomplish the same thing. It failed as well, and the 13th month checks continued to flow, illegally, from the plans' assets.

Because the *Detroit Free Press* had such difficulty ferreting out the records on which it based its story, it was never able to determine exactly how many dollars were disbursed or for how long. Records prior to 1985 are missing, and one of the plans — the uniformed officers plan — is distinctly opaque about such things.

Added all together, Detroit's pension plan liabilities are estimated to exceed assets by something close to $3.5 billion, only a fraction of Orr's overall estimate of Detroit's fiscal black hole of $18 billion. But with the help of the researchers and writers at the *Detroit Free Press*, it is now clear for all to see that the real problem isn't the math, it's the morals. It's the belief that there are "windfalls" and "free money" available, and that theft is justified by need. It's the Robin Hood mentality: taking from some and giving to others and calling it charity.

Photo of Detroit skyline from Detroit River

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