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Governing the Broke City:  
Fiscal Crisis and the Remaking of Urban Governance

by

Sara Margaret Hinkley

A dissertation submitted in partial satisfaction of the

requirements for the degree of

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in

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Committee in charge:

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## Abstract

### Governing the Broke City: Fiscal Crisis and the Remaking of Urban Governance

by

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Doctor of Philosophy in City and Regional Planning

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On July 18, 2013, the city of Detroit filed for the largest municipal bankruptcy in U.S. history. Despite Detroit's apparently extreme demographic, economic, and fiscal challenges, the city has been deployed as both a model of crisis response and as a warning of imminent fiscal distress for all U.S. cities. I argue that Detroit is an important site where the narrative of widespread urban fiscal crisis is constituted.

This dissertation examines the dominant narratives of urban fiscal crisis and the implementation of austerity budgets and restructured governance in U.S. cities in the wake of the Great Recession. Using data from the Census Annual Survey of Local Government Finances, city budget documents, ratings agency comments, news articles, and public speeches by local officials, I describe both the national emergence of urban fiscal crisis from 2007-2013 and four local case histories: Detroit, Dallas, Philadelphia, and San Jose.

I find that the same themes characterizing Detroit's crisis are reflected in many other American cities: ratings downgrades, high-risk debt instruments, reduced autonomy *vis a vis* state governments, restructuring obligations to public employees, expanded privatization of government goods and services, exhortations to adapt to a "new" economy, and the handing over of financial management to unelected experts. These policies are justified by a common narrative of urban fiscal crisis that has become "common sense:" a taken-for-granted explanation of widespread urban fiscal crisis that blames government overreach, municipal fiscal irresponsibility, excessive public employee compensation, and a "new normal" of scarcity and economic volatility. Through the reproduction of this common sense by local officials, austerity and external fiscal discipline are framed as the only alternatives to financial emergency.

I argue that the current wave of urban fiscal crisis contrasts with earlier periods of crisis in several important ways: (a) the scale and breadth of deep crisis after years of disinvestment and evisceration of the public sector; (b) the promotion of fiscal discipline as general governance, pushed by financial institutions, budget "experts," and state

legislatures; (c) the framing of cities as isolated fiscal entities that must practice “individual responsibility” and be held subject to the same consequences as private actors in financial markets. Finally, unlike the crises of the 1970s and 1980s, which were closely associated with the abandonment of people and capital from the central city, and an accompanying discourse of inner city crime and poverty, the current narratives of fiscal crisis must be understood in the context of a new political dynamic of city revitalization, inner city wealth, and suburban decline—along with growing spatial inequality.

My work is situated within three empirical and theoretical engagements that cut across urban planning, economic geography, and political science: (1) the politics of public budgeting, in particular the politics of collective consumption, tax equity, and retrenchment; (2) the embedding of neoliberal logics of market governance in urban politics, particularly through the circulation of narratives and policy models; and (3) the financialization of urban policy, and the role of political and economic context in shaping the relationship between cities and circuits of financial capital. My project demonstrates the fertility of city budgeting as a terrain for studying broad shifts in political expectations and the relationship between public finance and urban democracy.

For my mother, who made everything possible.  
1941-2015

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Writing the acknowledgments page of an endeavor this huge should be an outpouring of gratitude and relief. Instead, it is overshadowed by the fact that my beloved mother died suddenly just weeks before I was supposed to finish, a shock that hangs over these pages. But such a profound and abrupt loss also creates an expanded sense of gratitude. When my life ground to a halt on February 17, 2015, an extended web of support surrounded me and my family. Friends made dinner, delivered groceries, hosted sleepovers, played with my kids, brought flowers, and sent text messages, emails, and voicemails of sympathy and love. They made my grief a shared experience and reminded me of the infinite connections that run between us, bearing both sorrow and joy. Becky in particular carried me through the two most difficult weeks of my life with good humor, perspective, and just the right mix of sympathy and snark.

I owe of course tremendous thanks to those who have shepherded me through the past seven years. Teresa Caldeira, who gave me everything she had, including meeting me at a coffee shop to go line by line through my inside field statement, reading drafts diligently, and cultivating an invaluable support network of advisees. It meant a lot to me that my advisor was also a mother, because being a mother in academia can be lonely and frustrating, but also rewarding. And the rest of my committee: Ananya Roy believed in me as a teacher and a colleague and provided insight at key moments. Malo Hutson always made me feel better about my project and my ability to complete it. Marion Fourcade indulged my attempts to engage with sociologists on their turf, and believed in the value of my topic and my ability to do it justice. I also treasure the many colleagues from DCRP and beyond who have read terrible drafts and never been anything but encouraging and kind while providing invaluable criticism. I have been unbelievably lucky in neighbors (Kayko, Noriko, Maria, Carmen), babysitters (Shelby, Liron), and teachers (too many to name), not to mention the many children and parents who share our children's daily lives.

How do you acknowledge the importance of those who keep you alive, real, and happy every day? I owe everything to Phil, my partner in everything for a dozen years now, and my two children, Ethan and Austin (who remain convinced, despite my firm assurances otherwise, that they will someday enjoy finding my "book" at their local library). I have spent the better part of my marriage and their childhoods working on my doctorate. Their tolerance for my constant working has surpassed anything I had a right to expect.

I am especially grateful for the friends of my mother's who told me, over and over again, how proud she was of me; and for my brother and my father, who showed up with love and sincerity when it mattered most. And I am so very thankful for my mother, and everything she did for me, but especially for her belief that I would always be fine.

And finally I want to acknowledge the civic-mindedness of my parents, and my mother's family in particular. They demonstrated through their lives that we are always responsible for things greater than ourselves, that any collective thrives only because of the devotion of people like them to its sustenance. My grandmother was the first town welfare case worker after the Great Depression; she and my grandfather knew everyone in their

town. I still meet people whose parents were helped by my grandmother: with a bag of food, a washing machine, a kind word. “Civic life” was just *life* to them. After my mother died, I spent many days calling the organizations that she was still, at 74, involved in daily. They all lamented that her absence would be a tremendous blow to their organization, that she was the person who always signed up to help. That commitment to society—a profound and lived belief in the responsibility we all have to each other—humbles and drives me. I hope this project furthers the agenda of a robust, democratic society capable of providing for its citizens.

## **PART ONE: ANATOMY OF URBAN FISCAL CRISIS**

The budget is the skeleton of the state stripped of all misleading ideologies.  
(Schumpeter 1954)

Only a crisis—actual or perceived—produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around.  
(Friedman and Friedman 2002, xiv)

[T]he crisis is here. The question is, will it be articulated in terms of bond defaults or larger kindergarten classes—or no kindergarten classes at all?  
(Lowenstein 2011)

## INTRODUCTION

On March 1, 2013, the *New York Times* made two striking declarations on its front page: first, President Obama and House Speaker Boehner had reached an impasse in the high-stakes negotiations over the “fiscal cliff”<sup>1</sup> (Shear and Weisman 2013), and second, Michigan’s Republican Governor Rick Snyder would replace Detroit’s elected government by appointing an emergency fiscal manager for the city (Davey 2013a). Both events grew directly out of the wave of fiscal crises that had been set off by the Great Recession, and both events were evidence of the growing political struggle over the scope of government, the moral economy of debt, and the relationship between democracy and budgeting. Both news stories also raised the question of how deeply public services could be cut before the contract between a government and its citizens was stretched to the point of breaking. These and similar stories would come to reflect the meaning of crisis for cities across the United States, as one local government after another grappled with the consequences of prolonged recession.

Six months after Governor Snyder appointed an emergency fiscal manager to take over Detroit, the city filed for the largest municipal bankruptcy in United States history. The cover story in *Time Magazine* the following week asked: “Will your city be next?” (Ferozhar 2013). This way of framing the story of Detroit’s crisis, as a domino falling in a long line of doomed others, reflects the anxiety over, and the rising importance of, city budget woes in American political discourse. In this discourse, fiscal crisis is a kind of rampant contagion, with tottering city governments ready to collapse at a moment’s notice. And the blame for that fragility was implicitly laid on the cities themselves.

I argue that Detroit is best understood not as an isolated or even extreme case, but rather as a widely-circulating model of the relationship between crisis and policy in U.S. cities today. The same powers Michigan law gives to Detroit’s emergency manager—to break union agreements, sell off public assets, privatize basic services, terminate entire departments, and claim general fund moneys for debt repayment—are being pushed on cities around the country, either by state legislatures or by local officials, to the acclamation of financial ratings agencies and the financial press. The same themes characterizing Detroit’s crisis echo in many other American cities: ratings downgrades, high-risk debt instruments, reduced autonomy *vis a vis* state governments, restructuring obligations to public employees, expanded privatization of government goods and services, exhortations to adapt to a “new” economy, and the handing over of financial management to unelected experts.

The stories of urban fiscal crisis framed by local actors frames such disciplinary policies as the “only alternatives,” in part by foreclosing discussions of the policy decisions

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<sup>1</sup> The fiscal cliff, of course, was itself a construct, based on a theoretical model of the ideal national debt limit that turned out to be based on faulty calculations (Herndon, Ash, and Pollin 2013).

that have produced localized fiscal crisis (see Peck 2010). There are important political purposes served by presenting the fact of crisis as self-evident. In his analysis of the urban fiscal crises of the late 1970s, Marcuse argued that orthodox explanations often emphasize decline as organic and inevitable, naturalizing political phenomena and framing the preferred solutions as common sense (Marcuse 1981). In that era, the dominant narrative of urban fiscal crisis emphasized declining central city population, the dwindling significance of manufacturing cities, expansion of social spending, government incompetence, and the excess power of public employees. This explanation, Marcuse argues, failed to explain why economic changes should lead to a fiscal crisis in the public sector, and why they do so at certain times but not others (Marcuse 1981). The narratives of contemporary fiscal crisis mirror the 1970s in this respect. The global financial-economic crisis has been “socialized into a fiscal crisis of the state” (Oosterlynck and Gonzalez 2013), and the notion that cities have no choice but to cut services and take the safety net from their own workers seems to have been internalized by local politicians. What is described as necessary in response to crisis then becomes necessary to avoid it.

Crises have the potential to create political space for significant shifts in governance, in expectations about cities, and even in financial relationships (Hackworth 2007; Weikart 2009). While widespread urban retrenchment in the 1970s and 1980s severely reduced urban services (Fainstein and Fainstein 1986), the post-2008 U.S. urban fiscal crisis is more fundamentally reshaping the normative framing of local governance and the scope of the city (Pinch 1995). While retrenchment effectively shrinks the state through spending cuts and privatization, the power of cities is also diminished by significant restructuring of urban fiscal governance, reflected in the national move toward pension restructuring and state interventionism (see also Merrifield 2014).

The persistence of austerity as the policy response at all levels of government has led to an ongoing debate over the resilience of neoliberal ideology despite the devastation caused by deregulation of financial markets (see e.g. Peck, Theodore, and Brenner 2010b). While that literature has documented the global and national persistence of austerity, the aspects of differentiation that form an approach to comparative urban research are missing from contemporary debates about the relationship between neoliberal ideology in the U.S. and localized austerity. In order to understand Detroit’s paradoxical figurative role, I wanted to study fiscal crisis not as an event in one city but one constituted in multiple sites. The national debates over urban fiscal crisis (occurring in the financial and mainstream press) are produced through local narratives and policies of crisis, which in turn shape and reinforce local narratives. How a city comes to be understood as facing crisis, how its relationship to national crisis is framed, and how crisis is managed, are all processes I observed being made in reference (both direct and indirect) to other cities. This circulation of both narratives and policies constitutes an important space in which the meaning of crisis is constructed. I wanted to answer the following questions:

- What explains the persistence of neoliberal, austerity-driven approaches to local crisis, especially after the financial crisis generated new political space for rethinking financialization?

- Was the austerity practice in cities a continuation of the responses to previous crises (retrenchment, dismantling social welfare, etc.), or something different?
- What role is played by the relationships of cities to financial markets, and how did that affect different cities differently?

The adoption of local austerity requires that fiscal crisis be defined and described in a way that legitimates austerity as the policy response in that specific city at that time. I argue that the absence of significant local debate over austerity is a product of the fact that certain explanations for fiscal crisis have become taken for granted, in the sense that Wedel suggests, and it is those taken-for-granted narratives in which I became most interested. I found that several key shifts characterized the current narratives of crisis: the reframing of pensions as “debt” (and then of pensioners as investors), the framing of all cities as being in crisis, and the framing of states as the gatekeepers of city fiscal autonomy.

Although the recession officially ended in 2009,<sup>2</sup> American cities have seen declining revenues for six straight years, with the worst effects of the recession hitting only in 2012 (Pagano, Hoene, and McFarland 2012). Persistent unemployment, stagnant wages, and lagging property values are fueling budget shortages as struggling residents rely on government support in growing numbers. Cities face several obstacles to fiscal stability: they are heavily reliant on stagnant property tax values and depressed sales taxes, are required to balance their budgets annually, and face strong political and policy obstacles to raising revenues. The concentration of the Great Recession in the U.S. housing market has been particularly devastating for cities, as housing prices began to fall in 2006-2007, eventually dropping by as much as 50% in some states (Urahn and Pew American Cities Project 2012). City government reserves declined by 25% from 2008 to 2012, leaving cities more vulnerable to shocks and vulnerable to ratings downgrades, which are based in part on a city’s assets (Pagano, Hoene, and McFarland 2012). More than 500,000 local government jobs were cut from 2010 to 2012 alone (Dewan and Rich 2012). The earnings lost because of these job cuts (and outsourcing to lower paid workers) contributes to a vicious cycle of declining incomes, unemployment, and foreclosures, further decimating the local tax base (Norris 2011). Well into 2013, local tax revenues lagged well behind pre-recessionary levels, and financial institutions have tightened their control (both direct and indirect) over cities’ access to money through municipal debt markets (Urahn and Pew American Cities Project 2012; FitchRatings 2012).

By 2009, the federal government shifted from stimulus to austerity, and states devolved their own gaping budget deficits onto local governments. Governors and state legislatures have not only made enormous reductions in (or in the case of states such as Idaho, completely eliminated) fiscal aid to local governments, they have significantly cut money for programs such as libraries, medical clinics, and mental health, which are often operated by cities (Kellogg 2012; Cooper 2002). Many scholars have noted that the U.S. federal system devolves fiscal crisis to the local, ensuring that the politics of austerity are

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<sup>2</sup> The National Bureau of Economic Research identifies the start of recession as December 2007 and its end as June 2009: <http://www.nber.org/cycles.html>.

most deeply felt by cities and their residents (Gonzalez and Oosterlynck 2014; Peck 2012). In the current recession, the dynamics of state-local politics have been particularly important, although they receive less scholarly attention than federal-level policy; I take this up in Chapter 5.

In early 2010 a narrative of widespread urban fiscal crisis took hold in the national media, prompted in part by reports in the financial press that cities' debts were mounting and that there was a real possibility of poor municipal ratings spreading like contagion. In a cautionary article about the 2008 bankruptcy of Vallejo, California, the *New York Times* asked "Is this America's future?" (Lowenstein 2011). Financial experts from the New York Federal Reserve to Moody's published reports outlining their concerns about the likelihood of widespread municipal default (Appleson, Parsons, and Haughwout 2012). A financial adviser renowned for predicting the 2008 financial meltdown predicted that states would balance their own budgets by cutting aid to cities and thereby trigger a wave of municipal defaults (Tully 2010). No such disaster followed, but it reflects the contemporary atmosphere of panic about the financial solvency of local governments (most often framed in terms of the risk to investors in municipal bonds).

In 2015, more than six years after the financial market collapse, popular narratives of urban crisis focus less on the original event of bank-driven market failure, and instead on government as an obstacle to economic recovery, with cities dragged down by irresponsible public budgeting and unsustainable municipal debt and pension burdens. Instead of articulating a vision for government's response to a recessionary economy, the narrative of urban fiscal crisis that dominates headlines centers on governments needing to make 'tough decisions,' jettison unsustainable public benefits, eliminate the few remnants of the welfare state, and adapt urban governance to a new economic reality (R. L. Florida 2009). These narratives of local crisis largely omit the local and national policy histories that have produced urban fiscal crisis. Perhaps most importantly, they fail to articulate a vision for what happens to a withered local state when the economy rebounds. A vision of trimmed government in times of shortage morphs into an implied future of permanently limited urban services.

In this context, the very notion of the city has been reshaped using a language of necessity, scarcity, and absence of alternatives. Urban fiscal policy space—revenues, spending, debt, and governance—has been a key site for these processes of remaking, through the promotion of discipline, expertise, and austerity made permanent. These processes have effectively foreclosed discussions about how cities raise money, the city's role in redistribution, and power relationships between city, county, suburban, state, and federal governments. All of these dynamics build on years of material austerity produced by the steady retreat of federal urban spending, tax revolts, and the legacies of retrenchment from waves of urban crisis in the 1980s and 1990s.

I argue that the current wave of urban fiscal crisis contrasts with earlier periods of crisis (especially New York City's 1975 encounter with bankruptcy) in several important ways: (a) the scale and breadth of deep crisis after years of disinvestment and evisceration of the public sector; (b) the promotion of fiscal discipline as general governance, pushed by



financial institutions, budget “experts,” and state legislatures; (c) the framing of cities as isolated fiscal entities that must practice “individual responsibility” and be held subject to the same consequences as private actors in financial markets. Finally, unlike the crises of the 1970s and 1980s, which were closely associated with the abandonment of people and capital from the central city, and an accompanying discourse of inner city crime and poverty, the current narratives of fiscal crisis must be understood in the context of a new political dynamic of city revitalization, inner city wealth, and suburban decline—along with growing spatial inequality.

### *What is a fiscal crisis?*

The decision on whether or not a crisis exists is the essence of the political.  
(Brash 2003, 78 paraphrasing Schmitt)

This dissertation aims to treat fiscal crisis as a constructed concept in order to explore the ways that crisis is deployed as a justification for promoting particular policies. As Keil says, there is much ink to be spilled on the category of crisis and its trajectory in urban policy; I will not attempt to elucidate the possible meanings of crisis here (Keil 2010, 649). The current iterations of crises in financial markets, mortgage industry, and housing markets are simultaneously distinct and overlapping phenomena with important lineages in the relationship between crisis, neoliberalism, and restructuring (see e.g. Soureli and Youn 2009).

While acknowledging these important conceptual complexity, there are also measurable dimensions of municipal fiscal crisis, reflected both in policy and in general understandings of vulnerability to insolvency. The highest level of “crisis” for a city is fiscal insolvency: when a city cannot pay its bills because it lacks access to cash. On a day to day level, cities fund operations through short-term borrowing, to bridge temporary gaps between revenue collections and regular spending needs. Those temporary gaps can grow larger than expected if revenues fall below projections (as happened during the recession), or unexpected expenses occur (such as natural disasters). Insolvency can also follow several years of operational deficits (when a city draws down its reserves at the end of the year, or relies on borrowing to fill the gap created by the deficit). When a city’s access to short-term credit becomes restricted (i.e. only at very high interest rates) or unavailable (as when banks refused to lend to New York in 1975), insolvency may become imminent. When Detroit failed to make a credit payment in July 2013, it became insolvent and immediately filed for bankruptcy.<sup>3</sup>

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<sup>3</sup> But note that there are so few examples of cities failing to make debt payments and becoming insolvent that we can’t generalize about what happens next; Detroit stopped making payments when it was clear that it would pursue bankruptcy; New York City never missed a payment after banks froze access to short-term credit, banks and the state intervened to negotiate a “recovery plan” that entailed the reopening of credit markets.

But a city may be considered as in fiscal crisis long before it faces insolvency. A city may also be considered in fiscal crisis when its government (its mayor or city council) decides to take steps to avert insolvency (projected months or years in the future). External actors, such as state governments or financial ratings agencies, may also decide that a city is in fiscal crisis. When such declarations are made, they will refer to measures of fiscal strain (such as debt burden or recurring deficits); these measures are continually evolving, sometimes embodied in policy but just as often are fluid measures. I talk more about such external definitions in Chapters 4 and 5, but those external decisions are enabled by a vast literature on the indicators of fiscal crisis, which I describe now.

There is a dense literature devoted to constructing definitions and indicators of crisis, published in professional manuals for public finance officials and public administration journals. This literature plays an important role in shaping what is meant by “crisis” and in guiding policies to manage urban fiscal policy. Efforts to predict crisis are largely motivated by the question of how policymakers can “intervene” before crisis erupts, and take the form of indicators of fiscal stress. The International City/County Management Association (ICMA)’s *Financial Indicators for Local Government* is one of the most circulated guidelines, regularly updated in manuals for local officials to use in exerting fiscal self-discipline.<sup>4</sup> In the early 1980s (when there was a great deal of federal interest in municipal finance), there was a proliferation of these “indicators” of fiscal crisis, particularly in the policy-making arena, in part driven by a federal research infrastructure for evaluating fiscal policy and urban issues. Federal research departments played a significant role in studying and developing indicators and testing approaches to retrenchment, such as the Department of Housing and Urban Development’s *Municipal fiscal indicators* (reprinted in Carr 1984). *Cities Under Stress*, a 700-page tome by the Center for Urban Policy Research at Rutgers, contains dozens of essays on measuring urban stress and identifying causes for widespread fiscal stress (Burchell and Listokin 1981; see also Bahl, Martinez-Vazquez, and Sjoquist 1992).

There are many variations of such lists, and they are occasionally modified, but they share a core set of indicators and measures. The first focuses on revenues: total revenues, revenues per capita, the share of different revenue sources as a share of total revenues (to identify possibly vulnerabilities, or significant changes in one revenue source). The second focuses on expenditures: total spending, spending per capita, and spending as a share of revenues (i.e. the operating deficit or surplus). Third is the amount of available reserves (i.e. money not earmarked for another purpose that could be used for emergencies), as a percentage of all revenues. Fourth is the measure of the city’s debt burden: total debt per capita, or as a percentage of revenues (Groves and International City/County Management Association 2003).<sup>5</sup> Much of this literature treats fiscal crisis as something both quantifiable and, in turn, predictable if only the indicators are calculated and monitored. Inman, in his discussion of Philadelphia’s fiscal crisis, says “[a] simple accounting identity

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<sup>4</sup> See for example a report by the State Auditor in Ohio on fiscal indicators that relies on ICMA’s guidelines (Taylor 2009).

<sup>5</sup> In many states, these measures are governed by policy (for example the amount of reserves cities must hold, or the amount of debt they can issue).

clarifies when a fiscal crisis will occur” (Inman 1995, 378). Such models elide the political and external factors that bring cities to a point of declaring crisis.

A more expansive approach to studying fiscal crisis defines a set of circumstances that put a city at risk of fiscal strain; this set of defined indicators can then be deployed as predictors of future crisis (and thus also justification for treating a city as at risk of crisis). For example, Fuchs (1992) uses fiscal indicators including the diversification of revenue sources, property tax base, and ratio of long-term versus short-term debt as predictors of crisis vulnerability (Fuchs 1992, 151). Local economic conditions may also trigger fiscal strain—high unemployment and declining tax bases, which may be driven by a national recession or local economic circumstances (C. Clark and Walter 1991, 685). Clark and Walter (1991) cite rising demands upon urban governments (1) pressures from public employees, (2) state and local mandates, (3) demands for tax cuts, (4) high inflation, (5) demands for increased public services, as well as state pressures on cities (loss of state revenues & state limitations on urban financial powers), and loss of federal revenues (see also Bahl, Martinez-Vazquez, and Sjoquist 1992). These more complex factors reflect the broad array of policies and politics that shape a city’s fiscal health.

Efforts to predict crisis began to receive renewed attention after the 2001 recession, and again after 2008. Hendrick (2004) develops a metric of dimensions of fiscal health, grouped into environmental factors (revenue wealth, spending needs, and socioeconomic factors), the adaptation of a government’s fiscal structure to those properties; and the financial choices of city officials and others (reflecting “government’s adaptation to the environment and other structural features”) (Hendrick 2004, 82).

Local perceptions of fiscal stress by local officials are perhaps the most significant factor in determining whether a city frames itself as being in crisis. Clark and Walter find that “objective indices turn out to be much less associated with the utilization of retrenchment strategies than are the perceptions of stress by city officials” (C. Clark and Walter 1991, 684). Both Lobao and Adua (2011) and Maher and Deller (2007), also find that perceived, rather than real, fiscal stress drives local decisions to pursue austerity policies (Lobao and Adua 2011; Maher and Deller 2007). Maher and Deller also found that self-reports of fiscal stress were more predictive of austerity strategies than Census-based measures of stress (Maher and Deller 2007, 1567). The importance of perceptions and self-policing in relation to declarations of crisis makes clear the importance of looking at local official narratives, and also further challenges the idea of fiscal crisis as an “objective” externally-produced phenomenon, and as something that can be internally-produced.

Two terms from my title need further explanation. First, I use the term the “broke city” to shorthand the notion that cities are in a perpetual state of shortfall and fiscal precarity. Detroit has often been described as “broke” in popular media and local politicians. When politicians during the recession tout their own ability to manage costs and navigate fiscal crisis, the image presented of the city is still one of lean resources, of scarcity. I use the term “broke city” in the title to invoke the sense that every city is broke, that the “new normal” for urban governance is this constant threat to running in the red.

Secondly, I use the term urban governance to refer specifically to the control over urban policy, in particular urban fiscal policy (the ability to raise, borrow, and spend money). It is not just (or even primarily) city government itself that has been restructured through new forms of financial administration within the structure of city government, but *governance*: the multiple realms in which city policy is shaped and the power relations that saturate those realms constitute the urban governance in which this dissertation is interested (Newman 2014; See especially Merrifield 2014).

## Research design

A dissertation on urban fiscal crisis could study only the city of Detroit, positioning the city's decline and bankruptcy as an apocryphal story of our era, much like New York City's near-bankruptcy in 1975 (see e.g. Tabb 1982). Such a study could highlight Detroit's exceptional demographic and economic challenges: the city has experienced greater population decline than any other U.S. city (it is expected to fall below 700,000 people in 2014, from a high of 1.9 million in 1950); an estimated 30,000 homes sit vacant in an area three times the size of San Francisco; and in 2012 the city owed an estimated \$15 billion in debt, with annual revenues of just \$1.1 billion (State of Michigan 2013). Detroit's levels of poverty, unemployment, and industrial abandonment pose economic and fiscal challenges that defy comparison with any other city.

What I found while following the discussions of urban fiscal crisis across the U.S. is that, despite its apparent uniqueness, Detroit has, since 2010, been deployed in the media and in policy debates as both a model of crisis response and as a warning of imminent crisis for all cities. Thus, Detroit is an important site where the narrative of fiscal crisis is constituted, and from which it circulates to other places. This juxtaposition of a city weathering unique circumstances and its function as a generalizable model is the pivot on which I designed my study.

I became convinced that looking at multiple cities was important, but what kind of multi-sited project would this be? There is a long history in planning of doing comparative research by reducing information about cities to discrete points of comparison. I did not want to be in this genre of research; the idea of multi-sited case studies was not to produce comparisons of equivalence but to explore the relations between places. Two recent methodological innovations held promise for using multiple cities to answer my research questions.

First is the recent revitalization of comparative urban research that seeks to move beyond the conventional treatment of cities as discrete and analytically distinct units (Brenner 2007). Robinson argues that the push for more comparative urban research is necessary to understand "differentiated, but repeated urban outcomes" (Robinson 2014, 6). This approach to comparison treats multiple cases not as separate instances of variation but as sites of participation in shared processes, which are constituted in and through that variation. This relationship between differentiation and repetition echoes my

understanding of neoliberalism and its constitution in and of the local (I come back to neoliberalism later in this introduction) (Peck, Theodore, and Brenner 2010a).

Guided by this understanding of comparison, I decided to study the construction of policies related to fiscal crisis in four cities, and how those policies are repeated in diverse cases, while also reflecting the differentiation of those places. I approach my study of these four cities not as separate case studies but through their relation to the national narrative of urban fiscal crisis. Throughout this dissertation, I use the differences between those cities as a means for understanding how the common sense ideas about fiscal crisis are framed and reproduced in different places.

I hope that this comparative approach can do at least two things. It can counter a narrative that singularizes one place's story by finding similar circumstances in other places. It can also counter a universalizing narrative by revealing important differences between places. The questions raised by those differences draw attention to local political histories that are largely absent from dominant narratives about fiscal crisis. Comparing places also draws attention to the alternate choices that could be made, and demonstrates that the crisis is lived in different ways in different cities, which seems obvious but is not always apparent in the literature on urban crisis, nor in the news coverage (see Oosterlynck and Gonzalez 2013, 1081).

The recent work on multi-sited work in critical policy studies is also helpful, particularly the work on the power of policy models and their interaction with local processes and politics, which treats new venues of knowledge production as important research sites. Critical policy studies, originating in the anthropology of public policy, takes as its starting point the seemingly obvious idea that policy responses to crisis must be examined as events enabled by spaces of political possibility, shaped by local contexts and events (see e.g. Wedel et al. 2005). Unlike approaches to public policy that use rational models of decision-making to explain how some policies are chosen over others, this approach to studying policy seeks to understand "how taken-for-granted assumptions channel policy debates in certain directions, inform the dominant ways policy problems are identified, ... and legitimize certain policy solutions while marginalizing others" (Wedel et al. 2005, 34). Exposing these assumptions reveals the politics at stake in narratives that frame the need for urban fiscal reform, particularly in the language of finance and markets. It is especially important to take such an approach to studying policies that are "clothed in neutral language," and policies imbued with the language of efficiency or productivity, such as fiscal and budgetary reforms (Wedel et al. 2005, 33–34).

Critical policy studies itself expands the work on policy transfer in political science by paying attention to the "social and ideological contexts of the policy-making process," and the more "indeterminate zones of policy implementation and practice" (Peck and Theodore 2012, 23). I treat the sites in which responses to fiscal crisis are discussed and narrated as such "indeterminate zones:" investors' conferences and presentations by ratings agencies to state officials. These sites, in which narratives of fiscal crisis circulate and are (re)produced, often explicitly disavow their interest in directly influencing policy, but they must be treated as important venues in which the justifications for policy are

produced and circulate. I believe this element of narrative production and spaces in which “knowledge” becomes treated as common sense are important innovations in the critical study of policy-making.

Peck and Theodore argue that the policy-making space of knowledge production and expertise needs to encompass actors that operate at multiple scales and arenas, but much of the work in critical policy studies has privileged global and national networks of policy-making, paying less attention to the intermediate zones: state and regional policy-making in particular (Peck and Theodore 2010, 23). I find that these networks can consist of spheres that overlap in complex ways, such as state experts and officials and financial actors, in particular the bond ratings agencies, who have multiple positions in relation to state actors. I suggest that these modes of knowledge production sometimes do not resemble networks but rather that knowledge itself becomes “common sense.” That common sense emerges from conferences, legislation, and other arenas that require the attention that must be paid to “hierarchical and nodal sources of power,” and that such sources of power can be texts as well as actors (Peck and Theodore 2010, 25). In particular, the combination of legislation and financial control can bring models into being, and that also play a role in shaping the narrative, by telling a story that has a particular weight that enables it to be accepted as fact.

These stories circulate as stories of national crisis and also as cities compare themselves to other cities in crisis. McCann and Ward outline a methodology of critical policy studies that identifies two key components: following and situations (McCann and Ward 2012). “Following” defines policies, stories, or conflicts as research sites, which can be followed as they travel between places. “Situations” can be thought of as “relational sites where past, present, future of a policy exist,” such as conferences, public hearings, speeches, and other sites where “policy knowledge is mobilized and assembled” (McCann and Ward 2012, 47). Peck and Theodore also emphasize that policy is often constructed through processes of comparison with other places (Peck and Theodore 2012). The idea of crisis itself as mobile, and contagious, characterizes much of the national dialogue around cities and fiscal distress, justifying the adoption of policies from cities in crisis (such as Detroit) even in the absence of severe local crisis.

In order to investigate this form of implicit knowledge that, I argue, constitutes an important policy-making site in urban fiscal crisis, I use the idea of “common sense:” taken-for-granted assumptions that shape the realm of possible policy options (see also Kingdon 2003). By identifying those ideas and assumptions that operate as “common sense” in times of crisis, I include both the explanations for fiscal crisis and the policy response. As Marcuse argues, the dominant narratives of fiscal crisis and its appropriate responses rely on a story of crisis as organic, inevitable, rampant, and contagious (Marcuse 1981).<sup>6</sup> That

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<sup>6</sup> There is always, of course, more than one “dominant” narrative, and there are also counter-narratives that seek to make explicit what common sense framings of a story render invisible. This dissertation acknowledges the presence of such counter-narratives, but they are not my subject (nor is the important question of how such counter-narratives). My focus is rather on the generation and circulation of a common sense narrative of crisis that has been reproduced and reiterated (with variations) across a wide range of cities.

story is repeated often enough that it takes on the aura of common sense—it becomes taken for granted. A key element of this common sense is the identification of causes (and assigning of blame) for fiscal crisis that are then generalized to evaluate the fiscal structure of all cities. Stories of fiscal crisis are stories of causation: of a cause and effect relationship between aspects of urban policy or the urban condition that generate crisis. During the 1970s urban crisis, discussions of urban policy took for granted the idea that technological change and the increasing competition for global economic activity had rendered previous models of governance and urban development obsolete (Marcuse 1981). During the recent recession, the dominant narrative of crisis blames the overreach of government, the fiscal irresponsibility of the public sector, the power of public employees, the obsolescence and burden of the welfare state, and the need for market-based governance (Addie 2008).

In the public realm, this common sense can echo Gramsci's notion, a broad term he uses to explain how concepts and imbalances of power become internalized as the natural order of things by people in a society (Crehan 2011). Gramsci proposed that "common sense" has a logic and a history, while being episodic and not necessarily coherent, adapting to new realities (Hall and O'Shea 2013; Gramsci 1971).

It may be true, as some argue, that neoliberal ideologies in particular have become embedded in common sense after years of policy dominance (Stuart Hall and O'Shea 2013), meaning that the apparatus and ideology of neoliberal ideas is no longer apparent, as alternatives to those ideas disappear from common debate. Peck also argues that neoliberalism is fundamentally characterized by an ethos of restructuring, and should be understood as a regulatory project that encompasses technocratic normalization and enforced public austerity, trends that I encounter and describe in this study. The relationship between restructuring and crisis has also been closely associated with the expansion of neoliberal urbanism. Harvey proposed that New York's narrowly-averted bankruptcy was the "iconic case" of what would later be understood as a pattern of crisis-assisted transformation to neoliberal urbanism, emphasizing the replacement of the city-as-welfare-state with a new urban vision (Peck, Theodore, and Brenner 2010b, 140).

Many scholars have already argued that neoliberal, market-logic ideologies have come to operate as common sense (Keil 2002). Addie argues that neoliberalism constructs the "discursive naturalization" of markets and globalization as political economic forces (Addie 2008). Cerny argues that neoliberalism has moved from a doctrine into "a kind of common sense for the 21st century," in which a political consensus emerges around basic neoliberal principles even as conflict and mutation continue, an "embedded neoliberalism" (Cerny 2010). Neoliberal policy approaches become embedded in common-sense understandings of problems and solutions, ideologically and discursively, institutionally (through regulation) and through class relations (Cahill 2011, 486). Thus as crisis creates the demand for new strategies, these common-sense ideas are what is "lying around." This "mutually constitutive nature" of neoliberalism and crisis, however, needs some definition in order help us understand the relationship between crisis and cities in particular (Peck, Theodore, and Brenner 2009). The forms of policy innovation being promoted in the current crisis—in particular regarding pensions and debt—are also specific products of the local, state, and national politics surrounding the emergence of this particular crisis. My

dissertation lends needed specificity to this relationship of crisis, neoliberalism, and restructuring. Ultimately, the production and management of fiscal crisis is a political question that must be answered locally and with reference to broader narratives and phenomena that help produce local policy.

### *Data sources and case selection*

My research draws from four sources of information:

**(1) Public and media narratives of fiscal crisis:** For the period of 2007-2013, I gathered a broad range of statements about the fiscal health of cities in order to develop a picture of the dominant narratives of fiscal crisis that took hold shortly after the recession began. I collected media coverage of fiscal crisis from local newspapers in my case cities, national papers such as the Wall Street Journal and New York Times, and financial news sources such as Bond Buyer and Bloomberg. I also use statements made by ratings agencies (Moody's, S&P, and Fitch), and guidance statements issued by professional associations (the National League of Cities, Government Finance Officers Association, National Governors Association, and U.S. Conference of Mayors) as well as statements by national bodies charged with regulating municipal finance.

**(2) City budgets and Census financial data:** In order to analyze revenues and spending, I use both Census local and state government survey data and original city budget documents and annual audits (Certified Annual Financial Reports, or CAFRs). I have constructed a national dataset from the Census Bureau's Annual Surveys of State & Local Government Finance from 1997 through 2012 (the dataset for years 2007-12 was built from scratch, as the Census ceased publishing government data by city in 2006). In my five cases, I analyze adopted budgets and CAFRs from fiscal years 2007 to 2013 in order to examine the restructuring of revenues and expenditures immediately before and during the recession.<sup>7</sup> I analyze trends in revenue and spending, as well as debt issuance and intergovernmental transfers. I identify post-2008 shifts in city spending by a set of comparable categories, in absolute terms and relative to population detailed in Part Two.

**(3) City and state fiscal policy:** Using information from city budgets, I identified local policy changes that affected revenue structures, such as tax rate changes, and examined the history of those changes through municipal regulations or laws and public votes, focusing on 2001-2008 and 2008-2012. I also researched state policy responses to urban fiscal crisis, focusing on three common forms of fiscal discipline that have been commonly pursued by states during this recession: changes in state municipal bankruptcy law, state fiscal monitoring systems, and receivership laws permitting state takeover of local governments. In order to understand how these policies are framed in terms of specific local crises, I review government analyst reports, floor speeches, committee reports and minutes, legislative preambles, and court interpretations of the laws.

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<sup>7</sup> I chose this time period because it includes one fiscal year (2006-07) before cities began to feel the effects of the slowdown in real estate and financial markets, which began around 2007-08.



**(4) Budget presentations:** In order to examine how the recession was being described by those managing the budget process within my cases, I reviewed public statements and presentations made during budget processes of fiscal years 2009 through 2013. I reviewed video of public meetings, proposed and adopted versions of the budget, analyst reports, and local news coverage of budget processes.

In designing this comparative project, I chose four cities along a spectrum of fiscal stress and political context: Detroit (Michigan), Dallas (Texas), Philadelphia (Pennsylvania), and San Jose (California). Two cases typify cities undergoing multiple urban crises: industrial and population decline, and a tradition of high service demand and provision. The third (Dallas) appears often on lists of the most resilient or “recession-proof” cities (Zumbrun 2008), and exemplifies a lean urbanism approach to service provision. But the Texas state government has enacted aggressive tax cuts, leaving local services (in particular education) and city infrastructure critically underfunded, leaving cities to fend for themselves (see e.g. Fernandez 2012). The fourth city I chose, San Jose, has also performed relatively well economically (it ranked first on the Brookings Institute evaluation of metro economic recovery) (Friedhoff and Kulkami 2013), but California was one of the states hardest hit by the recession (four California cities filed for bankruptcy after 2008). San Jose’s Mayor has capitalized on this atmosphere of crisis by pushing for radical reforms in public pensions and reducing service provision, leaving libraries and fire trucks unused, sacrificed to an ethos of economic competitiveness. These four cases, representative of the various economic and political challenges faced by cities, offer a window into both the uneven experience of crisis and the mobility of crisis as a concept shaping urban policy.

Table 1.1 Population change and demographics, case cities

	2013 population	1990 population	Non-Hispanic White	Hispanic	Black
Detroit	688,701	1,027,974	8%	8%	83%
Dallas	1,257,676	1,006,877	29%	42%	25%
Philadelphia	1,553,165	1,585,577	43%	13%	37%
San Jose	1,000,536	782,248	29%	33%	3%
U.S.			63%		13%

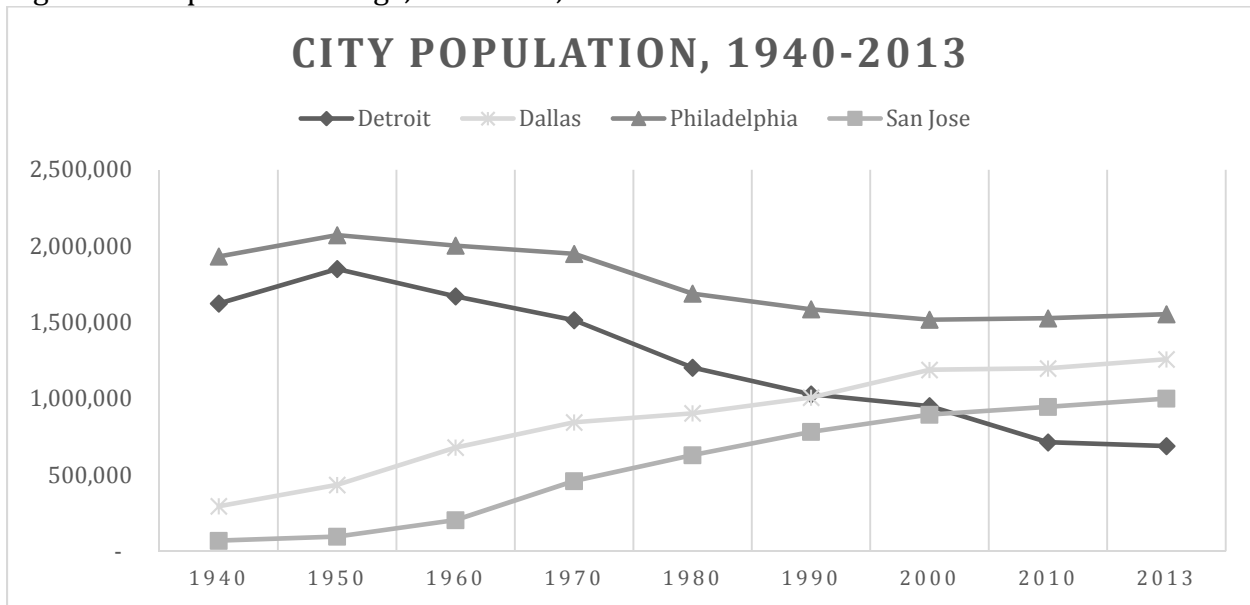
Sources: 2013 Census population estimates, 1990 Census; 2013 American Community Survey

Table 1.2 Unemployment and poverty, case cities

	Poverty	Unemployment
Detroit	38%	18.1%
Dallas	24%	6.4%
Philadelphia	27%	10.4%
San Jose	12%	7.3%
U.S.	15%	6.7%

Sources: Local Area Unemployment rates 2009, 2012 annual average (BLS); American Community Survey

Figure 1.1 Population change, case cities, 1940-2013



Source: American Community Survey

## Organization of the dissertation

The dissertation is organized as follows. In Part One, I make two arguments about this recent unfolding of urban fiscal crisis. First, I argue that the emergence of fiscal crisis has been over-simplified by describing crisis as something that affects nearly all cities and that rarely encompasses the policy choices contributing to cities' fiscal instability. Second, I argue that in the name of post-crisis recovery and stability, a particular set of fiscal policy responses to the recession has dominated urban policy: downsizing local government, privatizing basic public functions, promoting "self-help" for cities, and increasing the role of financial experts in urban governance. I demonstrate this by describing how stories of fiscal crisis are recounted, analyzed, and explained in four cities during the current period, and during previous eras of urban fiscal crisis.

Next, I turn in Part Two to an empirical demonstration of the material effects that fiscal crises has on cities. Chapter 2 shows how cities are restricted in their revenue options, producing a growing reliance on regressive and unstable sources of revenue. Chapter 3 shows the material effects of retrenchment, or spending cuts, on cities in crisis, centering on cuts to public employee benefits. My approach is comparative; that is, I highlight common themes across my four cases and also point out variations, unevenness, and points of difference. Based on this picture of scarce revenue and sharp spending cuts, I argue that the current wave of fiscal crises differs from previous crises (during which the welfare state was dismantled) in important ways—particularly the focus on restructuring public pensions (while it echoes previous crises in its preservation of development spending and holding down tax rates). The argument of Part Two supports my larger point that fiscal crisis, far from having only one possible policy response, generates policy

prescriptions that emerge from both local and national political contexts in which those policies are shaped.

Finally, in Part Three, I take up the subject of how municipal governance is remade by fiscal crisis. As I will show, the governance changes made in times of crisis have long-lasting effects for cities. Chapter 4 examines how the crisis has deepened trends of financialization that have reduced cities' fiscal autonomy and stability. These include the shifting of many funding sources and programs off the primary budget (using authorities, methods of privatization, and enterprise funds), and the increasing role of technical financial expertise in setting urban policy. I examine the role of banks, ratings agencies, and financial policy-making institutions in shaping urban policy, facilitated by the growing complexity of municipal debt and the narrative of impending municipal collapse. Chapter 5 describes the complex political relationships between states and cities in the current recession. I examine the national and local histories of decentralization and devolution, and how those processes facilitated the growing dependence of cities on state politics. I then describe how the specific relationship between each of my cases and their states' politics has affected the cities' experience with recession. I focus on several strategies used by states to exert power over the policies of cities in fiscal stress, and how those policies have expanded to encompass state oversight in times of normalcy. In the conclusion, I summarize these arguments, demonstrating that the dominant policy responses to urban fiscal crisis were constructed by relying on a very limited repertoire of alternatives that circulated during this period of the necessary approach to dealing with crisis.

## **Contributions**

By examining the narratives of urban fiscal crisis in multiple sites, this project explores the political conflicts at stake in how fiscal crisis is framed. There is perhaps no more important question for democracy than how the government raises and spends money, which makes the locus of fiscal decision-making, and the narrowing of political debate around city budgeting, a vital political question. What does it mean for urban democracy if cities are no longer able to control their own budgets and finances? How should we frame the implications of the inability of cities to provide services that were considered basic less than a generation ago? By framing the relationship between city budgets and radical political shifts in urban policy, I demonstrate that Detroit represents a dire warning not for cities to pay closer attention to their finances (as the headlines proclaim), but for citizens to pay closer attention to their government, broadly conceived. The notion of crisis is often used to bolster claims for the necessity of radical change, of wholesale experimentation, of demolishing what came before (Klein 2008). In his study of 2001 New York City, Brash asks "what does the idea of fiscal crisis do, and what does it do now?" (Brash 2003, 61). These are questions that both scholars and citizens should be asking.

This dissertation also makes the case for the budget as an important but under-researched site of study for urban scholars. Studying city budgets has been largely left to

political scientists, who tend to examine discrete processes of political negotiation and isolate the budget process from broader forces. This project makes clear that budgets, in fact, both reflect and shape shared ideas about the scope of urban governance, including the divide between public and private, the obligations cities have to their residents, and the role of finance in policy decisions. By treating the budget as a pivotal site for policy circulation, I demonstrate the fertile terrain of city budgets for studying broad shifts in what cities do, which should be a central question for all urbanists.

The importance of budgeting and taxation to the maintenance of democracy bears restating. In budding democracies, public input and control over budgets is a central focus of initial reform. The circulation of participatory budgeting over the past several years suggests both the centrality of the idea of budgets as fundamental to democracy, and the significant challenge of maintaining that relationship (Baiocchi and Lerner 2007). In many U.S. cities, at the same time that key aspects of city governance are removed from democratic control, there have emerged new channels of public participation in the budget process: such as participatory budgeting, efforts by cities to involve the public in budget hearings (“town halls”), and the release of government financial data for public consumption. We must not confuse these efforts at “transparency” with true democracy; this project focuses on the erosion of urban fiscal autonomy at the hands of ratings agencies and state governments, with dire results for workers and residents.

Finally, this project is framed by the national context of deep tensions over U.S. fiscal policy, national and urban income inequality (higher than anytime but the years immediately preceding the 1929 crash), and an economic recovery that is historically anomalous in its disproportionate benefiting of the top ten percent of earners (Piketty 2014; Noah 2010). The early 1930s in the U.S. also saw a great reworking of the relationship between government and the public, forged by political resistance and labor organizing. As Anderson (2013) editorialized in the *Los Angeles Times*, we are now at a moment where the public must examine our expectations for the basic goods and services we expect cities to provide, because ultimately that is the battle being fought, in Detroit and elsewhere (Anderson 2013). Today, in a climate of federal legislative inaction, cities have been the primary sites of policy responses to inequality, through minimum wages, public preschool, immigration havens, and housing support, while states have moved political to the right. The fiscal autonomy of cities is thus a vital question for the country’s political and economic future.

Widespread changes in technologies of governance (particularly those that emphasize technical expertise) alter, in fundamental ways, the ability of certain interests and voices to affect urban policy (Rose and Miller 2010). We must be attentive to the landscape of political possibility being shaped by the current crisis.

## CHAPTER 1: Narrating Urban Fiscal Crisis

While neoliberal capitalism promotes a collective social amnesia, an important task of counter-hegemonic, insurgent planning is to stimulate historical collective memories and historicize the problems arising from the actions and inactions of authorities. (Miraftab 2009, 45)

What does the idea of fiscal crisis do, and what does it do now? (Brash 2003, 62)

I have proposed in this dissertation that fiscal crises (like all crises) are key conjunctural and constructed moments of remaking urban governance. Urban fiscal crisis is not a discrete event, but a construction that emerges from a dominant narrative that is reproduced and taken for granted, while both its construction and its particularity are ignored. Brash, above, refers to fiscal crisis as an “idea,” one with the power to shape policy and thereby produce material changes in cities. The framing of crisis narratives and policy solutions is key to understanding that remaking. Histories of fiscal crisis are both deeply informative and influential in subsequent crises. A great deal depends on which histories are told, and how they are placed in temporal, social, economic and political contexts, and compared to current events. Stories of past crises can also change over time and be deployed in different ways in later iterations of crisis; they are always told in relation to other stories: cities are compared to other cities and other times. The narrative of fiscal crisis is not constructed the same way every time and in every place, and does not perform the same policies.

In this chapter, I connect the construction and narration of historical and contemporary urban fiscal crises in an effort to answer two questions: First, what are the central “lessons” of historical crises that are carried into, or contrasted with, contemporary episodes of fiscal crisis? Second, how are crises explained? Where is responsibility for the production of crisis situated?

### 1.1 Histories of fiscal crisis

This chapter treats the “history of the evocation of crisis itself” as a matter of central importance (Brash 2003, 62). While there have also been isolated incidents of crisis, there are three main periods in which urban fiscal crisis has been described as widespread, generating both public and academic attention: the 1930s, the 1970s, and the late 1980s-early 1990s.

### *The 1930s*

Fuchs argues that the Great Depression provoked a pivotal period for city fiscal policy, shaping expectations for the services cities would provide, the expansion of “professional” city government, and several transformations in intergovernmental fiscal relations. The federal government took a more active role in city services, thanks to mayoral lobbying for relief in an era of widespread fiscal crises. Cities’ dependency on state governments for legal fiscal authority also took central importance, as cities found themselves constrained in their options for recovery (particularly as relates to the property tax)(Fuchs 1992, 5). Cities at that time were not, largely, providing significant social services; in fact, the Great Depression provoked a significant expansion at all levels of government into service provision. The creation of food assistance, jobs programs, and an expansive welfare state associated with the 1930s occurred alongside what Fuchs calls the depoliticization of the budget process in many cities, as well as local retrenchment in many cities (Fuchs 1992). This “rationalization” of city budgeting, however, occurred in the context of political support for public taxation and spending to stimulate the economy and create employment, and was accompanied by the regulation of financial markets and actors, in significant contrast to today, when early calls for financial regulation disappeared into a maze of abandoned and weakened policies. Widespread municipal crisis during the Great Depression led to several reforms in municipal financing and municipal debt in particular (see e.g. Chapter 3 in Monkkonen 1995; Sbragia 1996).

### *The 1960s and 1970s*

After the long period of national prosperity following World War II, the 1960s were a time of “urban crisis” and national reckoning with the increasingly visible problems of urban poverty, racial discrimination, and demands by urban residents for services and political representation. Beginning in the 1950s, the flight of the affluent outside city boundaries had left cities with decreasing revenue and growing economic need. Even where cities retained most of the jobs, the people who worked there left the city boundaries at night, taking their money (their property taxes) with them. People with resources moved to suburban areas, where they would only be paying for the goods and services they would use themselves (see Tiebout 1956). Residents willing and able to pay more for safety, green space, and easier roads left for the suburbs, instead of paying for services they wouldn’t use: public housing, welfare, public defenders, food stamps, and Medicaid (Swartz and Bonello 1993, 5–6). Cities now couldn’t afford to pay for such “luxury” items as parks, zoos, libraries, gifted education, summer recreation and crafts, golf courses, swimming pools, instead devoting their dwindling revenues to the urban safety net (Swartz and Bonello 1993, 6). Those left behind either lacked the resources to move or who were legally proscribed from living in suburbs by racial exclusion laws. The political and economic consequences of these dynamics for central cities and their residents are well-described in Sugrue’s study of Detroit, but the pattern repeated itself across the country (Sugrue 2005).

As urban problems increased, so did pressure on the federal government to address vast inequalities within and between cities. The War on Poverty created a vast

infrastructure of urban interventions managed by the federal government; the federal government also found itself at odds with many state governments in addressing racial inequities. The consequences of white flight—and the loss of capital—for cities was becoming apparent. While the 1960s have been described (in particular by conservative assessments of New York City’s fiscal crises) as a time of government expanding and overspending in response to demand for social programs, in fact residents were claiming benefits that had long been accrued to the middle-class, upper-class and white residents: infrastructure, housing, decent education, and a safety net. The federal government stepped in to address these mounting fiscal inequalities by using federal revenues to significantly expand the urban safety net, in particular housing, community development, education funding, and support for city governments through General Revenue Sharing (Swartz and Bonello 1993).

But in the 1970s, the federal government’s policy shifted, as an era of “competitive federalism” took hold (Swartz and Bonello 1993; see also T. N. Clark and Ferguson 1983). A global recession, combined with the withdrawal of federal funding, led to a period of sustained fiscal crisis. Hill (1977) calls the mid-1970s an era of fiscal crisis rivaling the Great Depression (Hill 1977, 76). In 1975, New York City almost declared bankruptcy, becoming the cover story for the woes of large central cities in the 1970s, much as Detroit serves as a symbol of urban fiscal crisis today.

### *New York City, 1975*

New York City first began to experience fiscal trouble in the 1960s, but crisis officially erupted in 1975 when the banks that had provided short-term loans to cover intermittent shortfalls refused to issue any more short-term debt, and the city was forced to enter into a recovery plan to avoid default. New York City’s near-bankruptcy in 1975 is often viewed as a pivotal moment in U.S. urban history, a defining case of fiscal crisis that continues to shape municipal policy and discourse (see e.g. Brash 2003). Many narrative elements from 1975 New York echo in the discourse around Detroit’s bankruptcy (and “experts” from New York’s recovery have been invited to speak to Detroit officials and residents about the benefits of state receivership). New York, like Detroit, also plays a particular role in the American imagination of urban life, city government, and race.

There is a vast literature devoted to the causes and implications of New York’s 1975 crisis; I highlight two divergent perspectives here to illustrate the debate. Ken Auletta’s *The Streets Were Paved with Gold* represents the conservative argument. He attributes New York’s troubles to a local inability to make good decisions, to face facts, to stare down the demands for spending, to acknowledge the “plague” of poverty and decline eating the glittering city from within (Auletta 1979, 8). The city’s economy, he argues, was being eaten away by globalization and the mobility of capital and a misguided “politically popular and compassionate effort to care for the less fortunate by taxing the more fortunate” (Auletta 1979, 30). He quotes Robert Wagner, the city’s Mayor, in 1965: “I do not propose to permit our fiscal problems to set the limits of our commitments to meet the essential needs of the

people of the city,” as embodying the sentiment behind an “explosion” of spending on both unions and the poor, with middle-class residents leaving as fast as they could (because the jobs were leaving, or because they weren’t getting the share of spending to which they were accustomed) (Auletta 1979, 30–31). Spending grew at first because of state and federal aid subsidizing the growth of anti-poverty programs. But when that aid was reduced, the city couldn’t shrink its own spending accordingly. Sometimes the services were still required by law, but more importantly, “powerful new constituents were loose,” making it politically difficult to cut programs (Auletta 1979, 36).

William Tabb’s *The Long Default* articulates an alternative explanation to blaming the welfare state and its constituents. He further argues that a focus on the fiscal elements of crisis distracts from more complex political causes, in particular the failure of government, broadly speaking, to deal with the social costs of private decisions, of corporate relocations and suburbanization that left central cities sorely deprived of the resources needed to serve the population left behind (Tabb 1982). He takes a political economy approach to emphasize the political struggle at the heart of New York’s near-bankruptcy, in opposition to those who frame retrenchment as historically inevitable (Tabb 1982, 4–5).

The cynical distortions of the powerful have been accepted by the media, and have affected the very language in which the crisis is discussed. To tell the story differently means moving beyond the way the issues have been presented in the media and congressional debate. (Tabb 1982, 5)

Both authors argue that the city represents a symbolic and a literal central place, that the implications of New York’s crisis had national or even global consequences. The “urban crises” of the 1960s and 1970s, in particular New York City, served to galvanize conservative attacks on liberalism and the great society project (A. O’Connor 2008).<sup>8</sup> Despite the rocky path to recovery, the approach taken to resolve New York’s crisis is treated in hindsight as a great success, producing what Freeman refers to as a “post-fiscal crisis consensus” (Freeman 2000). In his discussion of the post-2001 crisis in New York, Brash argues that the 1970s specter is evoked as an “ideological prop” for a particular set of policies (Brash 2003, 62). After the 1970s, the idea that a city must balance its budget was written into most state laws, and became a “naturalized legal fact” (Brash 2003, 78).

### *The 1980s and 1990s*

Cities emerged from the severe crises of the 1970s in very different ways. Deindustrialization and decentralization continued to take a toll particularly on the economic and fiscal resources of larger cities in the Midwest and Northeast, while cities in the “Sunbelt” added population and business. By the 1980s the full effects of the shift in

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<sup>8</sup> New York was just one of many cities embroiled in fiscal crisis in the 1970s. In 1978, a standoff developed in Cleveland between banks and the Mayor (Dennis Kucinich) over his resistance to privatizing the city-owned power company caused the city to go into defaults (Glasberg 1989).



federal policy were being felt by cities and states; especially when Ronald Reagan ended federal revenue sharing in 1986. States tried to make up some of the difference (see Swartz and Bonello 1993, 9), but their ability to do so was limited, and state aid began to fall sharply in the early 1980s. This period led to an explosion of literature on retrenchment, in political science, public administration, and planning that makes up the better part of the articles cited in this chapter.

There was less attention paid to city fiscal crisis in the early 1990s, even though cities were still suffering from the severe cuts made in the 1970s and 1980s and their fiscal situations were continuing to deteriorate, in part because of the reductions in state and federal aid and their failure to cut spending deeply enough (Bahl, Martinez-Vazquez, and Sjoquist 1992).<sup>9</sup> As national economic growth took off in the 1990s, there was much less discussion of cutbacks, although a few cases of isolated fiscal stress happened through the decade.<sup>10</sup> Throughout the 1990s, the restructuring of federal welfare spending and urban programs (such as public housing) significantly shaped urban policy.

### *Post-2000*

The beginning of the 21st century brought the 2001 and 2002 financial market declines, and the first recession after the longest economic expansion in U.S. history. Many cities began to see declining revenues and property values, bringing some media and policy attention back to the issue of fiscal strain and economic downturns, but little significant academic attention.<sup>11</sup> The escalation of home values from 2002 to about 2007 in most urban areas kept property taxes growing, although other economic indicators showed a weak post-2001 recovery. The true “urban crisis” of the post-1990s era is one of ongoing evisceration of the elements of city spending that aren’t associated with public safety or economic development (Peck 2012; Leitner, Peck, and Sheppard 2007; Hackworth 2007). Even periods of relative fiscal stability this century have been characterized by ongoing retrenchment of social services, human investment, and basic infrastructure.

## **1.2 Analyzing fiscal crisis**

There are three main approaches to the study of these phases of urban fiscal crisis. The first is a body of literature that seeks to predict and/or measure crises, through the development of indicators of crisis that construct *de facto* definitions of crisis intended to facilitate prediction of cities that avert or succumb to crisis. The second category examines

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<sup>9</sup> In the early 1990s, Philadelphia was forced into a state takeover when banks refused to provide loans for immediate expenses; Los Angeles neared insolvency in both 1991 and 1992.

<sup>10</sup> Orange County filed for bankruptcy in 1994 (also consistently underpaying pensions, under the veneer of lean, conservative governance, in reality supported by debt). Miami 1996, a federal corruption probe revealed a budget shortfall, a state oversight board was set up (Erie 2011).

<sup>11</sup> For exceptions see Brash on New York, describing the significant crisis in that city (Brash 2003), and Erie’s study of San Diego’s fiscal troubles in 2003, after years of tax cuts and risky pension strategies (Erie 2011).

explanations for fiscal crisis: what factors contribute to crisis, and why do some cities avoid it? The third category is evaluations of city responses to fiscal stress, in particular studies of retrenchment; I discuss this literature in Chapter 3.

Most studies of urban fiscal crisis take a limited approach to the complex politics at the heart of city finances. The most-cited texts from the crises of the 1980s and 1990s focus primarily on the budget itself, often ignoring the broader scope of urban finances, such as debt issuances and public-private partnerships. The domination of the study of fiscal crisis by political scientists has also led to an emphasis on quantitative modeling approaches, or explorations of political preferences, relying on “snapshot” views of fiscal politics that enable static analysis, treating “fiscal crisis” as a dependent variable, whose likelihood can be determined as a matter of statistics, not politics.

### *Explanations of crisis*

Any narrative of crisis is characterized by debates over its primary causes; how those causes are framed inevitably limits the range of possible solutions. In 1981, Marcuse argued that there is an “organic explanation” of urban fiscal crisis that paints it as an inevitable consequence of modernization (particularly in transportation), changes in the location of economic activity and population, antiquated central city infrastructure, government inefficiency (or corruption), and taxpayer resistance (Marcuse 1981). By “organic,” Marcuse means both that the explanation describes crisis as emerging naturally from a set of phenomena that are themselves inevitable (deindustrialization, political opinion trends, technology, etc.), and that the explanation situates itself as the only explanation. The organic explanation goes as follows: “natural economic growth and development lead to locational, economic and population changes which impose costs on local governments; taxpayers being unwilling to pay for those costs, the quality of public sector-financed activities suffers, and those are inevitably hurt most who depend on the public sector most” (Marcuse 1981, 333). But, he argues, the “urban fiscal crisis,” a term coined and then deployed to push a specific policy agenda, in fact results from government policy; it is not an inevitable result of the trends used to explain it.

Like Marcuse, I argue that the organic explanation of crisis misses the role of government, and of policies, in creating crisis, with significant implications for policy. While it may seem obvious, the role of particular policies in creating crisis—tax policies that undercut the public sector, economic development programs that redirect public resources to supporting private profits and fuel decentralization, and the lack of any national fiscal coordination—have not been articulated as subjects for restructuring, despite the political opening created by public animosity toward financial capital after the 2008 market collapse. Meanwhile, the political right (embodied in the form of Reagan as Marcuse was writing) seeks to “manage” the crisis, rather than resolve it, because crisis itself serves as a useful means for achieving several ideological goals: passing the costs of the crisis to the most vulnerable, reducing the size of government, holding down wages, using government

funds for private business expenses, and diminishing the political power of central cities (Marcuse 1981).

Understanding why certain explanations come to hold sway and remain in the forefront of crisis narratives (and eventually becoming common sense), helps us understand why alternative explanations have not emerged. In today's narratives of crisis, many of the same ideas that circulated in the 1970s are mentioned (and treated as a given): the overreach of government, the inability of government to achieve the necessary efficiency in a time of resource scarcity, the need for public innovation that emulates the private sector, economic restructuring, and the excessive power of unions. I turn now to those explanations, and will then compare them to the most salient explanations being put forth during today's crises.

### *Over-spending*

The most simplistic explanation for fiscal crisis is over-spending. Throughout the crises of the 1960s and 1970s, discussions of crisis usually focused on particular types of spending: services that could be dismissed as discretionary. In 1975 New York, the focus on overspending was on the so-called welfare state (see e.g. Auletta 1979). Fuchs' examination of 1975 New York contradicts the common argument that the crisis was driven by over-spending on redistributive functions; she shows that in fact spending on welfare was primarily driven by federal grants, not the city's own money (Fuchs 1992, 143). But she does show that New York had a disproportionate burden of functional responsibilities: the was spending up to 73% on non-common functions, her name for services that not all cities provide (anything beyond public safety and utilities) (Fuchs 1992, 144). She argues that the city was fiscally burdened by an "extraordinary number of deficit-producing services," i.e. services that did not pay for themselves through fees (Fuchs 1992, 7). The right was quick to blame spending on social programs for the crisis, acknowledging that social-economic circumstances played a part (national recession combined with the flight of middle-class residents), but also using the opportunity to argue that cities simply couldn't afford such programs (A. O'Connor 2008; Peck 2006). Bahl and Duncombe, studying why New York state and its cities returned to crisis in the late 1980s, despite economic growth for almost a decade, argued that public employee payment, services for the poor, and lack of expenditure control (especially for Northeastern cities) led to crisis (Bahl and Duncombe 1992).

The second component of blaming crisis on over-spending is examinations of the ability of city governments (i.e. those responsible for the budget) to cut spending in times of fiscal strain and lowered revenues (what is often referred to as making "tough decisions"). These studies focus on the political dynamics within a city and test hypotheses about what type of political systems are best able to make necessary cuts. In Fuchs comparison of Chicago and New York, concludes that Chicago averted fiscal crisis because its political machine was better able to resist demands for spending by constituents (Fuchs 1992). Other authors emphasize politicians' efforts to avoid turmoil: Dunstan argues that

deficit spending began in 1960s as the power of unions and the threat of “ghetto riots” prevented the cutting of social expenses (Dunstan 1995). Shefter (1977) argues that political changes (e.g. the need to shore up support in minority communities) in the 1960s led to demands on expenditures, and the inability of politicians to refuse to increase spending in the face of capital flight and demographic change (Shefter 1977). Shefter also proposes that the ability of governments to cut spending in order to avoid default constitute the basis of creditors’ willingness to finance municipal debt (Shefter 1992).

Cutting spending is nearly always an element of the policy response to fiscal crisis (see Chapter 3), but the nature of how spending is framed as a problem shapes what gets cut. Some forms of spending—often that geared toward attracting or supporting private business—is rarely framed as discretionary or excessive. (Indeed, many forms of economic development spending are “off-budget”, taking the form of tax breaks and forgone revenue, through lowered tax rates; these forms of subsidy are difficult to frame publicly as “spending”). So-called “discretionary” spending usually means (as Fuchs describes) spending that other cities don’t provide, or that most cities don’t provide. This continual reference to what cities “should” spend money on generates intra-urban references that in turn facilitate widespread changes in city spending (it is one of the original circulating policies, outlined in part by both Tiebout and by work on the entrepreneurial city). Even a city not in crisis will reference the abandonment of public health funding by other cities as it becomes reframed as “discretionary” in the process of crisis-driven debates. When authors talk about the potential for expenditure control, and the limits of spending discretion, they often focus on the fixed commitments of pensions, entitlements, but not economic development spending (Bahl and Duncombe 1992). See for example Pecorella and Hill, emphasizing that city expenses to facilitate capital accumulation on behalf of the private sector had increased along with the costs of redistribution, i.e. of responding to “nonelite” claims and mitigating the effects of capitalism, particularly after deindustrialization and the reduction in federal aid (Hill 1977; Pecorella 1984).

### *Economic restructuring*

Fiscal crisis has also been attributed to the consequences of national and global economic restructuring. The mid-1970s discourse around fiscal crisis centered on the hollowing out of central cities around the U.S.— particularly the “Rustbelt” of the Midwest and Northeast—as jobs and workers moved to the suburbs. Conservative articulations of this explanation focused on the rapid influx of immigrants and “blacks” (Shefter 1977, 98), who demanded social services (or public jobs), but were excluded from stable job opportunities. As the 1970s national recession wore on, bringing widespread unemployment and inflation, tension mounted between the desire to provide benefits for unemployed and the decreased willingness or ability of residents to pay for such benefits (Shefter 1992). Clark and Walter found that fiscal strain was correlated with falling median family income and declining affluence (C. Clark and Walter 1991). Socio-economic changes that began in the 1980s were found to be not conducive to fiscal stability (see e.g. Bahl and

Duncombe 1992). Deindustrialization and decentralization of economic activity were a central part of the literature on urban fiscal crisis throughout the 1970s and 1980s.

As city budget troubles crept into the 1980s and 1990s, many argued that economic restructuring had made it difficult for cities to capture revenues from certain sectors, especially services and growth in capital income, even as the economy improved. State and local tax systems rely on bricks and mortar—property and traditional sales taxes on goods—while online sales and services, which fuel economic growth in many areas, go untaxed. Today, the return of capital and personal wealth to central cities (with some exceptions) makes it unclear how the 1980s version of urban fiscal crisis applies today. Friedland argued in 1977 that most studies ignore the varied conditions under which urban fiscal crisis has become widespread: “American cities have experienced fiscal strains at earlier historical junctures, at periods when capital was concentrating in the cities, not deserting them” (Friedland, Piven, and Alford 1977, 448). But the idea that economic restructuring necessitates a new approach to municipal finance retains significant narrative power (R. L. Florida 2009). The repeated implication that “there is no alternative,” the infamous echo of neoliberalism, has always relied on a narrative of economic transformation necessitating change (Peck 2010).

An alternative view argues that it is not *restructuring* that causes crisis but the inherent structure of the current economic system; that the changes described above are superficial ones, and that fiscal precarity inheres in the capitalist form. Hill and O’Connor argue that the 1960s and 1970s represented intensified class struggle, generated by the contradictions within capitalism (Hill 1977; J. O’Connor 1973). Hill also argues that fiscal crisis continued throughout the prosperity of post-World War II, despite the absence of public attention, as cities took on more debt and began to run deficits that reflect “a basic structural contradiction in the US political economy” (Hill 1977, 77). This contradiction derives from the role of urbanization in stabilizing capital by providing the means of accumulation (see also Castells 1977). Uneven economic development is not an unfortunate byproduct but a central feature of market capitalism; the city must not only facilitate capital accumulation but also mitigate the contradictions that ensue from relentless profit-seeking (Hill 1977, 80). As the poor move to central cities, cities are increasingly pressured to provide services or risk a legitimacy crisis (Hill 1977, 81). (This same idea that city spending grew because of demands for social welfare is of course also adopted by the right (see e.g. Auletta 1979). The federal system itself has facilitated local fiscal crisis through local fragmentation and the “imbalance” of revenue raising power and expenditure demands at the city level (Hill 1977, 82–83). This system also generates uneven fiscal development among cities, as certain services and expenditures spill over borders while others don’t. The constraints on city finances imposed by state governments further add to the contractions and political problems of cities.

## *Union power*

A third often-cited cause of fiscal crisis is the purported power of public employee unions, which are frequently described as both an obstacle to retrenchment and as driving excess spending by demanding high wages. Despite the newspapers' and conservatives' focus on municipal unions and their ability to demand high wages and benefits, using the threat of labor unrest to prevent spending cuts, several studies concluded that union strength neither determines fiscal strain (T. N. Clark and Ferguson 1983), nor does it constitute one of the primary causes of most cities' fiscal problems (Fuchs 1992). Today's fiscal crisis is also often blamed on unions, specifically their pension plans. Unions are an even easier political target today than they were in the mid-1970s, when union resistance to cutbacks in New York, along with their investment assets, gave union leaders power and access in the ensuing retrenchment decisions.

In the 1975 New York crisis, public employee unions played a central role in the city's recovery, both by negotiating wage freezes and layoffs, and by investing employee pension funds in large amounts of the NYC/MAC bonds issued by the city. Shefter and Weikart both detail the relationship between unions and banks that enabled the deepest consequences of retrenchment to be focused on social services rather than public employees (Shefter 1992; Weikart 2009). In his summary of that era, Shefter argues that if a city in crisis did not need similar support from unions, it would be politically possible to eviscerate them, particularly the "non-uniformed" workers (everyone but police officers and fire fighters).<sup>12</sup>

Detroit's role in this blame-shifting to unions has a particular symbolic power. Detroit has long been synonymous with the power of labor unions, the birth of the militant labor movement, the role of anti-unionism in driving industry from the Midwest to the Sunbelt, and the blame levied at private sector unions for the decline of American manufacturing (Sugrue 2005; Georgakas 1998). Detroit's public sector unions are now, like all public sector workers, being heaped with blame for the current fiscal crisis (Allegretto, Jacobs, and Lucia 2011). The simmering sentiment by white Michiganders that Detroit's troubles are linked to its history of Black governance (articulated daily by commentators on the *Detroit Free Press* website), and the long role of public employment as a refuge for Black workers discriminated against by private employers, makes the combination of racial and labor politics a volatile one. After a failed November 2012 ballot initiative that would have eliminated public unions, the Michigan legislature passed a right to work law, a stunning blow to Michigan workers, and evidence of the Governor's confidence in his ability to successfully blame unions (and workers in general) for the state's economic problems (The Economist 2012).

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<sup>12</sup> In the case of Detroit, this has proved to be an astute prediction.

## *Financial “Gimmicks”*

Finally, both public and academic explanations for urban fiscal crisis focus on what are colloquially called financial “gimmicks.” A recurring fixation on financial mismanagement threads throughout the literature on fiscal crisis, often centering on claims that politicians suppress the “truth” about a city’s fiscal situation, or that they push the problem down the road by using techniques that mask budget deficits. In New York’s crisis, politicians were accused of overestimating revenue forecasts and issuing revenue anticipation notes to cover short-term inability to pay (Fuchs 1992). New York was particularly excoriated for its use of short-term loans to cover its “chronic” and growing deficits for more than ten years (Shefter 1992). The idea of fiscal mismanagement drove the central feature of New York’s recovery program: the removal of the city’s control over its own budget, an annual balanced budget requirement, the emphasis on fiscal professionalism, and the installation of state and private sector oversight. The same language used to condemn New York’s fiscal management in 1975 recurs throughout the 40 years since,<sup>13</sup> and has been used to undergird the growing number of state policies for monitoring and intervening in municipal finance (see Chapter 5).

Accusations of gimmickry and obfuscation by city officials trying to manage mounting deficits persist during the current recession; the narrative of Detroit’s crisis centers on the lack of transparency and reporting endemic to the city (see Chapter 1). What constitutes a “financial gimmick” remains a floating and malleable concept, and strategies regularly used by cities (and even encouraged by financial markets) may be reframed as irresponsible in retrospect. Cities rely on short-term debt to enable them to pay operating expenses, as revenues come in lumps (property taxes are paid once a year, for example). Cities are also under pressure to engage in entrepreneurial and sometimes innovative financial arrangements (such as lease-backs of public infrastructure) in order to free up revenue streams. When these strategies prove to have fiscal consequences, cities are blamed. Kirkpatrick and Smith argue that U.S. cities are now characterized by structural fiscal crisis and extreme capital-market volatility, threatening many of them with a showdown between “municipal bondholders and municipal employees,” a showdown that has now materialized in several California cities. They link this development to neoliberalism’s rescaling, and to the explosion of “back-door’ debt instruments and hybrid municipal entities,” that divorce the interests of bondholders from the city itself (Kirkpatrick and Smith 2011). This framing of cities as financial actors, subject to the same standards of reporting, accounting, and risk as private actors, will show up throughout this dissertation.

The dominant framings of New York’s 1975 crisis, reflected in the language of state and federal politicians as well as the mainstream press, blamed over-spending, too-powerful unions, and an ambitious social welfare agenda, as well as the structural forces affecting many Eastern U.S. cities: national recession, suburbanization of people and business, unemployment, and inner city poverty. There is a different mix of interest groups

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<sup>13</sup> For example, in January 1995 S&P accused NYC of using “one-shot gimmicks” to cure financial problems and threatened to downgrade the city’s debt, mayor trying to balance budget.

today than there was in the 1970s. The public employee unions that were blamed so heavily for New York City's crisis have lost significant power, in every city, by any measure. Urban social welfare programs that were still taken for granted in the 1970s are now largely decimated. Financial actors have gained more power and more complex mechanisms have emerged for leveraging that power. City governments have less political power relative to both states and the federal government, even as capital has returned to the central city to a degree few envisioned in the 1980s.

### **1.3 Contemporary crisis narratives**

In each city there comes a moment when officials publicly describe the city as facing a crisis, and suggest that crisis can be averted only if specific steps are taken. That framing is accompanied by explanations and proposed responses to impending crisis; this chapter discusses those framings in four cities from 2007-2014. As I argue in the introduction, both crisis and austerity must be locally produced, which happens in part through reference to circulating explanations and narratives of crisis from other cities. That local production and referencing constitutes the common sense of urban fiscal crisis that this dissertation seeks to understand. In this chapter, I am interested in the emergence of fiscal crisis as described by local officials. In Chapters 2 and 3 I discuss the different manifestations of crisis in terms of revenue and spending, and how officials frame the possible policy responses to averting crisis.

As I describe in the introduction, fiscal crisis is not a discrete event with clear boundaries and characteristics, but rather a construct that is continually articulated and redefined. This chapter reviews the emergence of local crisis by asking: how do local political actors discursively construct crisis in narratives about their city? How are the causes of crisis framed / where is the responsibility for crisis located?

I want to identify the "taken-for-granted assumptions" shaping fiscal crisis is understood as a problem, thus narrowing universe of possible policy solutions (Wedel et al. 2005, 34). Those assumptions and solutions recur in very different cities, as officials look to other cities to reinforce their own narratives. This dissertation uses a comparative methodology because, I argue, the narratives that are used by local officials in one city cannot be treated as distinct from the narratives used in other city; nor can they simply be treated as local variations of a universal narrative.

The emergence of urban fiscal crisis in the U.S. reflects variations in local economies: differences in revenue structure, local housing markets, and capacity to weather revenue downturns (by drawing on reserves, issuing debt, or making other adjustments). Crisis emerged at different moments in different places, but with similar themes, in particular the explanations for crisis and the necessary nature of local response to crisis. This chapter describes the emergence of crisis in my four cases and then describes two common themes that emerge: (1) references to national and global crisis and future uncertainty, and (2) the "structural costs" of local governments, in particular public pension obligations. While the



unevenness of the impact of the recession is of great importance (and reveals things about the different relationships between cities and financial markets, the federal government, and other key elements of urban policies), for this dissertation I am primarily interested in how a common story emerges despite that variation; how explanations for crisis that emerge from widely differing circumstances then take on explanatory power reinforced by its emergence as “common sense.”

### *Emergence of a national urban fiscal crisis*

Although the U.S. recession officially lasted only from 2007 to 2009, American cities saw revenues decline revenues for six straight years, with the worst effects of the recession hitting only in 2012 (Pagano, Hoene, and McFarland 2012). Persistent unemployment, stagnant wages, and collapsing property values fueled budget shortages even as struggling residents relied on government support in growing numbers (Urahn and Pew American Cities Project 2012). While federal and state budgets have also been affected by falling tax revenues, many have convincingly argued that the U.S. federal system, decades of devolution, and the particular constraints on city fiscal policy, have meant that the politics of post-2007 austerity have been most deeply felt by cities and urban residents (see e.g. Gonzalez and Oosterlynck 2014; Peck 2012).

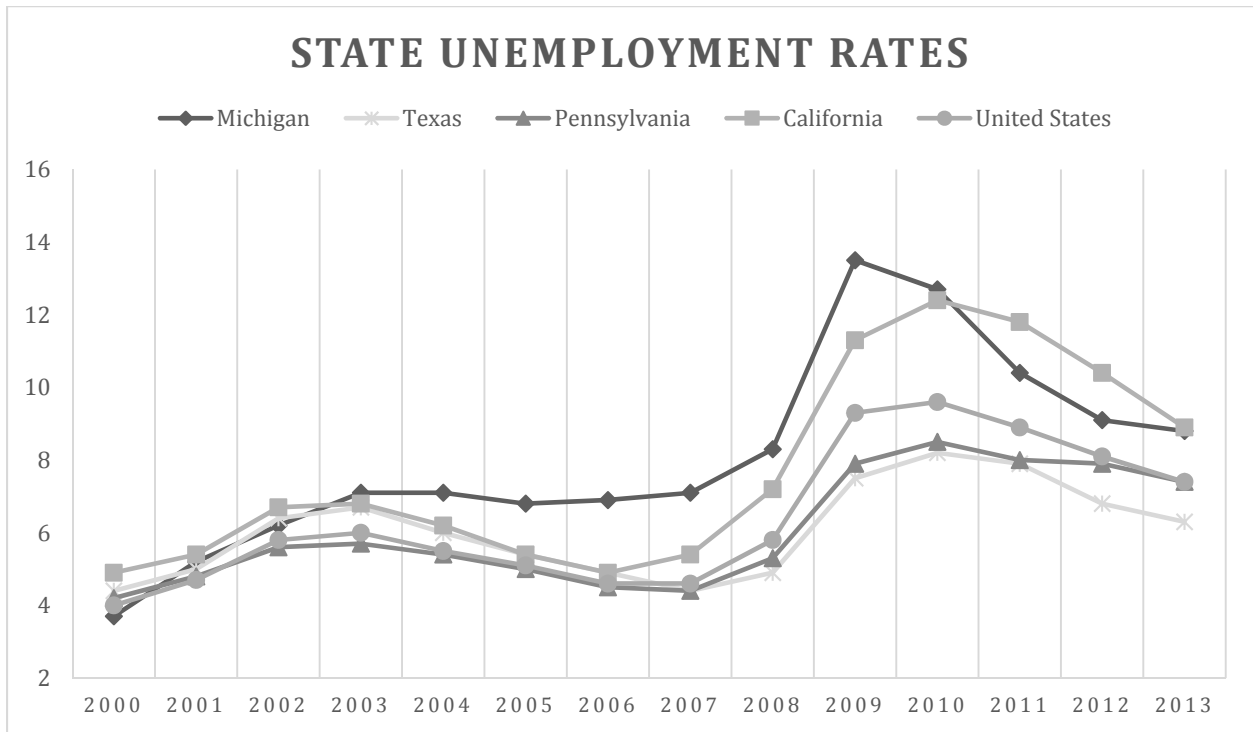
Most cities entered the fiscal year of 2008-09 with little ability—fiscal or political—to manage a recession, particularly one centered on the housing market. For many cities, this entire century has been a period of significant upheaval in their fiscal situation: after prosperity in the latter half of the 1990s (which itself followed fiscal crisis of the late 1980s and early 1990s), the early 2000s brought both a downturn and in many cities the culmination of significant tax cuts made during the period of economic optimism leading up to 2001. In many places (but not all), 2005-2006 was a time of regaining some of the ground lost in the early 2000s. That recovery, however tenuous, drove many cities to make fiscal policy decisions in anticipation of continued growth. That expectation of economic stability, as we now know, did not come to pass.

The concentration of the Great Recession in the U.S. housing market has been particularly devastating for cities. The largest source of local government revenues in the U.S. is property taxes (74% of all local taxes); 96% of all property taxes in 2009 were collected by local governments (U.S. Census Bureau 2012). U.S. housing prices began to fall in 2006-2007 (with significant local variation), eventually dropping as much as 50% in some states (Federal Housing Finance Agency 2014). This drop did not immediately impact property tax revenues (which are lagged to different degrees because of different assessment processes) but by 2009 cities were feeling the hit (FitchRatings 2012). Sales and income tax revenues—more economically sensitive revenue sources that primarily fund state governments—fell more quickly once the recession took hold, but also rebounded more quickly. The second largest source of city funding, state aid, fell by 6 percent from 2008-2012 (U.S. Census Bureau 2012). City government reserves declined by

25% from 2008-2012, leaving cities less able to weather future shocks and more vulnerable to ratings downgrades (Pagano, Hoene, and McFarland 2012).

National unemployment rose from 5.8% in 2008 to 9.3% in 2009, reached 9.6% in 2010, and was only down to 7.4% in 2013 (see Figure 2.1). State and metropolitan area unemployment rates uniformly peaked in 2009; by 2012 the had begun to fall everywhere, although not at the same pace or degree (see Figure 2.2). The recession officially ended in June 2009, but recovery has been weak. National unemployment is still nearly double the pre-2008 rate. Declining unemployment, particularly during and after a significant recession, is often critiqued as a measure of recovery, as people eventually drop from the unemployment statistics, or have to take part-time work and/or a significant cut in income. Underemployment and income stagnation has been particularly pronounced during the current recession (Leonhardt 2014). Household wealth and incomes are down to the levels before the 1990s boom, when adjusted for inflation.

Figure 1.2. State and national unemployment rates, 2000-2013



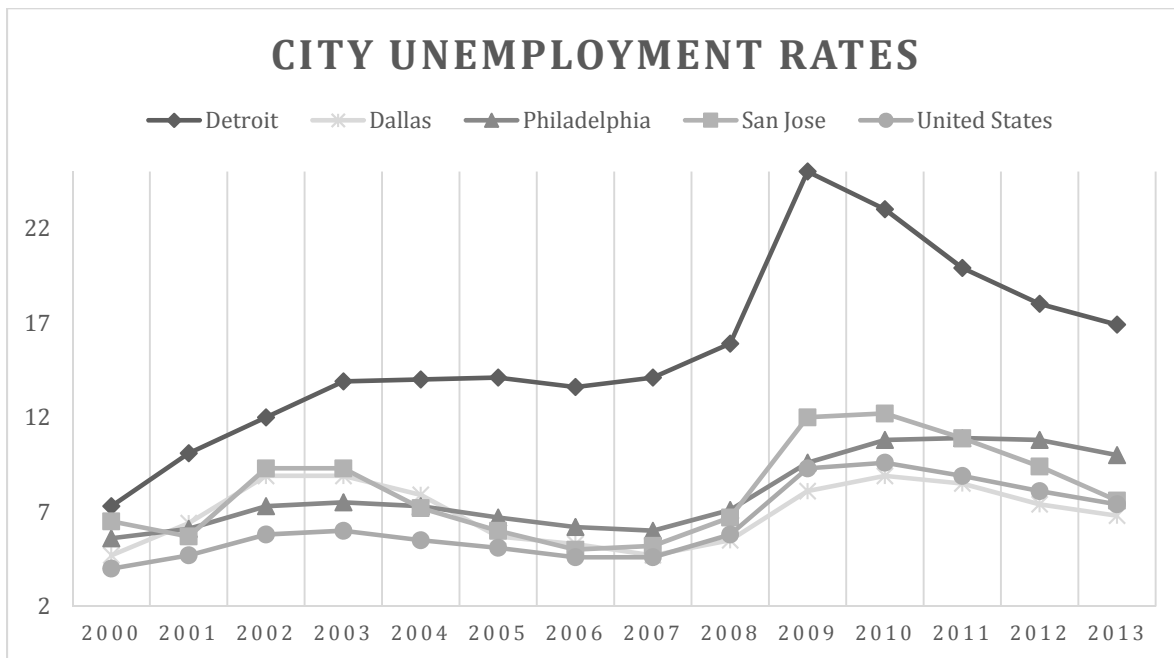
Source: BLS annual unemployment rate, 2000-2013

There is marked variation in how the recession affected state and local economies. State unemployment rates, which had not varied much in the early part of the century (Michigan began rising by 2003), diverged significantly by 2007, and continued to vary significantly from state to state through 2013. Pennsylvania and Texas hover below the national average, California and Michigan well above it. Regions and cities reflect even greater variation and volatility than states, particularly San Jose and Detroit areas.

Unemployment and the associated income loss threaten to federal and state revenues more directly than local revenues. Nearly all federal tax revenue is derived from personal or corporate incomes (46% individual income tax; 34% from payroll taxes)(Center on Budget and Policy Priorities 2015). States levy a more diverse mix of taxes, but nearly all rely heavily on income taxes and sales taxes. Falling or stagnant incomes also suppress consumption, causing sales taxes to drop, and increase the needs of residents: during times of high unemployment, demand for community services (public hospitals, senior services, etc.) grows. While the poverty rate has risen, the “near-poverty” rate has stayed steady, meaning that a larger percentage of people are hovering at or below the poverty line (Hokayem and Heggeness 2014).

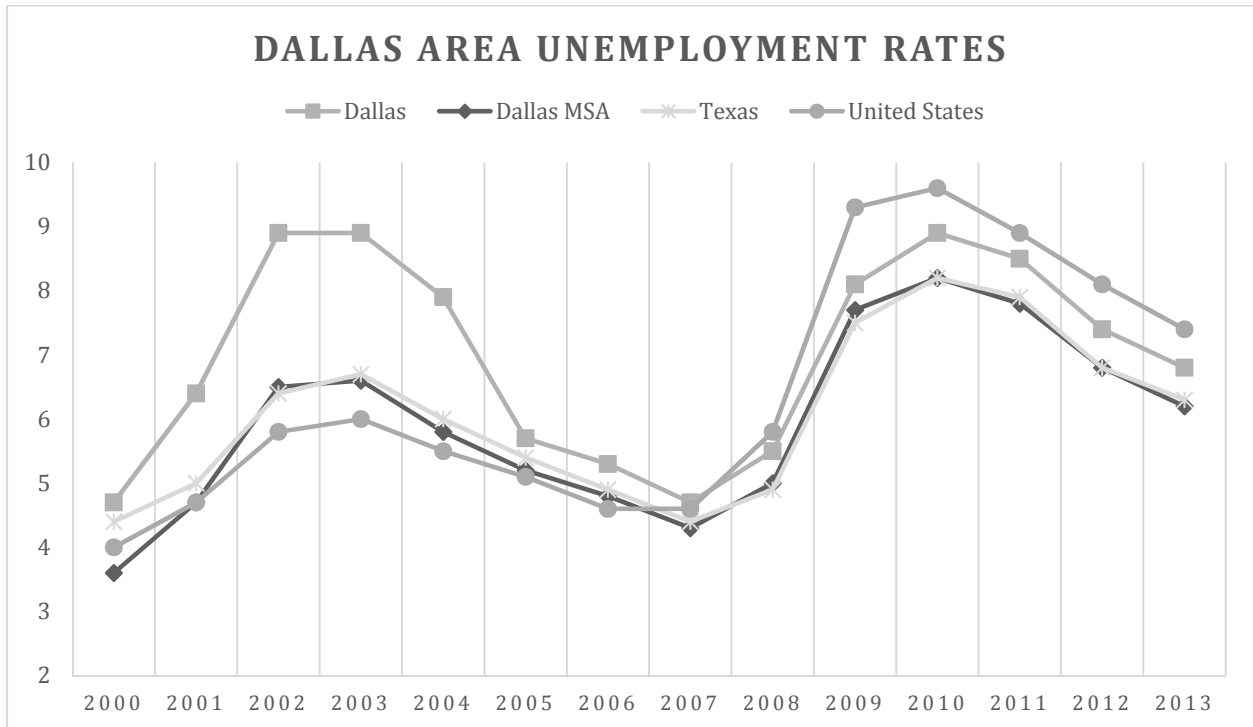
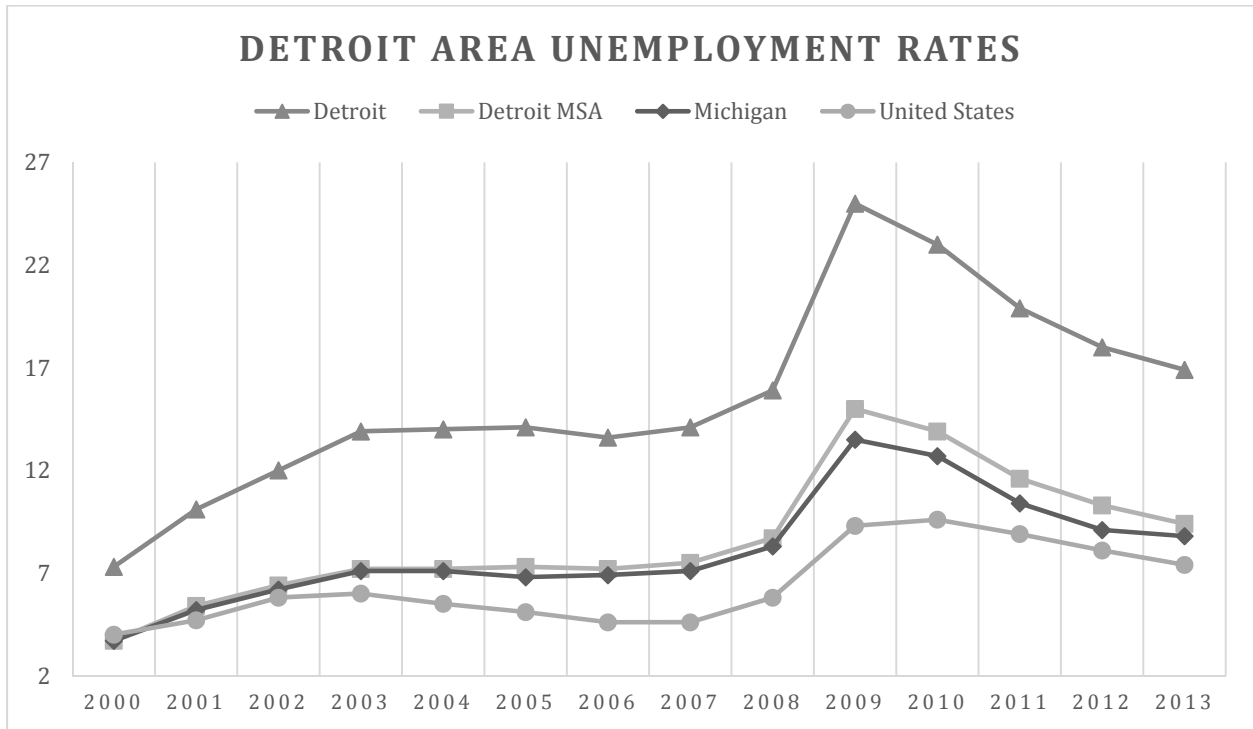
The effects and depth of the recession vary both within and between metropolitan areas. City unemployment in all four cases is higher than that of the wider metro area (see Figure 1.4). Only in San Jose does the city’s unemployment rate fall below the state’s, representing the depth of the recession in California. Thus, while central cities bear the costs of infrastructure and services associated with core cities, they also have a disproportionate share of residents needing public support, such as food stamps, unemployment assistance, and public healthcare.

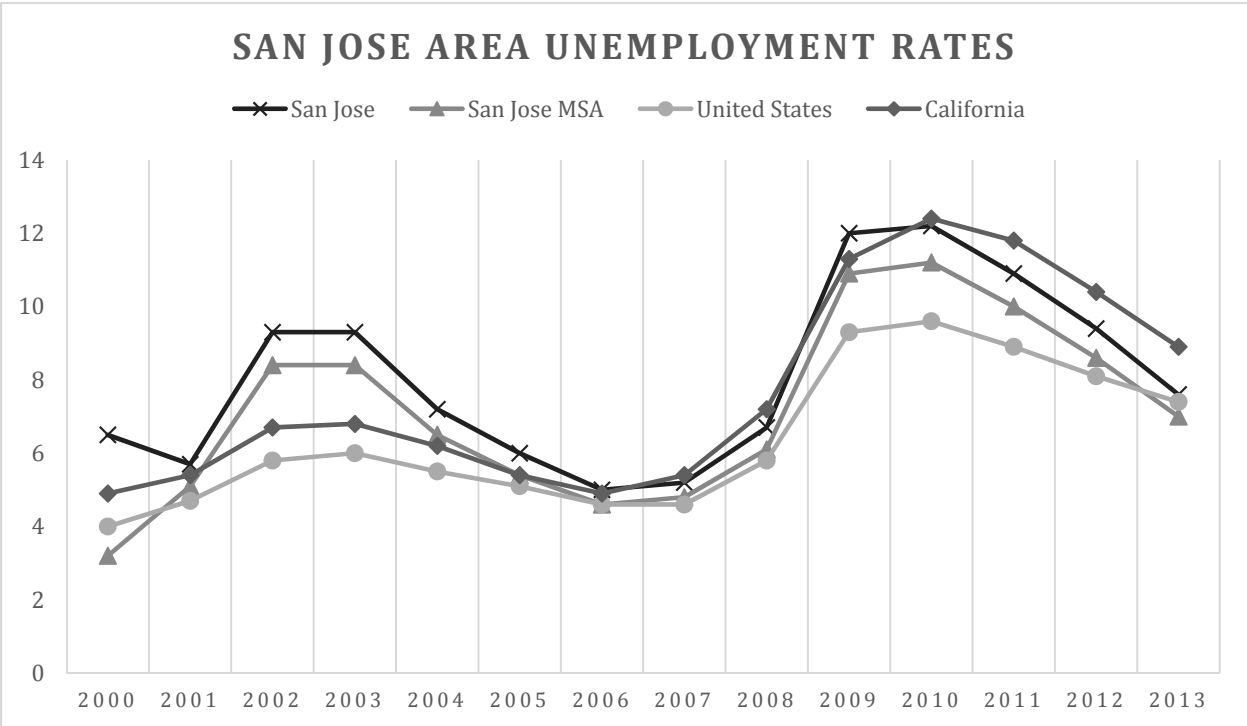
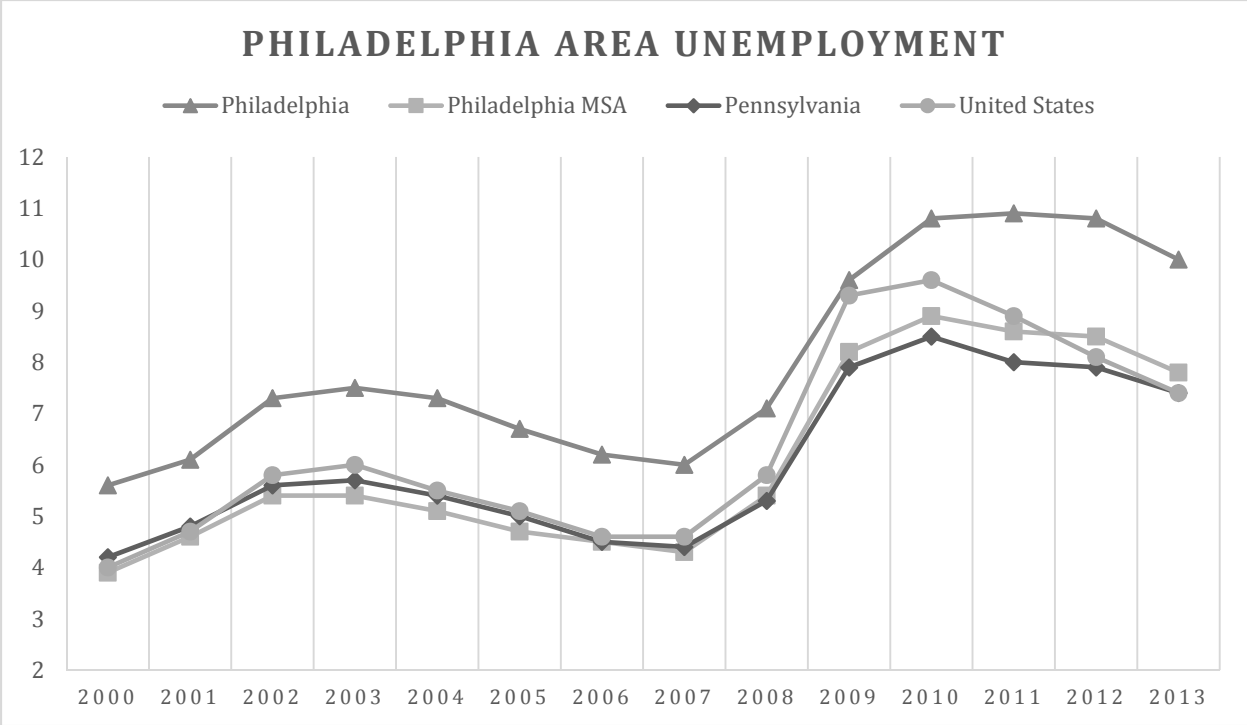
Figure 1.3 Unemployment rates in four cities, 2000-2013



Source: BLS annual unemployment rate, 2000-2013

Figures 1.4a-d Unemployment diverges between city, MSA, and state, 2000-2013





Source: BLS annual unemployment rate, 2000-2013

## *Detroit, Michigan*

The predominant narrative of urban fiscal crisis today is the story of Detroit's decline and bankruptcy. The city has long been a national symbol of the collapse of U.S. manufacturing and the racial dynamics of urban abandonment (Binelli 2012; Sugrue 2005). The city has experienced severe population decline; as of 2010 the city has 700,000 residents, fewer than half of its peak of 1.8 million in the 1950s (U.S. Census Bureau 2010). That decline has left the city struggling to maintain services and aging infrastructure in a territory plagued by vacancy and poverty.

Despite these challenges, the early part of this century brought optimism to the city, reflected in budgets that touted the possibilities of center city resurgence, an award-winning finance deal to manage pension obligations, and growing revenues from the city's gaming industry (Carvlin 2005; Kilpatrick 2006). Throughout much of his administration, Mayor Kilpatrick promised that the city would eliminate its structural deficit by the 2008-09 fiscal year. "No one is talking about receivership for Detroit today. No one is talking about bankruptcy for Detroit today" (Kilpatrick 2008, 9). Standard & Poor's had even upgraded the city's bond rating (Kilpatrick 2008, 1-2). But in 2007, as in most cities, Detroit's revenues dropped sharply as housing prices fell. The state mandated a phase-out of the city's income tax levy, and a steady reduction of state revenue sharing funds began (Rhodes 2013). The collapse of interest rates sparked by the global financial crisis saddled Detroit with unsustainably high costs for the 2005 pension deal, and forced the city to sign over its casino revenues to its creditors (Bomey and Gallagher 2013).

In response to these events, then-Mayor Kilpatrick tempered his optimism with emphasis on the "tough decisions" needed to "put this city in a position to thrive in the 21st Century" (Kilpatrick 2007). When Kilpatrick left office in late 2008 (charged and eventually convicted of corruption), interim Mayor Kenneth Cockrel, followed by elected Mayor Dave Bing, raised alarms about Detroit's fiscal situation. On April 30, 2009, Chrysler filed for bankruptcy; on June 1, General Motors did the same. Until 2009, the city had maintained investment-grade ratings by both Moody's and S&P; in 2009 that the city fell below investment-grade for the first time since the mid-1990s. The downgrades would continue from 2009 until the city's default in 2013 (I discuss Detroit's treatment by rating agencies in Chapter 4).

In response to these events, Mayor Bing created a "Crisis Turnaround Team," which issued a report on August 26, 2009 saying that the city had reached a "crisis point" (Crisis Turnaround Team 2009, 6). The report estimated that the city had a \$280 million cash deficit, and would need to cut the budget by \$250-300 million in order to eliminate the deficit before reaching a crisis (Crisis Turnaround Team 2009). In 2010, Mayor Bing tried to implement an ambitious plan to rationalize service provision, and blamed his predecessors for ignoring the growing crisis (Bing 2011a, 1).

Nothing is more important to the fiscal future of our city than restoring integrity to City Hall and making Detroit attractive for jobs and investment...

It's the only way out without state intervention or bankruptcy and as I have said before, it is indeed now or never. (Bing 2010, 6)

In November 2011, citing a leaked city-commissioned Ernst & Young audit, the *Detroit Free Press* reported that the city would run out of cash by April unless officials made immediate, painful reductions that would cut deeply in to public services (Neavling 2011). In response to the report, the Mayor warned of massive layoffs and told unions they had no choice but to comply with the city's demands in order to preserve local autonomy: "If we are unable or unwilling to make these changes, an emergency financial manager will be appointed by the state to make them for us" (Bing 2011a, 2). In March 2013, after more than a year of political, judicial, and legislative wrangling over the city's fate,<sup>14</sup> Governor Snyder appointed a corporate turnaround expert, Kevyn Orr, as emergency manager of Detroit (Davey 2013b). When he failed to resolve negotiations with the city's creditors and employee unions, Orr filed for bankruptcy in July 2013, from which the city emerged in December 2014.

### *Dallas, Texas*

Although Texas' economy was buoyed by oil and gas money through 2009, Dallas' steadily-growing population of over 1 million has seen stagnant local revenues since 2008 (McNichol and Johnson 2012). The first mention of fiscal stress by city officials came in July 2008, when the city manager mentioned the possible need for a property tax hike in the FY2008-09 budget (R. Bush 2008). Housing prices hadn't started falling yet, but foreclosures were beginning to take a toll, and the City Manager voiced fears that a flat housing market could deepen the economic slowdown, already affected by a slowdown in housing construction.

By January 2009 (halfway through the 2008-09 fiscal year), city officials were making dour predictions. The city manager described the city's outlook as "gloomy" in a budget presentation to the City Council (Levinthal 2009). "I'm looking at ways to reduce costs, but I'm not into panic mode... We just need to be very careful with the people's money" said the City Manager (Levinthal 2009). The Mayor repeated this message of caution: "What we're doing is trying to balance the reality of the situation... What we are trying to do is manage the size of government" (R. Bush 2009b).<sup>15</sup> The *Dallas Morning News* also echoed this theme of managing spending, saying that the city faced "the worst budget deficit Dallas has faced in generations, a \$190 million gap that has forced the city's management to rethink the way City Hall will operate in coming months and years" (R. Bush 2009a).

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<sup>14</sup> Which included an emergency financial assessment, a consent agreement with the state, the real of the state's emergency manager legislation, and the adoption of new legislation, described in Chapter 5.

<sup>15</sup> Dallas, unlike most large cities is a weak mayor form of government; the city manager controls all aspects of budgeting and the mayor serves primarily as a voting member of the city council.

As the Dallas economy worsened in 2010, City Manager<sup>16</sup> Suhm described the budget scenario as “painful, painful, painful” (Merten 2010). She began publicly warning about the budget in March 2010, when she asked all city departments to prepare budget reductions of 30%, public safety by 5% (R. Bush 2010a). Just a week after her briefing, Moody’s placed the city on negative outlook, citing the weakening economy and shrinking reserves (Williamson 2010). In May, the Mayor said the city would have to continue to shrink the city government: ““I think we will have to find what services are not core to what we do,” Leppert said (Panchuk 2010).

As of 2013, annual property tax revenues were still 8% below the peak of 2009; total revenues, which peaked in 2008, were still down 10% in 2013 (City of Dallas 2014). For a city whose population has grown by 6% since the recession began, this decline is significant. As the narrative of Dallas’ own crisis abates, a narrative of broad national and international fiscal precariousness moved to the forefront, as I describe below. The normalization of fiscal caution defines the city’s post-recessionary approach to budgeting, despite the city’s relatively strong economic and financial health (particularly in comparison to Detroit).

### *Philadelphia, Pennsylvania*

Like Detroit, Philadelphia has been plagued by significant population loss and deindustrialization; once home to more than two million people, the city is now just over 1.5 million. Unlike Detroit, Philadelphia has seen steady population growth since 2008, but has struggled to fund services for many reasons, including an ambitious tax reduction strategy, and a crisis in its school system that has required infusions of city money (Lyman and Walsh 2013). Throughout the early 2000s, the Mayor affirmed the city’s commitment to “steady tax reductions” in order to stimulate economic development (City of Philadelphia 2005). Population decline had stemmed, and property values had increased significantly. Only in late 2008, when it became clear that revenues would be well below budgeted amounts, were tax reductions put on hold. In late 2008, Mayor Nutter issued a “rebalancing plan,” stating that the city needed to “adjust to a new reality. Government is going to look different and major cities all across the country are making significant changes in the way that they operate” (The City of Philadelphia 2008, 4–5).

The scale of the challenge we face does not allow us to take anything off the table or to preserve any sacred cows. This is a budget shortfall of enormous proportion, and because the economy may not recover quickly, we cannot afford to look for quick, one-time changes. (The City of Philadelphia 2008, 3)

In February 2009, Nutter published an editorial letter to the city about the budget as numbers came in even below the dire estimates of November 2008.

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<sup>16</sup> Unlike most large cities, Dallas has a City Manager government, which means the Mayor has largely symbolic powers.



Sadly, the recession has only deepened and the cost to city government is a second billion-dollar gap that must be closed in the next budget and Five-Year Plan. To secure our city's future, we must make some very tough choices that preserve our smartest investments of your hard-earned tax dollars. And frankly, there is no avoiding that we face a depth of sacrifice not seen since the 1940s. (Nutter 2009)

Nutter called on residents to participate in a series of public meetings about resolving the deficit and make the necessary "hard choices:"

As we struggle together to rebalance the city's income and expenditures, I will be relying on our city's greatest asset – the people of Philadelphia. In the coming months and years, we all face major sacrifices, but I also believe this process will bring us closer together.... In a year or maybe two, we will work our way out of this national economic crisis. (Nutter 2009)

By 2010 the Mayor was focusing on the city's pension costs as a driver of crisis and as key to solving it:

The unique convergence of a profound financial crisis, the collapse of residential housing markets, a global contraction in economic activity, and soaring unemployment has beset the City with severe contractions in tax revenues, at the same time as the City's contribution into its employee pension fund increased, due to market losses. (Nutter 2010, i)

Despite a slowly improving economy, Philadelphia's finances had not improved significantly by 2013, when a temporary state reprieve on pension payments expired and tax rate reductions restarted, generating a second moment of crisis.

Like most major cities, Philadelphia continues to deal with increasing labor and pension costs, delinquent taxes and public safety, all in the face of a slow-to-recover national economy. (The City of Philadelphia 2013, 3)

In an effort to reassure investors in advance of a debt issuance, Philadelphia held a closed bond investor conference in 2013, where it revealed that it has only 48% of assets needed to cover its pension liabilities, and that it had been chronically underpaying into its retirement fund (The City of Philadelphia 2013). Of the four cities, Philadelphia's fiscal situation remains the most in the public spotlight (as Detroit emerges from bankruptcy).

### *San Jose, California*

San Jose, the second-largest city in California, sits in the center of the nation's high-tech economy and has weathered the recession better than most other U.S. cities. The city has doubled in size since 1970, currently just at 1 million people. It ranked first on the Brookings Institute Metro Monitor evaluation of economic recovery (Friedhoff and Kulkami

2013). But revenue declines have been especially steep throughout California, resulting from a combination of volatile property values, two decades of state tax cuts, and a state law that severely limits property assessments and the ability of local governments to raise taxes (*People's Initiative to Limit Property Taxation* 1978).

San Jose's Mayor, Chuck Reed, has sounded the fiscal alarm since he was elected in 2006. In his first state of the city address, he announced: "the budget deficit is public enemy number one, an enemy that will steal our hopes and kill our dreams of becoming a great city if we ignore it" (Reed 2007a). In March 2007, San Jose's Mayor issued his first "budget message" for the FY2007-08 budget process, highlighting the rising costs of employee benefits on page 2, the first chart. In light of these rising benefit costs, the Mayor described the city as "in an extremely difficult financial situation," facing a structural deficit that had built over five years. "Our budgets have been developed with the hopes that the economy would bounce back and revenues would once again boom," but, he said, such a recovery would not be enough to resolve the "structural gap" (Reed 2007b, 2) The community, through a series of "Priority Setting Sessions," must determine which programs are considered low priority and should be "seriously questioned" (Reed 2007b, 3). In a time of continuing economic uncertainty, the Mayor described the city's goals as: "to maintain our core services, avoid layoffs, and stimulate our local economy as much as possible" (Reed 2007b, 19). The Mayor created a General Fund Structural Deficit Task Force, spearheaded by a consultant firm, which culminated in a "structural deficit elimination plan" in November 2008 (Office of the City Manager 2008). Meanwhile, in March 2008, the Mayor again emphasized that the city faced a structural fiscal crisis, to a degree that "will require us to cut services that are vital to our residents and businesses" (Reed 2008, 1).

In San Jose, the Mayor's efforts to frame the city as being in deep, structural crisis occurred largely before the beginning of any national narrative around city fiscal crisis. The Mayor has focused his speeches about fiscal distress on the city's pension plan and on "fiscal reform" from the beginning. His framing of the city's problems has been echoed by the business community: "Significant reform must be considered - reform in the pension system, in ways of governing, in ways of engaging the citizenry" (Silicon Valley Community Foundation 2012). Supported by such messages, in 2012 the Mayor convinced voters to pass a ballot initiative that reduces pension benefits for future employees and raises the retirement age (Woolfolk 2012). The Mayor also attempted to declare a fiscal emergency (which would have permitted the city to propose amending contracts, including employee agreements), but the effort was postponed several times and eventually scrapped in 2012 (Koehn 2012).

Interestingly, the Mayor pairs his ongoing message of fiscal despair with a claim of economic primacy: "San Jose is a beacon of peace and prosperity for the world. Our economic outlook is strong and opportunities abound" (Reed 2013). San Jose's seemingly paradoxical narrative of a simultaneously broke and prosperous city perhaps epitomizes the notion of a new normal, in which even affluent cities cannot afford to provide more than the most basic services, and must shape city governance around the ever-present possibility of fiscal crisis.

### *Explanations of crisis*

These four cities reflect the variation in how “fiscal crisis” comes to be a topic of local official discourse and policy-making. As I describe above, narratives of earlier crises focused on four primary explanations: over-spending (particularly on welfare or redistributive programs), global economic restructuring (deindustrialization and globalization), union power, and financial “gimmicks” that enabled deficits to grow unmonitored. In the current crisis, local official narratives have focused on a different set of factors: while spending cuts have been significant, there has not been a focus on specific aspects of public spending to blame for crisis. Discussions of the economy refer not to a new mix of industries or trade patterns, but to an overall level of national and global scarcity and precariousness. Finally, the focus on public employee unions has taken the form of an intense attack on public employee pensions, which is the subject of Chapter 3.

### *Generalizing crisis: blaming national and global trends*

In the wake of the 2007-08 crisis, some local officials were quick to proclaim that their cities’ troubles were far from unique, and to relate them (or attribute them to) a broader crisis of the economy. Even Detroit’s mayor situated his city’s budget woes in this context:

Detroit like all cities, is suffering the effects of the global economic crisis. The housing market continues to suffer, the financial markets are still in limbo and our auto industry is being reorganized. As a result, we as a city need to make critical decisions that help us in the short term, while at the same time position our city better in the long term. Unfortunately, very few cities are immune from staff reductions. Cutting back on services is necessary in today’s economic environment. It is an issue that cities from New York to Seattle and Los Angeles to Washington, D.C. are dealing with. (Cockrel 2009, 6)

Of all the four cities, Detroit’s crisis would be the easiest to view as isolated from national trends, as it had been running a deficit for many years before the recession began. But the triggering event for Detroit’s default—nonpayment of its swap deal—was directly precipitated by the collapse of financial markets and interest rates. The Mayors of Detroit repeatedly connected the city’s crisis to both of these broader events, and the state government’s withdrawal of funding. Detroit of course faces other challenges, including the legacy costs of a much larger city now supported by a population of half its maximum size, but its connection to national crisis has been an agenda of leaders and residents.

In contrast to this local language of structural and national crisis, the state officials who took over Detroit have suggested that the city’s fiscal problems could be solved simply and rapidly, and made little reference to national context. Both Snyder and Orr emphasize the long-term nature of Detroit’s troubles: “The fiscal realities confronting Detroit have been ignored for too long.... This is a difficult step, but the only viable option to address a

problem that has been six decades in the making” (Governor Snyder’s Office 2013). In his first statement about the city’s finances, Orr said that “factors over the past 45 years have brought Detroit to the brink of financial and operational ruin” (Woodall and Neavling 2013). But despite this acknowledgment of long-standing structural challenges faced by the city, both men repeatedly emphasize that the city can be turned around quickly, and that the decisions facing the city are simple ones. In an interview with *Wall Street Journal*, Orr said that the emergency manager job was “just judgment calls, common sense” (Finley 2013). Referring to his negotiations with unions, he says “This is fifth grade stuff.” The city’s accumulated debt (estimated at \$18 billion in 2013) is framed not as the legacy of decades of decline, but as a moral failing. In Orr’s words, “We have to break our addiction to debt” (Helms and Guillen 2013). Both state and local officials also use the language of modernization: bringing Detroit from the 20th century into the 21st; of his ambitious plan of outsourcing and privatization, Orr quipped: “some of these services are anachronistic...What big city still does some of these services?” (Finley 2013). The structural fiscal challenges created by disinvestment, uneven revenue capacity between Detroit and its suburbs, and high poverty have never been part of the state’s official narrative of Detroit’s crisis or its future (Bomey and Gallagher 2013).

In Dallas, officials have repeatedly emphasized the precarious nature of the national and global economies, as part of a narrative of ongoing fiscal caution even as the local economy recovers:

It is imperative that the City’s approach is cautious because deterioration in the world financial situation or a spike in oil prices could tip the U.S. and Dallas economies back into recession. (City of Dallas 2011, 10)

As the local focus on Dallas’ own crisis wanes, a narrative of broad national and international fiscal precariousness moves to the forefront as justification for continued fiscal caution. The normalization of fiscal caution defines the city’s post-recessionary approach to budgeting:

Over the past fiscal year, the organization [the city] has gone through significant changes due to the global economic recession. The upcoming fiscal year will present a new set of challenges. The workforce is committed to providing superior customer service, and maintaining the confidence and trust of our residents and business owners during a difficult period of economic uncertainty. (City of Dallas 2010, 12)

With some indications of economic stabilization appearing, it is imperative that the organization move forward prudently and cautiously to seize recovery opportunities in a paced manner. Indeed the uncertainty regarding the depth and duration of the current economic situation will have an impact on revenues next fiscal year and perhaps into the future. (City of Dallas 2011, 16)

And continuing in 2012:

The post recession approach to managing City government remains watchful and measured. There is still cause for some caution with the uncertainty as to the depth and duration of the economic situation in Europe. A financial crisis overseas could lead to shifts in the domestic economy due to the integrated relationship between the European Union (EU) and the U.S.

In addition, there is potential uncertainty in the federal budget as several large tax cuts are set to expire at the end of the year and big spending cuts are scheduled to kick in.

According to economic analysts, without a balanced Congressional response, the U.S. could suffer another recession and the global economy could slow sharply. Continuing a conservative financial approach is wise. (City of Dallas 2012, 10)

Dallas officials are both externalizing the blame for local austerity, and justifying an approach to “lean budgeting” that may not appear necessary as the city maintains a high credit rating and strong local reserves. Dallas’ pension plan was restructured before the recession, so the “legacy costs” explanation (see below) that other cities have focused on is not available for Dallas officials. Of the four cities, Dallas officials have been the most cautious in their framing of national and global financial risk.

San Jose’s Mayor has been less likely to emphasize national or global causes, as he focuses on drawing comparisons with other cities facing fiscal crisis because of public pension plans, the cause he has chosen to focus on:

San Jose is hardly alone in having a problem of expenditures growing faster than revenues. Other cities have these problems and worse. In the past few weeks, the City of Vallejo made headlines for having to consider declaring bankruptcy. San Diego also faced bankruptcy as a result of the retirement system having a \$1.4 billion deficit. (Reed 2008, 3)

Philadelphia’s mayor has repeatedly emphasized that the city’s finances were damaged by the national and global recession:

The 2008-2009 global recession is still wreaking havoc on Philadelphia’s economy and affecting the City’s fund balances. The unique convergence of a profound financial crisis, the collapse of residential housing markets, a global contraction in economic activity, and soaring unemployment has beset the City with severe contractions in tax revenues, at the same time as the City’s contribution into its employee pension fund increased, due to market losses. (Nutter 2010, i).

Philadelphia’s mayor has also repeatedly mentioned the city’s vulnerability to cuts in state and federal funding, and advocated for federal assistance to his city and the Philadelphia school district (City of Philadelphia 2012, i). As Philadelphia’s economic performance has lagged behind the national recovery, he has also emphasized the city’s

vulnerability to future economic slowdowns, which are likely to disproportionately affect Philadelphia's economy more than, for example, a city like Dallas.

Officials in these four cities all use the broader national and global economy differently to frame their own narrative of local crisis, shaped by the form of austerity. This referencing of external forces include both the actions of state and federal policymakers and "the economy" as a force that acts upon cities. This externalization of the causes of crisis contrasts with the framing of local crisis as "structural," although both explanations can operate in concert with each other.

### *"Structural costs": blaming pensions*

Leaders in all four cities use the word "structural" to describe the deficits and costs the city is grappling with in times of crisis. "Structural costs" are generally understood to refer to costs that cannot be easily reduced from year to year, but represent long-term obligations that are either difficult or impossible to alter. In the current crisis, the primary structural costs identified by local officials are the commitments made to city retirees through public pensions and healthcare.

Throughout his tenure, Kilpatrick argued that the city faced "structural costs" that revenues couldn't cover: in the Departments of Public Works, Transportation, Public Lighting, Resources Recovery Authority, all public utilities that were subsidized by the city's general fund, and "our biggest structural problems—pensions and health insurance costs" (Kilpatrick 2006, 2). The Mayor said he was working to negotiate employee co-pays "to levels that reflect the realities of the workplace in this new century" (Kilpatrick 2006, 11).

I'm sure you remember that just two years ago we faced a potential deficit of \$300 million... Structural costs that we had inherited were killing us.  
(Kilpatrick 2007, 1)

In March, 2010, Mayor Bing blamed his predecessor for not dealing with these costs, displacing blame for the city's crisis:

The financial crisis inherited by this administration is by now familiar to all of you. An accumulated deficit of \$330 million with no plan to reduce it... Financial decisions were too often driven by politics, not sound fiscal policy. Budgets were developed using smoke and mirrors, rather than data. And difficult but necessary *structural changes* were ignored instead of fought for, even as we fell deeper into financial crisis. (Bing 2011a, 1 emphasis mine)

After his first year in office, Mayor Bing began to put the focus squarely on pension and health costs:

Pension and medical costs are rising at an uncontrollable and unsustainable rate. From 2008 through 2011, the City of Detroit cut \$40 million from service delivery to offset the rising cost of benefits. Without action, benefit costs will consume a larger and larger portion of our operating funds, potentially growing to 50% by 2015. (Bing 2011a, 2)

We can't afford benefit packages so rich, nor can we continue to protect the interests of 30,000 people at the expense of 700,000. (Bing 2011a, 3)

Detroit's pension "crisis" became part of the central narrative of the city's woes, again despite the unique demographic challenges that it faced.

San Jose's mayor also refers to structural costs: "The City of San Jose is in an extremely difficult financial situation," facing a structural deficit that had built over five years; even a recovery would not be enough to resolve the "structural gap" (Reed 2007b, 2) In 2012 the Mayor convinced voters to pass a ballot initiative that reduces pension benefits for future employees and raises the retirement age (Woolfolk 2012).<sup>17</sup>

Despite his disavowal of the common narrative of local self-reliance,<sup>18</sup> the Mayor Nutter of Philadelphia has also been firmly supportive of the narrative that frames labor unions as a central obstacle to fiscal stability.

Despite these achievements, however, the basic *structural financial challenge* remains: A weak tax base, high tax burden, escalating costs, high service responsibilities, and low federal financial support. (City of Philadelphia 2007, i emphasis mine)

In September 2009 the state legislature passed a law allowing the city to effectively defer part of its pension payments in 2010 and 2011 (*Resolving the Philadelphia Pension Crisis* 2009). By 2010 the Mayor was turning his attention to pension costs as a driver of crisis:

The unique convergence of a profound financial crisis, the collapse of residential housing markets, a global contraction in economic activity, and soaring unemployment has beset the City with severe contractions in tax revenues, at the same time as the City's contribution into its employee pension fund increased, due to market losses. (Nutter 2010, i)

In March 2013, the Mayor directed his budget address to the city's employees, emphasizing to the need for reforming a pension system that "is taking more and more public resources that could be spent on citizen services or tax relief" (Nutter 2013). In an effort to reassure investors, Philadelphia held a closed bond investor conference, where it

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<sup>17</sup> His message was echoed by significant voices in the community: "Significant reform must be considered—reform in the pension system, in ways of governing, in ways of engaging the citizenry" (Silicon Valley Community Foundation 2012).

<sup>18</sup> Mayor Nutter of Philadelphia has been outspoken about both the city's struggles and his demands for state and federal assistance (Kerkstra 2009).

revealed that it has only 48% of assets needed to cover its pension liabilities, and that it had been chronically underpaying into its retirement fund (The City of Philadelphia 2013). The report touted the city's "substantial expenditure cuts," a "deep bench of financial managers," and workforce reductions, and assured investors that the Mayor is "committed to achieving material pension reform with local unions" (The City of Philadelphia 2013).

While the explanations for crisis in the 1970s-1990s centered on the restructuring of the economy, particularly deindustrialization and globalization, the explanations during the recent recession have centered on global and national economic instability and the problems posed by long-term obligations or structural costs of cities, rather than specific spending programs as were targeted in earlier crises. This shift has important implications, and derives from, the growing financialization of urban policy and the displacement of blame from the welfare state to public pensions, as I describe in Part Three.

## **Conclusion**

Decades ago, Shefter proposed that fiscal crises are inevitable moments of political correction, generated by recurring tensions in our system of governance. Fiscal crises, he argues, are integral to American urban politics (Shefter 1992, xiii). As crises appear to reach resolution, there is often talk of a "new normal," echoing this normalization of crisis. A narrative of normalized scarcity, such as that used by Dallas' officials in order to buffer against global uncertainty, generates every city as the "broke city" I refer to in my title. Brash describes how this normalization operates in New York this century:

[T]he post-fiscal crisis regime is in fact one of permanent fiscal difficulty, as its fiscal and spending policies lead constantly to budget shortfalls—accompanied by the crisis rhetoric that assists in the maintenance of the post-fiscal crisis consensus during these times of increasing austerity. (Brash 2003, 77)

Throughout the literature on urban crisis, whether focused on measuring and predicting crisis, or evaluating its consequences, there is a shared presumption that crisis itself is the fundamental question, rather than a produced outcome of policy or even politics. Federal devolution, state limits, and economic restructuring appear as exogenous forces to cities, taken for granted as part of the landscape in which cities must manage. This has resulted in limited calls by those in the policy world for rethinking the structure of urban finance, moving from "managing cutbacks to rethinking the work of cities" (Brash 2003, 77). Some of this I revisit later in this dissertation, such as Pagano's proposal for addressing "the fairness of revenue systems; the pro-cyclical nature of local budget practice; accumulated long-term liabilities (pensions and infrastructure); definition of 'core services;' pricing infrastructure and services; and partnerships in service delivery" (Barnes 2011).

The framing of crisis as endemic to cities, as resulting from external and unavoidable forces, normalizes fiscal scarcity and precarity and creates the need for



ongoing retrenchment and fiscal discipline. The language used by Dallas typifies this framing:

Actions taken in tough times should be made with a focus on future stability. As the City contracts to fit the current economy, we are poised to capitalize on the recovery opportunities that will allow us to fulfill our commitment to give future residents of Dallas an even better city than we inherited. (City of Dallas 2009, vii)

The purpose of this chapter was to describe the “common sense” framings of urban fiscal crisis following the 2007-08 recession and in previous eras. There are local variations in the emergence of crisis, due to variations in local economies, differences in revenue structure, the local housing market (effect on prices and foreclosures), and local capacity to weather revenue downturns (by drawing on reserves, issuing debt, or making other adjustments). These cases embody that variation in the material impacts on their budgets, but the narratives used by officials to describe crisis present a more uniform picture. The framing of crisis by local officials, often with reference to other cities and a national crisis, reflects similar assessments of the causes of fiscal stress.

Leaders in all four cities referenced a national, even global crisis, that left them no choice but to cut spending significantly. In all four cities, the fiscal crisis is described as “structural,” a term with no fixed meaning, but one that has been interpreted, as I discuss in Part Three, to mean requiring outside intervention and the disrupting of historic privileging of city contractual obligations.

While over-spending still holds general explanatory power, it has changed significantly as a narrative force from earlier crisis episodes. While much of the criticism of New York City in 1975 by conservatives was that it could no longer afford the “welfare” expenses that could be cut, Detroit, already reduced to a “night watch” state, has not been subject to the same critique. The solutions for fiscal crisis today, given the already-reduced scope of welfare state, are less apparent, although the reflexive language of belt-tightening and living within means is invoked. Today with inflation at near zero and interest rates held near zero for more than five years, wage freezes don’t help over the long term, and the value of debt does not decrease over time. Economic recovery has substantially benefited the top tier of income earners, and has failed to translate into significant revenue growth for governments.

The explanations for crisis described in this chapter have helped produce a national-level consensus that the best response to recession was to avoid revenue increases and reduce government spending. In Part Two I discuss how this shared common sense of the implications and causes of crisis produced a common response: continued restrictions on raising revenues and continued retrenchment. Chapters 2 and 3 will illustrate the production of austerity.

## **PART TWO: PRODUCING AUSTERITY**

## Introduction

Part Two presents a material perspective of the remaking of cities in the midst of fiscal crisis. Specifically, I draw on Census Bureau and city financial data to develop a picture of how revenues (Chapter 2) and spending (Chapter 3) contract in times of fiscal crisis. In order to show both the common themes and the unevenness in revenues and spending, I use the both national data and four case studies to construct a complex picture of the emergence of fiscal strain and austerity in U.S. cities since 2007.

The framework of neoliberal urbanism is frequently used to explain cities' recent histories of austerity. The category of urban neoliberal policy encompasses several phases and arguments, but in general refers to the kinds of policies adopted by governments after the 1970s that have led to the dismantling of the welfare state and of the relationship of government labor and private enterprises on which it was based. The 1970s fiscal crisis and the waves of 1980s deindustrialization (although they had roots even earlier) fundamentally reconfigured the relationship between the government and the economy, through the dissolution of the Fordist social compact, and the rise of individual responsibility as a putatively central social value (see e.g. Fainstein and Fainstein 1986). Key moments and categories of change associated with neoliberal urbanism include the retrenchment of public finance, the restructuring of the welfare state, the recalibration of intergovernmental relations, reconfiguring the institutional infrastructure of the local state, and privatization of the municipal public sector and collective infrastructure (Brenner and Theodore 2002, 369–370). A corollary development is the shift to the “entrepreneurial city,” in which cities must take risks in order to attract economic development, making them responsible for their own economic success and, consequentially, their fiscal health (Harvey 1989). This model predicts that cities will prioritize spending to attract and service capital, such as tax breaks, subsidized infrastructure, and other goods that accrue to the private sector and promote development, at the expense of redistributive spending.

In broad terms, this characterization of neoliberal urban austerity is reflected in my findings, but the emergence of fiscal crisis, its structure, and its consequences vary from city to city. This chapter draws out the similarities and differences. The common themes that I describe include local revenue constraints and reliance on a volatile mix of revenues; the ability of state governments to pass their own budget shortfalls onto local governments; significant tax cuts made by both state and local governments in the name of economic development; and a budgetary climate of incrementally whittling away at the remaining havens of social spending that seeks to extract its most significant cuts by dismantling benefits for public workers.

### Data sources

In these two chapters I construct a picture of revenue and spending changes nationally and in four case studies from 2007-2013, using data from multiple sources.

## *Census local government finance data*

Chapters 2 and 3 draw from an original dataset that I built using the raw data files from the Annual Survey of State and Local Government Finances, to which I was granted access by the Census Bureau. This survey collects data from state and local governments (cities, townships, counties, school districts, and authorities) annually about revenues and expenditures, including intergovernmental funds and debt. All states, and all municipalities with 75,000 or more residents, are surveyed every year, along with a sample of smaller governments. Every five years (2012, 2007, 2002, 1997, etc.), the survey is administered to all governments of any size are surveyed; this quinquennial administration is called the “Census of Governments,” but it contains the same survey questions as the Annual Survey. As of this writing in 2015, the most recent local government finance data available comes from the 2012 Census of Governments (which represents data from fiscal year 2011-12). Data from fiscal year 2012-13 will not be available until early 2016. As I observe in my cases, the 2012-13 year was still one of tentative growth or continued stagnation, so we do not yet have a full picture of how cities are faring in the long wake of this recession.

The Annual Survey has a high response rate, and significant efforts are made to ensure that each city’s response is thorough. After each municipality fills out the survey and responses are also confirmed and standardized by Census staff. Census staff also use city documents—such as audits and debt issuances—to fill in missing responses and confirm details.<sup>19</sup> This standardization, while imperfect, enables comparison between cities.

My construction and analysis of this dataset fills a gap that has existed since 2006, the last year for which the Census Bureau compiled and released data from the survey by city (it now publishes data aggregated to the state). In order to compare my compiled city-level data from 2007-2012 to the Bureau’s released city-level data from 2006 and earlier, I also had to construct a bridge using the Census methodology for generating subtotals from individual survey questions.<sup>20</sup>

I indexed all financial data to 2007 dollars using the consumer price index (CPI), and where applicable I have calculated per capita data using figures from the Census population estimates program. For my national analysis I defined a universe of the 425 cities and townships with populations of 75,000 or higher<sup>21</sup> that had responses for every year from 1992-2007. I chose the threshold of 75,000 because it represents the size of city that is surveyed annually by the Census, and represents cities that are likely to be providing their own police, fire, library, schools, and other key services.

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<sup>19</sup> Within the data itself, Census staff code each response to indicate how the information was obtained.

<sup>20</sup> I used the User Guide to Historical Data Base on Individual Government Finances (INDFIN), part of the file package I was given by the Census Bureau, and the Methodology for Summary Tabulations, Chapter 13 in State Government Finances on the Census website methodology files, available at [https://www.census.gov/govs/www/ch\\_13.html](https://www.census.gov/govs/www/ch_13.html).

<sup>21</sup> All cities of 75,000 and above are included in the annual Census survey (will have more details on the Census methodology in the appendix). I included only cities that had current year responses from 2008-2012, and I used population data from 2010 to determine the size cutoff.

### *Census revenue categories*

The Census survey contains dozens of questions on revenues, and compiles a set of revenue categories that correspond closely to most cities' budget structures (see Table 2.1). The first distinction is between general revenues and non-general revenues: general revenues includes everything except utilities (primarily billing for utility service), liquor taxes, and insurance trust revenues (for employment insurance, primarily a state function). The Census also distinguishes between "own source" and intergovernmental revenues that come from federal, state, and other local governments.

Finally, the Census distinguishes between taxes (levied on specific goods or services, including income and property), and charges (sometimes called fees) that are tied to use of a service (like a toll bridge or park admission).<sup>22</sup> This definition is not always clear, although in many cases the semantics reflect differences in law: taxes require a higher threshold of voter approval than charges or fees.

City budgets generally hew to similar revenue categories and descriptions, but there is one significant difference: the treatment of revenues by "fund" and the meaning of the word "general." The Census uses the term "general" to mean all revenues that are not tied to utility, liquor, or insurance activities of government. Many cities make a further division between "general fund" monies (those not tied to any particular spending program, and therefore available to the government to use on anything) and monies in other funds. Sometimes these are "enterprise funds" in which the fees for a service (hospital, park, utility, etc.) are used to pay for the service itself—the fund effectively has its own budget and is often required to balance out each year. The use of enterprise funds is one mechanism for restricting the scope of the general fund budget (and there are strict accounting rules prohibiting the movement of money between funds), discussed more below. The Census attempts to standardize reporting for cities by ignoring this distinction between general funds and enterprise funds, and instead using the term "general" to mean all revenues except utilities, liquor, and insurance trust.

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<sup>22</sup> Obviously, there is some blurriness between these two categories (not everyone pays all taxes, if you don't purchase certain goods for example, and some charges may be levied on everyone, or may be prorated by use in the way that a tax has a percentage rate). But the division is fairly universal.

Table 2.1 Census revenue categories

<b>Revenue categories</b>	<b>Explanation</b>
Total revenues	
General revenue	Total revenue without liquor, utility, and insurance trust (includes intergovernmental)
General revenue own sources	General revenue without intergovernmental revenue
Total taxes	All taxes (sum of property, sales & gross receipts, income, licensing, and other taxes) - see below for details
Total charges	Charges/fees for education, hospitals, highways, airports, parking, ports, natural resources, parks, housing, sewerage, solid waste, & other
Miscellaneous revenues	Interest, special assessments, property sale, state dividends, finds & forfeits, rents, royalties, donations, lottery, and other
Utility revenues	Utility charges for water, electric, gas, transit
Liquor revenues	(not in all states)
<b>TAXES</b>	
Property tax	Property taxes (a single question)
Total sales tax	Includes both general sales and selective sales taxes
General sales tax	General sales tax (a single question)
Total selective sales tax	Sum of all selective sales taxes (alcohol, amusement, insurance, motor fuel, pari-mutuel, public utilities, tobacco, other)
Total licensing taxes	Sum of all license taxes (alcohol, amusement, corporation, hunting/fishing, motor vehicle, public utility, occupation/business, other)
Income tax	Individual income & corporation net income
Other taxes	Death and gift, documentary & stock transfer, severance, other

*Source: Census Annual Survey of Local Government Finances; 2006 Classification Manual, compiled by author*

## *City budget documents*

To supplement the Census data, I also analyze the adopted budgets and Comprehensive Annual Financial Report (CAFRs) for my four cases. My compilation of data into measures of overall revenue and spending behavior that can be compared between cities also represents an important original contribution. I look at both *adopted* and *actual* spending and revenues (reported in subsequent year's budgets as well as end of year audits). City budgets are not required to follow a standard formula, so that budget categories vary widely from place to place. In the spending section below I provide more detail on how I set up the framework for comparing cases to each other and to national trends. For my four cases, I analyzed budget documents from fiscal year (FY) 2006-07 to FY 2012-13.<sup>23</sup>

In the introduction to this dissertation, I make the case for the importance of comparative urban research. I should note that the wide variation in fiscal structure, governance, and allocation of service responsibilities across U.S. cities makes it difficult to strictly compare policy responses between cities. Indeed, there are several empirical challenges to constructing a comparative analysis of city budget data, particularly of city spending. The U.S. federal system of government defines cities as creatures of state law. State law and policy therefore determine revenue structures and spending responsibilities, and those laws vary widely across the country. Local fiscal capacity thus depends on both local wealth and on the state laws governing how cities can raise money. The political relationship between cities and state governments, which has many implications for how cities manage economic downturns, varies for many reasons: demographics, history, economics, and overall political climate (I take up this issue in Chapter 5).

There is also no uniformity in how responsibility for service provision is allocated among city, county, and state governments (not to mention public or public-related authorities, agencies, etc.). While certain activities—such as public housing and welfare—originated as federal programs (and were once primarily funded through the federal budget), the history of devolution of responsibility for those programs (key elements of the so-called “welfare state”) has been complex and uneven. Revenue data is easier than spending to compare between cities as it fits into standard categories, making it relatively simple to match cities' budget data with the broader universe of Census data (and thus enabling more national context). Spending data are more difficult to compare because responsibility for spending varies substantially between cities, and the ways that cities categorize spending programs in their own budgets often changes from year to year. I discuss this more in the section on spending below. I only partially solve this problem by standardizing data on tax revenue and overall spending, focusing on particular programs, and describing changes within each city rather than attempting a direct comparison between spending patterns.

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<sup>23</sup> A government's fiscal year typically goes from July 1 - June 30 of the following year, or October 1-September 30. Fiscal year 2013 refers to the year beginning in 2012 and ending in 2013.

## CHAPTER 2: Producing Scarcity

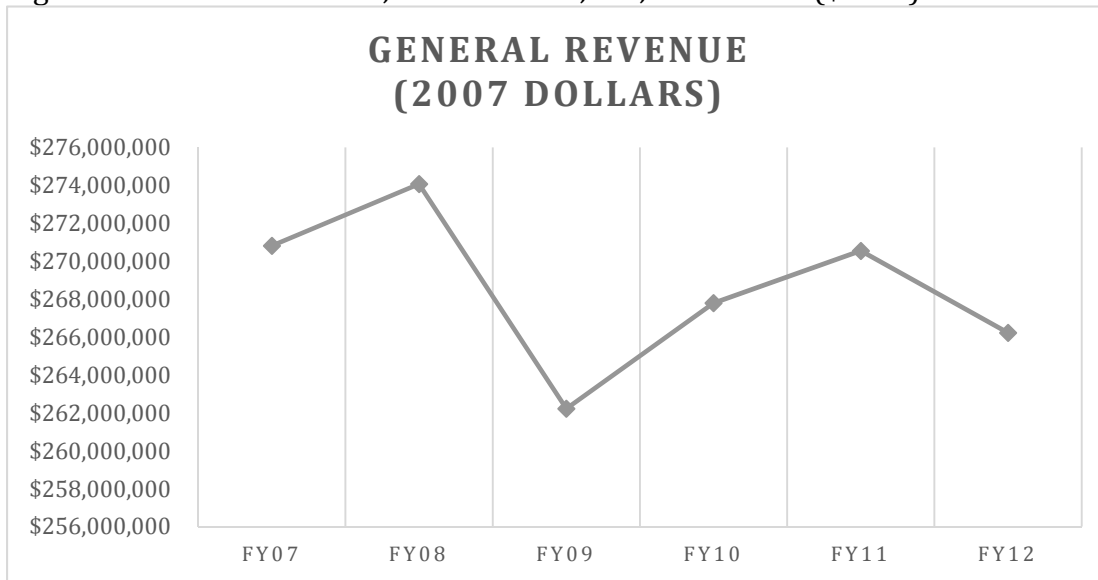
This chapter describes the revenue challenges faced by cities since 2007, highlighting several shifts that emerge as central features of this urban fiscal crisis. These include obstacles to raising taxes during the recession, the move toward more regressive forms of revenue-raising, and the retreat of state funding for local governments. This chapter also documents the volatility of city revenues, in particular the volatility generated by reliance on property taxes and abandonment of income taxes. All four cities in this study, like most other U.S. cities, saw actual revenues fall behind budgeted revenues at some point during 2008 and 2009, precipitating a mid-year adjustment and, depending on the city, a flurry of local news coverage and public debate. Much of the initial “crisis” experience of cities originates in the urgency experienced during that time.

Cities do not have unfettered power to generate revenue; rather, the federal and state governments grant and define the power of cities to levy taxes on economic activity within their jurisdiction, such as sales transactions, wage earnings, business profits, and property. Cities may also levy fees or charges for activities ranging from obtaining a business license to using a city park. City powers to levy taxes and fees, and the power to control how revenues are collected, distributed, and spent, vary significantly by state. All states put restrictions on when and how local governments can change tax rates, and in some cases states have implemented increasingly severe restrictions since the 1970s, both in response to popular tax revolts (like the one that inspired Proposition 13 in California) and as a result of the “race to the bottom” approach to attracting economic activity by lowering taxes (Swartz and Bonello 1993).

Nationally, revenues for cities have remained stagnant or declined slightly since 2008, leaving cities to manage with the same amount of money in 2012 that they had in 2008, after four years of population growth and deepening need. From FY2007 to FY2012, general revenues have declined by 2% (See Figure 2.1).



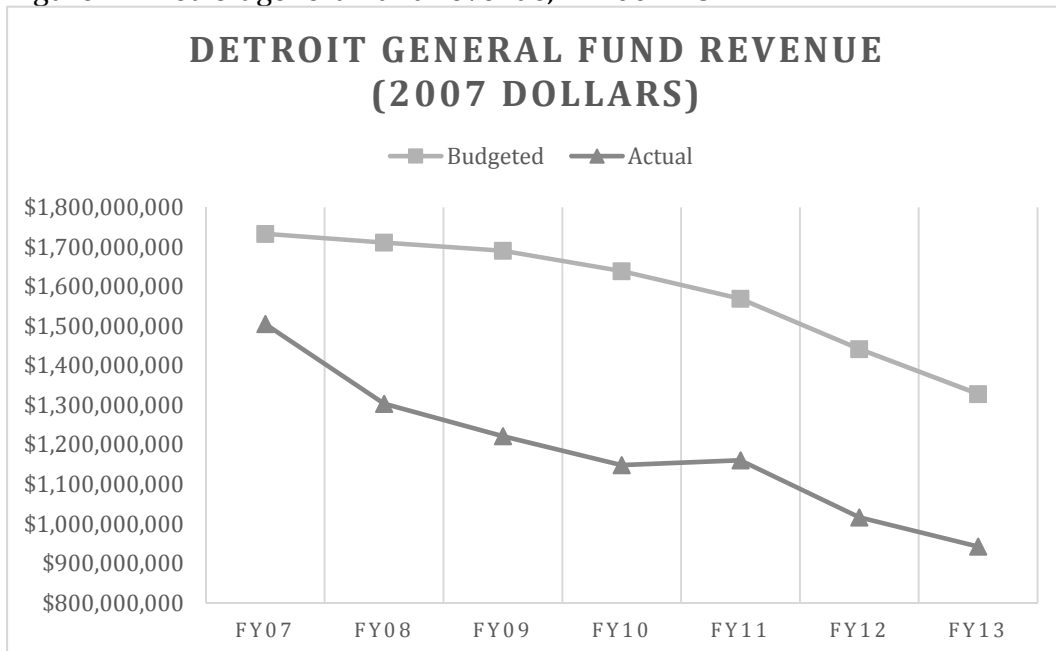
Figure 2.1. General revenue, cities over 75,000, FY2007-12 (\$000s)



Source: Census Annual Survey of Local Government Finances, compiled by author

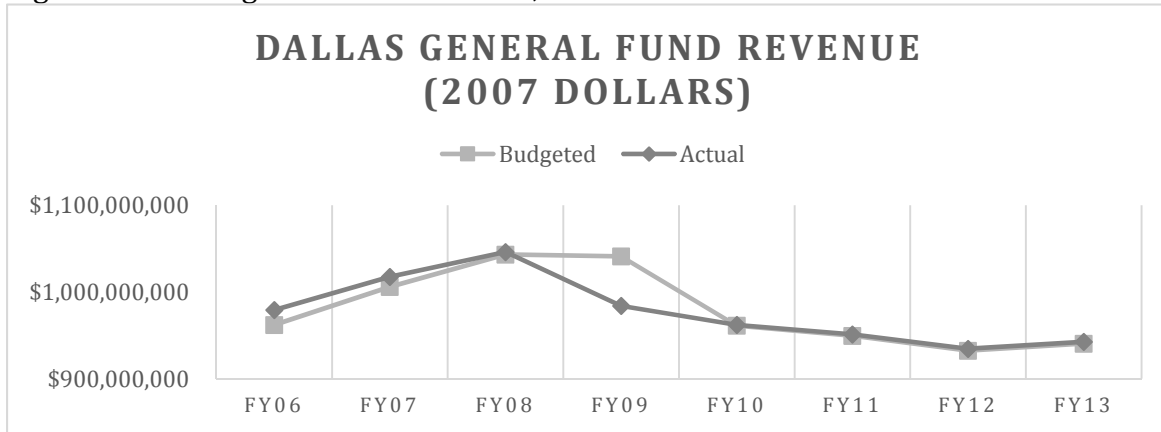
I discuss the components of this revenue fluctuation below; there is also significant variation between cities, as my cases demonstrate. San Jose’s general fund revenues increased after 2010; Detroit’s general fund revenue continued to decline through 2013, while Dallas and Philadelphia stabilized (see Figures 2.2 - 2.5). The divergence between budgeted and actual revenues is significant in Detroit, but in all four cities the gap appears biggest in FY2009.

Figure 2.2 Detroit general fund revenue, FY2007-13



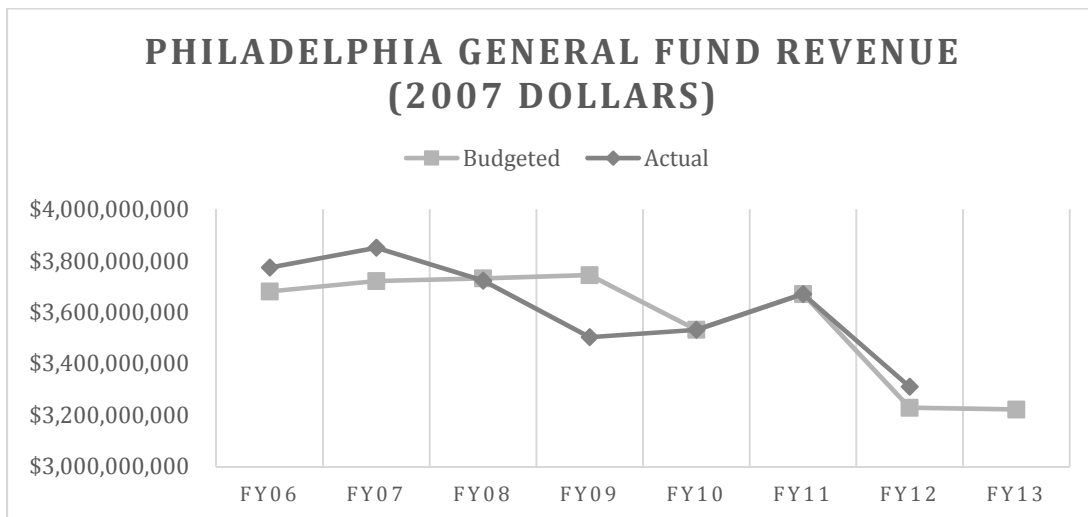
Source: Detroit budgets & CAFRs, compiled by author

Figure 2.3 Dallas general fund revenue, FY2006-13



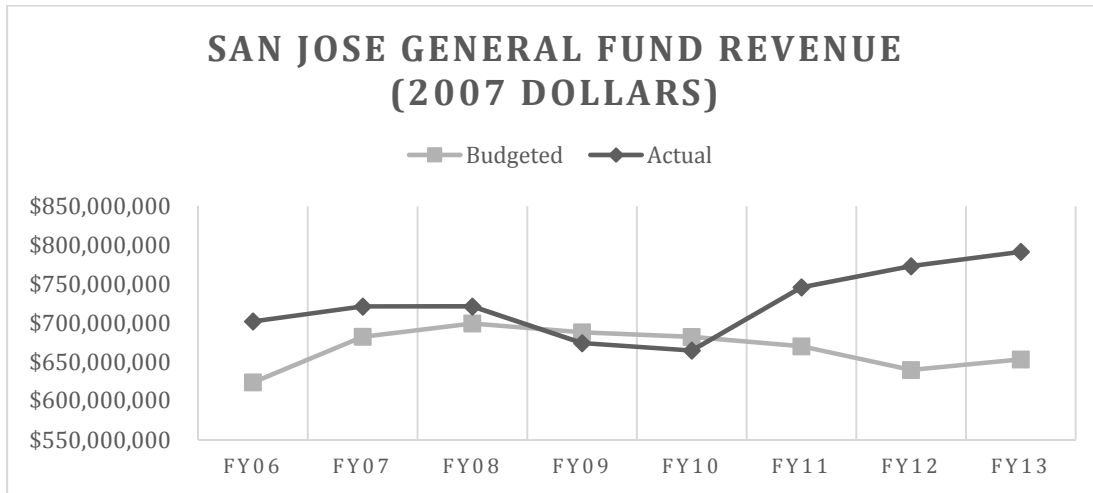
Source: Dallas budgets & CAFRs, compiled by author

Figure 2.4 Philadelphia general fund revenue, FY2006-13



Source: Philadelphia budgets & CAFRs, compiled by author

Figure 2.5 San Jose general fund revenue, FY2006-13



Source: San Jose budgets & CAFRs, compiled by author

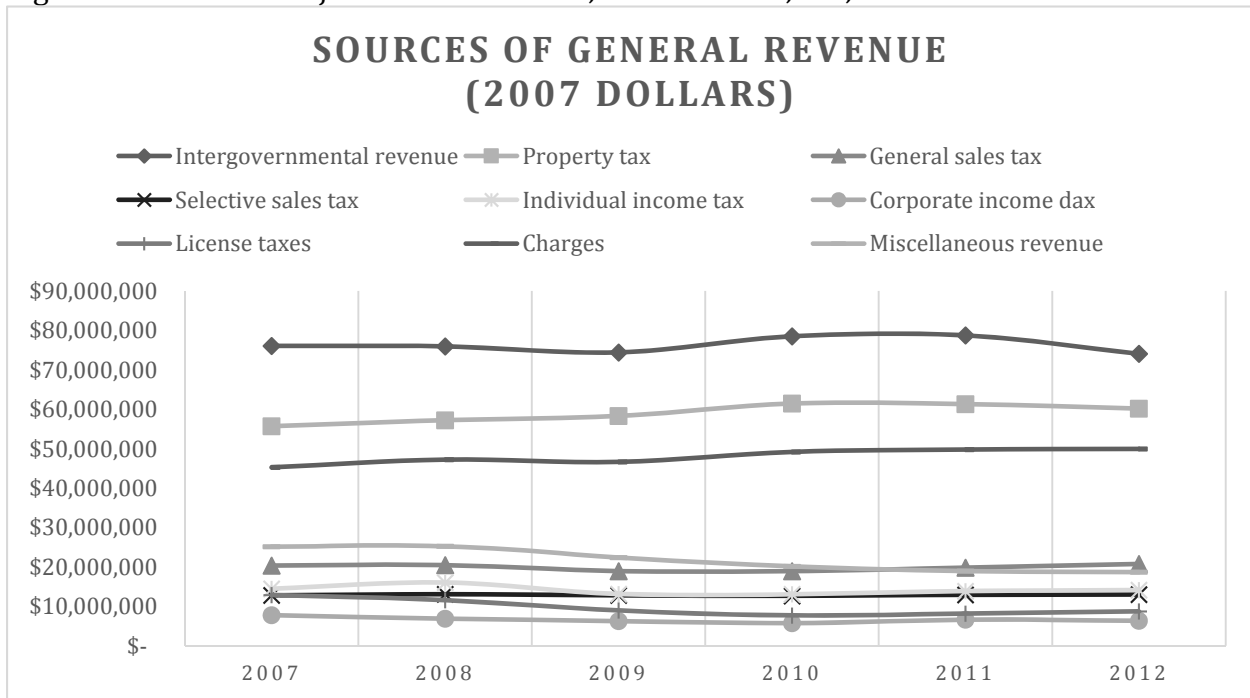
General fund revenues per capita in all four cities stagnated or declined; San Jose’s general revenue rose by in real dollars, but actual revenues rose by just \$4 per capita; budgeted revenues fell from \$740 to \$650 per capita. The variation in these four cities is reflective of the general trajectory of city finances: overall contraction and stagnation, with contraction centered in all cities from 2008-09 and diverging afterward.

While it is generally true that cities rely on property taxes, there is some variation in the makeup of general revenue sources between cities, which accounts in part for the variation in total revenues after the recession. My four cases reflect the range of variation among large cities.

In 2007, the year before the recession hit, property taxes made up 21% of all general revenue raised.<sup>24</sup> The other categories of general revenues are intergovernmental revenues (from federal, state and other local governments) (28%), charges and licenses (20%), sales taxes (13%) (see Table 2.2). Of all taxes collected by cities, nearly half were property taxes (46%) in 2007, rising to nearly half (49%) in 2012.

<sup>24</sup> All data in this section is from the Census Local Government Survey compiled in my analysis covering 425 cities of 75,000 people or more.

Figure 2.6. Share of major revenue sources, cities over 75,000, FY2007-12



Source: Census Annual Survey of Local Government Finances, compiled by author

Table 2.2 Sources of general revenue, cities over 75,000, FY2007 and FY2012 (in \$000s of 2007 dollars)

	FY2007	FY2012	FY2007-12 change
Intergovernmental revenue	28%	28%	(\$2,006,651)
Property tax	21%	23%	\$4,490,655
General sales tax	8%	8%	\$370,324
Selective sales tax	5%	5%	\$190,861
Individual income tax	5%	5%	(\$338,429)
Corporate income tax	3%	2%	(\$1,415,091)
License taxes	5%	3%	(\$4,169,528)
Charges	17%	19%	\$4,700,426
Miscellaneous revenue	9%	7%	(\$6,446,025)
Total general revenue	100%	100%	(\$4,589,030)

Source: Census Annual Survey of Local Government Finances, compiled by author

The distribution of revenue sources varies widely over my four cases (see Table 2.3). Dallas and San Jose, like U.S. cities overall, are very reliant on property taxes. Both Detroit and Philadelphia have historically relied on a city income tax. I go through each of these types of revenue more below.

Table 2.3 Sources of general revenue, case cities, FY2007

	Detroit	Dallas	Philadelphia	San Jose
Intergovernmental revenue	31%	7%	41%	9%
Property tax	13%	22%	6%	26%
General sales tax	0%	9%	2%	7%
Selective sales tax	9%	6%	2%	9%
Individual income tax	11%	0%	24%	0%
License taxes	1%	2%	11%	8%
Charges	23%	41%	11%	29%
Miscellaneous revenue	11%	13%	4%	12%

Source: *Census Annual Survey of Local Government Finances, compiled by author*

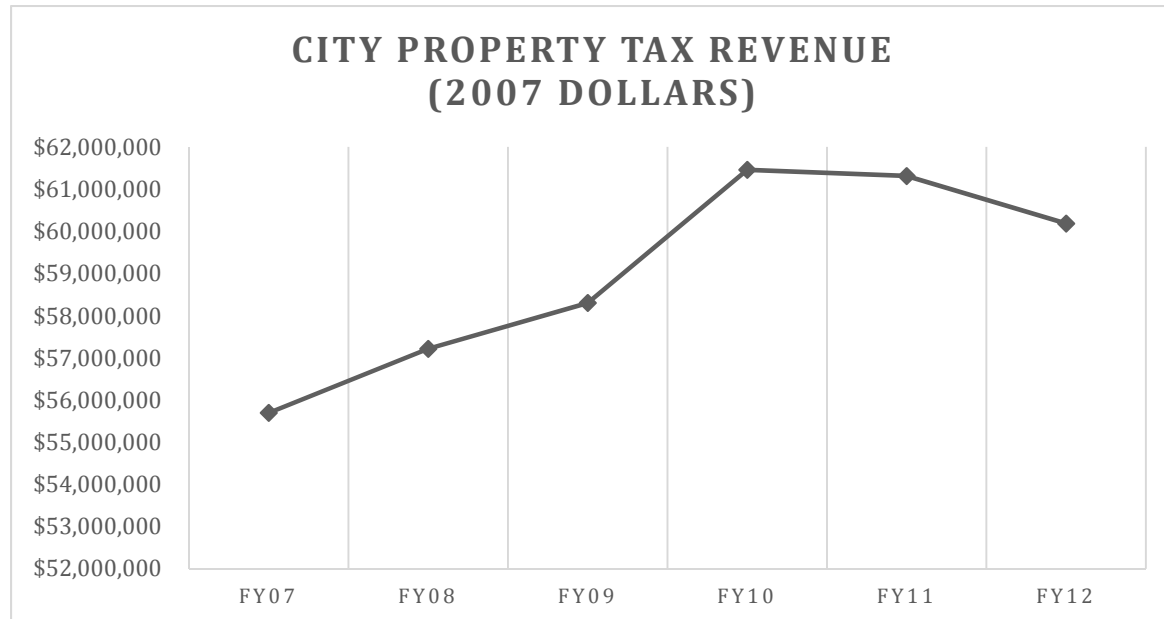
Comparing the amount of general revenues available to cities is complicated by the use of “enterprise funds.” Cities increasingly structure their budgets using “enterprise funds,” in which services or functions that are paid for by fees or charges (or even a tax) are designated as enterprise funds, separate from the general fund. Both income and spending from that service—a bridge, utility, airport, etc.—is separated from the city’s general fund. The income and spending are still reported in the city’s budget, but are held apart from the city’s general revenues (and the enterprise’s income cannot be used to pay any other city spending). The idea is that these functions are “self-funding” and shouldn’t be mixed up with the hodgepodge of city revenues (or subject to a money grab by the city when general revenues decline). Cities may also designate specific geographic areas (or development projects) for which property tax revenue (or sales tax) will be diverted into a specific fund. Those proceeds may be used to pay for specific, or to pay the costs of financing (for example tax increment financing, often used to subsidize private development). The Census survey seeks to resolve this problem by requiring cities to report all revenues and expenditures, whether part of the general fund budget or not. But the distinction creates problems when attempting to compare data from cities’ own budgets and the Census data.

## 2.1 Property tax reliance

Apart from school districts, cities rely more on property taxes than does any other form of U.S. government. Local governments (including both cities and school districts) collected 96% of all property taxes in 2009, making up 74% of local government taxes); 57% of property taxes go to school districts, 43% to cities and towns. It is for this reason that the concentration of the Great Recession in the housing market was so devastating for cities (and school districts, although state and federal funds made up some of the school funding drop). The unfolding of property tax declines varied widely from city to city. From 2009 to 2010, property tax revenues fell by 2.5% (for all governments), the first decline since the mid-1990s (Urahn and Pew American Cities Project 2012). For cities in my dataset, property tax revenues continued to grow slowly through 2010, and then stagnated and declined (2%) in 2012 (see Figure 2.7). The coincidence of high unemployment and general economic decline with falling property values is unique to this recession, and due in part to the housing bubble that immediately preceded it, inflating property values

despite stagnant incomes. (State aid also fell by 2.6% from 2009 to 2010, the first time that both property tax revenues and state aid fell in the same year (Urahn and Pew American Cities Project 2012, 1).)

Figure 2.7 Property tax revenue, cities over 75,000, FY2007-13 (\$000s)



Source: *Census Annual Survey of Local Government Finances, compiled by author*

Nationally, housing prices began to fall in 2006-07, eventually dropping by as much as 50% in some markets (Urahn and Pew American Cities Project 2012). This drop in prices (and in sales transaction volume, which some cities also tax) did not immediately impact revenues in all cities, because sales and reassessments that drive down a city's taxable values lag behind changes in market values (FitchRatings 2012). The effect of the collapse of the housing market and the ensuing foreclosure crisis on property tax revenues varies significantly by city, both because property values behaved differently between local urban markets and because the length of time between market value changes and assessed values varies, depending on the state structure of the rating and assessment system. In some states, like California, re-assessments are only triggered by sales, which means they lag any downturn in property values by several months or longer. In my dataset, property tax revenues continued to rise through FY2010, and then declined through 2012 (Figure 2.7)

The effect of housing declines on overall city budgets also depends on the overall mix of revenue sources. By 2009, property taxes made up 25% of Dallas' general revenue and 31% of San Jose's, compared to 18% of Detroit's, only 11% of Philadelphia's.<sup>25</sup> Of taxes overall, property taxes are 60% of Dallas' tax revenue, 37% of Detroit's, 15% Philadelphia's, and 60% of San Jose's. Nationally, property taxes constitute 21% of general revenue in 2007, 45% of all taxes; that increased to 23% of general revenue and 49% of all

<sup>25</sup> From city CAFRs for fiscal year 2008-09, compiled by author.

taxes.<sup>26</sup> These percentages did not change substantially through the crisis as housing prices fluctuated. Detroit’s sales price and volume drops sharply halfway through 2007, and has stayed low, with only a slight uptick in 2013. Philadelphia’s sales volume has been slightly depressed since 2008, but sales prices have been, if shaky, on an overall upward trend. San Jose, like California, has had more volatile swings in all economic indicators, saw a dip in sales prices in 2007 but not a steep one, and a near recovery by 2014, while sales volume has stagnated.

Cities’ ability to raise property taxes is constrained by state enabling laws; property taxes are levied on residential properties, personal property (much less common), and business property (commercial and industrial, which may be treated differently by state law).

Table 2.4 City property tax powers

Dallas	Texas state law restricts cities from raising more property tax revenue than in the previous year. The tax rate is adjusted automatically to keep the total amount the same. If the council wants to raise the rate in order to generate additional revenue, it must hold public hearings, and the public can demand a direct vote on any increase. Texas also has an enterprise zone property tax abatement program, managed by the Texas Economic Development Bank.
Detroit	Michigan limits taxation to 15 mills (on each dollar of assessed value) or 18 with voter initiative. Michigan limits the increase in assessed value to 5% per year or CPI, whichever is lower. Several breaks for low-income homeowners, veterans, and others, designed to be “circuit breakers.” Several property tax abatement programs are managed by the state.
Philadelphia	Philadelphia raises relatively little revenue through property tax (called “real estate tax”), instead relying primarily on income taxes. Pennsylvania does not cap the amount of property tax that Philadelphia could levy (although it does limit all other jurisdictions). Property taxes in the city have been repressed primarily because of assessment processes, which were controversially overhauled in 2010. Pennsylvania has a “Keystone opportunity zone” that provides tax abatements for businesses.
San Jose	California’s Proposition 13 limits (1978) the increase in assessed value to 2% per year or the CPI, whichever is less. Property taxes are limited to 1% of assessed value. With few exceptions, property is only reassessed at the time of sale, at which time the assessed value is set at the sale price. California cities can also levy real estate transfer taxes if their counties don’t already.

Source: *Census Annual Survey of Local Government Finances, compiled by author*

<sup>26</sup> From city CAFRs for fiscal year 2008-09, compiled by author.

## *Detroit*

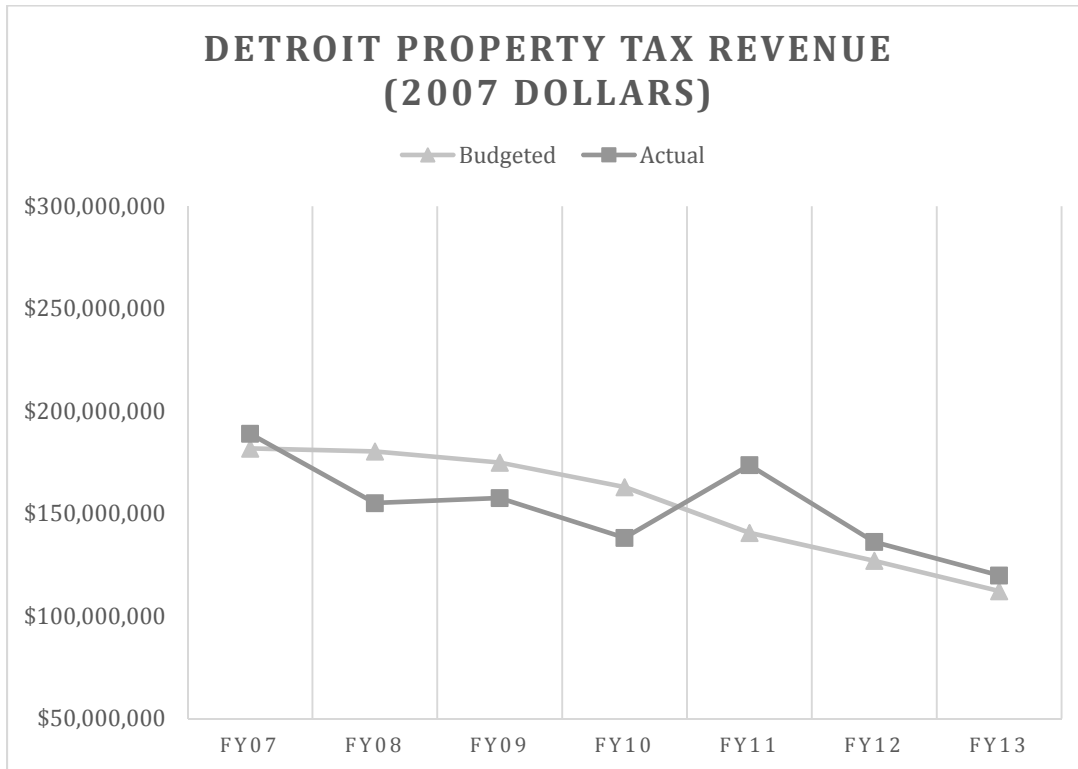
Detroit has long been unable to make property taxes work as a stable source of revenue; in FY2007 property taxes made up only 25% of all taxes collected by the city, slightly less than the revenue raised by casinos and just over half the amount raised by the city's income tax. By 2012, property taxes had dropped by 28%, to only 21% of the total taxes collected by the city. Detroit's high residential vacancy rate (estimated at 28% in 2010) has steadily driven down property values (the median sales price in Detroit was just over \$30,000 in 2012, down from \$80,000 in 2006) (Trulia.com 2015). Property tax revenues rose through the late 1990s and early 2000s, as the value of business property and assessed values increased, but the city has a high delinquency rate in property tax collection, which has plagued budgeting accuracy. In 2005, the city transferred responsibility for collecting delinquent taxes to the county in exchange for a portion of the value, and estimated that collection rates would approach 95% (after dipping around 80%). That solution turned out to be short-lived (and put the city into an ongoing battle with the county that the state has declined to resolve). Property tax revenues declined by nearly 20% from 2008 to 2012, a function of both property value decline (16%) and a rising delinquency rate.

Detroit's high delinquency rate for property taxes reflects an agonism over taxation in cities where residents perceive that government services are inadequate. It also highlights the effect of deep poverty and economic decline when residents have to choose between paying property taxes and basic consumption. Detroit's ongoing focus on increasing property tax collections (a repeated theme of Mayoral speeches; nearly every budget claims that *this* will be the year that the delinquency problem is solved). In 2007, Mayor Kilpatrick proposed a one-time amnesty program for delinquent property owners, to be followed by an aggressive campaign of enforcement (Kilpatrick 2007, 8). Raising the property tax rate has never been on the table in Detroit throughout the crisis. Detroit already levies nearly the highest property tax rate permitted by Michigan law; Detroit's property owners pay nearly twice again as much property tax to several other entities, including the state, the county and the school district.

Detroit's situation is a reminder that a city's tax capacity is a function not just of the assessed values and tax rate, but of the economic resources of residents and their relationship to that property and their government. These issues have driven an effort by the city's emergency manager, and now Mayor Duggan as the city leaves bankruptcy, to reduce assessments across the board in 2014, and to propose reassessing all city properties in response to complaints about over-assessments (Alberta 2014). In the long term, stabilizing the property tax will be an important aspect of making Detroit's revenue mix more similar to most large cities, but the state-driven move from income to property taxes has been prolonged by the bankruptcy.



Figure 2.8 Detroit property tax revenue, FY2007-13



Source: Detroit CAFRs, fiscal years 2007-2013, compiled by author

### Dallas

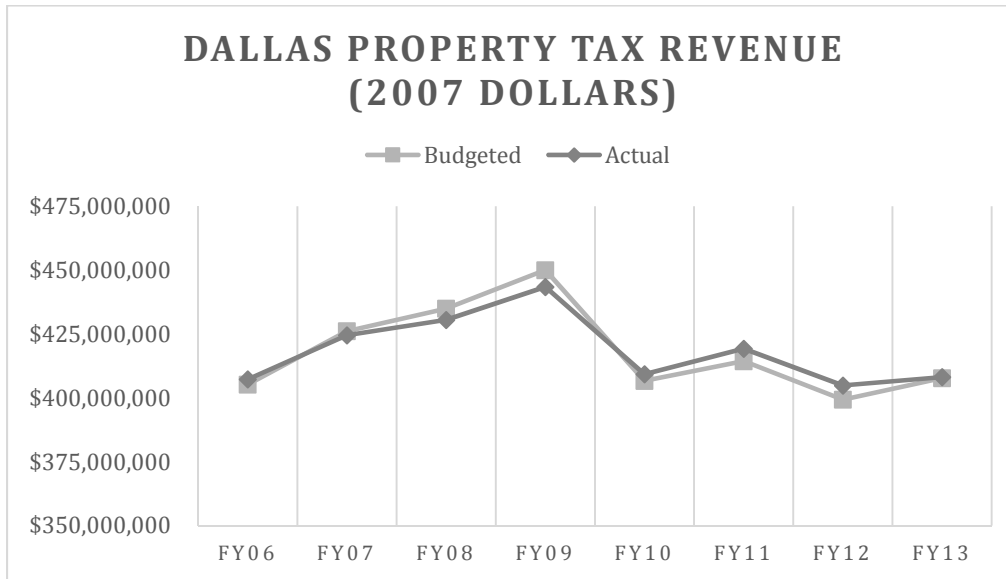
Property tax revenues in Dallas, which made up 42% of its general revenues in 2007, fell by more than 10% in 2009. Declining property values and the failure of the city to maximize its property tax increases have kept Dallas’ budgeted revenues at nearly 10% below their peak in 2008-09. Dallas’ conservative approach to budgeting is in part because the city’s property tax rate must be adjusted every budget cycle to produce the same amount of revenue as the previous year, regardless of actual expenditure needs, inflation, or population increases (*Texas Local Government Code 2013*).<sup>27</sup> This law means that in years when home values rise, the property tax rate will automatically fall, preventing the city from automatically capturing the benefit of increased home values. The city council can vote to increase (or decrease) the property tax rate to override this requirement, but it must hold separate public hearings on the tax increase and voters may petition to put any tax increase on the ballot. This process puts the property tax rate in play every year, but it also brings an inherent, albeit incremental, volatility to property taxation, and contributes to the city’s orientation to incremental and cautious spending. Dallas’ property tax rate has

<sup>27</sup> Getting around this requirement takes considerable political will, and was made more difficult by revisions to the code in 2013.

increased steadily since 1990, albeit in fits and jumps (and a couple of tax cuts along the way), reflecting both political circumstance and fluctuations in the property market.

Despite several recent rate increases, the city is still levying well below the maximum allowed by state law (which is \$2.50 per \$100 valuation), and despite heated debates during the crisis, proposals to raise the property tax in 2009 failed to pass a majority of the council (R. Bush 2009c). Even as assessed values fell and the city manager proposed significant spending cuts. The City Manager said she would consider tax increases only “if I think it’s the end of the world” (Merten 2010). Property tax increases continued to be shunned by most of the council, although the falling property values meant that legally the city could raise the tax rate by as much as 13%. The *Dallas Morning News* reported that “Almost every city council member has been adamant that one thing Suhm can’t propose is raising taxes.... At a time of rising unemployment and dropping home values, the chance of convincing residents of the need to increase the property tax rate is slim to none” (R. Bush 2009a). In September of 2009, Council member Atkins insisted on putting a property tax increase before the council for a vote; only four of the 14 council members voted for it (R. Bush 2009c). The *Dallas Morning News* editorialized against a property tax increase, arguing that the budget contained a slew of fee increases that would be “a double whammy for many families” (Editorial 2009). The paper also suggested that things would be even worse in 2010: “Raising taxes should be reserved for a worst-case scenario. Unfortunately, the worst may still be ahead” (Editorial 2009). Alas, failing to enact a tax increase in 2009 effectively reduced the increase the council could approve in following years, since the legal rate increase is limited by the amount of revenues raised the previous year. Over the opposition of the mayor, Dallas council members approved a 6.5% property tax rate increase in 2010, supported by representatives of the poor city districts, whose residents had long complained of inadequate services and infrastructure (R. Bush 2010b). That rate increase was not enough to offset the fall in property values, the city’ property tax revenue did stabilize in 2012-13.

Figure 2.9. Dallas property tax revenue, FY2006-13

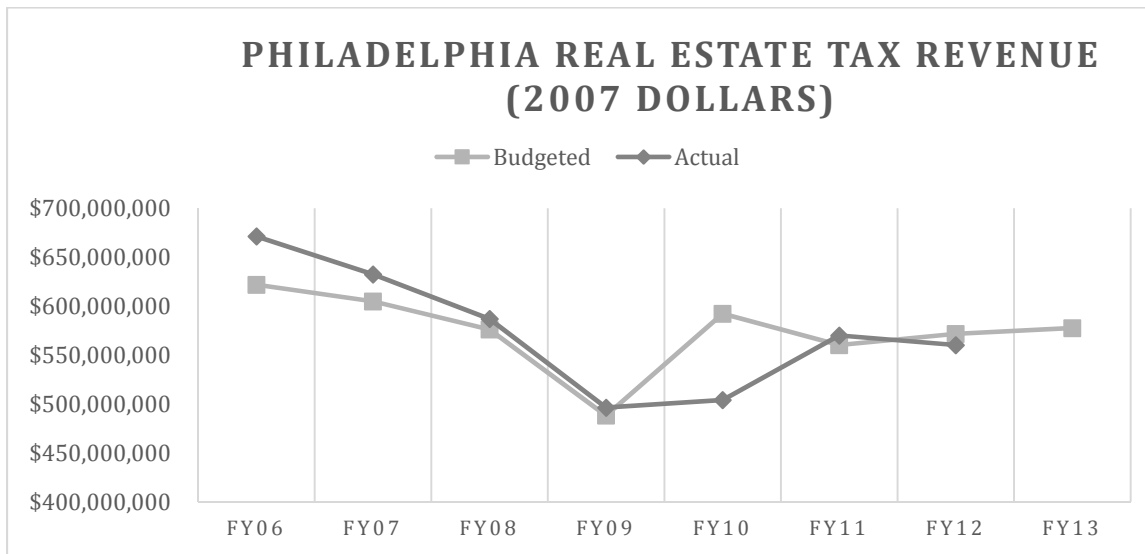


Source: Dallas CAFRs, fiscal years 2006-2013, compiled by author

### Philadelphia

Philadelphia relies very little on property tax (only 6% of general revenues), less than any city of its size. Since before the recession began, the city has been moving toward increased reliance on property taxes and away from income taxes (which were 24% of its revenue in 2007). The city's low property tax revenue is a function of its very low value assessments, rather than its tax rate. The city is trying to expand its collection of property taxes through a revised assessment system called "Actual Value Initiative" or AVI) and by reducing delinquencies, but so far those increases are equivalent to other residential tax reductions. The property tax rate has increased from 3.305% in 2008-2010 to 4.462% in 2013, after which the city switched to a different system for assessing value, which reduced the rate to .6018%, to increase to .6317% in 2016; for all property owners, this will represent an increase in their property tax bill. While the changes to the city's tax system were touted as being "revenue neutral," the long-term goal as articulated by the state has been to decrease the city's business and income taxes (see below), thereby increasing the city's reliance on property taxes as the primary levy on all individuals.

Figure 2.10 Philadelphia real estate tax revenue, FY2006-13

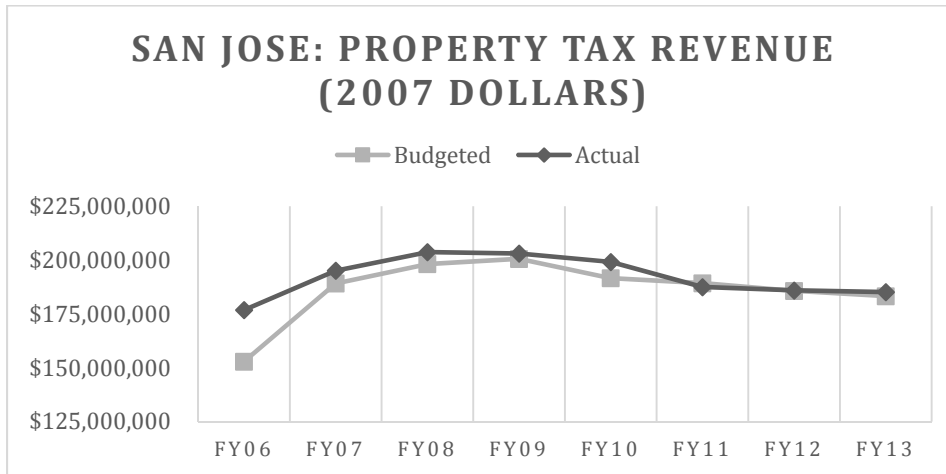


Source: Philadelphia CAFRs, fiscal years 2006-2013, compiled by author

### San Jose

San Jose relies on property taxes for 30% of its general fund revenue, but is constrained by California’s Proposition 13, which sets the rate cap at \$1 per \$100 valuation, requires 2/3 voter approval of any tax rate increase, and freezes assessment increases to the rate of inflation except when properties are sold (*People’s Initiative to Limit Property Taxation* 1978). The city thus fails to capture most of the increase in valuation, particularly for commercial property, which has a very low turnover rate. On the downside of a property market bubble, is required by law to reassess properties under the state’s Proposition 8, which allows owners who owe less than their home’s purchase price to have their property reassessed. While there have been murmurings about repealing Proposition 13 at the state level, cities in California do not have the option of raising their property taxes for general funds (school districts can ask voters to approve parcel taxes, an earmarked property tax increment, but cities do not have this power).

Figure 2.11 San Jose property tax revenue, FY2006-13



Source: San Jose CAFRs, FY2006-14, compiled by author

Despite the severity of the housing market collapse, most large cities continue to rely on property taxes as the largest source of tax revenue. The diversity of constraints facing these four cities exemplifies the precarity and limitation of property values as a primary source of revenue.

This recession provided a stark reminder that property values play a pivotal and volatile role in city finances. The absence of any discussion by local officials about the reliance on property taxes (and their control by local, rather than state, governments) reflects a widespread political acceptance of cities' reliance on property taxes, although some scholars have noted that more diversified revenue base could be more stable (Chernick, Langley, and Reschovsky 2011a)(there is, by contrast, more criticism of school districts' reliance on the tax, which has been demonstrated to contribute to significant educational inequalities (Kenyon and Reschovsky 2014)). Despite the severity of the housing crisis, and its centrality to the Great Recession, there was little local debate in any of my cities about the dangers of relying on property taxes; in fact cities with relatively low reliance on property taxes (such as Detroit and Philadelphia) are working to increase that reliance. Property values vary more significantly between cities than do incomes, property taxes represent a more unequal, and less progressive, source of income for cities.

State limitations and local political opposition to property taxes also make property taxes one of the least flexible sources of revenue for cities (Sokolow 1998). National campaigns to reduce local taxation have centered on property taxes, in part because their payment is more concrete for residents than sales taxes, which are paid in increments over the year. The property tax has long been a particular target of anti-tax sentiment. One reason for its unpopularity is that property values fluctuate independent of the incomes of property owners, at least in the short-term. Many anti-tax revolts were prompted by stories of property owners who could no longer afford the taxes on fixed incomes when property values escalated. The first wave of public pressure for property tax limitations began during the Depression, driven by high delinquency rates and the fact that tax assessments did not fall as quickly or as far as housing prices, a pattern repeated in

significant part during the Great Recession (see Yuan et al. 2009). A second wave in the 1970s and 1980s was encapsulated by the passage of Proposition 13 in California in 1978, which caused California property tax revenue to plummet by 57% within a year (see Yuan et al. 2009, 153). California local governments were immediately rendered more dependent on state aid and turned toward fees and charges (and eventually sales taxes) to compensate for the lost revenue. According to Yuan, 43 states adopted new property tax limitations (or provisions for homeowner relief) between 1978 and 1980 following the passage of Proposition 13 in California (see Yuan et al. 2009, 153) These restrictions increased dependence on state aid and increased fiscal centralization, as well as increased reliance on non-tax revenue sources, including fees/charges and state aid (Sokolow 1998).

## 2.2 Tax limits

State governments, in addition to providing legal restrictions on tax increases, also shape cities' revenue options by pushing the reduction or phasing out of specific types of taxes, in particular city income taxes and business taxes. There were instances in which states enacted stronger restrictions during the current recession, but these restrictions were predominantly adopted in earlier waves of tax cuts (the phasing out of both Detroit and Philadelphia's income taxes began several years before the current recession) (see Bowman and Kearney 2012). Such restrictions, which center on the property tax, severely constrain cities' options for responding to economic downturns.

States have always tinkered with limitations on the powers of cities to raise revenues. In 1995, the Advisory Commission on Intergovernmental Relations (ACIR) reviewed state laws limiting local government taxation and spending (Advisory Commission on Intergovernmental Relations (ACIR) and Center for Urban Policy and the Environment Indiana University 1995).<sup>28</sup> The report raised several concerns stemming from the growing number of such limitations: increased reliance on regressive revenue sources (fees and charges), and increased dependence on state aid and growth of state spending on specific services: education and highways. Most limitations took the form of restrictions on property taxes, both overall rate limits, and a new form of limitation at that time, limits on general revenue or expenditure increases, and restrictions on assessment increases (which took most restrictive form in California) (see Anderson 2012a).

There was little research or political attention given to the impacts of state laws on local government fiscal health through the late 1990s and early 2000s, in large part because relative local revenue growth, particularly in the form of property taxes, brought a measure of temporary stability. As the recession began, there was some renewed attention to the precarity of local revenue in relation to state policy in particular. In 2007 a group of researchers affiliated with the Lincoln Land Institute looked at the relationship between tax and spending limits cities' ability to provide services, and found that the encroachment of state control over local revenues has left cities highly dependent on property tax, a

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<sup>28</sup> Alas, the ACIR was slowly marginalized and eventually abolished in 1996 by President Clinton, ending an era of federal focus on intergovernmental relations (McDowell 1997).

politically unpopular tax that is highly restricted by state governments (Yuan et al. 2009). These limitations generate a conflict between a drive toward localism and decentralization and the inadequacy (in the view of local officials) of local revenues to pay for needed goods and services. Some of these tax limitations were supported by voters in the name of stopping out-of-control government spending, but legislated at the state level they have produced a more centralized form of revenue decision-making that prevents urban residents from deciding the size of their own governments (Yuan et al. 2009).

### *Attack on city income taxes*

With most states already several restricting property taxes, states have turned to eliminating a more progressive but rare form of city revenue, the income tax. For the federal government, the primary source of tax revenue is the individual and corporate income tax, and states, too, rely heavily on income taxes. By contrast, only fourteen states allow local governments (including cities, counties, and school districts) to levy income taxes.<sup>29</sup> Several large cities levy taxes on individual earnings of people living or working in city boundaries: Denver, Detroit, Cleveland, Columbus, New York City, Philadelphia, and Baltimore. San Francisco and Portland (Oregon) levy a payroll tax on employers. Philadelphia also levies a corporate income tax. In my Census dataset, 30 of 425 cities have data for individual income tax; 8 for corporate income. Because they are levied by a small group of cities, income taxes are easy pickings for lists of “highest taxes” and the discourse of cities in competition for residents and businesses pinpoints any tax difference from other cities. Thus although income taxes are far less volatile than property taxes, and are more progressive, they have fallen out of favor. Over the past 20 years, political pressure to reduce income tax rates has come from state governments. Both Detroit and Philadelphia have been under pressure to reduce their income taxes by people arguing that workers (especially the most affluent) simply move to the suburbs to escape the tax, and that businesses move out to be more attractive and closer to their workers. (Neither Dallas nor San Jose collects a city income tax, so they are not part of this discussion.) In both Detroit and Philadelphia, the reduction in income tax has been a leading contributor to their overall revenue decline, as property taxes have yet to become a viable replacement income source. As the two cities’ income taxes are further phased out, it is not clear how either city will make up the difference.

### *Detroit*

Detroit’s collection of income tax is subject to several constraints by the state of Michigan. Although Michigan’s City Income Tax Act (1964) allows any city to levy an income tax (22 cities do), it sets a higher rate for cities over 600,000, which only includes Detroit. Public Act 500 of 1998 amended the City Income Tax Act to reduce the income tax rates in Detroit, and in 2002, the law set policies for it to rollback if a city no longer meets criteria for financial distress, with the goal of phasing out the tax completely. From 2003 to

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<sup>29</sup> States where all or most counties, cities or school districts levy income taxes are Maryland, Kansas, Kentucky, Ohio, Indiana, several cities in Michigan, Pennsylvania

2012, the rollback was suspended (from 2004-2007 because Detroit met the criteria of fiscal distress, for 2008 and 2009 because state legislators passed a law giving the city a reprieve, and in 2010 and 2011 the city again met the criteria for freezing the rollback). Beginning in 2012 (while, ironically, the state was pushing for a declaration of crisis and the imposition of an emergency manager), Detroit no longer met those criteria and the rollbacks began again.

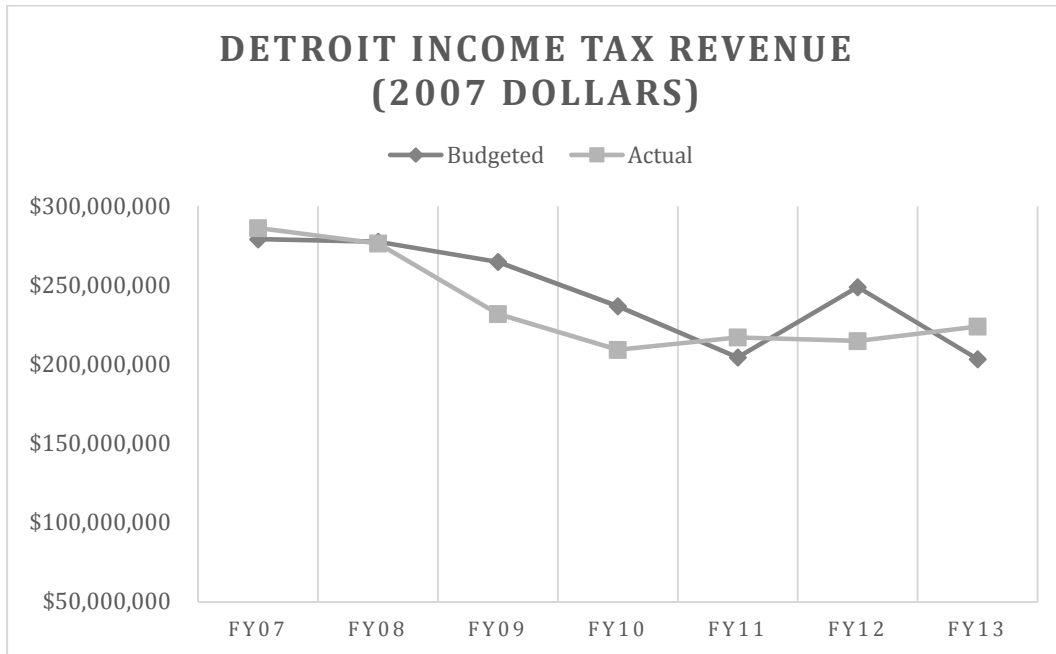
Another income tax challenge that Detroit faces is that the money from the tax is collected by the state and then returned to the city. This process creates two difficulties: (1) the city is dependent on the state exercising its authority to pursue individuals who fail to pay the tax, which city officials allege it has been negligent in doing, and (2) the state's timeline for returning the money to the city is often quite long, and has contributed to the city's worsening cash flow problems. In late 2011, Mayor Bing expressed his frustration at the city's difficulty in collecting income taxes:

We've requested assistance in collection of the City's income tax, a service Lansing could provide that would help us collect up to approximately \$155 million in additional revenue on an annual basis. We've asked the State to see what they can do about the \$220 million owed to the City of Detroit that helped put us in a fiscal crisis in the first place. Refusal to consider those proposals while initiating this [takeover] process sends a disturbing signal to our community. (Bing 2011b)

In 2010-11, the city's income tax was budgeted at \$215 million, a \$30 million decrease from 2009-10 and down from a high of \$378 million in FY2000. Throughout 2011-12, the city tried to negotiate a modification of the law by offering to create a new private lighting authority to appease the state's demands for privatization, but negotiations fell through in July 2012. The cut imposed in 2012 (2.5% to 2.4% for residents and 1.25% to 1.2% for nonresidents) is estimated to cost the city \$8.5 million a year. In the plan Orr presented to creditors June 14, 2013, in the process of pre-bankruptcy negotiation, he proposed eliminating its income tax (K. Orr 2013). In the bankruptcy plan of adjustment, Detroit's income tax is preserved, but collection of the tax has been handed over to the State. The rollback has been halted at least temporarily, until the property tax collection rate and reassessment program has stabilized the property tax as a significant source of Detroit revenue.



Figure 2.12 Detroit income tax revenue, FY2007-FY13



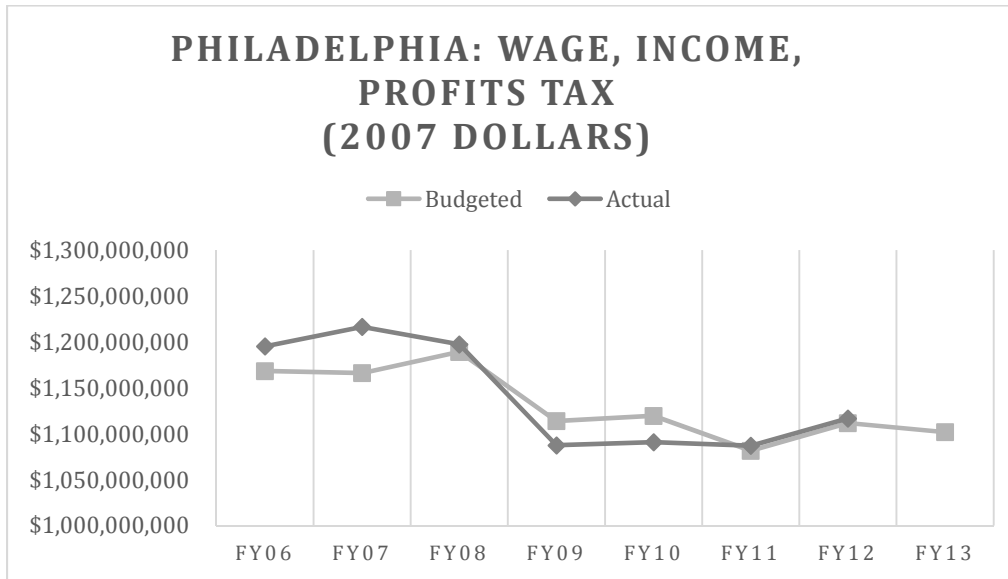
Source: Detroit CAFRs FY2007-2013, compiled by author

### Philadelphia

Philadelphia’s largest source of revenue is a tax on earnings by people living or working in Philadelphia, making up over half of its total tax revenue, more than twice the amount raised by its property tax. In 1939, the Sterling Act authorized Philadelphia to levy a tax on income earned by people working in the city, at the time in response to fiscal distress fueled by the Depression. Today, Philadelphia levies a 4.0% tax on individuals earning income in the city, as well as a wage tax paid by employers in Philadelphia on the wages earned by their employees. Since its state bailout in 1991, Philadelphia has been under state pressure to reduce local taxes to spur economic development; the wage and earnings tax has been cut steadily since 1995. From 1995 to 2007, under state pressure to cut taxes to spur economic development, the city cut a total of \$1.6 billion in wage and business taxes. From 2000 to 2007, the city cut \$1.1 billion in wage and business taxes; beginning in FY14 those cuts will cost \$230 million per year.<sup>30</sup> In 2007, the Mayor affirmed his commitment to the tax cuts, but noted that the city’s revenue growth from 2004-2007 was only in the “volatile realty transfer tax and business privilege taxes,” while wage taxes, slated for reduction, still constituted half of all tax collections. The reductions were temporarily suspended from FY10-FY14 in response to the city’s budget crisis. Business privilege tax cuts were also implemented from 1995 to 2008, part of the mandate by PICA to focus on economic development by shifting emphasis to the property tax.

<sup>30</sup> Information compiled from Philadelphia CAFRs for FY2007-2014.

Figure 2.13 Philadelphia wage and income tax revenue, FY2006-FY13



Source: Philadelphia CAFRs FY2006-2013, compiled by author

The tax limits era of the 1970s and 1980s produced a landscape in which cities have few revenue options to weather economic recessions. Like all taxes, property tax increases face significant political obstacles in the current political climate, compounded by state limitations on tax increases and growing state control over all revenue decisions. These limitations have produced a precarity in city finances and they raise important questions about how local governments (which are prohibited from deficit spending) should behave in a recessionary environment.

Despite the political obstacles to making revenue changes, it is not the case that voters don't support increases in local taxes. Residents often testify at budget meetings in opposition to tax increases, but polling consistently demonstrates public willingness to pay, and council members who know their constituents have stood up and advocated for tax increases in all four of my cases. The issue of tax competition does matter for cities, and Mayors or city council members sometimes refer to property tax rates of neighboring jurisdictions, or other cities of comparable size in the same states). Certainly cities compare their tax structures and levels to other cities, often using lists widely circulated about local tax burdens. One of the key elements of the "competitiveness" narrative has been competition for low tax rates, particularly on business taxes and to a lesser extent on income taxes. There are many lists of "good" tax states and cities, rankings, that take for granted that a "good" tax structure (i.e. low taxes, particularly on key taxpayers such as businesses and high-income workers) promotes economic growth and influences business' decision to locate or expand in a city (see e.g. Kennedy 2012). In general, this has meant a move away from business taxes and progressive taxes on individuals (i.e. income or wealth taxes) and toward more regressive forms of revenue, despite their instability and disproportionate burden on low-income residents (see e.g. Tomlinson 2015).

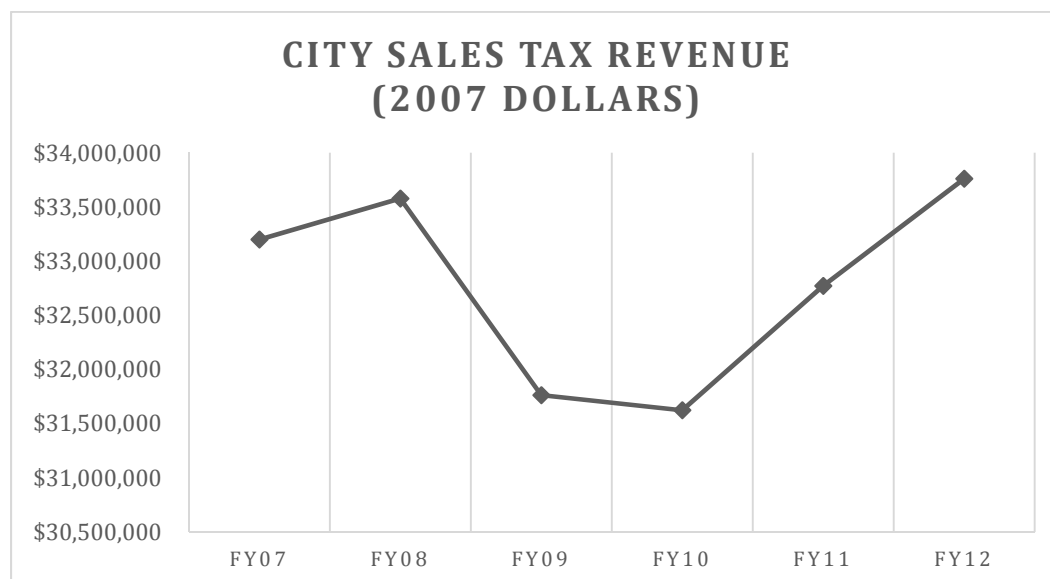
## 2.3 Regressive taxation

There has been a measurable shift toward more regressive forms of taxation, in particular sales taxes and fees and charges. This shift is in part because cities have greater control over such revenue sources, so are able to pass increases in times of need, and also in part because such regressive taxes tend to be more politically palatable.

### *Growing sales taxes*

Sales taxes are the second-largest source of city tax revenue; many cities are allowed to levy an additional general sales taxes on top of any sales tax levied by the state or county, and cities also levy special sales taxes. Particularly given the strict state limits on property tax rate changes, sales tax levies represent one of the few mechanisms by which cities can increase their taxes on their own. Some cities must take sales tax increases to the ballot, others can do it through the legislative process. Sales taxes are one of the most regressive general taxes levied by governments; the poor pay a much higher percentage of their income for goods and services than do the wealthy. Even with exemptions for food, general sales taxes are very regressive. They also response more rapidly to swings in the overall economy than do property taxes; nationally, sales tax revenue dipped more rapidly (from 2008-09) than did property taxes, but recovered much more quickly as spending rebounded (see Figure 2.14). Sales taxes are sensitive to changes in economic confidence and consumer spending, and because they are collected at the moment of spending, they track any changes in the local and national economy very closely, with little lag time. Sales taxes are appealing to local residents and politicians because they can also be framed as a way for cities to tax non-residents (i.e. shoppers from surrounding communities), driving a focus on retail development as an economic development strategy.

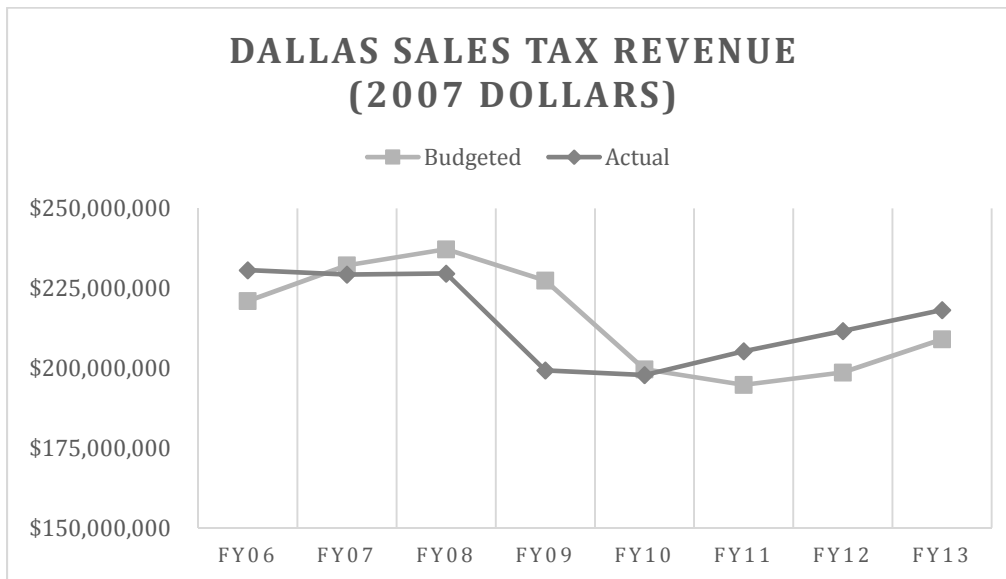
Figure 2.14 City sales tax revenue, cities over 75,000, FY2007-FY12



Source: Census Annual Survey of Local Government Finances, compiled by author

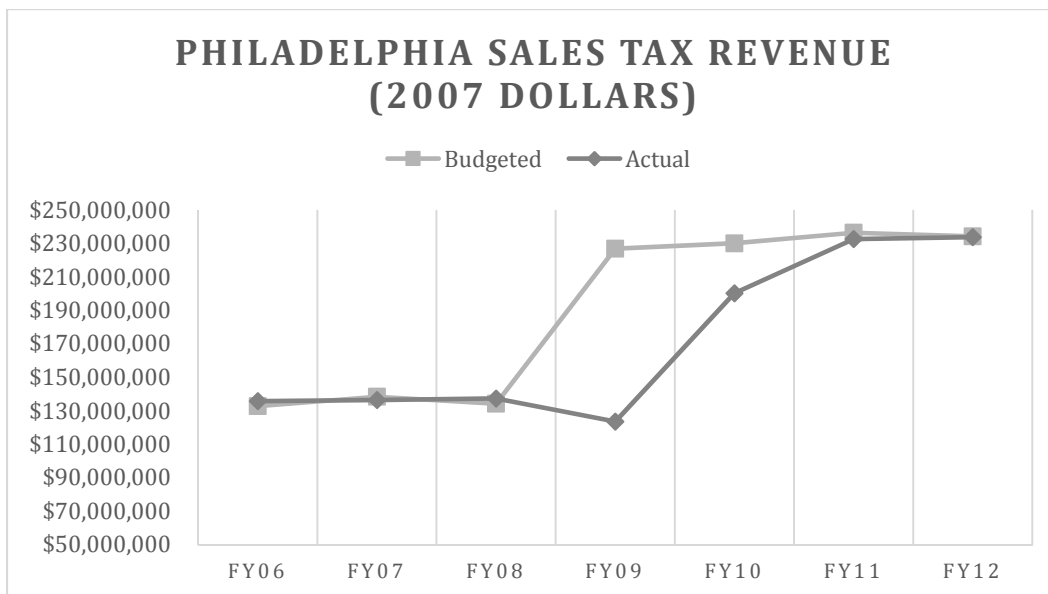
Detroit levies no sales tax itself, although the state levies a 6% sales tax that it uses to fund revenue sharing programs, among other things. At no time during the bankruptcy was a city sales tax proposed (Long 2013). Dallas levies a 2% sales tax, the maximum it is permitted by state law, on top of the 6.25% sales tax levied by the state. Half of that 2% goes to the city's general fund, the other half to its rapid transit system. Texas has no state income tax, so sales taxes provide a more significant source of state revenue than in most states.

Figure 2.15 Dallas sales tax revenue, FY2006-FY13



Source: Dallas CAFRs, FY06-FY13, compiled by author

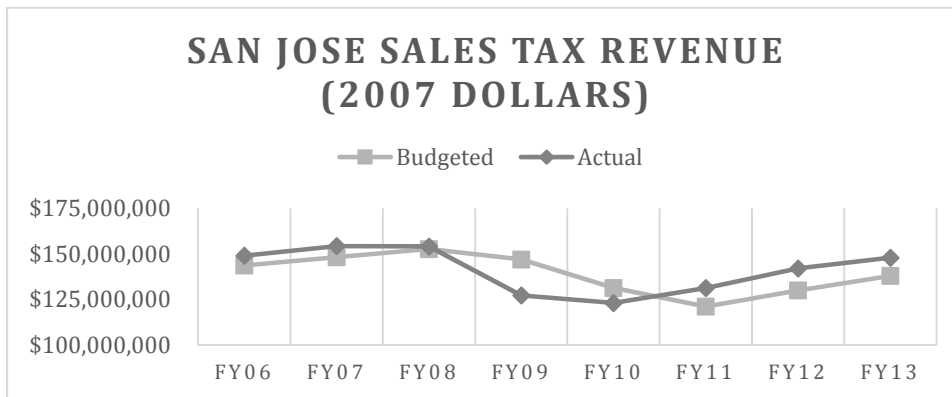
Figure 2.16 Philadelphia sales tax revenue, FY2006-FY12



Source: Philadelphia CAFRs, FY06-FY12, compiled by author

The state of Pennsylvania levies a 6% sales tax, and Philadelphia levies an additional 2% tax, the maximum authorized by state law, but sales tax revenues make up only 10% of the city's general budget. The sales tax was raised to 2% in fiscal year 2010; the state originally gave the city permission to temporarily increase its sales tax from 1% to 2%, but the increase has remained in force, despite frequent reminders by state officials that the increase should not be permanent.

Figure 2.17 San Jose sales tax revenue, FY2006-13



Source: San Jose CAFRs, FY06-13, compiled by author

San Jose's sales tax rate is 8.75%, about average for its county, higher than California. California levies a 6.5% tax, plus a 1% mandatory local tax rate.

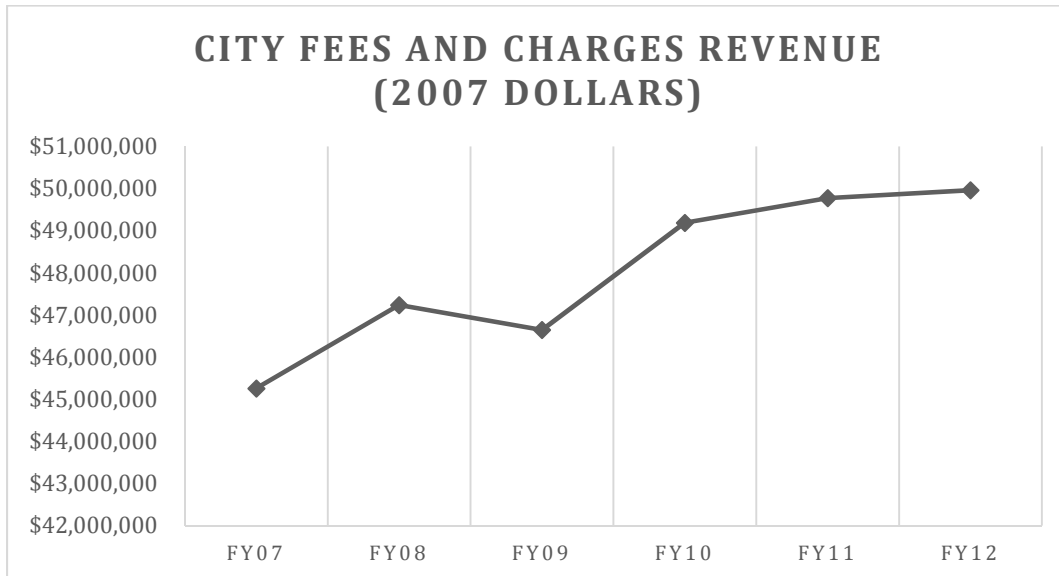
While many cities have already maximized their sales tax rates, many states are seeking to move toward greater reliance on sales taxes, away from property and income taxes (Stevenson 2013). Until such policies are instituted, the cities have the greatest autonomy over fees and charges, which have been the primary focus of revenue increases during the recession.

### *Growing reliance on fees and charges*

As sales taxes and property taxes are maxed out, cities have turned to increases in fees and charges to manage revenue problems. Many city services are supported by fees, and the idea that services should be "self-funding" if possible gives rise to the focus on pay-as-you-go funding for everything from sewer systems to parks. In all of my cases, the creation of new fees and charges, and increases to existing fees, accounted for the majority of revenue increases after 2008. Fees and charges increased steadily in real dollars through the recession, growing from 17 to 19% of city general revenue. The increased reliance on fees and charges can be difficult to capture nationally for a few reasons: first, the sheer number of fees and charges means that the Census data lumps them all into two categories: Charges and Miscellaneous Revenue. Secondly, services that can be monetized are often moved out of the general fund, often into separate enterprise funds that consist solely of revenue from that service, which means that those revenues no longer appear in the

primary government budget. Despite these challenges, we can observe a significant increase in fees and charges revenue nationally from 2007-2012 (Figure 2.18).

Figure 2.18 Growing reliance on fees and charges, cities over 75,000, FY2007-12 (in \$000s)



Source: *Census Annual Survey of Local Government Finances*, compiled by author

Fees and charges are inherently more regressive than most taxes. Often (like Detroit’s garbage fee), they are on a per-parcel or per-service basis, with no relationship to an individual’s ability to pay. They are politically appealing for two reasons. First, they feed into the notion that government services ought to pay for themselves. It’s easy to see on paper whether the garbage system, or bridge, pays for itself if you can track the revenues the service generates. Second, they are less likely to stimulate opposition by voters because they only apply to people when they actually pay for the good or service, and are paid in smaller lumps than property taxes, which are paid only once a year. The sheer variety of fees being introduced and increased defies easy summary: In Detroit, new fees were proposed on smokeless tobacco, and charges for garbage pickup were converted to a per-quarter fee system, instead of funding it from the city’s general property tax revenues. In Dallas, fees were increased for vehicle registration, health care services, traffic tickets, and garage sale permits (Findell 2015). City budgets are studded with such fees—some permanent, some temporary stopgaps during the crisis—enabling local officials to proclaim their resistance to tax increases, while increasing the cost of everything from community college credits to court fees. Over the past two years, the growing reliance of cities on fines and charges associated with the criminal justice system has received national attention (see e.g. Stillman 2013), perhaps one of the most ominous legacies of the recession.

## 2.4 Retreat of the state

States not only limit the revenue options available to local governments, but their control over a significant percentage of city funding (20% of large city revenues come in the form of state aid) adds an element of vulnerability to city revenues in times of widespread economic downturn. As early as 2009, there was a widespread press narrative of states “balancing their budgets” by cutting funding to local governments (Cooper 2011). In 2009 the Center on Budget and Policy Priorities found that 44 states faced budget deficits (all but those states reliant on energy sources) (Applebome 2009). A National Association of State Budget Officers (NASBO) survey of state leaders found that states were scrambling to close budget holes: cutting aid to schools, furloughing employees, and closing parks (Goodnough 2009). Forty-nine states have balanced budgets laws that require states to either raise revenues or cut spending in order to eliminate any projected budget deficit. By 2011, states were enacting severe cuts to services provided by cities, such as libraries, education, health care, and transportation (Cooper 2011). States that still maintained general aid support (often through complicated revenue sharing arrangements such as Michigan’s) were making significant cuts to those programs (Neumann and Levitz 2013). State legislatures began to go after remaining general state aid programs for municipalities, such as in Tennessee and Ohio (see e.g. Moody’s Investors Service 2014e). States also diverted funds from local programs, such as school districts, to plug state deficits (as in Philadelphia, for example, where the city ended up issuing debt to help the school district open after state cuts) (See e.g. Bowman and Kearney 2012, 530).

Thus, cities suffer twofold during times of widespread recession: first from the limitations placed by states on city revenues, and secondly from state budget cuts, which were widespread in this recession. Cities that have been receiving direct state aid (whether in the form of revenue sharing or other programs, such as Philadelphia and Detroit) are affected most directly, as states are able to reduce that aid quickly (and the lack of political support for cities, described in Chapter 5, makes such cuts more politically palatable than cuts to state funding for education, for example). But even in states without such programs, cuts to state funding for social programs, which are often administered by local governments, serves to reduce the scope of urban governance and thereby limit cities’ ability to serve their residents, particularly in times of need.

While much of the literature on retrenchment in the 1980s focused on cuts in federal aid to cities, a central theme of the current crisis has been the withdrawal of state aid for local governments; and the idea that that state governments balanced their own budgets “on the backs of” cities (see e.g. Cooper 2011). The role played by state funds in city governments varies widely between and even within states, but nationally, cities got about 28% of their general revenue from federal or state governments in 2007, 20% from state, 6% from federal, and 2% from other local governments.<sup>31</sup> From 2007 to 2012, that distribution shifted only slightly, with the federal share rising to 7% and state dropping to 19%; intergovernmental revenue remained at 28% of general revenue, but dropped by 3% in real dollars.

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<sup>31</sup> Census Annual Survey of Local Government Finances, compiled by author.

Figure 2.19 Total intergovernmental revenue, cities over 75,000, FY2007-FY12 (in \$000s)



Source: *Census Annual Survey of Local Government Finances, compiled by author*

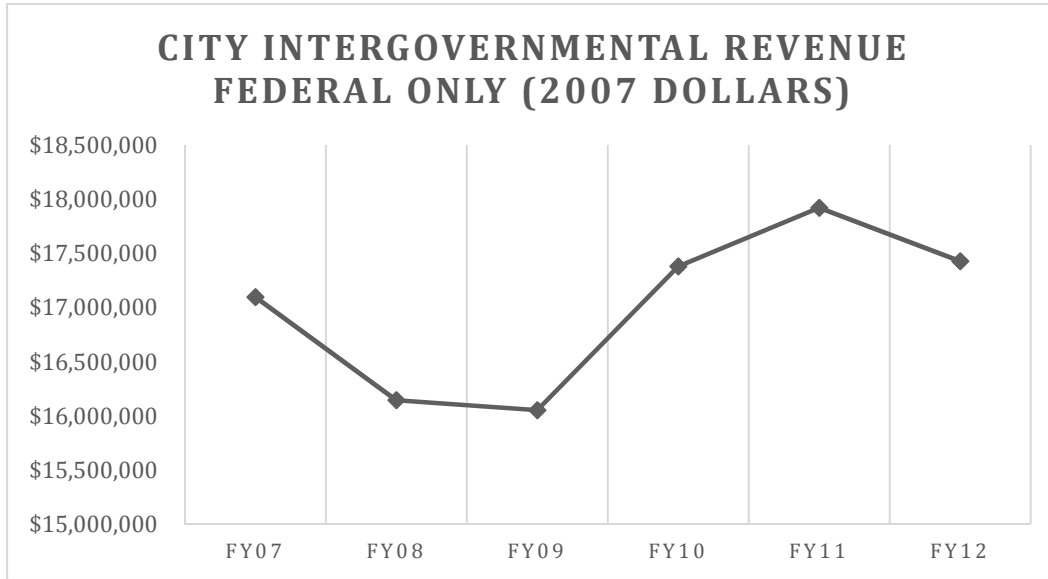
The role of the federal government in providing fiscal stability for local governments—and in redressing the vast inequalities in fiscal capacity, particularly between city and suburban governments—has been drastically reduced over the past 40 years. Federal revenue sharing was introduced in 1972 motivated by concerns about urban poverty, central city deterioration, and uneven development (Liner 1989). By the mid-1970s the political support for this was already wavering. In 1986 President Reagan embarked on his agenda of devolution and withdrawal from urban policy, and replaced federal revenue sharing with block grants. Much of the literature about city-suburb inequality from the 1980s and 1990s emerged as the fiscal consequences of devolution for central cities were becoming clear. The much-touted revitalization of central cities has not fundamentally changed much of that reality, although inner-ring suburban poverty and budget problems have also become significant challenges (although many suburbs simply don't provide much in the way of services, and don't have comparable fixed infrastructure costs, so their fiscal situation is different) (T. N. Clark and Ferguson 1983). Since the end of federal general revenue sharing in the 1980s, virtually all of the money cities receive from the federal government is in the form of grant aid, tied to specific program spending (Liner 1989).

The story of federal devolution no longer defines what's happening in cities, which now get more revenue from state governments than federal. Federal intergovernmental funds to cities have been relatively stable over the past decade. Federal intergovernmental revenue for cities still makes up a small share of general revenues—about 6% of all general revenue for cities over 75,000 in 2007— but is dwarfed by state intergovernmental revenue, which made up 20% of all general revenue in 2007. These figures did not change from 2007-2012. But the absence of significant federal urban spending continues to plague



cities; it would be a mistake to dismiss the federal budget and federal policy as unrelated to the fiscal situation faced by cities during the Recession.

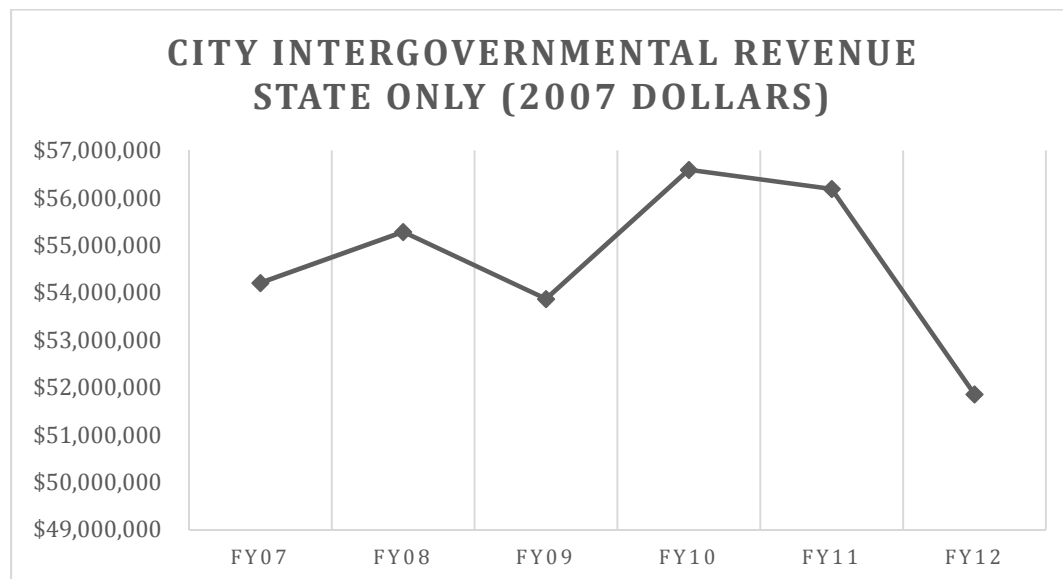
Figure 2.20 Federal intergovernmental revenue, cities over 75,000, FY2007-FY12 (in \$000s)



Source: Census Annual Survey of Local Government Finances, compiled by author

In the wake of federal devolution in the 1980s, many states adopted revenue sharing policies to allocate funds to local governments using taxes aggregated by the state or from the state's general fund. Such policies often contain requirements that local governments must meet in order to obtain funds or criteria for determining the amount of funds they receive. The most common forms of revenue sharing are similar to Michigan's and California's, in which tax dollars (usually raised through sales taxes) are collected centrally by the state and redistributed according to specific formulas, but with stipulations that permit the state to withhold funds in specific circumstances. Nationally, state intergovernmental revenue fell from 2008-09, rising briefly as states passed on federal stimulus money to cities, and then dropping sharply from 2011 to 2012. Federal revenues to cities made a similar drop after the stimulus ended, but not as sharply.

Figure 2.21 State intergovernmental revenue, cities over 75,000, FY2007-FY12 (in \$000s)



Source: Census Annual Survey of Local Government Finances, compiled by author

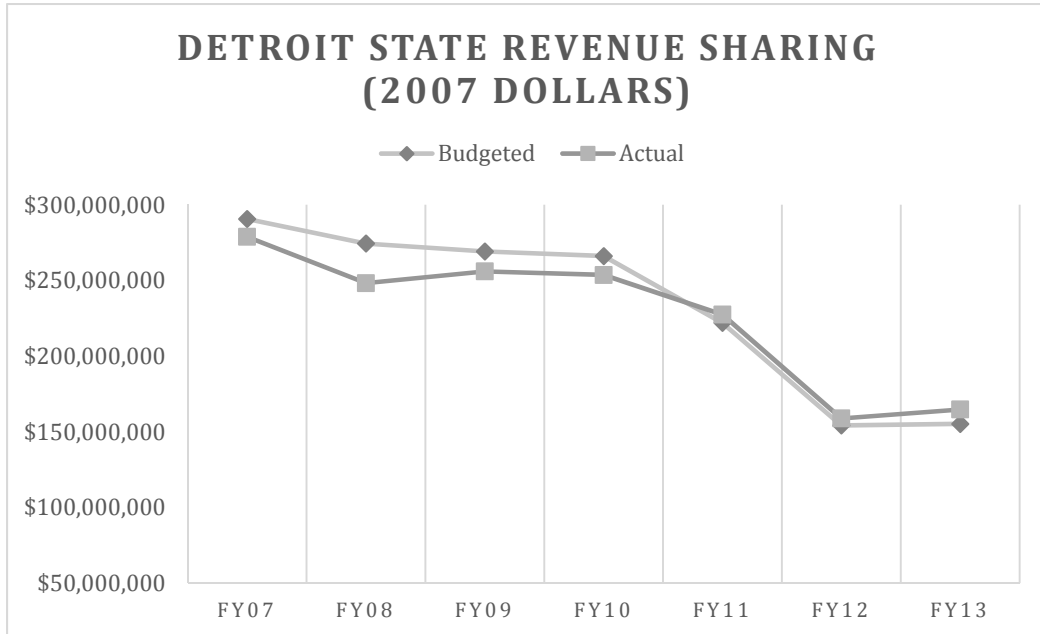
### *Detroit*

The starkest example of the role of state funding in a city's finances is in the case of Detroit. The steep decline of state revenue sharing to Detroit was a clear contributing factor to the city's growing deficits, emphasized by local officials and the bankruptcy judge (although not by state officials). The State has repeatedly withheld state revenue sharing funds until Detroit met specific conditions, particularly during negotiations over the 2012 consent agreement, prompting a lawsuit by the City Attorney over the legality of withholding funds the state was obligated to give Detroit (Bell 2012). Before the appointment of the emergency manager, the Mayor lambasted the state for its withdrawal of revenue sharing funds, which he estimated at \$700 million over the past 11 years (Bing 2013).

This withdrawal was the result of repeated state legislative attacks on revenue sharing, often focused specifically on aid to Detroit. Public Act 532 of 1998 froze revenue sharing payments to Detroit at \$333.9 million for 8 years from FY 1998-99 through FY 2006-07. This act also stipulated that for fiscal years in which State sales tax collections decreased from the previous fiscal year, the City's payments would also decrease in a like amount (City of Detroit 2010). The revenue sharing law was again amended in 2002, leading to ongoing decreases in revenue sharing payments to the city, totaling \$99.2 million reduction by 2011. In March of 2011, Snyder proposed overhauling the state's revenue sharing program, replacing it with a program in which cities must try to "win back" state aid by adopting a set of policy reforms, including consolidation and reducing employee compensation (Stanton 2011). The federal judge overseeing Detroit's bankruptcy cited the loss of state revenues as one of the primary factors contributing to Detroit's crisis. Cities'

vulnerability to state politics is embodied in the tale of Michigan’s dismantling of state revenue sharing as a tool for equalizing resources between cities, and reshaping it into a tool for disciplining cities.

Figure 2.22 Detroit’s loss of state revenue sharing, FY2007-FY13



Source: Detroit CAFRs, FY2007-FY2013

All three of the other cities found themselves affected by the withdrawal or absence of state funding as a countercyclical force during the recession. In Philadelphia, the city faced cuts in the aid it was receiving from PICA, the state agency charged with overseeing Philadelphia’s finances (money that was only going to Philadelphia, as part of its oversight function). Some state funding was passed through the city to the school district, which nearly closed in 2012 because it couldn’t afford to open the schools in August. As the crisis wore on, the city made up that shortfall itself, by issuing \$50 million in debt on the district’s behalf, to be paid out of the city’s own general revenues. Temporary state support intended to help Philadelphia soften the shock of reducing its income tax declined throughout the crisis, leaving the city in more distress in 2012-2013 than at the beginning of the recession.

San Jose was hampered by California’s elimination of Redevelopment Agency funding effective February 1, 2012, effectively diverting millions in property tax revenues back to the state. Although the direct budget impacts are hard to quantify because redevelopment agencies spent money on behalf of the city but were not part of the general fund budget, the Mayor highlighted the damage done by the elimination of RDA funding after in 2011 (Reed 2012b). Because of simultaneous state education funding cuts, most of those property tax revenues will instead be spent on local school districts, effectively allowing the state to balance its own budget and avoid catastrophic education cuts by removing a significant source of revenue from cities. Dallas receives minimal state funding,

but the state's continued emphasis on cutting state-level taxes has left the city's infrastructure significantly under-maintained, a threat to the city's finances mentioned repeatedly in ratings agencies reports.

At the same time, cities were often able to use federal stimulus money to keep open programs in public health, maintain public safety staffing levels, and fund important infrastructure projects. This shifting reliance on state funds, and the vulnerability that reliance represents for cities, has characterized this post-recessionary period. In Chapter 5 I address the politics behind this level of state power over cities, a subject that has been neglected by the literature on urban austerity, which prioritizes the narrative of federal withdrawal.

## **Conclusion**

This chapter has described the revenue challenges faced by cities since 2007, highlighting several shifts that emerge in contrast to previous eras of urban fiscal crisis to produce scarcity. These include the continued vulnerability of heavy reliance on property taxes, the move toward more regressive forms of revenue-raising, limitations on raising taxes, and the retreat of state funding for local governments. This chapter also documents the volatility of city revenues, in particular the volatility generated by reliance on property taxes and cities' limited autonomy in raising or diversifying their tax base.

In this dissertation, one of my goals has been to deconstruct the totalizing stories of fiscal crisis that are told both locally and nationally. Marcuse argues that what is left out of crisis narratives are the political relations that produce fiscal crises, and in particular those that produce the unevenness of fiscal crisis. The recent crisis, grounded for cities in the collapse of what had been fast-growing housing markets, has a particular appearance of having been both unpredictable and unavoidable. The byzantine structure of city budgets (with their numerous funds and hundreds of pages of budgeting) makes it difficult to construct clear counter-narratives. Yet such counter-narratives are very much needed if we are to understand the nature of city precarity. Revenue changes are generally incremental and reactionary, as are spending changes, and it can be difficult to see an overarching ideology or vision in a 300-page budget document. The growing reliance on regressive and volatile income sources, and the limits placed on city revenue options, provides some demonstration of the production of urban austerity through mechanisms of revenue structuring and control. I now turn to the question of how the resulting scarcity is managed through retrenchment.

## CHAPTER 3: Restructuring Through Retrenchment

What we've been doing is looking at each operation in city government and asking a basic question: Is this a business that most cities are in? Is this a business that we should be in? And if we should, how can we afford to stay in it? (Mayor Kwame Kilpatrick, in Wilgoren 2005).

Where Chapter 2 focused on the material evidence of cities' scarce revenue, this chapter presents evidence of another form of material restructuring, specifically retrenchment: the spending cuts that cities have made in response to dwindling revenues. The purpose of this chapter is not only to demonstrate the details of retrenchment in my four cases, but also to show how, insofar as the four cases are similar, they represent a significant departure from the retrenchment occasioned by previous urban fiscal crises. The process and politics of how retrenchment decisions are made has been a central preoccupation of studies of urban fiscal crisis. This literature has focused on the "hows" of retrenchment: How are spending cuts distributed between city functions? What role do politics play in such decisions? What types of programs are more likely to be cut? This chapter looks at the data on spending from 2007-2013 to understand how retrenchment in this period departs from those descriptions of the 1980s and 1990s.

In his description of the cuts made in the name of urban crisis in the 1970s, Marcuse cites a broad range: elimination of public jobs, canceling construction projects, cutting services, all disproportionately affecting minorities, women, city residents, children, the elderly, and tenants. Cities were engaged in "closing municipal hospitals, letting ghetto neighborhoods deteriorate, enlarging school classes and shortening the school day" (Marcuse 1981, 345). These cuts were achieved by privatizing public services, promoting "self-help" for the poor, abandoning public services and public investment in specific neighborhoods ('planned shrinkage'), and deregulation. Many observers characterize the current era as a similar one of retrenchment and austerity (see e.g. Peck 2012). However, as the proceeding analysis will show, the present age of austerity is less focused on reducing spending on programs, which have already been largely decimated; instead, recent retrenchment focuses on chipping away at programs such as libraries and swimming pools, and pushing for significant concessions in the area of healthcare and pensions for public workers, so-called "legacy costs" or structural obligations.

### *Studying retrenchment*

The widespread retrenchment of the 1980s generated studies attempting to determine the factors that drove differences between cities' policy responses to fiscal stress and crisis. How did cities decide whether to increase revenues or cut expenses? How do they decide which programs would be cut? As most of this literature frames it, cities

have a limited repertoire of responses to real fiscal crisis: raise revenues, cut spending, borrow money, or use other financial techniques to bridge a budget deficit. In the wake of the 1970s and 1980s, when widespread fiscal crisis characterized American cities, particularly in the Midwest and Northeast, there were many studies to examine why cities responded differently to fiscal crisis (Bahl, Martinez-Vazquez, and Sjoquist 1992). The choices available to cities depend on many factors, including the immediacy of the “crisis” (i.e. to what extent the crisis is an urgent cash flow problem, as in New York 1975, versus an impending deficit that will draw on reserves), state laws governing municipal fiscal policy, and the city’s relationship to credit markets. There are numerous models for evaluating how cities choose from the basic range of responses to crisis (Bahl, Martinez-Vazquez, and Sjoquist 1992).

The origin point of this literature are studies of the retrenchment imposed on New York City after its 1975 crisis, describing the pattern of spending cuts pursued by the city. In addition to direct program cuts, the city adopted certain policies to cut spending by moving it out of the city’s budget: in particular by shedding service responsibilities to the state, including courts, probation, public assistance, and higher education (Brecher and Horton 1985, 271). Spending cuts were not the only policies credited with New York’s recovery: “Notable changes include the rationalization of budgetary practices, the achievement of greater efficiency in service delivery, the modification of collective bargaining policies to reduce real labor costs, and the establishment of a long-range planning process involving multi-year financial plans and capital needs assessments” (Brecher and Horton 1985, 271). Much of the literature on retrenchment focuses on these elements of efficiency, cost reduction through reorganization, and other forms of “rationalization.” Others argue that by and large, cities continue to make decisions to increase or decrease funding for programs in minor increments, or implement across the board cuts to avoid making decisions (Wildavsky 1984; Meltsner 1971). Behn, however, contrasts retrenchment budgeting with incrementalism and identifies the political conflicts that ensue in times of cutbacks (Behn 1985). Brecher and Horton also suggest that retrenchment is not decremental to the same degree that increases in spending tend to be incremental (see Brecher and Horton 1985, page 269).

When cuts are not incremental or across-the-board, but are targeted to specific programs, redistributive programs and “discretionary” services have suffered most. Clark and Walter (1991) found that cities with large minority populations targeted those groups for cutbacks, as those groups are less able to successfully campaign for redistributive policies (C. Clark and Walter 1991). Larger and poorer cities are forced to assume broader responsibility for public services, while cities that have already adopted a low-service model are both less likely to experience fiscal stress and more able to implement budget cuts without significant resistance (C. Clark and Walter 1991). Cities with well-established unions and with poor populations, on the other hand, may be more likely to get into fiscal trouble and face greater political obstacles to implementing austerity (C. Clark and Walter 1991). Clark (in 1985) also argued that it was citizens, more than any other factor, that drove retrenchment strategies in the 1970s, specifically a “middle-class taxpayer revolt,” part of a “New Fiscal Populist” movement associated with President Carter and others (T. N. Clark 1985, 336).

The study of retrenchment has been limited, Levine et al argue, by its inherent difficulty. Officials hide budget problems in order to avoid drawing negative political attention, much not available to public view (or is so buried in numbers that it's hard for the public to discern the forest for the trees). They find that officials tend to behave incrementally: "Under conditions of fiscal stress, local officials tend to take a short-term view of their problems. Their imperative is to survive each fiscal year by trimming costs in areas where citizens, especially voters, are unlikely to notice service deterioration" (Levine, Rubin, and Wolohojian 1981, 14). Gottdiener argues that even the visible forms of retrenchment often mask larger changes in the city's spending, which produce a fundamental redistribution of public resources (Gottdiener 1987). Pecorella also argues that periods of retrenchment, when viewed historically and over longer time periods, have also produced significant shifts in political and institutional arrangements (Pecorella 1984).

As the post-2008 recession has unfolded, a similar literature has emerged examining how cities are responding to revenue shortfalls. For example, Nelson (2012) examines 16 cities and their approaches to managing fiscal stress, choosing from types of spending cuts or revenue increases (Nelson 2012). Nelson argues that political and economic environmental factors have changed since the retrenchment studies of the 1980s and 1990s, mandating a new approach to understanding cities' political decisions. The two primary differences, she argues, are a "new environment of lower revenues" and greater state restrictions on new revenues. She finds that after an initially similar pattern of cuts, cities pursue different strategies, depending on support for specific services (such as public safety), the size of revenue decline, and state limits, among other factors. Maher and Deller argued that in 2004 local governments were already experiencing fiscal stress, as a Result of increased tax resistance and "weakening financial support" from state and federal government (Maher and Deller 2007). They found that both urban and rural governments were already reducing expenditures (through layoffs, across the board cuts, increasing debt, refinancing debt, delaying maintenance or capital expenditures, or targeted budget cuts) and trying to increase revenues (raising taxes, drawing on reserves, adopting user fees, or requesting grants).

There have been some efforts to place cities' recessionary budgeting in the context of ongoing neoliberal austerity. Lobao and Adua investigate what political-economic factors influence cities' pursuit of neoliberal austerity policies (Lobao and Adua 2011). They define service retrenchment as both direct cutbacks and failure to increase social services, both from survey responses about whether they had cut spending (Lobao and Adua 2011, 6). They classify austerity policies into different types of "limited government policies," including privatization, service retrenchment, spending cuts, and layoffs; they also examine the relationship between pursuit of austerity policies and pursuit of business attraction policies. In this chapter, I focus on spending cuts and service retrenchment as evidence of austerity. There are many other elements to retrenchment, and in particular to how retrenchment can restructure urban governance by reshaping the relationship of a city to its residents, as that relationships rests fundamentally on the services a city provides, and how people perceive that provision (often in relation to the degree to which they are taxed) (see e.g. Pecorella 1984).

For purposes of this chapter, I focus on the aspects of retrenchment that draw out some of these themes: incremental versus targeted cuts, the treatment of some spending as more “discretionary” than others, and the targeting of public pension benefits for the most significant retrenchment.

*City budget spending categories*

In this examination of cities’ recent spending cuts, two models of city spending are particularly useful: Fuchs’s distinction between “common” and “non-common” expenditures and Weikart’s six categories of municipal spending. These models enable me to compare expenditures across cities whose budgets are structured differently from one another. Fuchs’ comparative study of fiscal policy in New York and Chicago is one of a handful (Fuchs 1992, 1). She distinguishes between “common function” expenditures and non-common function expenditures. Common expenditures include those services most often provided by the municipal government: governmental control, general government building, finance, police, fire, sanitation, sewage, highways and recreation. Non-common expenditures include services that may be provided by other jurisdictions, especially counties or special districts. These include libraries, urban renewal and redevelopment, utilities (including transportation, mass transit, water), corrections, and education (see Fuchs 1992, 100). She considers public welfare services (including welfare, health, and hospitals) separately. Non-common services, in Fuchs’ definition, also include services for the poor, services that she describes as being viewed as a drain on city’s resources, used primarily by residents who tend to be less powerful, less politically active, and less influential (Fuchs 1992, 101). Fuchs groups under public welfare services those services that do not pay for themselves, and are consequently considered “redistributive” and as a “drain” on a city’s resources (Fuchs 1992, 101). She also distinguishes them as services that are often available only to a subset of residents.

Table 3.1 Common versus non-common spending functions

<b>Common functions</b>	<b>Non-common functions</b>
Government control General government building Finance Safety (police & fire) Sanitation and sewage Highways Recreation	Public welfare services (welfare, health, hospitals) Libraries Urban renewal Utilities (mass transit, water) Corrections Education

Source: (Fuchs 1992)



More recently, Weikart’s study of New York City’s budget divides spending into six categories (2009):

1. Economic Development
2. Maintenance of public order (police & fire, police protection, corrections)
3. Quality of life (parks)
4. Investment in human capital (education, libraries)
5. Redistributive functions (healthcare, hospitals, housing)(Weikart 2009, 21)

Analyzing economic development is central to the question of how urban entrepreneurialism—the one on cities to facilitate economic development through public subsidy and capital—has changed over time. However, economic development spending is not tracked as a functional category by the Census, so it cannot be traced through Census data, only by studying individual cities’ budgets. Some cities track economic development spending as a “focus area,” but the more elusive category of economic development spending—forgone business tax revenue—is more difficult to capture.

Table 3.2 organizes the spending categories that I use to analyze spending data in this chapter. I use seven categories, with subcategories that match general categories often used in budgets. The third column identifies the specific census variables that I include in each of those categories.

Table 3.2 Functional categories of city spending

<b>City function</b>	<b>Includes</b>	<b>Census categories</b>
Public safety	Police & fire, sometimes corrections	Police Protection Fire Corrections Judicial
General government	Government control General government building Finance	Central staff Employment SA Financial administration General building General NEC Miscellaneous
Public welfare	Welfare Health Hospitals Legal Aid Social Services Homeless Services	Public welfare Health Hospitals Housing and community development
Human investment	Libraries Education	Library Education (elementary, college, other)
Recreation and quality of life	Parks, arts, culture	Parks and recreation Natural resources

Utilities	Sanitation & sewage Highways / streets Mass transit, water (sometimes city) Lighting	Airports Highways Sanitation Utilities (water, electric, gas, transit) Parking
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Source: Census Annual Survey of Local Government Finances; 2006 Classification Manual

Table 3.3 provides more specificity about how each of my cases organizes spending in their budget and other reports: the second column by department, the third column by “focus area,” a loose grouping that each city uses in their budgets (and often in the public face of the budget, which rarely organizes the narrative around city departments).

Table 3.3 City budget spending categories

Function	By department	By focus area
<b>Economic development</b>		
Detroit	Finance department, Detroit Workforce Development Department	Develop economic capacity
Dallas	Office of economic development; Convention and event services	Economic vibrancy (includes first-time homebuyer loans; flood control; some other housing / community services department; fire construction; Fair Park (park & recreation); street lighting; lots of miscellaneous things, public works; water capital funding (nearly half of budget)
Philadelphia	Commerce department; Convention Center Authority	Economic development & arts and culture (subtract out the arts)
San Jose	Convention Facilities department; Office of Economic Development (includes some cultural affairs)	only part of Community and Economic development
<b>Public Safety</b>		
Detroit	Fire & Police, Detroit Office of Homeland Security	Protect individuals and property)
Dallas	Fire & Police	Public safety (includes some court services)
Philadelphia	Police, Fire, Prisons, Courts	
San Jose	Fire, Police	Public safety
<b>Public Welfare</b>		
Detroit	Department of health and wellness promotion; Human Rights Department	Maintain and improve health
Dallas	Housing / community services; Environmental and health services (but not all, will need to pull out)	No clear focus area (clean healthy environment, but need to separate out the waste/environment stuff); some items in Education (childcare, WIC)
Philadelphia	Human services ; Public health department; Homeless & housing assistance	Health & opportunity (partial)
San Jose	Housing (includes community development)	Community and economic development (Housing only)

<b>Human Investment</b>		
Detroit	Library	
Dallas	Library, Education	Education (includes library)
Philadelphia	Library; [subsidies to Philadelphia School District]	Arts & culture aspects of economic development and Health & opportunity
San Jose	Library	Neighborhood services
<b>Recreation and quality of life</b>		
Detroit	Recreation (Department for cultural opportunities)	Recreation and culture
Dallas		Culture, arts & recreation (includes park and recreation)
Philadelphia	Parks and recreation; Office of arts and culture; museums	
San Jose	Parks, Recreation, Neighborhood Services	Neighborhood Services

*Source: City budget documents, compiled by author; Census Annual Survey of Local Government Finances; 2006 Classification Manual*

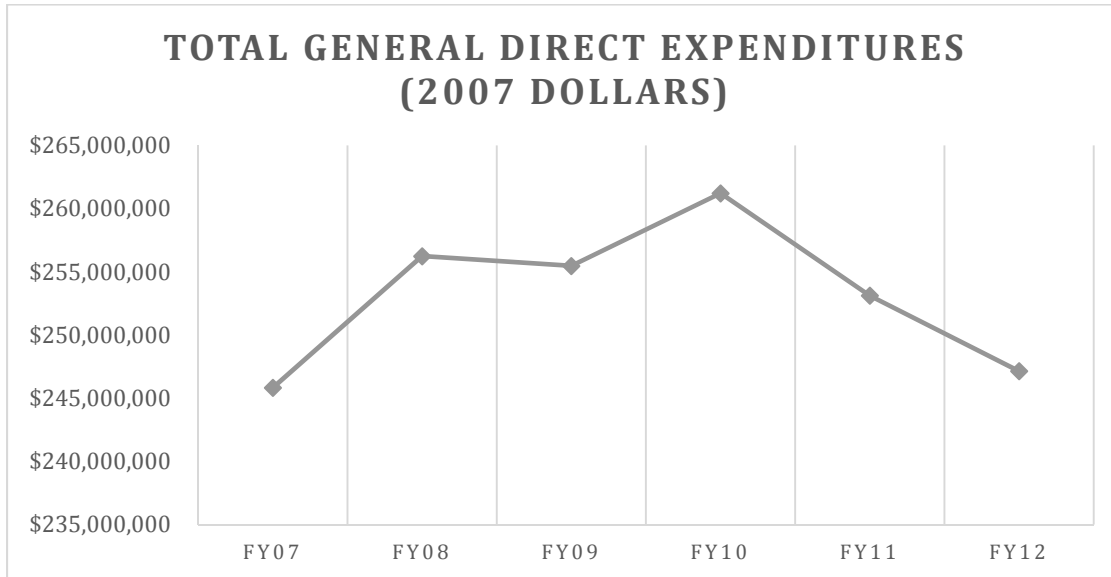
Unlike revenues, there is very little standardization in how cities organize their spending in an annual budget. That is, cities differ in their budget spending categories. How cities organize their own budgets reflects each city’s conceptualization of priorities as well as the complex structures of how spending is supported by revenues (for example, “self-liquidating” expenditures, or spending that is paid for by a specific earmarked source, may appear only on a page that deals with that specific fund).

The rest of this chapter discusses cities’ spending cuts in greater detail. Section 3.1 describes three categories of spending that have experienced cuts: public safety, which has been least affected; public welfare, which has been considerably affected; and human investment/quality of life, which has been severely affected. Section 3.2 then details an especially fraught form of spending, public pensions, and the battles over whether or how much to cut these previously inviolable expenditures. All four cities that I study have cut spending in both targeted and across-the-board ways, yet they vary in terms of the details of those cuts, and in how they were implemented.

### **3.1 Overall spending cuts**

From 2000 to 2012, cities across the United States made major cuts to a wide range of services that previously had been considered essential. The widespread cuts were framed by local officials—in budget presentations, budget documents, and the media—as necessary but painful cuts. While certain services were framed as more essential than others, there was less effort made to frame certain programs as over-funded or discretionary, in marked contrast to earlier periods of crisis, when redistributive and welfare spending in particular was routinely framed as elective spending, and not just by conservatives. From 2007 to 2012, cities’ spending in real dollars declined significantly, particularly after 2009, when federal stimulus money ended.

Figure 3.1 Total direct general expenditures, FY2007-FY12 (\$000s)



Source: Census Annual Survey of Local Government Finances, compiled by author

Table 3.4 Spending by city function, cities over 75,000, 1997-2012 (\$000s)

City function	1997	2002	2007	2012
Public safety	\$41,024,256	\$47,633,951	\$49,373,665	\$49,864,973
General government	\$8,982,160	\$10,546,170	\$13,452,161	\$11,859,782
Public welfare	\$36,235,935	\$34,022,662	\$40,163,063	\$41,963,215
Human investment	\$26,756,540	\$37,256,134	\$39,512,092	\$41,229,205
Recreation	\$9,008,168	\$11,501,734	\$12,637,201	\$11,635,937
Utilities	\$70,637,131	\$85,123,153	\$98,873,790	\$103,824,091
Interest on debt	\$13,360,960	\$13,514,299	\$14,524,698	\$15,261,798
<b>Total</b>	<b>\$206,005,150</b>	<b>\$239,598,104</b>	<b>\$268,536,670</b>	<b>\$275,639,001</b>

Source: Census Annual Survey of Local Government Finances; in 2007 dollars

*Public safety: the police and fire state*

Spending on public safety (which includes police, firefighting, and those aspects of corrections paid for by cities)<sup>32</sup> has been protected better than any other general function over the past decades, including during the recent recession. There have certainly been cuts to public safety, but those cuts are small in relation to other operational reductions and nearly always made with assurances that they are temporary. Nationally, spending on police grew by 4% from 2007-2012, while overall general spending grew by only 1%; growth in police spending accounted for 17% of the increase in total spending. Public safety spending accounted for 38% of all general spending increase when utilities and

<sup>32</sup> City jails and some criminal processing.

education spending were excluded. There has not been a dramatic shift nationally in the percentage of general spending going to public safety, but spending has been preserved to a degree not true of other city services.

The protections and assurances given to “uniformed” unions in obtaining security and benefits for their members is often sharply divergent from other “civilian” unions representing city employees. In all of my cases, uniformed workers were given fewer furlough days, more pay raises, and better health benefits. In Detroit, the pension cuts to public safety workers (5%) were significantly less than those given nonuniformed personnel (18%) (City of Detroit 2014). Federal stimulus money through the State Fiscal Stabilization Fund was used predominantly to fill gaps in funding for public safety: officers, equipment, and training. Indeed, setting aside the most basic infrastructure of finance and public buildings, the budgets and public narratives of all four cities indicates that their core mission remains police and fire. As other forms of spending are cut, public safety comprises an ever-larger percentage of cities’ budgets. In Dallas, for example, nearly half (46%) of every dollar of the city’s budget is spent on public safety; of just general fund revenues, over 60% go to police or fire. Before the onset of the recession, public safety spending had been increasing as a percentage of city budgets.

This emphasis reflects an important shift in the relationship between a city government and its residents (not to mention its police and firefighters): as “uniformed employees” make up the vast majority of city public workers, the relationship between residents and their government is mediated through the context of emergency, protection, and prosecution. Despite this, cities also made real cuts to public safety for the first time in decades. Philadelphia implemented rolling brownouts of its fire stations (Ammons and Fleck 2010). San Jose left hundreds of police jobs left unfilled, reduced the number of firefighters on each truck, and cut uniformed officers’ wages by nearly 4% (compared to 10% for all city employees) (Reed 2010). In the year of its most severe retrenchment, 2010, Dallas implemented furloughs (effectively wage cuts) and benefit cuts to all employees, including police and fire employees (City of Dallas 2010). These cuts are always framed as the last resort: “I am asking police and fire to cut their salaries. They’re grouchy about it, but everyone else has taken a pay cut. So where else do you go?” (Merten 2010).

### *The post-welfare state*

Public welfare redistributive spending, has seen greater retrenchment than public safety, but not nearly as dramatic a retrenchment as it would have seen if it had not already been decimated by the dismantling of the welfare state that began in the 1980s. The attack on the welfare state beginning in the 1980s led to restructuring the provision of social services away from redistribution to policies promoting labor market flexibility, penalizing poverty, and privatizing collective consumption goods (Mayer 1999). So-called “welfare state” programs (income support, housing, other parts of the safety net) are often cut by local governments in times of fiscal stress, not just because they are “discretionary” but

because their constituencies are less politically powerful and the narrative of “wasted” welfare spending still dominant (Lobao and Adua 2011).<sup>33</sup>

At the same time, responsibility for social welfare programs has been devolved from the federal government (which was once responsible for managing income and housing support programs, as well as community development) to state and local governments. The retrenchment of national and even state welfare systems has “imposed powerful new fiscal constraints upon cities, leading to major budgetary cuts during a period in which local social problems and conflicts have intensified in conjunction with rapid economic restructuring” (Brenner and Theodore 2002, 367). Thus, in the context of the recent fiscal crises, the social services that remain are often subjected to market principles: efficiency measures, the use of incentives, privatization, and contracting out. At the end of this roll-back, a “postwelfarist urban state” would “do a few (essential) things well” (Peck 2006, 688), i.e. maintaining order and facilitating economic growth, which is indeed reflected in the focus on public safety and economic development spending. Peck’s description echoes the description used by many mayors and city managers about their cities by the end of the 2000’s. Indeed, an important difference between the retrenchment of earlier eras and the post-2000 spending cuts has been that much of this roll-back was accomplished in the 1990s, and many cities are very much out of the business of core programs associated with redistribution.

We often think of the federal government as the largest provider of redistribution, the safety net, the biggest sources of money for income support, healthcare for the poor, unemployment insurance, et cetera. But over the past decades cities have increasingly taken over this role, both as a result of the discontinuation of federal programs (requiring cities to take up the slack) and the devolution of federal and state programs (such as Medicare, housing, which cities now manage with federal funds passed through states)(Liner 1989). The most significant aspect of “retrenchment” in this area is the inability of cities to meet the growing needs of residents during the Great Recession. In 2011, the U.S. Conference of Mayors issued a report stating that cities lacked the resources to provide adequate food and shelter to their neediest residents. Dallas eliminated funding for HIV/AIDS programs and public health clinics, \$5 million in funding for homeless outreach and low-income housing, and most of its budget for immunizations and homeless services; Philadelphia outsourced its human services department; Detroit privatized its health department. These cuts to social programs at a time of desperate social need have been deeply felt, and reflected in growing numbers of people seeking shelter and food from the array of private, nonprofit services that have been filling the gap of the welfare state for several decades now.

In the shadow of the elimination of most public welfare spending, the cuts made to human investment and education have emerged as a significant threat to the remaining set of urban services for the poor. the category that has been most greatly affected by the recent fiscal crises, is expenditures on human investment and quality of life amenities, such as libraries and parks. These resources are often considered middle class amenities, but

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<sup>33</sup> See my discussion of New York in Chapter 1.

they also represent important local spending in support of social mobility and anti-poverty. Such spending serves the poor, unemployed, or homeless in ways that are not always obvious. Most urban library programs offer shelter, a place to get clean, free internet and computer access, and other important services. Children’s homework programs and childcare programs, in addition to free access to books, constitute an important public service in cities. Parks and recreation departments serve a similar function, with many cities offering free or very low-cost summer and afterschool programs for low-income children, almost always administered by city agencies. There are other functions that, when cut, disproportionately affect the poor: cuts to the court system leave public defender’s offices strapped, leave people in detention for longer awaiting trial, and cause backlogs in family court (see e.g. Karmasek 2012). Cuts to cultural amenities like zoos and the arts (both Dallas and Detroit privatized their zoos; Dallas eliminated its separate cultural department (R. Bush 2009b)) make such services less affordable and diminish the cultural opportunities for those who can’t pay increased fees or travel to more distant programs. All four cities raised fares for public transportation; Detroit’s bus service eliminated its program of free rides for disabled residents (Kilpatrick 2007, 10). In many cities, cuts to transportation take the form of increased bus fares or the elimination of fare subsidy programs for seniors, students, and the disabled. Hours and services of swimming pools and recreation centers were cut in all four cities, eliminating one of the primary sources of recreational activity for the poor.

It is not difficult to understand why human investment spending has been hardest hit by the current recession: this area of spending represents the largest segment of “discretionary spending” after earlier reductions to the public welfare spending described above. Whereas public safety spending has been relatively well preserved, and public welfare spending represents an already small share of city spending, spending on human investment and quality of life has been protected by the demand for cultural and social amenities. I found that in my cases cuts to these forms of spending—particularly libraries, pools, and parks—were the most likely to spark neighborhood-based resistance, although that was most often directed into campaigns to raise private funds, leaving intact the move toward privatization, which removes the public mandate of accessibility to all Detroit residents. The privatization of Detroit’s museums and parks garnered significant public outcry, but the lure of private funding, and the presumption of greater efficiency, proved overwhelming to the opposition; both were privatized.

Retrenchment of city spending has taken different form than in previous recessions. Cuts to public safety have been deeper than previous recessions, while public welfare has not been the most significant target. Spending on human investment and quality of life programs have been more significantly cut, but in general the ideologically-driven program cuts observed in the 1970s and 1980s have been notably absent. The elimination of public health programs in both Detroit and Dallas garnered significant public debate and official hand-wringing. The elimination of the last vestiges of city support for the poor was implemented in a language of scarcity, not of restraining government excess.

That language—of city government needing to be put in check, and of blaming a powerful constituency for excessive spending—instead appeared in the debates over public pensions.

### 3.2 Public pensions

While the cuts described above are significant both fiscally and in their impact on city residents, they have not been a central focus of debates over how cities need to respond to crisis. That focus has rested squarely on the perceived threat posed by public pension plans to cities' fiscal sustainability. At the extreme, financial analysts have described the structural threat posed by pension and health care costs as “unsustainable” and “ridiculous” (Chappatta 2012). The bankruptcies of Detroit and Stockton (California) have fueled reports of a widespread public pension crisis, and prompted much national handwringing and calls for reform (Norma Cohen 2013).

Many large U.S. cities have their own pension plans to provide for public employees upon retirement: publicly-managed, with defined benefits negotiated through by labor contracts.<sup>34</sup> In the current crisis, public pension funds have been described as “chronically underfunded,” threatening to hobble cities and states if measures are not taken to cut benefits; such cuts are being implemented through bankruptcy and the ballot box (Carlson 2012; Raphael 2012).

Both Detroit and San Jose have become pivotal national sites for testing the possibilities of restructuring pension commitments to both retirees and to current workers. In addition to politicians, ratings agencies and financial watchdog groups have also zeroed in on the idea of a pension crisis, pushing rule regulations that more tightly integrate a city's fiscal evaluation with the health of its pension plans (and changing how that health is measured) (I discuss this in Chapter 5). Framing the pension crisis as driving looming financial chaos thus becomes a justification for exerting greater control over the city's fiscal autonomy—and making unprecedented cuts to public pensions.

To illustrate the unprecedented nature of the cuts, it is worth pointing out that one of the primary contrasts between the recent recession and the discourse of crisis in the 1970s and 1980s is that the focus on “over-spending” has centered on public pensions rather than on the welfare state. This shift from focusing on cutting programs to cutting pensions represents a larger attempt by governments to redefine their obligations to their people and make themselves more nimble in the process. However, this narrative of a national public pension crisis is simplistic on two counts.

First: the complex relationship between economic cycles and the dynamics of pension health is simplified into a story in which pension plans are inherently unsustainable because of excess promises or the new economic normal. In truth, the

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<sup>34</sup> For many public workers, who are ineligible for federal social security, this is their only source of retirement income.



financial recession provoked several pieces of the public pension puzzle into crisis. In 2008, the value of pension plans' assets, only partially recovered from the stock market declines in the early 2000s, again fell sharply as investment values plummeted across the world. These market declines widened the gap between assets and liabilities, boosting a key measure of pension plan distress: unfunded accrued accounting liability (UAAL). Rates of return that seemed reasonable in 2007 (and which were widely used by the private sector) were suddenly flipped upside down, sharply increasing the contributions cities would have to make the following year to keep their plans on track. In Philadelphia, for example, pension plan assets fell by 3.7% during FY08, after rising by 17% over the previous year (The City of Philadelphia 2008). Since the budgeted contributions for plans in FY08 estimated positive returns, and because the annual contribution is based in part on estimations of future returns, cities abruptly faced a significant cost increase. Their plans also looked worse on paper than they had the previous year, drawing scrutiny from ratings agencies (Moody's Investors Service 2010a).

The second oversimplification in the standard pension crisis narrative is that it ignores how a city's pension plan fits into an overall financial management strategy, especially at times of fiscal stress. Both the formula for calculating the city's annual required contribution (ARC) and the degree to which it must comply with that calculation are subject to local and state policies (Munnell et al. 2013). In some cases, cities' discretion over how much of the recommended ARC to pay represents a significant share of the discretion available in the budget. In good times, cities have deferred those contributions in order to pay for economic development projects, or to cut taxes, gambling that the assets would grow fast enough to cover the gap. In bad times, cities paid less than the ARC in order to weather economic downturns; Philadelphia obtained state legislative authorization in 2009 to defer part of its pension contributions for several years.

Notwithstanding the fierce arguments made against pensions, the so-called "pension crisis" actually represents the downstream of urban fiscal crisis, not its proximate cause. Cities' management of their pension obligations reflects the structural weaknesses in U.S. municipal finance and governance: the absorption of greater risk by the public sector, the sustained impact of the recession, decades of state and federal program cuts, and the structural impossibility of reconciling balanced budget requirements with volatile revenue sources (and an increasingly volatile economy). Deferring pension payments and issuing pension obligation bonds has been a tool of last resort for cities that have cut spending to the bone and are looking for creative ways to finance their way out of looming insolvency. In some cases, including Detroit, Philadelphia (and Stockton), cities borrowed to cover the resulting gap in skipped payments, with contributions to resume in full as revenues rebounded. Some of these short-term solutions floundered when the recession dragged on longer than projected; others collapsed because of factors relating to the financial collapse itself (as when failed insurers triggered the cancellation of swap agreements).

Public pensions have become an easy target—and a convenient distraction—in the U.S. even though restructuring pension obligations does not address the structural financial issues at the root of American cities' widespread fiscal stress. Anti-government political sentiment has been stoked by anti-public-employee movements in several states (e.g.

Michigan, Wisconsin, both of which have enacted laws dismantling public unions). While pension obligations have historically been considered untouchable in municipal bankruptcies, in California and Detroit banks are arguing that judges should prioritize bondholders over retirees and set a precedent for allowing cities to discharge public employee obligations through bankruptcy. In Detroit's case, public employees and retirees consented to reductions in their payments after a federal judge ruled that they could be forcibly reduced (Bomey et al. 2014). This has radically shifted the perception of possibility of dismantling pension obligations. Several mayors have successfully taken pension reform to the local voters: San Jose and San Diego residents approved measures to significantly restructure public pensions for city workers and retirees (Saillant 2012).

This focus on challenging pensions has consequences, as other contributing factors are ignored, and alternative solutions—such as revenue-raising options, supplemental contributions by state funds, or broader national solutions to the fragmented healthcare and retirement funding system that puts the risk of supporting retirees fully onto local governments—are absent from discussion. Putting the public's focus on "greedy" public employees removes pressure to address other elements of the crisis while expanding leverage for financial institutions over urban policy.<sup>35</sup>

The combination of underfunding and the financial collapse dealt the pension systems a one-two punch, but not necessarily a fatal one; many observers have noted that the system is likely to recover with the economy, that the pension crisis is in part cyclical. Morningstar affirmed shortly after Detroit's bankruptcy filing that the pension fund was funded at 90%, the industry standard (Gallagher and Spangler 2013). In short, this narrative that pensions are to blame for the fiscal crises, which is perpetuated in dozens of reports on problems with U.S. local and state government pensions, is problematic because it tends to obscure other fiscal issues facing governments.

Detroit is held up to the rest of the nation as an illustration of both the pension problem and its solution, and yet the reality of Detroit's pension situation is extreme. The city's challenge is demographic; it has simply lost too many people to be able to support a system that requires contributions by current employees to function. In 1960, Detroit had more than twice as many employees (over 26,000) as pensioners (over 10,000); by 1991 there were roughly 18,000 of each, and by 2012 there were twice as many pensioners (over 20,000) as employees (just over 10,000) (Bomey and Gallagher 2013). Other cities and states do not face a similar demographic challenge, but the perceived structural failings of Detroit's system have been used to justify a narrative that frames all public pension programs as unsustainable.

Dallas has already restructured its pension plan twice, in 2003 and again in 2011 when large shortfalls led officials and voters to approve significant assistance to shore up the funds. As part of the 2003 resolution, the city raised employees' contributions from 6.5% to 9.27%, and the city's contribution from 11% to 15.78% (Cook 2008). Despite these

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<sup>35</sup> Fixating on pensions also gives conservatives the opportunity to attack unions by jeopardizing one of the key benefits they offer their members.

measures, the city's fund has again been declared underfunded in 2015 in the wake of real estate investment losses; in November of 2014, Moody's warned that the city's pension liabilities needed to be improved, or the rating would risk "downward pressure" (Moody's Investors Service 2014j).

While Philadelphia's pension plan has been under some scrutiny since 2009, an arrangement made with the state to permit the city to defer pension payments kept the issue on the back burner for the years immediately after the recession. Once that arrangement expired, Philadelphia's pension plan emerged as one of the most troubled, the subject of intense state political debate. In March 2013, the Mayor directed his budget address to the city's employees, emphasizing the need for reforming a pension system that "is taking more and more public resources that could be spent on citizen services or tax relief" (Nutter 2013). In an effort to reassure investors in advance of a large bond issuance, Philadelphia held a closed bond investor conference, where it revealed that it has only 48% of assets needed to cover its pension liabilities, and that it has been chronically underpaying into its retirement fund. The report touts the city's "substantial expenditure cuts," a "deep bench of financial managers," and workforce reductions, and assured investors that the Mayor is "committed to achieving material pension reform with local unions" (The City of Philadelphia 2013). After the conference, Moody's affirmed the city's A2 rating, commending Pennsylvania's state oversight and the city's "enhanced budgetary discipline," but cautioning that "weak demographics" and "heavy burden of tax-supported debt and unfunded pension liabilities" constrain its financial prospects (Moody's Investors Service 2013d). The Pennsylvania government has now taken up the issue of statewide pension reform, and the Mayor has taken up the campaign of shifting the city's workers to a 401(k) plan.

San Jose's Mayor Reed has aggressively pursued pension restructuring during his entire tenure as mayor. The Mayor attempted to declare a fiscal emergency (which would have permitted the city to propose amending contracts, including employee agreements), but the effort was postponed several times and eventually scrapped in 2012 when the drastic spending cuts produced a \$10 million surplus was discovered and the unfunded pension liability amount was revised downward by \$50 million (Koehn 2012), but the idea of emergency had taken hold. The Mayor's continued hammering on the idea of crisis bolsters his argument for pension reform as the central strategy for increasing the city's fiscal stability. "Significant reform must be considered - reform in the pension system, in ways of governing, in ways of engaging the citizenry" (Silicon Valley Community Foundation 2012). Supported by such messages, in 2012 the Mayor convinced voters to pass a ballot initiative that reduces pension benefits for future employees and raised the retirement age (Woolfolk 2012). Measure B, which was approved by 60% of the city's voters in 2012, required employees to contribute an additional 16% of their salary or be moved to a reduced benefit program.

Most cities have pursued various means of reducing the benefits of future workers or moving them to individually-managed retirement options, such as Philadelphia's effort to move employees to a 401(k) plan. The unresolved question in all four cities is to what degree pension benefits already accrued to a city's workers can be reduced or restructured.

Detroit's pension holders have had their benefits reduced through federal bankruptcy, after the judge determined that he had the legal ability to impair contracts, including pension obligations (Rhodes 2013, 74). So far, the ability of San Jose's ballot measure to similarly reduce benefits for existing retirees remains unclear. San Jose's mayor has supported a state law that would restructure existing pension obligations, but so far that has not gained momentum. Meanwhile, a plethora of policy reports has framed the need for addressing both city and pension shortfalls (The Pew Charitable Trusts 2013; see e.g. Munnell, Aubry, and Medenica 2013). As I describe in Chapter 5, this narrative of pension crisis, and the lack of clarity surrounding the policy options for addressing it, has been taken up by financial ratings agencies, who have reframed pensioners as creditors in an ongoing effort to reframe pension obligations as a form of debt.

## Conclusion

The motivation for attacking public pensions is certainly ideological in part, but also strategic. Retrenchment accomplished by going after workers—and particularly by divorcing public workers from the services they provide—makes the issue one of fairness between public and private workers (or public workers and “taxpayers,” as if they are two distinct categories), rather than about what cities actually do for their residents. Reed has explicitly framed the choice as between pensions and residents: “Every dollar the city pays for retirement costs is a dollar we can't spend on services for our residents” (Reed 2012a). The city as a site of collective consumption becomes reframed as a site of political conflict between the “haves” (public workers with their pensions and job security) and the “have nots” (private sector workers with their insecure jobs and dwindling real incomes). This is not hard to accomplish in a country in which mainstream political figures have propose privatizing social security, and any non-private healthcare system faces fierce political resistance. The attack on public pensions has been accompanied by a wave of legislation seeking to dismantle public employee unions, who now represent about half of all union members in the U.S.; 40% of local government workers are unionized, compared to just over 6% of private workers (U.S. Bureau of Labor Statistics). Particularly after the recession, public employee unions have been one of the few constituency groups (and the best-resourced) to articulate a strong argument for the public good, for public funding of services, government's role in stimulus spending, and other strategies. The political implications of removing one of public employee unions' central member benefits, and of eroding popular support for public unions by blaming them for service declines, could do significant long-term damage to a pro-public, anti-neoliberal policy agenda.

As this chapter shows, cities' fiscal crises have profoundly—and measurably—affected their spending. Cuts to spending, or retrenchment, in recent years have differed in important ways from retrenchment in early fiscal crises of the 20th century. The growing focus on restructuring pensions signals and reflects the narrative that governments must avoid fixed commitments wherever possible, in order to minimize “legacy costs” and “fixed obligations,” that prevent them from weathering an increasingly volatile economy. Part Two also demonstrated the importance of state policy in producing revenue scarcity.

In Part Three, I examine how the recession has normalized not just austerity but what I call “crisis governance,” a shift of urban politics in which the role of financial institutions and state governments in defining cities’ policy options has become common sense.

## **PART THREE: NORMALIZING CRISIS GOVERNANCE**

## Introduction

Local government finance and budgetary behaviour are a crucial site for political struggle and the varied ways in which local authority professionals and politicians negotiate this process, within the context of varied local circumstances, must remain a key agenda for those interested in the changing forms of local governance. (Pinch 1995, 966)

Existing political arrangements are likely to be inadequate in a crisis.<sup>36</sup>  
(Rohatyn 1981, 31)

Having described the dominant narratives of urban fiscal crisis in Part One, and the mechanisms of scarcity and retrenchment in Part Two, I now turn in Part Three to the subject of how municipal governance itself is remade in and through fiscal crisis. I look at shifts in urban governance that are enabled by and solidified in times of crisis, specifically as enabled through the mechanisms of financialization associated with the growing complexity of municipal debt and expanded state power over cities.

The idea that new forms of governance emerge in the wake of crisis is not an original or even a radical proposition (see e.g. Klein 2008). Crisis opens up new spaces of uncertainty and demand for policy change, allowing certain ideas to deepen their hold on policy. In recent decades, proponents of neoliberalism have been particularly adept at using moments of crisis to increase their grip on policy (see Peck 2006). Some of this restructuring is a consequence of material retrenchment: when spending and services are reduced or restructured, the constituency for those services disappears, and the former recipients' demands on the city often evaporate (see Shefter 1992). Proclamations of crisis are in their nature calls for change: politicians assert that whatever got them into the crisis won't get them out. The relationship between crisis and restructuring makes debates over what causes urban fiscal crisis especially salient. Some of those reforms originate in cities where crisis has taken the deepest hold, and then filter more broadly as techniques for preventing other cities from suffering the same fate (alleviating fiscal distress,

I have proposed in this dissertation that crisis governance is becoming normalized for all cities, regardless of the nature of localized fiscal crisis and its divergence from the national pattern. This normalization is accomplished through specific technologies of fiscal management, which are promulgated, managed, and promoted by two central actors: bond ratings agencies and state governments. That is not to say that the same policies are ultimately adopted everywhere, but that city councils, politicians and residents are forced to respond to this set of technologies as they come to be seen as "common sense" approaches to fiscal governance, vital to preserving city fiscal health in a time of ongoing scarcity.

In Chapters 4 and 5, I explore two avenues through which governance is restructured:

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<sup>36</sup> Felix Rohatyn was the mastermind of New York City's fiscal recovery in 1975, and continues to speak publicly about fiscal crises.

1. The technology of municipal finance: the growing regulatory apparatus and shaping of crisis narratives by financial agencies, and the modification of fiscal health indicators and ratings methodologies to increase the weight given to future obligations (pensions and debt). The role of credit ratings agencies and the apparatus of municipal bankruptcy has been particularly instrumental in the current recession in reframing pensions as debt, with significant implications for both workers and residents. This discussion is in Chapter 4.

2. The growth of state power: the expansion of states' legal ability to oversee and intervene in city fiscal policy. This includes state monitoring and intervention (from receivership to gatekeeping municipal bankruptcy), and tax and spending limits (which were discussed in Part Two). The political relationship between states and cities has shaped this dynamic with significant consequences for urban fiscal autonomy. This discussion is in Chapter 5.

Together, these chapters illustrate how the crisis has built on histories of financialization that have reduced democratic control over the budget. These include the shifting of many funding sources and programs off the primary budget, by setting up public authorities and enterprise funds to manage non general-fund revenues, and pursuing diverse methods of privatization. It also includes the growing role of technical financial expertise (including appointed financial managers) in shaping urban policy (see Merrifield 2014). I find a growing role of banks, ratings agencies, and financial policy-making institutions in shaping urban policy, facilitated by the growing complexity of municipal debt and a national media narrative of impending municipal collapse.

I also illustrate the complex political relationships between states and cities in the current recession, drawing on both national and local histories of decentralization and devolution that have facilitated the growing dependence of cities on state political whims. I describe several strategies used by states to exert power over the policies of cities in fiscal stress, and how those policies have expanded to encompass state oversight in times of normalcy. These techniques are enabled not just by crisis but by the shrinking fiscal policy space and erosion of collective urban democracy leading up to the crisis. This erosion is part of a steady movement toward the technicalization of not just fiscal policy but all urban policy, what Merrifield calls "accountancy governance" (Merrifield 2014).

These strategies function not just as *de facto* limits on city autonomy, although they certainly do that. Perhaps more important—and insidious—they serve to depoliticize questions of revenue, spending, budget-making, and the scope of city government by framing them as purely technical—accounting— questions. Fiscal discipline thus serves both as a means for achieving specific policy goals—such as restructuring union contracts and privatizing city functions—and as a technique for limiting the expansion of urban programs. Ultimately, I argue, the public conception of what cities can do and how they should be limited are continually reshaped by these fiscal processes. The policies discussed here, I argue, reflect a narrowing in the debate over what causes and constitutes fiscal crisis, and are pushing the limits of state intervention and municipal autonomy.



Anderson invokes the term “shrinking governance” to describe the contemporary processes of reducing the governing scope of cities through fiscal policy (Anderson 2012a). She traces this shrinking governance to several cases that emerge from the current fiscal crisis, in particular legal actions and policies that restrain the scope of city governance by strictly limiting revenue increases, adopting spending caps, or mandating that cities provide only basic services (Anderson 2012a). These responses, she argues, are constraining local government and in some cases amounting to “de facto dissolution,” where local governments find themselves stripped of a range of vital powers, including the ability to set fiscal policy and approve budgets. By shrinking governance she means: a “system of reforms that actually retract local government” in an era of economic cutbacks (Anderson 2010). She cites five examples illustrating how city governance is being reduced in the wake of crisis:

- extreme privatization (such as Sandy Springs, Georgia)(see Segal 2012);
- expansion of state receivership laws (such as the municipal insolvency laws passed by Michigan and Rhode Island);
- initiatives to prevent expanding local services or reduce local government size (such as Ohio’s repeal of the estate tax, a primary source of local government revenue);
- downsizing movements (such as Rahm Emanuel’s attempt to cut the number of Chicago aldermen); and
- dissolution and merging with other jurisdictions.

In all of these cases, a vision of local government as limited to urban containment and basic public safety has been bolstered by the open rhetoric of defunding local government as a way of solving state fiscal crisis, produces a set of policy approaches to reducing the scope of urban governance (see Anderson 2012b). Fiscal crisis has provided additional fuel for experimenting with new technologies, but many of these trends are evident beginning in the 1970s.

There are many trends to which we can attribute changes in local governance over time, beginning with the narratives emerging from the urban crises of the 1960s that fixated on cities’ high poverty, social conflict, crime, and rioting. The fallout from 1960s social movements, and deep political divides in the US about the causes and solutions to urban crises, fueled a conservative backlash against city governments that took firm hold in the 1970s. The “Drop Dead” response by federal officials to New York’s potential insolvency in 1975 embodied this attitude (Van Riper 1975). High inflation in the 1970s fueled tax revolts and emboldened “fiscal populists” such as those behind Proposition 13 in California (many tax and expenditure limits date from this era) (T. N. Clark and Ferguson 1983). Starving government of revenue, of course, is a central component of today’s anti-government ideologues like Grover Norquist, who famously said he wanted to shrink government to the size where he could “drown it in the bathtub” (Liasson 2001). Most public officials do not hold views this extreme, but are nonetheless susceptible to a

narrative that government must be continually prevented from growing too big, that it naturally seeks to expand and devour if not constrained (Baker 2012). This narrative can be especially popular in times of collective and individual economic hardship, when governments suddenly cannot find cash to pay for budgeted expenses.

But austerity—the retrenchment of spending and revenue restrictions outlined in Part Two—does not necessarily require or imply permanent changes in governance. As I showed in Chapter 3, some program cuts are deliberately framed as temporary (e.g. public safety), while others are implemented by restructuring service provision in such a way that restoring services becomes difficult even when the economy recovers. In order to draw a connection between temporary revenue declines (driven by severe economic downturn and financial sector collapse) and calls to restructure urban governance, a supportive narrative must be accepted. That narrative is of central importance to this chapter.

The literature on neoliberalism tends to treat the current wave of austerity politics as a continuing withdrawal of a certain form of the state and predominance of market logics (see e.g. Lobao and Adua 2011; Oosterlynck and Gonzalez 2013). Peck and Tickell argue that “roll-back neoliberalism” produced a marketization and denuding of local government through the 1980s that continues today (Peck and Tickell 2002). This roll-back is accomplished by transforming the city discursively from an arena of policy-making, “progressive reform and policy innovation” to an ungovernable arena in need of reform, particularly in times of “crisis” (Peck 2006, 683). Hackworth argues that the “boundaries of urban governance have shifted dramatically in the past thirty years” (Hackworth 2007, 10). Federal decentralization and devolution coincided with the emergence of “splintered urbanism:” the proliferation of private service providers (utilities, protective services, schools, etc.), resulting in the city no longer being the central provider of residents’ experience with services associated with urban living: schools, housing, utilities, transportation, and even protection (Graham and Marvin 2001).

Pinch argued that the economic recession in 1980s Great Britain was characterized by a co-constitutive relationship between austerity cuts and governance changes that differed from earlier recessions (Pinch 1995). Pinch observed that over the 1980s in Great Britain, in addition to the outsourcing of local service provision, the private sector was increasingly involved in decision-making, paralleling observations in literatures on the restructuring of local government into local governance (Pinch 1995, 966). He argued that the institutional practices of budgeting and spending, which were left intact in earlier phases of budgetary bargaining, were the site of renewed conflicts and changes in the 1990s. I believe this provides a framework for looking at how the crisis is being narrated in the U.S. today.

There have been some efforts to document this shift in governance through case studies of U.S. cities. In *Restructuring Philadelphia*, Adams et al examined changes in economic and governance structure in the Philadelphia region, and found that: “In case after case, we observe that local governments are relinquishing authority, either to state government agencies or to organizations operating in the ‘third sector’ of the region’s institutional landscape” (Adams 2008, 9). The central argument of this chapter and Chapter

5 is that this relinquishing of authority also takes the form of increased deference to financial actors and financial markets, as both debt and the institutions that police municipal debt play a central role in narrating crisis and defining the universe of policy solutions.

## CHAPTER 4: Financializing Governance

There are three ways that debt has featured in the production of fiscal crisis and the common sense narratives of crisis: (1) the growth of complex or “risky” debt, and (2) characterizing fixed obligations (such as pensions or health benefits) as debt, and (3) framing debt as a moral question, particularly for individuals and governments. Together, these reframings of debt and structural obligations have been used to justify external intervention into city finances, shrinking the scope of urban governance.

### 4.1 Financialization of urban policy

The degree of financial market penetration is reflected in the increase in municipal debt, the privatization and securitization of public assets, the size and scope of the financial services available to city governments, and the investor-orientation of critical collective consumption decisions. Local governments have come to rely heavily on financial markets, and not just through traditional forms of municipal indebtedness, for the provision of standard public services. (Weber 2010, 252)

Financialization can be understood most broadly as the “growing power of money and finance in contemporary processes of economic, political and social change” (French, Leyshon, and Wainwright 2011, 814). Financialization encompasses the growing control by financial actors and market processes over urban policy and budgeting. One of the most important shifts in urban governance since the 1970s has been the financialization of many aspects of city government: development, budgeting, housing, and borrowing. For cities increasingly engaged with and dependent on complex financing arrangements, these shifts have deepened the depoliticization of the fiscal aspects of city governance by handing them over to financial experts, as many cities lack the internal expertise to manage complex financial arrangements (Weber 2010). These increasingly complex financing structures combine with the pressure on cities to be entrepreneurial and competitive, has increased the power of financial experts to shape policy. The predominance of “common sense” notions of economic necessity normalizes the prioritization of efficiency, competition and the need for market-based reforms in the realm of public finances. Key elements of governance become viewed as the logical domain of financial managers, accountants, and the private sector (see Merrifield 2014). The market mechanism is held up as the ideal form of distributing goods and services of all kinds; government’s role should be limited to activities that cannot be adequately provided by the market. Privatization can take many forms, not just the complete handing over of a good or service to the private sector, but the compartmentalization of aspects of governance to public-private institutions and oversight, using market logics to evaluate performance, and accepting a reduced level of public oversight and control over how activities are carried out.

Financialization explains several key elements of the context of urban fiscal crisis: the growth and complexity of municipal debt, the power of financial actors and financial expertise in urban policy-making, the shifting of risk from the private to public sector, and the increasing importance of financial capital to the functioning of cities (Coq-Huelva 2013; Weber 2010). The financialization of the economy that began in the 1970s has also produced a growing flow of capital looking for investment outlets, increasingly volatile asset prices and interest rates, and an increasing demand for liquidity vehicles to capitalize municipal assets (see Krippner 2005). This shift has produced growing pressure on cities to monetize the income streams of public assets, such as parking spaces, sewer systems, street lights, and land. As Weber argues, different cities have different abilities to successfully capitalize on public goods, but all cities have internalized the risks inherent in such schemes; a combination of expertise and state policies produces differentiated access to these complex capital markets, while dispersing risk broadly across the municipal sector. Financialization of the broader economy has coincided with the increased volatility of the general economy, which in turn increases the volatility of municipal revenues, as described in Chapter 2.

Financialization is also associated with the growing dominance of a mode of corporate governance and economic rationality, with a fixation on “shareholder value” (Rutland 2010). The massification of financial assets that reframes individuals as economic subjects (Sarah Hall 2011) has also reframed citizens who use city services into investors in municipal assets. As reflected in the narratives described in Chapter 5, maintaining the stability of the municipal bond market is held up as an important social value, more important than the fate of individual cities. Investors become morally and politically equivalent to city residents—their stake to claims on the city is equal, if not greater. Of particular salience in the current recession has been the reframing of public employees and retirees as creditors, and of employee obligations as debt, positioning claims by investors as morally equivalent to the livelihoods of retirees.

There is a small but growing body of research on the local effects of financialization and its implications for urban governance in particular (see French, Leyshon, and Wainwright 2011; Coq-Huelva 2013). Weber and others have begun to document the increasing use of complex financial instruments, technologies, and consultancies that cities use for development projects and as investment and revenue-generating tools. Pacewicz argues that tax increment financing, a popular strategy for generating revenue to support private development, has given economic development professionals power “to exercise jurisdiction over municipal budgets” (Pacewicz 2013). But little of this literature has treated city budgets themselves as sites of financialization.

Financialization is enabled by the construction of “the economic” as an arena of knowledge and expertise, in the process depoliticizing questions that can be framed as economic. Bourdieu proposed that “[e]verything conspires to make us forget the socially constructed, and hence arbitrary and artificial, character of investment in the economic game and its stakes” (Bourdieu 2005, 10). That economic game, in municipal finance, includes the banks, ratings agencies, and financial experts who participate in constructing a

narrative about cities and finance that is divorced from the political and social constructions of urban fiscal policy.

This construction of an economic “field” facilitates the rationalization of handing over a city’s financial decisions to an unaccountable group of financial actors (such as state-appointed emergency managers, consultants hired by cities to negotiate complex financial deals), removing them from democratic (“political”) control. The calculations performed by ratings agencies and buyers of municipal bonds are framed by those actors as rational calculations, incorporating political and social factors but not co-constituted by such factors. Bourdieu argues that a particular set of policies follows from the construction of the economic as a separate domain from the state: the commercialization of public goods, privatization and contracting out, the avowal by the state of its inability to control economic matters or intervene in market outcomes (such as inequality) (see Bourdieu 2005, 11–12). Maintaining political calm in the face of encroaching personal economic crisis requires that the economy be maintained as a separate terrain, and that any perceived shocks be naturalized. This naturalization is accomplished through the narratives circulating about the crisis: “the ideas, public narratives, and explanatory systems by which states, societies, and political cultures construct, transform, explain, and normalize market processes” (Somers and Block 2005, 264). When the economy can be framed as a natural force that is continually and inexorably changing, it becomes something acting upon cities, divorced from its social and political context, and framed as a natural phenomenon to which cities must respond in order to survive. The economy becomes an irresistible, exogenous force—impacting revenues and shaping policy approaches.

Underlying these policy framings is the presumption that the market is the best system for organizing economic activity, that government’s role is only to manage spheres the market can’t adequately manage, and that government must be attentive to the effect of policy on the behavior of business. Thus systems of governance are continually revised in order to minimize their “distortion” or interference in markets. The actions of banks are presumed to be “rational” and informed, and cities must behave in ways that will elicit investor approval. Similarly, banks’ decisions about lending are presumed to be based solely on economic rationales, not political interests; the actions of banks are thus unavoidable outcomes of naturalized economic forces. This presumption must be continually reinforced and reproduced in a variety of shifting political terrains. The narratives I discuss in this chapter are part of that reproduction.

### *Banks and crisis*

The growing power of financial actors in municipal finance can be traced to previous episodes of urban fiscal crisis. Weikart argues that the 1975 New York City fiscal crisis reflected a turning point in the expansion of cities’ use of credit and the control that this reliance on municipal credit gave to ratings agencies and financial institutions (Weikart 2009; Hackworth 2007). The role of debt in cities’ everyday finances (which I describe more below) means that banks have always played a pivotal role in moments of crisis,

through their decisions to cut off funding, or sell the debt they hold for a city. In these moments, such as during the Great Depression, banks have a prominent platform for shaping urban policy (and a national platform for airing their opinions) (Fuchs 1992, 72–86).

New York's 1975 crisis was essentially a "capital strike." Some scholars go so far as to blame banks for creating the crisis in order to shape policy (Tabb 1982). Banks had also sold off New York securities starting in 1974, since they had access to information about the city's financial condition, which created a panic that later justified their move to cut off credit (Brash 2003, 65). (The banks would of course loan money to the city shortly afterwards, through the financial entities set up to govern the city, at higher interest rates.) In 1975, arguing that the city "didn't respond adequately to reassure markets," the banks started to sell off their holdings of NYC bonds, causing the cost of NYC debt to rise even higher (Dunstan 1995). By March 1975, underwriters became hesitant to issue more debt, concerned that city was not doing enough to manage deficits, and that bondholders would not be protected in the event of bankruptcy (Dunstan 1995). The legislature acted to protect contractors, but not bondholders, raising banks' fears that they would end up losing money. In April 1975, the city took out a three day loan to cover its immediate expenses. The banks wanted to refuse any more issuances, but they held a lot of the city's debt, so they were in a precarious position related to their own customers, to whom they had been selling New York City municipal bonds. The state advanced revenue sharing funds to get the city past the immediate crisis, but when the banks finally decided to close New York's access to capital markets (the markets the city had been using to access the short-term loans to cover its shortfalls), the stage for crisis was set. Within days, the city would be unable to pay its bills to employees and suppliers, and would cease to function. A recovery plan was negotiated by the banks, state government, the city and its unions, one that implemented severe spending retrenchment but also an elaborate structure of fiscal governance that would overlay the city's existing government, and which continues to this day. I describe this structure in Chapter 5.

Weikart argues that New York's recovery plan represented the first time that banks demanded control over a city's financial policy as their condition for future credit, rather than fees or commissions. Dramatic power shifts trace back to the New York crisis, as balanced budgets became a key priority for local governments and the ability of banks to control municipal credit gave them considerable political influence on city budgets (see e.g. Glasberg 1989). Weikart argues that "the structural changes made to our public institutions during fiscal crises so altered the political landscape in favor of market interests as articulated by financial elites" that theories of urban politics and political coalitions no longer explain urban policy (Weikart 2009, 14).<sup>37</sup> I now turn to the relationship between banks and cities in the current crisis.

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<sup>37</sup> Other observers of urban politics (and the banks themselves) have argued that this influence is much more neutral. Shefter (1992) argues that creditors don't care how the city spends its money, just that the expenditures are less than the revenues. It is municipal officials, he argues, who decide how to manage spending to forestall political consequences, e.g. to decide how to manage "those elements of the city's population that are most likely to disrupt public order," and distribute the "rewards of city politics"

## 4.2 Creditors and debtors

The history of the United States... is also a history of the power of creditors over debtors as recession after recession demonstrated the struggle between the two. (Weikart 2009, 7)

Though nearly everyone agrees that Detroit is in particularly bad shape, many of its underlying issues—crushing debt and unfunded and unsustainable retiree benefits—are not unique. And those legacy costs are at the heart of what many experts believe is a coming municipal-finance crisis in the U.S. (Frooohar 2013)

We have to break the addiction to debt. Because that's what we've been doing for a long time. (Detroit Emergency Manager Kevyn Orr, quoted in Helms and Guillen 2013)

One of the central components of the financialization of urban policy is the growing complexity of municipal debt. Municipal debt plays an increasingly important role in urban politics, and is often invoked as a core driver of urban fiscal crisis. American cities have limited options for weathering economic downturns: cities are prohibited from deficit spending, and rely on short-term debt to cover time gaps in tax receipts and expenditures (see Monkkonen 1995). With limited ability to raise revenues, and few expenditures left to cut, cities have increasingly turned to debt financing to effectively cover funding gaps and even shorter-term expenditures. A city's ability to issue bonds plays a pivotal role in its everyday financial management as well as its long-term needs to provide infrastructure and services to its residents. The municipal bond market is also the central leverage point for financial institutions over urban policy. Over the past 25 years, in the face of limited revenue-raising options, and under pressure to be financially innovative, cities have been increasingly driven to take creative approaches to financing urban development and operations through borrowing and leveraged revenue streams (French, Leyshon, and Wainwright 2011).

Debt also plays a central role in the narratives about causes and solutions to fiscal crisis. This is in part because of the role debt plays in triggering insolvency. Although cities

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accordingly (Shefter 1992, p.234). Wall Street Journal editorials at the time argued that the banks didn't get *enough* concessions—that wages and other spending were still too high (see Shefter 1992, 157). Shefter goes on to suggest that the banks' cooperation with unions to form a powerful alliance meant that more radical demands from business—for privatization and radical cuts—could be resisted: “the monitoring agencies enable the market to make concessions to local political forces” (see Shefter 1992, 191). Shefter describes FCB as mediating demands of business, suggests that banks are a more benign force, and that “Contrary to the claims of many observers, however, the crisis has not placed effective control over the city's finances in the hands of New York's business elite” (see Shefter 1992, 223). Shefter argues that the Financial Control Board (FCB) gives investors confidence, so the city doesn't have to make as many cuts, especially to public employee unions, make concessions to “local forces capable of provoking conflicts that could delay the city's regaining full access to the public capital markets” (see Shefter 1992, 223).



can adjust their budgets in future years, the onset of a fiscal crisis originates with a city having trouble paying its expenses as revenues fall short of expectations for the current year. Ratings agencies will then downgrade a city's debt, raising the costs of short- and long-term debt, further exacerbating the expense-revenue imbalance, and making it harder for cities to take out the short-term loans (tax anticipation notes) needed to pay bills. The system of municipal debt thus exacerbates a fiscal crisis as it unfolds. In addition, as cities near severe fiscal crisis, the question of how a city's debt obligations will be renegotiated or settled under some form of adjustment (bankruptcy, receivership, etc.) is a question the banking industry is very interested in. Ratings agencies may downgrade a city if anything in the city's behavior indicates the future probability of not meeting a full debt obligation (even one of a related authority, rather than the city itself). The issue of precedent keeps the financial community vigilant for any sign that municipal debt will be treated other than a nonnegotiable, fully honored commitment.

The growth of complex municipal debt has given rise to an infrastructure of actors and rules that shape urban policy. Those rules and the spaces in which those actors operate provides an arena for promulgating narratives about how cities should perform. This chapter describe the way that these actors use debt to frame city's obligations to banks in moral terms, while legitimating the dissolution of other obligations, to employees and citizens.

#### *Data sources*

The Census local government survey tracks interest on all other debt (i.e. all non-utility debt). It also calculates debt outstanding, which includes long-term debt outstanding at the beginning of the fiscal year (divided into public debt for private purpose & public purpose), long-term debt issued or retired during the year, and short-term debt at the beginning and end of each fiscal year. Until 2005, the Census tracked many more categories of debt, including full-faith and credit v. non-guaranteed debt, debt for education, and all general purpose debt. Unfortunately, the restructuring of the Census survey on debt makes it difficult to construct exact comparisons across the two surveys, and also reduces the richness of municipal debt information after 2005. In addition to the Census data, I rely on CAFRs for each of my cases to measure common indicators of debt burden.

#### *Types of municipal debt*

Cities borrow money by selling bonds, for which they make interest and principal payments to bondholders until the original debt is paid off. The three basic types of debt cities can issue are (1) secured debt (i.e. bonds that are secured by a revenue separate from the general revenues, and secured by a lien on those revenues built into the bond), (2) unsecured debt, and (3) general obligation (GO) debt, which is guaranteed by "full faith and credit" of the government entity, i.e. by its ability to levy taxes and fees to pay the debt. Most states require voter approval via ballot referendum on all general obligation debt. It is considered the most secure, since cities rarely default and will (presumably) exist in perpetuity (unlike a private corporation, which can liquidate and limit its liability). General

obligation debt is tax-exempt under federal law<sup>38</sup> and most state laws, which appeals to investors and enables cities to pay lower interest rates.

Revenue bonds—the most common type of secured debt—are backed by a specific revenue stream, such as utility payments or bridge tolls, or the increment of property taxes as in TIF bonds. They do not require voter approval. The debt is considered securitized (i.e. backed by collateral) from a specific revenue stream. Some revenue bonds are tax-exempt, depending on the purpose of the debt. In some states, cities also issue “limited tax” debt, secured by a specific revenue source (such as Detroit, which issued bonds secured by specific general revenue sources). If debt is not unsecured—i.e. not guaranteed by a specific revenue stream—then in the event of default the bondholders have no legal claim to any city revenues.

Cities issue debt to cover short-term cash flow (some of which is normal business—tax revenues lumpy but paying employees is not—and some of which can be a sign of fiscal stress), as well as to finance large investments, such as a sewage plants, transportation project, and other multi-year expenses. Cities may also issue debt on behalf of private entities, usually for economic development projects.

### *Regulating debt*

State constitutions define the legal environment for both state and local public finance; city charters may set additional limits on the amounts and uses of debt. Most states limit the amount of debt that cities can issue, typically based on assessed value of taxable property in the city; state laws also define what kinds of debt must be approved by voters or the city legislative process (Feldstein and Fabozzi 2011). Cities’ ability to borrow by issuing bonds has been shaped primarily through legislation in the wake of crises or scandals, particularly after widespread municipal defaults during the 1930s (Sbragia 1996).

The debt limits placed on cities by state law, however, only apply to some of the debt for which cities are responsible. All four cities have a limit on general obligation tied to the percentage of their total assessed value (10% in Detroit and Dallas,<sup>39</sup> 15% in San Jose, 13.5% in Philadelphia).<sup>40</sup> This limit does not apply to revenue bonds or so-called “self-supporting or “self-liquidating” debt. It mirrors the guidance promulgated by all three ratings agencies for debt service as a percentage of expenditures: 5-15% (Moody’s), 8-15% (S&P), and 10% (Fitch) (City of Philadelphia 2009, 5).

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<sup>38</sup> Federal tax regulations outline the acceptable purposes of the GO bonds, which must usually be spent on infrastructure or a few other limited options (in 1986 the federal government removed the tax-exempt status for GO bonds used for private activity).

<sup>39</sup> Dallas has an additional lower limit, 4% of the true market value of properties.

<sup>40</sup> This limit is somewhat meaningless for Philadelphia, as it does not rely primarily on property taxes for revenue.

Beginning in the 1970s, non-GO debt began to consume an increasingly large share of the growing municipal debt market (see e.g. California Debt & Investment Advisory Commission, Fisher, and Wassmer 2011; Gillespie 2010). After fiscal crises in the 1930s and 1970s, debt limitations were tightened by many states, but these limits primarily affected GO bonds, and thus could be circumvented by the rapid growth of new debt instruments, created and marketed by banks (Weikart 2009). In addition to allowing municipalities to borrow money in excess of state limits, non-GO issuances were often not subject to voter approval, making them appealing to local officials. Complex debt instruments such as asset lease-back agreements or revenue bonds (backed by revenue streams that creditors could seize in the event of default) became more popular, and those were not subject to state or federal limitations on the amount of debt a city could take on (Weikart 2009).

Over the past 25 years, cities have experimented with a much broader array of financing instruments, especially in the wake of high inflation, reductions in federal aid, tax and expenditure limitations, and a slowing economy. This is partly to get around state limitations on debt, but also to capitalize on income streams from public assets in the post-1980s environment of entrepreneurial urbanism (Harvey 1989). Cities have also turned to more complex uses of borrowing and asset liquidation to finance development to cover short-term operating costs, raise money to cover liabilities such as pension funds, and fund private economic development projects (Weber 2010).

The most straightforward form of municipal debt, general obligation bonds, now makes up only 30% of the nation's municipal debt issuances (see e.g. Hackworth 2007). Revenue bonds in particular—bonds backed by specific revenue streams, such as fees for a sports arena, often for private development projects—have outpaced growth in GO debt. From 1970-1980, revenue bonds grew from 30 percent of all debt issued to 72 percent (T. N. Clark and Ferguson 1983); in 1981 private activity bonds accounted for 48% of the market (Hildreth and Zorn 2005). Some of these issuances, such as certificates of participation, are not actual bonds but are considered “unconditional contractual obligations” of the city, which means that in the event of a missed payment, a contract administrator can sue to force the city to pay from its general fund, or raise taxes to make the payment. Some types of revenue bonds are in fact drawing on abstract revenue streams, rather than a simple tax or fee, adding a greater layer of risk for both cities and investors, and uncertainty over how that risk will be allocated in the event of fiscal crisis.

Over the last four decades, the municipal securities market has ballooned, as has the level of debt taken on by U.S. cities. In 1975, there was \$235 billion in municipal debt outstanding; by 2012 this figure totaled roughly \$3.7 trillion (U.S. Securities and Exchange Commission 2012). Municipal debt portfolios also contain more high-risk forms of debt: such as variable interest rates, interest rate swaps, auction bonds, and other derivative instruments (see Weber 2010). Instead of one or two credit ratings, the three ratings agencies (Fitch, S&P, Moody's) now issue ratings for a complex portfolio of debt, often including bonds issued to pay previous bonds, all backed by different and sometimes unclear revenue streams. Just as new instruments—public authorities, special assessment districts, and revenue bonds—devolution fueled the growth of municipal debt in the 1970s

and 1980s, so have new instruments such as interest rate swaps, combined with nearly a decade of revenue declines, fueled municipal debt since 2000. In the past five years, the combination of increasing public risk, tightened fiscal margins, and market collapse has been toxic for places like Detroit and Philadelphia.

As a growing array of increasingly complex instruments has transformed the relationship between cities and credit markets, the nature of those markets and its actors has also been transformed. The creation of the Municipal Securities Rulemaking Board (MSRB) in 1975 greatly standardized the market, opening it up to more investors and increasing profit rates, making the municipal bond market a complex and fertile terrain for large investors. As the deregulation of the banking sector began in the 1970s, and accelerated through the 1980s and 1990s, major buyers of municipal bonds went from being commercial banks to representing a wider range of financial institutions. Before 1975, the major buyers of municipal bonds were commercial banks; banks often headquartered in the cities they invested in (the banks involved in negotiating New York's recovery had a state as both investors and sited corporations in the city). After 1975, as the financial industry began its long path of deregulation, bonds were held by a much larger set of investors, rather than large, local banks with a stake in the city's future (Weikart 2009). Particularly after 1986, mutual funds and other individual investors accounted for a growing share of bondholders; by 2004, commercial banks held less than 10% of municipal bonds, compared to 50% in 1975 (Hildreth and Zorn 2005).

This growing complexity of the municipal debt market has had two important consequences. First, it has exposed cities to significant risk through their increased to exposure volatile financial markets. Second, it has created a vast infrastructure of municipal finance and expertise that in turn shapes urban policy over much more than debt itself.

Two forms of complex debt that have attracted attention in the current recession are interest rate swaps and pension obligation bonds. One of the central pieces of Detroit's debt is in the form of Certificates of Participation (COPs) for its Pension Obligation Bonds.<sup>41</sup> The certificates were issued in 2005 in an effort to reduce the city's pension liabilities. In 2005, the Mayor fought a hard-won battle to get the Council to approve a complex deal in which the city issued \$800 million in pension obligation bonds to direct funds into its retirement systems, and negotiated a 30-year repayment and interest rate swap agreement to hedge the city against fluctuating interest rates. The COPs were issued at variable interest rates, and the city entered into swap agreements to stabilize the interest rates. The deal won Mayor Kilpatrick an award for "Deal of the Year" from *Bond Buyer*, and was intended to remove the pension liabilities from the list of structural deficit issues facing the city (Carvlin 2005; Bomey and Gallagher 2013). In 2005, the city also issued \$250 million in bonds intended to gradually repay its operating deficit. The deal covered \$1.8 billion in debt. After interest rates collapsed in 2008, making the deal a negative burden to the city every year, and possible long-term losses of \$500 million or more.

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<sup>41</sup> Pension Obligation Bonds (POBs) are bonds issued to generate cash to pay pension obligations, with the expectation that the returns from the pension fund will exceed the interest rate on the bonds. They are intended as a way of paying down pension liability.

In 2009, interest rates fell dramatically, making the 2005 swap deal attached to Detroit's pension obligation bonds a rapidly-growing liability, estimated at \$1.14 billion by 2013 (Rhodes 2013). In January 2009, the city was downgraded by S&P, triggering a "termination event" that gave banks the right to demand that the city immediately pay the termination costs and net value of the swap agreement, about \$400 million at the time (Bomey and Gallagher 2013). Under interim Mayor Ken Cockrel, the city negotiated a deal in which the banks secured the debt with revenue from the city's casinos (approximately \$170 million per year). If the city had not negotiated the deal, it would have been forced to default on its debt and file for bankruptcy.

This deal has become pivotal issue in the bankruptcy, as several triggering events have prompted renegotiation and raised the specter of termination (in which case the city would have to pay the current market value of the swap, which the banks demanded \$250-350 million, and still owe the original debt). In 2009, to avoid termination when the swap insurer was downgraded, the city negotiated to commit all casino revenues to the bank counterparties. After Orr's appointment in 2013, the banks again had the right to termination, but did not pursue it. Instead, they took a hard line with Orr in credit negotiations, ultimately failing to agree to deal and prompting the city's bankruptcy filing. The banks and insurance company involved in that deal continue to litigate the terms of settlement, after being forced by the bankruptcy judge to accept \$85 million to terminate the swaps.

Detroit's pension debt deal may appear disastrous in retrospect, but it is hardly exceptional. Dallas has also issued pension obligation bonds (see Table 4.2). In November 2004, voters adopted a proposal to close the unfunded liability of the Dallas Employees Retirement Fund plan by raising employee contributions, the city's contributions, and requiring employees to pay 37% of the cost to issue bonds to fund the pension system. Unlike Detroit and Stockton, the city's pension obligation bonds have not brought negative attention to Dallas, but it does have nearly \$300 million in outstanding pension obligation bond balances as of fiscal year 2014 (although the turnaround of the stock market has boosted returns, increasing the health of the bonds). Dallas has no outstanding swap agreements, although Texas governments have been one of the biggest users nationally of interest rate swaps since the state legislature authorized them in 2007 (Fulbright & Jaworski, LLP 2007).

Philadelphia also has a significant debt tied to pension payments—a Pension Service Agreement had \$1.4 billion outstanding in fiscal year 2012, representing nearly 20% of the city's total debt burden. Like Detroit, Philadelphia has been entangled in the derivatives market and downgraded for its high liabilities. Philadelphia also entered into swap agreements designed to smooth out payments on variable rate bonds, but which backfired after the 2008 crash and has resulted in cities paying windfalls to banks, sometimes long after the original debt is paid off (S. Ward 2012). For struggling cities like Detroit, Philadelphia, Pittsburgh, and New Orleans, these deals are often paired with other risky financial techniques, such as pension funds or other assets to guarantee complex debt arrangements, always with the encouragement of banks that stood to make money on the deals (Taibbi 2010).

Philadelphia's use of swaps has brought attempts by the state to prevent the city's use of such instruments. Pennsylvania's state auditor published a report exposing the risks of these swaps to cities and school districts, and urged the state legislature to prohibit municipalities from using them. As of 2012, the city and school district had already lost \$331 million in net interest payments and cancellation fees (\$109.6 by the city), all to banks that had received federal bailout funds (S. Ward 2012). More than 13% of Philadelphia's debt is still bound by swap agreements, and it has already paid \$109.6 million to terminate such agreements; if interest rates remain at record lows, the city stands to pay an additional \$240 million in additional net interest payments. But attempts by state legislators to prohibit such instruments have been unsuccessful so far, and although Philadelphia recently joined a lawsuit against several banks over such agreements, the mayor and council have been silent about the consequences of these deals for the city's budget. Philadelphia has also been using its ability to issue debt in order to bridge a serious funding gap in its school system. In 2013, the city issued \$50 million in bonds in order to hire back the 1,000 laid-off school employees that are needed to open Philadelphia's schools on time that fall (Lyman and Walsh 2013).

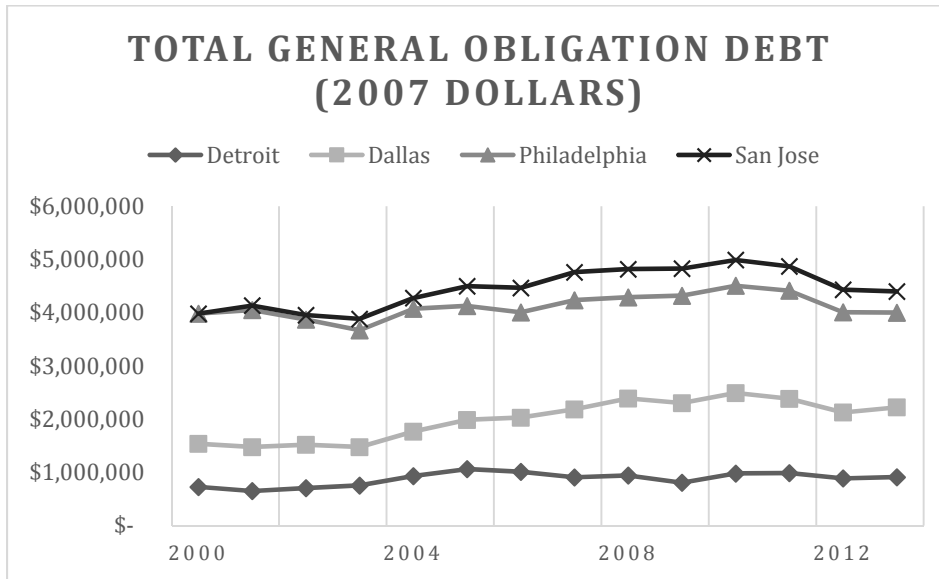
#### *Debt: four cities*

All four cities have seen their per capita debt burdens increase significantly since 2000: by 45% (Philadelphia) to as much as 285% (San Jose); well above the pace of inflation (33%) for the same period.<sup>42</sup> Detroit's debt burden is high, but a significant percentage of it is self-supporting (water and sewer debt), or comprises the estimated value of pension liabilities (Rhodes 2013). General obligation debt for all four cities, however, has remained fairly stable in all four cities since 2000, reflecting the decreasing reliance of cities on general obligation debt (and also reflecting the strict limitations on municipal general obligation debt) (see Figure 4.2).

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<sup>42</sup> Information compiled from city CAFRs by author.

Figure 4.1 Total general obligation debt, case cities, FY2000-13 (in \$000s)



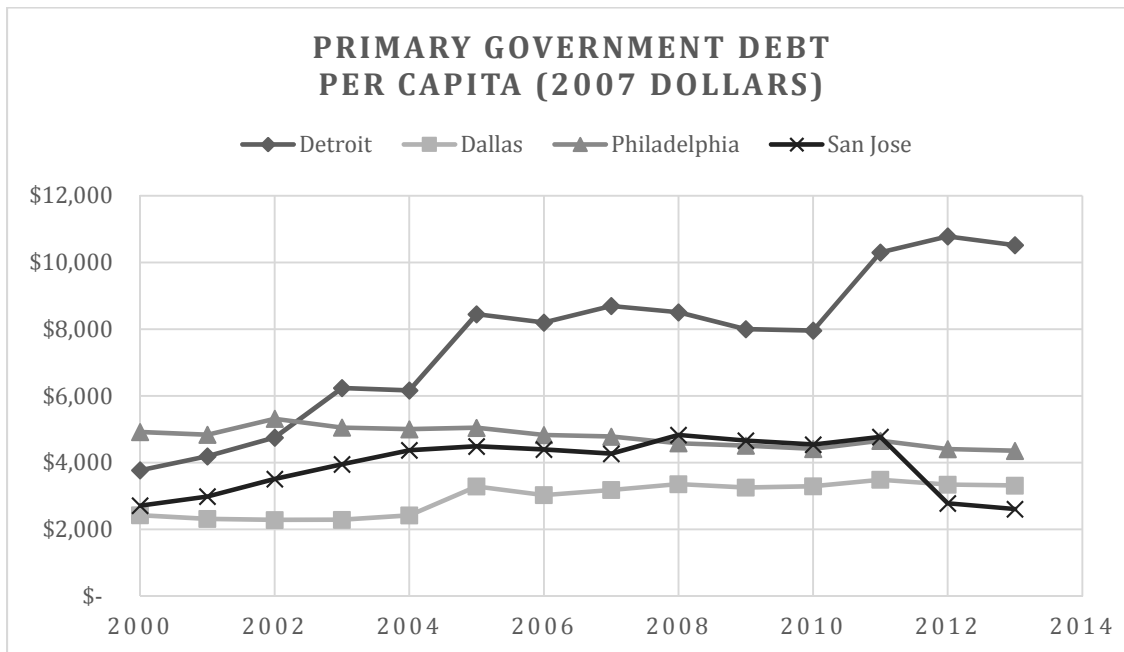
Source: City CAFRs FY2006-07 and FY2012-13, compiled by author

Table 4.1. Outstanding debt, case cities, FY2012-13 (in \$000s)

	Detroit	Dallas	Philadelphia	San Jose
Total GO debt	\$1,009,395	\$1,452,292	\$1,777,896	\$441,025
Total bonded debt	\$2,157,764	\$2,043,260	\$4,279,800	\$1,198,485
Total bonded debt per capita	\$3,023	\$1,701	\$2,497	\$1,220
Total bonded debt as % of assessed value	25.54%	2.44%	4.58%	0.98%
Assessed value	\$8,447,370	\$83,681,722	\$11,212,655	\$121,793,350
Pension obligation bonds	\$1,180,285	\$407,301	\$1,171,300	\$0

Source: City CAFRs FY2012-13, compiled by author

Figure 4.2 Primary government debt per capita, case cities, FY2000-13 (in 2007 dollars)



Source: City CAFRs FY2006-07 and FY2012-13, compiled by author

### Detroit

Throughout Detroit’s debate over the emergency manager and bankruptcy, it was the city’s debt that figured most prominently in discussions: an estimated \$15 billion in debt 2010, a figure that had risen to \$18 billion by the time the city filed for bankruptcy. Unlike New York in 1975, Detroit actually defaulted on long-term debt payments after negotiations with creditors broke down. In the weeks building up to the bankruptcy filing, Kevyn Orr and his staff met several times, in Detroit and in New York, with the insurers of Detroit’s complex pension-related swap agreements, the bank parties to the swaps, and representatives of the pension plans (Rhodes 2013, pp 34–35). On June 14, 2013, the emergency manager announced that Detroit would stop making payments on its swap COPs, sparking immediate downgrades. The city filed for bankruptcy just a few days later.

Many of the reports of Detroit’s fiscal crisis, emergency takeover, and eventual bankruptcy center on the amount of the city’s debt problem. Local and national press emphasized that the city had been “burying itself” in debt and allowing budget deficits to accumulate, unable to rein in spending (Neavling and Egan 2012). In 2014, the bankruptcy judge listed the following liabilities for Detroit:

- \$18 billion total debt: \$11.9 billion unsecured, \$6.4 billion secured (of which \$5.2 billion was for the water and sewerage system)
- \$5.7 billion for OPEB (health & life insurance)



- \$3.5 billion for unfunded pension liabilities (a figure debated by the plans themselves, who presented a figure closer to \$1 billion)
- \$651 million GO bonds
- \$1.43 billion for the COPs tied to pension obligation bonds
- \$346.6 tied to the swaps attached to the COPs; and
- \$300 million in other liabilities (sick leave, workers comp).

The bankruptcy judge also affirmed the city's estimate that the cost of debt service in 2013 was 38% of tax revenue (\$247 million), increasing to 65% in five years if nothing changed because of an estimated \$150-200 million operating deficit per year (Rhodes 2013, 17). By comparison, in New York 1975 outstanding debt was estimated at \$14 billion, including \$6 billion in short-term bonds, with an operating deficit of at least \$600 million, and a population of 7.9 million people (Dunstan 1995). Detroit can also be compared to other cities today. A conventional measure of a city's debt burden is the amount of debt relative to the assessed value of its properties, or to total revenues or expenditures. A second measure is debt service payments as a percentage of general fund revenues or expenditures (Government Finance Officers Association (GFOA) 2003).

Throughout the 2000s, Detroit's general obligation debt was within its state debt limit of 10% of the assessed value of city property. But the other \$6.4 billion of bonded debt was not subject to that limit, including debt issued for water and sewerage. Although Detroit is often portrayed as hooked on debt, its borrowing strategy has not been unusual among cities, who often issue bonds with 10- 20- and 30-year maturity rates, fixed obligations that will inevitably seem oversized during a recession.

Dallas' high debt burden is in part because of its need to borrow to fund the high costs of basic infrastructure and maintenance. The city's inability to raise revenues, and the state's lack of an income tax, puts the burden for road maintenance and flood control, in addition to other public facilities, entirely on the city. The City Manager, in proposing a \$500 million bond issuance in 2012, stated that the city had \$10 billion of backlogged projects (Watts 2012). The city has also issued bonds on behalf of economic development projects, including the Dallas Convention Center, a sports arena, and a surface-street park.

A large portion of Detroit's debt costs include the fees and issuance costs associated with borrowing—underwriting expenses, bond-insurance premiums, fees for swaps, Bloomberg estimated at \$474 million for these indirect costs of borrowing (D. Christoff and Preston 2013). Some of these fees are triggered by downgrades, as agreements such as swaps include provisions for requiring immediate repayment in the event of an issuer or insurer downgrade. The real story of Detroit's debt crisis is (1) the exposure to financial markets created by the swap deal executed in 2005 and (2) the incorporation of pension obligations into the calculus of Detroit's debt burden.

## *Debt as a moral question*

In the current crisis, discussions of municipal debt have taken on a particular moral tone, with cities described as “addicted to debt,” irresponsibly borrowing their way out of crisis (see e.g. Zakaria 2012). One narrative is that U.S. cities have accrued unsustainable levels of debt because they have been irresponsibly borrowing to cover structural deficits and thereby avoid hard political decisions. This moralistic rhetoric around government borrowing also featured predominantly in national debates over the federal debt ceiling. Fourcade argues that economic questions are often framed as moral arguments, that markets are explicitly moral projects, saturated with and producing normative prescriptions (Fourcade and Healy 2007). (Best finds a similar moral framing of government debt in discourses of restructuring under the International Monetary Fund (Best 2005).) This language of morality appears frequently in assessments of city finances and particularly in relation to debt. The framing of debt as a moral question is central to the way narratives of fiscal crisis focus the blame on cities for their own fiscal troubles and define the fate of bondholders as a moral question, ahead of the concerns of city residents.

This narrative uses the language that cities in times of crisis “choose” to avoid their moral obligations to bondholders, by pursuing strategies that jeopardize the ability of bondholders to collect their debt. Ratings agencies and banks understand that cities cannot function without issuing debt (and that municipal borrowers are among the most responsible in the world; with default rates far below corporate issuers). Nonetheless, any idea that cities may want to negotiate existing debt in certain eventualities, or default on any part of their debt portfolio, is met with this language of “willingness” and obligation that frames the management of public debt not as strategic or rational but as immoral and careless.

In 2012, in response to a cluster of California bankruptcies, Moody’s issued several statements about its intention of reviewing the debt of California cities, including a special comment: “Recent Local Government Defaults and Bankruptcies May Indicate a Shift in Willingness to Pay Debt” (Moody’s Investors Service 2012e). The statement says that the bankruptcies of two California cities suggests that the “willingness to pay debt obligations may be eroding in the US municipal market” (Moody’s Investors Service 2012e, 1). Moody’s repeatedly used the language of “willingness” and “walking away” (a term often used to describe “irresponsible” individuals who walked away from underwater homes) (McCormack 2014). The report suggests that the two cities did not try hard enough to cut spending, and questions “whether distressed municipalities will begin to view debt service as a discretionary item in their budgets...events of the last few years prompt us to review our long-held assumptions about municipal *behaviors* and *attitudes* toward debt repayment” (Moody’s Investors Service 2012e, 1 emphasis mine). The coverage of these issues in the financial press emphasizes this language of cities avoiding their obligations: “investors are starting to wonder if cities are using bankruptcies as a way to shirk their debts” (*Business Insider* 2012).

The narratives of excessive debt, and the moral language used to describe cities’ willingness to pay debts, frame cities as financial actors capable of taking on risk as a

calculated and moral obligation, rather than as keepers of the public good, with multiple obligations to their residents and employees. Moralistic narratives promulgated by financial actors must also accomplish the complex task of avoiding any notion of the financial community's responsibility for ballooning debts caused directly by the bank crisis in 2007-08, and simultaneously emphasizing cities' responsibility to the collective to pay those debts, or risk the stability of the market. One consequence of this simplistic narrative of cities and debt is that it omits the complexity of cities' relationship to financial markets, particularly secondary markets such as for municipal bond insurance. Many bonds carry an insured and an uninsured rating. Before 2007, many bonds were insured and about 50% carried a AAA rating and were insured (Feldstein and Fabozzi 2011, xxxv). The collapse of the financial markets—and its concentration in mortgage-backed securities—severely damaged the reputation of the financial insurance sector, and many were downgraded or folded, triggering downgrades in the bonds they insured. The bond insurance industry collapsed after 2008 and went from insuring 57% of municipal bonds in 2007 to 3.5% in 2012 (Renick and Bonello 2014); the increased risk faced by municipal bondholders reflects many aspects of the financial crisis, not just the vulnerability of cities' own credit.

Central to understanding how these narratives of cities and debt take hold is the role played by ratings agencies in producing and reinforcing those narratives. I turn now to that discussion.

### **4.3 Ratings agencies**

Just as the power of banks over cities has grown in iterations of crisis, the role played by ratings agencies has become increasingly comprehensive and pivotal. The reports issued by credit agencies play a significant role in shaping discourses of fiscal crisis, financial responsibility, and ultimately, how cities must respond to crisis (Hackworth 2007). The frequency and technical nature of those reports, and the increasingly complex relations between cities and financial institutions, has also increased the power of financial experts who craft both policy statements that city officials take to heart, and public narratives that circulate through the financial press (see e.g. Chernick, Langley, and Reschovsky 2011b). The perceived neutrality and objectivity of these forms of narrative production help them become seen as “common sense,” rather than as constructs with specific motives and politics.

As the market for municipal debt grew to involve more complex instruments, the importance of standardizing the assessment of debt issuances also grew, and a group of ratings agencies arose in response (Sinclair 2005). A host of other financial actors—including bondholders, bond insurers, and regulating institutions increasingly weigh in on city fiscal policy through their articulations of risk and value in the municipal bond market (Leyshon and Thrift 1999). This influence puts indirect limits on city policy choices, shrinking the scope of possible responses to fiscal crisis (Hackworth 2007). As cities' fiscal choices are subject to the scrutiny of ratings agencies in the press, city leaders frame policy choices in the context of their bond ratings and their appraisal by the financial community.

Sinclair has studied the power of rating agencies in all aspects of capital markets, including the market for local and state government debt (Sinclair 2005). He outlines how rating agencies shape policy:

The agencies' views on what is acceptable shape the actions of those seeking their positive response. This anticipation effect or structural power is reflected in capital market participants' understanding of the agencies' views and expectations. In turn, this understanding acts as a base point from which business and policy initiatives are developed. The coordination effect of rating agencies therefore narrows the expectations of creditors and debtors to a well-understood or transparent set of norms, shared among all parties. (Sinclair 2005, 15)

Hackworth argues that “[B]ond-rating agencies are arguably the most directly influential ‘police officers’ of neoliberal urban governance for cities in wealthy countries like the U.S. (Hackworth 2007, 18). Ratings downgrades have clear financial consequences for cities; lower-rated debt issuers must pay higher interest costs, so a downgrade raises the cost of debt for cities. Public ratings and ratings agencies are still, as Union Bank says, “embedded in bank documents, loan and credit agreements” (Sakai 2013). But it is in the narratives, not the ratings themselves, that agencies exert the greatest power, and that is the focus of this discussion.

I obtained access to Moody's Investors Service comments relating to U.S. public finance and news coverage of those comments using a variety of techniques. Some reports by Moody's are publicly available; others have been republished online in their original format. I catalogued all relevant reports and systematically searched for original copies. I obtained an academic research account with Moody's to obtain reports that were behind the paywall. There are a few relevant reports for which I was unable to obtain the originals; for those I relied on press releases by Moody's and news coverage by financial outlets for the general content and tone of the reports.

There are three municipal ratings agencies: Moody's and Standard & Poor's (the two primary raters of municipal bonds), and Fitch Ratings (less important in public finance but growing). A bond issued by a city may be rated by any or all three of the agencies. For large cities, all general obligation bonds (the rating that most directly reflects the evaluated fiscal health of the entire city) will be rated by both Moody's and Standard & Poor's. Cities tout their ratings on their websites and in their budgets, and issue press releases in the event of any major rating action. A city's general rating is held up as a public, valid, and vital measure of its fiscal responsibility. Budgetary policy (such as debt management laws) follows the methodologies outlined by the ratings agencies (see e.g. City of Philadelphia 2009).

Ratings agencies also perform ongoing surveillance of city finances. Every issuance is assigned a rating when it is first “sold” or put on the market, and then continually evaluated for possible upgrade or downgrade. Those ratings are all public information (and in fact is being centralized through EMMA (Electronic Municipal Market Access), the

federal clearinghouse for municipal finance created in the wake of Dodd Frank). Ratings are important throughout the life of a bond: municipal bonds are priced daily, which means they have great price sensitivity to daily events. They are also purchased by a wide range of investors, including speculators and hedge funds, who buy and sell rapidly. The symbiotic relationship between ratings agencies and the commoditization of municipal bonds enables this rapidly-trading market for municipal debt.

When assigning a rating to an issuer or new bond issuance, or changing the rating (“downgrading” or “upgrading”) on an outstanding issuance, the agency will issue a press release with a short explanation as well as a detailed commentary. The full text of comments is available only to the paid subscribers of the service, but portions of it may be released by the agency itself or by the financial media such as *Bond Buyer*.

The agencies’ information and public face are highly managed, and rely heavily on their positionality as “impartial” observers. Their issuance ratings are prompted by issuers themselves, but their sector comments and ratings actions (upgrades and downgrades) are internally driven, discretionary actions, often made in response to events in the news or broader trends, and intended to intervene in those debates.<sup>43</sup> The reputation of ratings agencies took a hit after the collapse of financial markets in 2008, as their evaluations (and impartiality) were questioned (particular those who had rated derivatives containing mortgage products).<sup>44</sup> The loss of AAA bond insurers, however, has changed the market more as issuers (cities) can no longer “buy” a AAA rating, as many insurers were the first to collapse in the initial crisis.

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<sup>43</sup> The ratings agencies have twitter accounts: @FitchRatings, @MoodyRatings, @MoodyAnalytics, @standardpoors, through which they comment on ongoing fiscal policy issues.

<sup>44</sup> S&P has recently settled a lawsuit with the federal government over inflated ratings of instruments related to mortgage-backed securities (Protest 2015).

Table 4.2 Municipal bond ratings scales

	Moody's			S&P		Fitch	
	Long-term	Short-term	Municipal obligations	Long-term	Short-term	Long-term	Short-term
Prime	Aaa	P-1	VMIG1 / MIG1	AAA	A-1+	AAA	F1+
High grade	Aa1			AA+		AA+	
	Aa2			AA		AA	
	Aa3			AA-		AA-	
Upper medium grade	A1		MIG2 / VMIG2	A+	A-1	A+	F1
	A2			A		A	
	A3	P-2		A-	A-2	A-	F2
Lower medium grade	Baa1		MIG3 / VMIG3	BBB+		BBB+	
	Baa2	P-3		BBB		BBB	F3
	Baa3			BBB-	A-3	BBB-	
Non-investment grade speculative	Ba1		SG	BB+	B	BB+	B
	Ba2			BB		BB	
	Ba3			BB-		BB-	
Highly speculative	B1			B+		B+	
	B2			B		B	
	B3			B-		B-	
Substantial risks	Caa1			CCC+	C	CCC	C
Extremely speculative	Caa2			CCC			
	Caa3			CCC-			
Default imminent	Ca			CC			
				C			
Default	C			D	D	DDD,DD,D	

Source: Agency ratings methodologies, compiled by author

Table 4.3 Moody’s rating, largest U.S. Cities, 2006 and 2014

	2006	2014	Outlook (2014)
New York, NY	A1	Aa2	stable
Los Angeles	Aa2	Aa2	stable
Chicago	Aa3	Baa1	negative
Houston	Aa3	Aa2	stable
<b>Philadelphia</b>	Baa1	A2	stable
Phoenix	Aa1	Aa1	stable
San Diego	A3	Aaa	stable
<b>Dallas</b>	Aa1	Aa1	stable
San Antonio	Aa2	Aaa	negative
<b>Detroit</b>	Baa2	B3	stable
<b>San Jose</b>	Aa1	Aa1	stable
San Francisco	Aa3	Aa3	stable

Source: Moody’s Investors Service, compiled by author from online data

As of July 2014, San Antonio and San Diego are the only cities over 1 million people with a Aaa rating (Dallas was downgraded in 2003, before that it was the largest Aaa-rated city).

#### Ratings methodology

Ratings agencies make public, and often revise, their formulas for calculating ratings. The rating formula for general obligation bonds—those bonds insured by the “full faith and credit” of a city—is the area in which agencies comment on the full range of policies, since in theory any policy can affect the likelihood that a city will pay on its bonds (or be able to). The rating has to evaluate (in Moody’s language) the ability of the city to raise revenues to cover debt costs, and to exercise “governance” “management” that may be necessary to implement politically unpopular solutions (spending cuts and revenue increases) in hard times. Moody’s uses four rating “factors” and several subfactors:

Table 4.4 Moody’s rating factors (2014)

Broad rating factors	Factor weighting	Rating subfactors	Subfactor weighting	Other sub factors from agencies
Economy / tax base	30%	Tax Base Size (full value)	10%	Assessed valuation growth
		Full Value Per Capita	10%	
		Wealth (median family income)	10%	
Finances	30%	Fund Balance (% of revenues)	10%	Diversity of revenue streams and financial flexibility to contain expenditures
		Fund Balance Trend (5-year change)	5%	

		Cash balance (% of revenues)	10%	Prudent use of reserves and maintenance of liquidity levels
		Cash balance trend (5-year change)	5%	% of expenditures used for debt services, pension/OPEB
Management	20%	Institutional framework	10%	On-time budgeting and reporting; multi-year budgets and capital plans  Management staff stability and experience
		Operating History	10%	Easy access to management and timely responses to questions / concerns
Debt / Pensions	20%	Debt to Full Value	5%	Debt per capita, debt service coverage (revenue secured or enterprise debt)
		Debt to Revenue	5%	Capital plans and future debt issuances
		Moody's-adjusted Net Pension Liability (3-year-average) to Full Value	5%	Pension / OPEB funding levels and UAAL
		Moody's-adjusted Net Pension Liability (3-year-average) to Revenue	5%	Access to capital markets and public debt / credit ratings

Source: Moody's Investors Service

While these guides present the agencies' methodologies as simple, transparent, and technical, they also reserve a role for qualitative and discretionary elements. Standard & Poor's says that its "Issuer Credit Rating Definitions" are intended to encompass both the "obligor's overall capacity (its creditworthiness) and willingness to pay its financial commitments" (Feldstein and Fabozzi 2011). It's through this notion of *willingness* that raters bring issues of governance, and politics, into a determination of how much debt will cost the city. Government is always referred to as "management," and the methodologies and comments refer continually about management's "willingness" to do things. A presentation given by FitchRatings to California officials compared two hypothetical California cities (A. Ward 2013, 28). Under "Management" it contrasted two scenarios:

"Political / labor environment is complex, but city has long record of managing pressures well"

*(Versus)*

"Political / labor environment is difficult, and management has struggled to implement desired financial changes"

Under "Management 'Red Flags'" Fitch mentions "misalignment between management and elected officials" and "Inability of policymakers to make necessary decisions" (A. Ward 2013, 30).



The agencies, of course, describe their ratings as impartial and disclaim any relationship to policy. From FitchRatings presentation to investors (FitchRatings 2013):

A Rating is NOT...

- Judgment or statement regarding any aspect of public policy
- Political statement in favor of or against a particular person, party or public policy
- A 'report card' on government or management performance.

These formulas, despite the agencies' efforts to frame them as technical evaluations, are not without controversy. In the wake of several municipal downgrades in 2008, state officials protested the relatively lower rating of municipal bonds to corporate bonds, despite the significantly lower default rate of governments (Mysak 2008). Public officials have also at times responded to specific ratings agencies actions, such as Stockton's City Manager (Smith 2013), and California's treasurer has squabbled publicly with S&P over several comments (Grimm 2013).

Since 2008, all three agencies have revised several aspects of methodologies for local government ratings. The most significant revisions have addressed the role played by debt and pension liabilities in the overall credit rating, which I discuss below. The moments of methodology revision are public and constructive moments, in which the power of the agencies is exerted and reaffirmed, as their revision processes are circulated through the financial press, with requests for comment circulated to finance officials and national organizations of finance professionals. This effort to frame their methodology and revisions as transparent processes, subject to public scrutiny and feedback, is an important aspect of framing the agencies as providing a form of impartial public service.

In addition to rating government entities and specific issuances, ratings agencies also produce regular reports on the "sectors" they rate, including U.S. public finance (states, cities, and the federal government). These comments are a mix of commentary on local policies (always with an eye to the potential replication or circulation of those policies to other governments) and the economic health of the sector in general (each agency also has a "separate" department that issues economic analysis reports). Since 2007, all three ratings agencies have issued dozens of comments on the state of local government finance (See Table 4.6). There have been a flurry of downgrades since 2008 (FitchRatings 2012), and the specter of municipal bankruptcy has roiled the normally staid government bond market several times in the past five years (Ng and Corkery 2012). In 2008, the fall of the stock market prompted several comments about the outlook for local government finance (Standard & Poors 2008; Moody's Investors Service 2008b). In April 2009, Moody's placed the entire local government sector on watch: "This negative outlook reflects the significant fiscal challenges local governments face as a result of the housing market collapse, dislocations in the financial markets, and a recession that is broader and deeper than any recent downturn" (Moody's Investors Service 2009b, 1). With increasing frequency,

Moody's issued general comments on the status of city finances regularly through 2014 (see Table 4.6). In 2013, Moody's described the "new stable" as an "era of constrained resources" (Moody's Investors Service 2013m)] Its most recent report, "Anatomy of Successful U.S. Cities" highlights the actions taken by the 34 large cities who maintained or improved their credit ratings during the recession: "aggressive and timely" spending cuts, (property) tax base growth, and "politically difficult" revenue increases, specifically on sales taxes (the agency particular touts Phoenix, Arizona's increased tax on food for home consumption) (Moody's Investors Service 2014i, 4).

Table 4.5 Selected Moody's comments on fiscal crisis, 2008-2014

22-Jan-08	Housing Market Downturn Creates Fiscal Challenges For State And Local Governments
23-Dec-08	Impact of the Credit Crisis and Recession on Local Governments
2-Apr-09	Moody's Assigns Negative Outlook to U.S. Local Government Sector
27-May-09	Compilation of U.S. Public Finance Rating Roadmaps
7-Sep-09	Free to Furlough?
22-Feb-10	U.S. State and Local Governments Remain Inherently Resilient, Despite Growing Pressures
12-May-10	Management Strategies of U.S. Local Governments Responding to the Economic Downturn
13-Jul-10	Roadmap 2010: Local Governments
24-Feb-11	U.S. Public Finance Rating Revisions for Q4 and Full Year 2010: The Stress Continues
17-Mar-11	2011 Sector Outlook for U.S. Local Governments – Toughest Year Yet
16-May-11	Rising Property Tax Appeals Are Credit Negative for US Local Governments
6-Jun-11	Further Home-Price Declines Will Pressure Local Governments Differently
19-Sep-11	Sector Outlook for U.S. Local Governments Remains Negative
21-Sep-11	Weak Economy Will Prolong Municipal Credit Pressure
14-Nov-11	The Impact of US Federal Fiscal and Economic Strain on Municipal Credits
7-Mar-12	US municipal bond defaults & recoveries, 1970-2011
5-Oct-12	Outlook for US Local Governments Remains Negative
7-May-13	US Municipal Bond Defaults and Recoveries, 1970-2012
20-Aug-13	Outlook Update: Why US Local Governments Still Have a Negative Outlook Despite Our Revised Outlook for States
3-Dec-13	US Municipal Speculative-Grade and Distressed Issuers
4-Dec-13	2014 Outlook – US Local Governments
7-May-14	US Municipal Bond Defaults and Recoveries, 1970-2013
27-Aug-14	High Poverty, High Ratings – 27 Large Cities Have Both
11-Nov-14	Anatomy of Successful US Cities

Source: Moody's Investors Service sector comments, compiled by author

## Detroit

Detroit has received significant attention over the past decade from municipal ratings agencies, with comments focused on three categories: Detroit’s financial indicators; Michigan’s emergency manager law; and the implications of Detroit’s bankruptcy, particularly with regard to pensions. Detroit’s downward ratings spiral, has actually been relatively recent, reflecting the impact of the recent recession on Detroit’s finances. The city maintained a Baa1 rating (a low but still investment-grade rating) from 1998 to 2005, when it was downgraded by Moody’s to Baa2 on November 29, 2005 (Moody’s Investors Service 2005). This downgrade came just before the city completed a deal issuing debt to cover its pension obligations, resolving a threat to insolvency featured in the downgrade (Carvlin 2005). The city’s rating remained there until May 29, 2008, when Moody’s downgraded the city citing repeated lateness in filing audits, “chronic economic challenges” and “weak” demographic and economic profile (Devitt 2008). Throughout his administration, Mayor Kirkpatrick referred to ratings agencies as the gatekeepers of the city’s fate. For example, his office responded to the May 2008 downgrade:

We are disappointed by Moody's decision to downgrade our bond rating... We have received positive ratings from two other rating agencies because of the bold steps the Kilpatrick administration has taken to regain structural balance by negotiating historic health care concessions, reducing overtime spending, and increasing revenues. Our administration will continue to work with them to change their view of the city and its finances. Our efforts will be directed at continuing the tremendous progress we have made in restructuring the city's finances. (Devitt 2008)

During Mayor Bing’s first year in office, the city was downgraded twice; Moody’s cited “the city’s failure to limit expenditure growth” as producing “a series of sizable operating deficits” (Moody’s Investors Service 2009a). Moody’s attributed those deficits to reductions in the city’s two largest revenue sources: income taxes and state aid, and noted the city’s increasing use of short-term debt to cover deficits. “[T]he city’s economic and demographic profile remains one of the weakest in the nation” concluded the comment (Moody’s Investors Service 2009a). The comment also cited the risk that Detroit’s swap agreements (tied to the pension bonds issued in 2005) might be subject to termination, as a result of circumstances associated with the recession. Seven months later, in a “high profile rating update,” Moody’s downgraded the city to Ba3/B1, so-called “junk” status (Moody’s Investors Service 2009c).

Table 4.6 Detroit ratings actions and key financial events, 2005-2014

<b>2005-2010</b>	
November 29, 2005	Downgrade (Baa2) (first since 1998)
May 29, 2008	Downgrade (Baa3/Ba1)
January 13, 2009	Downgrade (Ba2/Ba3)
August 21, 2009	Downgrade (Ba3/B1) (and high profile update)
October 1, 2010	Update and negative outlook

<b>2011</b>	
<i>December 2</i>	<i>Snyder initiates fiscal emergency review</i>
December 7	On review (Ba3)
<b>2012</b>	
March 20	Downgrade (B2/B3)
June 14	Downgrade (B3 / Caa1)
<i>August 4</i>	<i>Public Act 4 suspended</i>
October 15	Under review pending resolution of Public Act 4
<i>November 6</i>	<i>Public Act 4 repealed</i>
November 28	Downgrade (Caa1 / Caa2)
<b>2013</b>	
<i>March 14</i>	<i>Emergency manager appointed</i>
<i>May 12</i>	<i>Emergency manager 45-day plan issued</i>
June 13	Downgrade (Caa2 / Caa3)
<i>June 14</i>	<i>Detroit defaults on some debt</i>
June 17	Downgrade (Caa3 / Ca)
<i>July 18</i>	<i>Bankruptcy filing</i>
July 18	Under review
November 19	Negative outlook
<i>December 3</i>	<i>Judge finds Detroit eligible for bankruptcy</i>
<b>2014</b>	
<i>December 10</i>	<i>Detroit bankruptcy ends</i>
December 18	Upgrade (B3) and stable

*Sources: Moody's ratings website, and Moody's High Profile Ratings Update, September 30, 2010 (Moody's Investors Service 2010b)*

On September 30, 2010, Moody's released another "high profile rating update" for Detroit, again highlighting the risks posed by the city's swap agreements, the city's failure to cut expenditures "sufficiently" to offset revenue declines (particularly in state aid and income taxes), the city's ongoing operating deficits, and its heavy reliance on short-term borrowing for cash flow (Moody's Investors Service 2010b, 1). Moody's also castigated the city for continued delays in reporting and disclosure, and for continually postponing its time frame for eliminating its deficit. But the comment also praised city "management" (the agency's standard term for referring to city government) for eliminating staff positions and reducing wages, and for its efforts to settle union contracts (Moody's Investors Service 2010b, 5). The update also notes the city's temporary prevention of a swap termination event in 2009 by putting up its wagering tax revenues as collateral, but notes its continuing concern about the risks posed by that deal (Moody's Investors Service 2010b, 9).

In March 2011, the Census Bureau released numbers from the 2010 census showing that the City of Detroit had lost 25% of its population since 2000, potentially costing the city significant revenues from federal and state programs (as well as a declining tax base) (Moody's Investors Service 2011d). In December 2011, the city was placed on watch for further downgrade after the state announced a review of the city's finances, possibly triggering the appointment of an emergency manager: "The risk of a bankruptcy filing by the city is in our view a low risk event, but nonetheless has a rising probability" (Moody's

Investors Service 2011f). A central concern (echoed by Fitch's watch notice of the city the same month) was not that an emergency manager would be bad for the city (several other comments positively frame the possibility of state intervention), but that the appointment of an emergency manager was a termination event under the swap agreement (which would require the city to pay termination and cancellation fees immediately) (Kaffer 2011).

In March of 2012, Moody's downgraded the city when a judge approved a ballot measure to allow voters to repeal the emergency manager law (Moody's Investors Service 2012b). Moody's spokesman stated: "There's been a persistent inability to achieve structural balance despite all the big spending cuts" (Fleming and Nichols 2012). The article quotes a financial expert saying that the ratings reflects the market's uncertainty over whether the city and state would be able to reach an agreement to "restructure" the city; the downgrade came as the city and state were deep in negotiations over a consent agreement to avoid an emergency manager.

Moody's has continued to comment on the political conflicts over Detroit's financial restructuring. On June 14, 2012 it further downgraded Detroit based on the "lack of a clear political consensus to successfully implement the city's Financial Stability Agreement (FSA)" (Moody's Investors Service 2012d). While the FSA was in place, Moody's left the city's rating untouched, but in August the state's emergency manager law was suspended pending a voter referendum in November, prompting Moody's to put the city's rating "under review" pending resolution of Public Act 4 (Moody's Investors Service 2012h).

When Michigan's emergency manager law was ultimately repealed by voters, Moody's downgraded Detroit to Caa1, reflecting "substantial risk," citing "a weakened state oversight framework" and "the city's ongoing inability to implement reforms necessary to regain financial stability" (Moody's Investors Service 2012i). The report also cites the city's "ongoing political instability," despite the "strong working relationship" between the executive management and the Governor's office (Moody's Investors Service 2012i). The appointment of an emergency manager on March 14, 2013 led to a ratings upgrade by Standard & Poor's, and cautious optimism by Fitch and Moody's; all three agencies cited the possibility of bankruptcy as the caution, while expressing optimism over the state's takeover (Standard & Poor's 2013).

Over the next couple of months, as Detroit's emergency manager proposed several recovery plans, Moody's commented on the likelihood that bondholders might be asked to accept less than full value of their debt (see e.g. Moody's Investors Service 2013c, 16). On June 13, 2013, Moody's downgraded Detroit on news that the emergency manager planned to meet with investors the following day, stating that:

[T]he EM's recent pronouncement that Detroit's current liabilities require significant restructuring to ensure the city's long-term financial health. Should default or bankruptcy occur, the recovery levels for bondholders could potentially be quite low based on recent municipal recovery rates for other distressed local governments. The EM and his staff are reportedly planning to meet with creditors and stakeholders to commence negotiations

for restructuring the city's liabilities this week. (Moody's Investors Service 2013e)

The following day, June 14, Detroit announced that it would default on some of its debt, first in a closed conference to investors in which Orr hoped to get creditors to accept 10 cents on the dollar. S&P and Fitch immediately downgraded the city (Woodall and Neavling 2013). Moody's downgraded the city on June 17 (Moody's Investors Service 2013g), and issued a longer discussion about the downgrade, citing the "unconventional and precedent-setting" nature of the emergency manager's restructuring plan, in particular the treatment of certain forms of debt as unsecured (reiterated in a separate report about the impact on bond insurers) (Moody's Investors Service 2013f). The report on bond insurers implies that the Detroit restructuring plan—specifically its treatment of pension and health benefit debt—presents an added risk for bondholders (Moody's Investors Service 2013f, 3).

On July 18, the day Detroit filed for bankruptcy, Moody's issued a comprehensive review of the city, warning that bankruptcy would likely be a "protracted" process of determining bondholder recovery (Moody's Investors Service 2013i, 2). There were no more ratings actions on Detroit until November 19, when Moody's affirmed the city's ratings, clarifying that the ratings reflected "our assessment of expected recovery for bondholders following the city's default on these classes of debt" (Moody's Investors Service 2013l). On December 18, 2014, the city was upgraded after exiting bankruptcy (Moody's Investors Service 2014k).

Dallas is the highest-rated city among the four cities. The city was downgraded in 2003 from AAA, after having been upgraded in 1996. It had been the country's largest AAA city, until it was downgraded a month after voters approved a \$579 million bond program, the largest in the city's history, primarily for street repair (Williamson 2003).

"We're very disappointed," said David K. Cook, Dallas' chief financial officer. "We pride ourselves on our philosophy and our prudence, and we'll continue to keep our practices on sound financial footing. We just couldn't overcome the economy." (Williamson 2003)

City officials, who have touted the AAA rating, said they were 'surprised and discouraged' by the news. ... The ratings, which assess the city's ability to meet financial commitments, are more than a badge of honor for Dallas, though. The lower rating could cost the city money when it issues bonds. (McCain Nelson 2003)

Although Dallas' rating has not been increased since 2003, the city has not been downgraded or received much attention from ratings agencies in the current recession; the city's home prices held out longer than most cities, although Moody's placed the city on negative outlook March 9, 2010, it maintained the city's rating on bonds issued that year, touting the following positives: the city's restructuring of pension benefits, relatively high per capita income, unemployment below the national average, and pension obligation

bonds. Moody's repeatedly praises the city for its "conservative budgeting" (Moody's Investors Service 2013h). True to Moody's growing focus on pension issues in its municipal ratings, in its most recent report on Dallas, on November 13, 2014, Moody's reaffirmed its caution that the city hasn't been meeting its annual required contribution in 2013, and warns of the pension issue's possible "downward pressure" on the city's rating (Moody's Investors Service 2014j).

Despite its fiscal troubles, Philadelphia was downgraded only twice during the recession: June 2009 and November 2010 (Moody's Investors Service 2010c), and Moody's commented on possible improvements in the city's fiscal situation in 2014 (tied to the city privatizing its gas utility) (Moody's Investors Service 2014c). Since 2010, Philadelphia's underlying rating has remained at A2, a moderate rating reflecting Moody's concerns about the city's economy, and its temporary deferral of pension payments per an agreement with the state. The agency has repeatedly emphasized that the role of Pennsylvania Intergovernmental Cooperation Authority (PICA) in overseeing the city's finances mitigates other negative factors.

San Jose has also been primarily left alone by the ratings agencies, despite the focus on California cities. In March 2012, Moody's downgraded San Jose's general obligation bonds from the top rating of Aaa to Aa1, citing the city's difficulty in managing retirement costs, and "arduous barriers to reduce the impact of those obligations" (Moody's Investors Service 2012c). The agency cites under strengths the city's "aggressive pursuit of opportunities to effectively manage retirement costs," reflecting the Mayor's pursuit of pension restructuring through many avenues, including passing a local ballot measure to cut the pensions of current and future employees.

These four cities exemplify the common themes that ratings agencies have emphasized in the wake of the recession: rating pensions, concerns about bankruptcy, and acclamation for state intervention policies. I discuss these in turn.

### *Rating pensions*

No . . . law impairing the obligation of contract shall be enacted.  
Article I, Section 10, Michigan Constitution

The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.  
Article IX, Section 24, Michigan Constitution

(Title page of Detroit's bankruptcy eligibility ruling (Rhodes 2013))

Impairing contracts is what the bankruptcy process does (Rhodes 2013, 74).

The bankruptcies of Stockton and San Bernardino (California) that followed after 2010 were closely associated with pension liabilities, and the national financial press and ratings agencies began speculating about the fate of such liabilities in bankruptcy proceedings, and how bondholders would fare in large municipal bankruptcies (Editorial 2012; Reid 2012). The alarm about the health of pensions was first sounded at the onset of the financial crisis in 2008, commenting on the possible damage a falling stock market would cause value of pension investment holdings.<sup>45</sup> In November 2008, Moody's reported that retirement systems' stock investments had fallen 35%, and were exposed to high risk because of "hedge funds and other alternative investments" (Moody's Investors Service 2008a). A fall in plan asset values, Moody's reported, would require additional funding precisely as city revenues fell, possibly driving governments to issue pension obligation bonds to improve funded ratios in the short-term.<sup>46</sup> By 2014, in stark contrast, Moody's was painting pension plans as unsustainable, a very different vision than the sanguine comment of 2008. As bankruptcies have unfolded, putting city commitments to pension plans in question, Moody's has been at the forefront of voices framing these cases as precedent-setting conflicts between retirees and bondholders, with potentially severe implications for cities' access to financial markets.

In November 2009, Moody's commented that pension costs were "pressuring" state and local governments, and could affect municipal ratings. The funding trouble for pension plans, Moody's says, is a combination of demographic pressure (detailed in their 2006 report), investment losses, and "decisions by select governments to defer pension contributions during periods of budgetary stress" (Moody's Investors Service 2009d, 1). Governments that face "inflexible regulatory or legal pension funding requirements" are at special risk of downgrade (Moody's Investors Service 2009d, 1). The 2009 report focuses on "management decisions" on the viability of plans and their consequent ratings. Begins to divide cities into those that made conservative, "credit-positive proactive management approaches" to fulfilling pension obligations, and those that are struggling with their pension obligations and under "negative rating pressure" (Moody's Investors Service 2009d, 2).

Moody's itself hints at the cyclical and uncertain nature of evaluating pension liabilities; their methodology suggests that a quantifiable level of "underfunding" exists, but they also note that "the quantifiable level of under-funding is a fluid conversation with many nuances" (Moody's Investors Service 2009d, 6). Moody's announced that it would conduct a review of all large cities' pension liabilities and will also refine their method for incorporating pension information into a city's rating (Moody's Investors Service 2009d, 7).

In July 2010, Moody's responded to the proposed revised Government Accounting Standards Board (GASB) rules for pension accounting, which incorporated unfunded liabilities into cities' required financial statements for the first time (Moody's Investors Service 2010a).

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<sup>45</sup> Ironically, S&P had just rated the CalPERS system in 2007, giving it the agency's highest short term rating, matching Moody's AAA rating, and praising its liquidity (Saskal 2007).

<sup>46</sup> Bonds which would then be rated by agencies like Moody's.



We believe that the new rules will more closely align public pensions' reported expense and obligation with economic reality. With new insight into the true cost and funded positions of state and local pension plans elected officials might choose to increase employer or employee contributions to boost funding levels. At the same time, it will improve transparency and comparability. (Moody's Investors Service 2010a, 1).

The revised GASB requirements should, Moody's suggested, provide impetus for city governments to "increase contributions or reduce benefits granted" in order to get in balance (Moody's Investors Service 2010a, 3). These adjustments may cause "some pain" but would in the long term reduce the fiscal and credit risk to municipal bondholders (Moody's Investors Service 2010a, 3). In 2011, Moody's (and the other agencies) proposed revising its calculations of debt to include unfunded pension liabilities, following GASB's model.

In 2013, Moody's announced that it would be revising its methodology for local government GO bonds, and asked for public comment. In April 2013, Moody's had announced that it was adjusting state and local government reported pension data and released a revised methodology (Moody's Investors Service 2013b). The revisions were intended to provide "greater transparency and comparability" and to create a "balance sheet liability" similar to the private sector in which pension liabilities are treated as "debt outstanding as of a specific point in time" (Moody's Investors Service 2013b, 2). The revision was begun in response to the role played by "pension stress" in their own rating downgrades (a bit of self-reinforcing circular logic). The changes included revising the discount rate and assessment of assets, resulting in increasing the liabilities:

[T]his leads Moody's adjusted net pension liabilities to be much greater than actuarial unfunded liabilities. The approach also introduces greater volatility into the measurement of the adjusted net pension liability. (Moody's Investors Service 2013b, 4)

In June 2013 Moody's released a revised assessment of state pension liabilities, claiming that US states needed almost \$1 trillion (\$980 billion) to bridge the gap (Norma Cohen 2013). This figure circulated quickly around the financial press and into state houses. Two months later Moody's published revised pension liabilities for the 50 largest local governments (Moody's Investors Service 2013k). The ground was laid for a flurry of press attention to the "pension crisis." Like this quote from the *Wall Street Journal*:

Nationwide, pension costs are eating up more of city general funds, leaving less money to spend on day-to-day needs, such as garbage pickup or parks maintenance. The median spending on pensions among the country's 250 largest cities rose to 10% of general budgets in 2012, up from 7.75% in 2007. (*Wall Street Journal*, October 30, 2013)

Only a few months later, Moody's doubled, from 10% to 20%, the weight given to debt and pensions, reduced the weight given to economic factors (from 40% to 30%) and

introduced a scorecard to increase “transparency” (DePaul 2013). The agency has continued the drumbeat of mounting pension crisis (Moody’s Investors Service 2014a; Moody’s Investors Service 2014g).

The ratings agencies themselves lend legitimacy and eventually real consequence to the narrative that cities are buried by pension obligation; within a few short years the pension crisis has become a matter of fact, not opinion or politics. This despite the complexity of evaluating pension liabilities in a volatile financial climate. The movement of pension liability from off the balance sheet (and ratings methodology) into the center of debates over city fiscal solvency is a prime example of how financialized discourses define problems and render them in need of solutions. An issue that is not technically connected to the ability of cities to manage their non-pension debt (as Moody’s itself acknowledged (Moody’s Investors Service 2013n)) leads into a broader commentary on the existence of public pensions, to a discussion of the rights of pension holders over bondholders, and finally to a discussion of whether governments are just another employer, and pensioners just another creditor.

Of course, these are agencies charged with evaluating the financial risk of purchasing debt issued by local governments. They are used by investors to decide what bonds to buy, an action seemingly distant from urban politics. But this seemingly simple relationship is played out in meetings between ratings agencies, banks, and government officials, who actively campaign for ratings since those ratings ultimately determine the cost of borrowing. In “normal” times there may not be much to shape, but since 2007 the volatility of local finance, reflected in many downgrades and upgrades by the agencies, has created a larger space of political decision-making and a corresponding increase in the influence of these agencies’ descriptions of the crisis and narratives about specific crisis-response policies. They have also been right in step with the shifting national focus (especially since 2012) to public pensions as a critical threat to municipal fiscal stability (despite the relative lack of attention to it before 2008, and only a couple of memos in 2008 about the possible threat of the stock market fall on pension assets).

Treating pension liabilities as a form of debt, and combining the unfunded amount with outstanding indebtedness, improves transparency by providing a more complete comparison of states based on their total long-term obligations as a portion of available revenue and taxing capacity. (Moody’s Investors Service 2011a, 2)

Although Moody’s refers to state and city choices not to fund the full annual recommended contribution (ARC), it avoids any characterization of these as anything other than “management” choices. The politics behind such decisions are neutralized or left unquestioned; the role of anti-tax sentiment and tax restrictions on cities does feature in ratings comments, but when cities do raise taxes, Moody’s often equivocates by describing increases as potential threats to economic development. Thus, the agency redirects focus to the expenditure side as the best possible solution. During the current crisis, that focus has landed squarely on pension plans.

Table 4.7 Selected Moody's comments on pensions, 2006-2014

Date	Title
29-Dec-06	Review of Financial Audits Show Rise in Major Cities' Pension Liabilities
29-Dec-06	Moody's Survey of Other Post-Employment Benefits (OPEB) for Largest U.S. Cities
11-Nov-08	Pension Funding May Suffer From 2008 Stock Market Declines; Near-Term Credit Effects For U.S. Public Finance Governmental Issuers Will Be Limited
3-Nov-09	Employee Pension Costs Pressure State and Local Governments
6-Jul-10	Governmental Pension Contributions May Increase Due to New Guidance
26-Jan-11	Combining debt & pension liabilities of US states enhances comparability
14-Feb-11	Proposed Pension Legislation Would Improve State and Local Pension Transparency
11-Oct-11	GASB's Proposed Accounting Changes Would Improve Transparency and Comparability for Public-Sector Pension Plans
13-Feb-12	Public Sector Pension Plans' Reduced Investment Return Assumptions Are Credit Positive
17-Aug-12	Adjustments to local government pension data: FAQ
12-Oct-12	Adjustments to US State and Local Government Reported Pension Data: Status Report
11-Dec-12	US State and Local Governments Face Risks with Pension Funding Bonds
18-Mar-13	Update on Status of US State and Local Government Pension Data Adjustments
17-Apr-13	Adjustments to US State and Local Government Reported Pension Data
9-Sep-13	The US Public Pension Landscape: Patterns of Funding, Correlation, and Risk
19-Sep-13	Pension Risks for US Local Governments Range from Minimal to Severe
26-Sep-13	Adjusted Pension Liability Measures for 50 Largest US Local Governments
10-Jan-14	Courts Offer Contrasting Outcomes for California Cities Seeking Retirement Benefit Cuts
5-Feb-14	Lower Liabilities, Higher Costs: Pensions Still Weigh on US Local Governments in 2014
10-Apr-14	Divergent Pension Risks: US Corporates Will Remain in Far Better Position than State and Local Governments
30-Jun-14	Moody's US Public Pension Analysis Largely Unchanged By New GASB 67/68 Standards
17-Sep-14	Moody's Public Pension Landscape Series: Reform Flexibility in Ohio Lessens Pension Stress
24-Sep-14	GASB's Proposed Accounting Changes For Retiree Health Benefits Will Improve Transparency and Comparability
25-Sep-14	US State and Local Government Pensions Lose Ground Despite Meeting Return Targets
27-Oct-14	Moody's Public Pension Landscape Series: Wisconsin Pensions are Well Funded and Stable
14-Nov-14	Recoveries In Distress: Holders of Municipal Bonds Compete with Retirees and Employees

Source: Moody's Investors Service, compiled by author

## *Bankruptcy*

The prioritization of creditors in the event of municipal bankruptcy is a central and unresolved question. One of the bankruptcy judge's primary responsibilities is to determine the order in which creditors should have recourse to any assets available to pay debts, and to negotiate a percentage of the debt that will ultimately be repaid as the city emerges from bankruptcy. During this recession, as a wave of bankruptcies culminated in the largest-ever municipal bankruptcy filing by Detroit, ratings agencies have been fixated on the ability of federal bankruptcy judges to restructure pensions. The possibility that pension obligations might be treated like other forms of debt—or abridged in some way—raises the question of where pensioners would fall in the line of creditors in the event that they are treated as creditors, rather than as a separate type of obligation. This legal uncertainty has come to be described by ratings agencies, and repeated in national media, as a choice between bondholders and pensioners.

Throughout Detroit's bankruptcy, Moody's has repeatedly commented on the fate of bondholders in the bankruptcy. When it appeared that even GO debt, the most secure form of municipal debt, might be abridged given Detroit's significant debt obligations, the financial press rushed to describe the possible implications for the municipal bond market. Moody's used the words "unprecedented" and "unconventional" to describe Detroit's bankruptcy and the treatment of general obligation bonds. Only a week after the bankruptcy filing, Moody's issued a lengthy comment on Detroit's likely role as precedent-setter for other cities, titled "Detroit Bankruptcy May Change How Other Distressed Cities Approach Their Pension and Debt Obligations" (Moody's Investors Service 2013j). In particular, Moody's suggested that Detroit's bankruptcy may lead other cities to choose bankruptcy in order to "reduce liabilities," and specifically to weaken the standing of general obligation debt compared to pension liabilities, of particular importance when there isn't enough money to pay both. Michigan's explicit protection of accrued pension benefits, as well as the valuation of pension benefits (which the city sought to increase) became pivotal issues in Detroit's bankruptcy (Moody's Investors Service 2013j, 3).

Fitch Ratings accused the city of adopting an "us versus them" narrative, with banks being asked to suffer a disproportionate loss (Walsh 2014). The city's initial proposal to creditors, which Orr hoped would stave off bankruptcy, gave some bondholders ten cents on the dollar, while protecting pension significantly, prompting a flurry of outraged commentaries by ratings agencies and the financial press (Walsh and Yaccino 2013). In February, 2014 the city filed its Plan of Adjustment, proposing that pensioners get higher rates of recovery than GO holders, who would get "significant haircuts" (Moody's Investors Service 2014b, 23). In June 2014, a package passed by the Michigan legislature to help fund Detroit's pension plans (in a deal that also restricted future benefits and created a financial oversight position for the city) was critiqued by Moody's for provoking "tension" between pensions, services, and bondholders in the city (Moody's Investors Service 2014d). A comment from July, 2014—titled "Detroit's Proposal Favors Pensioners over Bondholders"—says the plan "provides substantial evidence that pension obligations are a substantial source of competition for bondholder and other creditors in Chapter 9 bankruptcy" (Moody's Investors Service 2014f, 1).

In addition to reiterating the higher recovery rate for “pensioners,” Moody’s focuses on four “additional recovery boosts” available to pensioners but not other creditors. These include “special outside funding” from the state (tobacco tax revenue) and privately donated funds (intended to keep the city’s art collection by donating funds for pensions), along with the *possibility* of increasing pension payments if the assets bounce back (Moody’s Investors Service 2014f). Pension holders ultimately voted to approve a bankruptcy plan that gave them 52 cents on the dollar of unfunded pension liabilities; Moody’s estimates that pensioners will get about 82% of their benefits (City of Detroit 2014; Moody’s Investors Service 2014h).

This reduction in pension benefits is only the second time (after Central Falls, Rhode Island) that pensions have been impaired in bankruptcy. Moody’s continues to emphasize that pensioners fared better than bondholders (“While impaired, pensioners fared much better than other unsecured creditors” (Moody’s Investors Service 2014h, 2), in part because pensioners benefited from outside sources “none of which were made available to any other creditors” (Moody’s Investors Service 2014h, 2). This marks the third time, along with Stockton and Vallejo, that pensioners were described as “faring better” than other unsecured creditors. “These discrepancies leave investors with more questions than answers, but the emerging picture is one in which pensions have better recovery probabilities than debt in a Chapter 9 case, and municipalities exiting from bankruptcy likely retain responsibility for paying down large unfunded pension liabilities” (Moody’s Investors Service 2014h, 3). Moody’s also suggests that the losses by investors in Detroit debt will make bondholders more likely to negotiate with cities in the future rather than risk bankruptcy (Moody’s Investors Service 2014h).

There’s a sort of schizophrenia in the press and ratings comments about the importance of Detroit’s bankruptcy—several articles seem intended to reassure investors (including the public, who may have retirement funds investing in such bonds) that Detroit’s situation is unique, and shouldn’t impact yields or risk as a whole (see e.g. Moody’s March 10, 2014 comment). But other comments argue that Detroit’s situation does have important potential negative ramifications for investors, and that any decisions about what happens to Detroit’s debt obligations will reverberate throughout municipal finance. A final set of reports (from 2013-2014) comments on the implications of Detroit’s bankruptcy resolution on the municipal market, in particular the implications for the allocation of bankruptcy consequences to bondholders and pensioners. A key finding in Detroit’s bankruptcy was that federal bankruptcy court can impair pension agreements, while the state cannot (Rhodes 2013, 74). This puts financial actors in a quandary: bankruptcy exposes them to greater risk than state-managed oversight, but also offers the option of pension restructuring, which has not yet been accomplished outside of municipal bankruptcy.

### *Promoting state intervention*

In response to the risk inherent in municipal bankruptcy, Moody's and other ratings agencies have unequivocally supported policies that permit state intervention into urban fiscal policy, particularly as a preferred strategy to bankruptcy, which leaves creditors more vulnerable to losses. Nearly all of the Detroit ratings comments from 2011 to June 2013 address the desirability of Michigan's emergency manager law. When it was passed, March 21, 2011, Moody's issued a comment "Michigan Law Allows for Greater State Control over Financially Stressed Municipalities, a Credit Positive" (Moody's Investors Service 2011b). The report says "even historically well-managed municipalities in Michigan are facing financial pressures, some of which will benefit from technical assistance, guidance, and expertise to balance their budgets and regain fiscal solvency" (Moody's Investors Service 2011c, 41). In its preamble, it describes the structural challenges to Michigan and its cities, but then presents the law as being able to restore fiscal health.

Moody's likes that the law offers Michigan cities "broad technical assistance sooner, and permits sweeping organizational and financial changes" (Moody's Investors Service 2011b, 41). Economic decline and the loss of state revenue-sharing has left cities in dire fiscal straits, and therefore able to "benefit from technical assistance, guidance, and expertise" (p. 41). Moody's emphasized a key expanded state power in the new law: the ability of the emergency manager to modify or terminate employee contracts, and suspend collective bargaining for up to five years. These powers are a "positive development for bondholders" (Moody's Investors Service 2011b, 41).

Six months later, as the Governor began his financial review of Detroit, Moody's warned that this was "credit negative" for the city, as an emergency manager would be a "termination event" for the swap agreement, which could trigger up to a \$400 million payment, which Detroit cannot pay (Moody's Investors Service 2011e).

In March 2012, after supporters of repealing Public Act 4 successfully submitted enough signatures to put a repeal on the November ballot, Moody's weighed in on the potential damage of such a repeal (and the suspension of the law until the election) in a comment: "Suspending Michigan's Emergency Manager Law Would Be Credit Negative for Distressed Local Governments." When the law was threatened by repeal in 2012, Moody's weighed in again, stating that repeal would jeopardize the credit of Michigan cities (Moody's Investors Service 2012a). The uncertainty around the law would be "credit negative" both for local governments currently under emergency managers and for all local governments under review in Michigan (Moody's Investors Service 2012a, 33). Immediately after the law was repealed, Moody's and other agencies downgraded Detroit's debt (Helms 2012). Bloomberg's coverage of the repeal quoted both bondholders and bankruptcy experts: "The benefit of Act 4 was that it had the efficiency of a dictatorship... They have to make sure whatever is developed has the efficiency of a financial manager, not the inefficiency of a committee" (Chappatta and Christoff 2012).

When the revised law, Public Act 436, was passed, Moody's praised the law for restoring "some of the key credit positive state oversight provisions" of the previous law,

but notes the increased risk of bankruptcy (Moody's Investors Service 2013a). The passage of Public Act 436 was acclaimed by ratings agencies, but the possibility of bankruptcy added to the law made them nervous: "New Emergency Manager Law to Support Michigan's Distressed Municipalities, but Creates New Risks for Bondholders" (Moody's Investors Service 2013a).

Ratings agencies have clearly articulated their belief that state intervention is the most stabilizing response to fiscal stress, while it simultaneously minimizing or ignoring the role of state governments in limiting cities' options for raising or stabilizing revenues. An example of how revenue scarcity is normalized, and that normalization in turn makes the idea that local governments can't manage their own finances into a kind of "common sense", while state governments are framed as sensible, expert actors. In fact, apart from abrogating pensions (which it's still unproven as a legal possibility outside bankruptcy) and canceling union contracts, it is unclear what state intervention offers. The difficulty in raising local revenues does not come from city politics but from state limitations; states could lift those limitations in the legislature, rather than giving an emergency manager the power to raise revenues. That has left the agencies to focus on the fate of pensions and bondholders in bankruptcy.

## **Conclusion**

Ratings agencies and financial institutions are in the complex position of having to reassure investors that the municipal bond market is stable, that city issuers (but not financial intermediaries) need regulation, and that if cities are not fiscally disciplined (by state governments or markets), the consequences will be dire and far-reaching. The influence of ratings agencies in reframing pension and other employee obligations as a form of debt, which should be subject to the limitations and evaluations that have historically applied only to municipal borrowing, demonstrates the power of financial actors to remake key avenues for managing urban governance. Ratings agencies have also successfully framed state intervention in city finances as a necessary safeguard against a destabilized bond market (or bankruptcy), in which bondholders might be pitted against pensioners.

The growing involvement of cities in circuits of capital and structures of financial rule-making has produced many effects on urban policy (Hackworth 2007). Ratings agencies have been central to these mechanics of rule-making. One of the most important narrative framings embed in such rules is the equating of governments with private actors, equating public risk with private risk. The discussions over pensions repeatedly mention that the private sector has moved away from defined benefit plans, implying that governments should do the same (see e.g. Moody's Investors Service 2009d, 2). Public sector employment is one of the remaining arenas of the U.S. economy in which collective bargaining dominates and sets expectations for work rules, wages, and benefits. City leaders have also complained that Moody's applies a private sector accounting approach to the discount rate it uses to evaluate public pension plans (which greatly affects the

calculation of liability), rather than maintaining a method specifically tailored to the public sector (and matching the public sector's own approach to valuing pension liabilities). Moody's approach ignores the many important ways in which public and private pensions plans differ, including the relative legal autonomy of public pensions and the long-term horizon of public entities, which almost never dissolve and have significantly lower default rates than private companies. Ratings methodologies are one example of the important financial consequences at stake in the equating of public and private entities.

The language used by ratings agencies continually affirms the nature of municipal debt not just as a relationship between cities and bondholders but as a *market*: an entity that can become unbalanced or unstable, which connects cities not through money but through "market confidence," permitting crisis to be a kind of contagion (Berndt and Boeckler 2009). Many of the institutions devoted to municipal finance and market anticipation use this terminology of contagion and engage in debates about whether this will be widespread (Moody's Investors Service 2012f; Chappatta and Hays 2012). These narratives of intervention and the need for market stability combine to produce a powerful argument for restructuring governance. They also affirm that the perception by market actors (investors, financial advisors, and others) of a city's potential distress is as important as its actual distress. These notions of contagion and the importance of perception are a key vehicle through which crisis governance is normalized for all cities (Lewis 2011).



## CHAPTER 5: Growing State Power

This chapter discusses the emphasis on state intervention as the primary strategy for managing urban fiscal crises, in particular the narratives used to justify such intervention, the models on which policies are based, and the implications for city autonomy. As cities and states diverge politically, and the federal government continues its retreat from urban policy, the political control states exert over cities has significant implications for the policies cities can pursue, particularly fiscal policy. Because cities are creatures of state law, the political relationships between cities and their state governments form one of the most important influences on the scope of urban governance. States exert particular control over city finances: they regulate cities' access to municipal credit, their ability to raise revenues and spend money, and the options available to manage fiscal distress. In this chapter I argue that state power over cities has been a defining feature of this recession, and one with important implications for understanding the constructions and narratives of crisis emerging from cities.

In times of fiscal crisis and national economic recession, intergovernmental relationships always take on greater importance. Sbragia argues that fiscal crises in the U.S. constitute histories of negotiation between city and state power, with states claiming additional oversight powers of city governance during each crisis (Sbragia 1996). The depth and length of this recession, combined with the particular federal politics of this century, have made this period a key moment of contesting and solidifying the relationships between states, cities, and the federal government.

State power over cities' fiscal autonomy takes two primary forms. First, states have the ability to shape the fiscal options available to cities: through tax and expenditure limits (TEs), debt limits, state aid and revenue sharing, and other constraints on cities' fiscal autonomy and solvency. This includes the ability of state governments to pass their own budget shortfalls down to cities, which I discussed in Chapter 2. This chapter deals with a second form of state control of cities' finances, namely the various forms of state intervention in city governance, including fiscal monitoring and reporting, receivership, and laws governing cities' access to municipal bankruptcy.

Both of these categories of power must be evaluated in the context of the national and local contrast between city and state politics. Broadly speaking, state officials and legislators are more conservative than the residents and politicians in large cities, a trend that has been exacerbated by the national growth in political divisiveness. There is also the ongoing complex politics between central cities and their suburbs in regional politics, and the changing dynamics of resource allocation within and between cities (see Pastor, Benner, and Matsuoka 2011). This chapter is intended to demonstrate the importance of the U.S. federal system in shaping these state-city relationships, and in turn shaping the local experience of recession.

Finally, these issues raise important questions about how different conceptions of city autonomy shape narratives about public finance, governance, and crisis. There is a contradictory narrative at work that both individualizes city failure and justifies state intervention as the best solution for fiscal crisis. This chapter describes that narrative at work in discussions of state intervention policies.

### *Devolution*

One immediate cause of increased state power is the historical devolution of federal spending and urban programs, which has increased the role played by state funding in government generally and has also removed a broader national support system for urban-focused policy. Devolution of responsibility and funding for services has left cities financially vulnerable and created a patchwork of responsibility for service provision. (See e.g. Desan 2014).

For decades, both federal and state policies have devolved responsibility for major social programs to city governments (Liner 1989). Particularly for social services, responsibility (and risk, as that responsibility often comes without adequate funding) have been devolved increasingly to local governments, with resources often reclaimed by states as the federal government plays a smaller role in funding and managing programs (see e.g. the discussion of welfare devolution in Byers and Pirog 2003). This has resulted in significant devolution of social reproduction onto local governments, particularly in the areas of public health, housing, and education (Addie 2008, 2677). The most significant discretionary federal funding that goes primarily to cities, Community Development Block Grant Funding, has been cut by 26% just since 2010 (Holeywell 2012). Since the late 1990s, local governments have been the primary providers of services such as housing supports, general income assistance (excluding TANF), and public healthcare. Community service providers that now provide the bulk of services to support homeless, addicted, and elderly residents are increasingly supported by locally controlled funds.

Devolution and diffusion of both risk and responsibility are seen as key elements of neoliberalism and contemporary austerity, and as core strategies used to dismantle the welfare state (Hackworth 2007; e.g. Peck 2014). Although other government functions have also been decentralized (Liner 1989), the decentralization of responsibility for social programs has left them particularly vulnerable to further cuts, as the lack of a national mandate and federal equalizing funding makes it likely that only a few communities will sustain the political will and fiscal ability to sustain such programs. While even some welfare advocates argue that programs are best administered at the local level, decentralization of such programs is strongly associated with the erosion of a national mandate toward providing a basic safety net, as local governments have greater political difficulty funding social services (Peterson 1981; Lobao and Adua 2011). This tension between local and national scale of services is a central political question.

The policy mechanisms by which social programs have been decentralized have also accomplished other policy changes, in addition to spending reductions. For example, federal policies that encourage privatization also set requirements for cutting aid when cities fail to privatize; thus although responsibility for program delivery has been devolved, local governments are constrained in how they provide services (Fuchs 1992, 281). This displaces services and programs formerly provided directly by the government onto private organizations, which further erodes cities' control over how services are provided to their citizens. Much of the recent literature on austerity (described in earlier chapters) cites "rescaling" as an important component of neoliberal austerity (Lobao and Adua 2011).

For many programs, devolution has meant giving states broad discretion in how services are delivered through local governments (cities and counties), which shifts the political dynamics between states and localities. During the 1960s and early 1970s, when the federal War on Poverty and its associated urban programs were still intact, state governments played second fiddle to the federal government in urban spending and policy. In the early 1970s, there was a great deal of attention paid to relationships between cities, states, and federal government, and an active national conversation about how best to sustain and equalize city finances (Advisory Commission on Intergovernmental Relations (ACIR) 1974). In the mid-1970s the expansion of the federal role into urban affairs was drawing attention and raising concerns about centralization:

Our localities are increasingly dependent upon larger governments for money, for resolution of basic policy issues, for reallocation of resources, and even for the delivery of many public goods and services. (Stephens 1974, 68)

But by the early 1980s a dramatic shift was already underway, reversing this move toward greater federal power and concentrating power instead in state governments. In 1982, DeGrove argued that the U.S. was moving toward a new system in which "the legal fact of local governments as the children of states will become much more a policy and political reality, and the long predicted emergence of states as the central cog in the system will become an accomplished fact" (Carr 1984, 350). This "new federalism" was making states, not the federal government, the primary source of aid to local governments.

The beginnings of that "new federalism" are rooted in the anti-urban politics of the 1980s, with a reduction on federal urban spending, a national backlash to the War on Poverty. Devolution was also hastened by the fallout from New York's fiscal crisis, the end of an era in which city leaders were powerful national figures (Fuchs 1992, 210). Federal devolution accelerated in the 1980s with Reagan's elimination of federal revenue sharing, and cuts to federal programs, a history well documented by Liner (Liner 1989). The restructuring of federal welfare by Clinton in the mid-1990s led to further devolution of control for welfare programs to state governments. Despite the widespread prosperity of the 1990s, the devolution of responsibility for social programs, a continued overall reduction in U.S. money spent on social programs, the steady withdrawal of any federal money for urban programs (e.g. CDBG, public housing), and an agenda of tax cuts continued apace.

As fiscal and program responsibility has been decentralized from the federal government, cities have become more dependent on state governments for both resources and program mandates. By the early 1990s, although cities remained the primary target of people's demands for service improvements, cities had access to fewer resources than the state or federal governments (Fuchs 1992, 283). There was significant attention to the growing power of states over city finances, and to the implications of state aid cuts to cities, especially in larger states, reflecting this steady trend of policy and revenue decentralization (Gold and Ritchie 1991). Liner documents the rising importance of the state-local relationship as federal aid has been reduced (Liner 1989). And although state governments raise more money, in many program areas local governments perform the majority of services, using state money, and employ more people.

At the same time as urban spending was being moved from federal to state governments, the political dynamic between cities and states was also shifting. In 1996, Weir found that large cities had lost significant political power in their own states, coinciding with the sharp reduction of federal aid to cities, and driven in part by a "pulling apart" of state and local politics (Weir 1996). This loss of power came from demographic shifts, population growth outside central cities, and the rise of "interest-based" politics in state legislatures, and resulted in the loss of a "metropolitan agenda" at the state level, just as federal support for cities was virtually disappearing (Weir 1996). More recently, Bowman and Kearney found that cities had experienced an "erosion of authority at the hand of their state governments" since the turn of the century (Bowman and Kearney 2012, 528). There is ample evidence that state policy restricts city autonomy in many areas, particularly evident in areas where cities seek to implement progressive social policies not supported by their states (e.g. same-sex marriage and gun control), and including areas of finance (see Frug and Barron 2008).

This reconfiguring of power has implications for how states respond to fiscal crisis particularly in large cities, implications that have not been revisited much since the 1990s but are starkly evident in today's crisis, as I show below. By the time of the 2008 crisis, there was little systematic social welfare spending left to cut (as I describe in Chapter 3). Although there was a brief spike in federal aid in 2009-10 through the Obama Administration's federal stimulus program (American Recovery and Reinvestment Act or ARRA), state governments across the country cut spending quickly, immediately impacting city budgets. Federal and state programs cuts leave cities as the last resort for populations facing long-term unemployment, stagnant incomes, and shrinking federal supports. These cuts are reflected in data on intergovernmental programs but are also embedded in the loss of social services formerly funded by states or the federal government. Relatively wealthy and politically progressive cities like San Francisco and New York may fill some of the gap for those services; cities like Dallas and even San Jose lack the political mandate to do so; Detroit and Philadelphia simply cannot afford to. This "rescaling" of the state reproduces and reinforces the inequality between cities that federal programs in the 1960s were intended to redress (see Sawers 1979). Detroit's bankruptcy, and widespread urban fiscal crisis, have renewed discussion of the consequences of such fiscal decentralization (see e.g. Steinmetz 2009).

The dynamics, intents, and implications of devolution are multi-faceted and beyond the scope of this dissertation. I lay them out here because it is in this climate that recession began in 2007, and in which states and cities negotiated the political terrain of fiscal crisis.

## 5.1 State crisis intervention

A common narrative in the current recession has been the need for state intervention to prevent “irresponsible” cities from getting into trouble, particular fiscal trouble that could affect the credit ratings of neighboring cities or the state itself. While some corners were calling for a return to intergovernmental policy and general support for cities, more conservative figures argued for states to intervene in city finances to solve crises not through the provision of aid or policy stability, but by forcing them to restructure services and obligations to match the decline in revenues (J. Bush and Gingrich 2011). As these strategies are implemented and refined, a common narrative emerges of the need for state intervention, justified by claims of cities’ mismanagement, lack of fiscal expertise, and political cooptation. The narrative also rests on claims that states have a stake in cities’ quick fiscal recovery, while simultaneously making clear that states have no fiscal obligation to help struggling cities. This contradiction is important.

Fiscal monitoring is a sort of gateway into stronger state intervention in city governance, justified by the discourse of expertise and good government. A common refrain in discussions about the possibility of widespread urban fiscal crisis was how states could ascertain which cities were in trouble *before* they entered a crisis, using a set of indicators as described in the introduction. Several models of “early warning” systems were touted by ratings agencies in their commentaries on local finance, and by state legislators proposing new models during the crisis. In the wake of the crisis, there has emerged new attention to the role of states in monitoring local finances and, in cases of crisis, intervening somehow. The narratives around monitoring often frame fiscal crisis as a problem of inattention, insufficient expertise, or lack of transparency. As Kloha (2005) notes, state systems are more likely to frame crisis in ways that presume managerial failures, rather than broader economic or social causes of distress (Kloha, Weissert, and Kleine 2005). Reports from the public finance community called for state intervention, an increase in attention to the state role in “managing” urban fiscal crisis (see e.g. Honadle 2003).

### *Municipal bankruptcy*

The most radical option available to (some) cities facing insolvency is municipal bankruptcy, which is governed by a combination of federal and state law. Bankruptcy policy at the state level has followed both fiscal cycles and political trends, and reforms are often passed in response to specific city situations. There has been a “wave” of municipal bankruptcy filings, with 28 since 2010, even though only about half of all states permit it.

Those cases, along with the wider narrative of a contagion of fiscal crisis, has produced a flurry of state bankruptcy policy amendments.

Federal provision for municipal bankruptcy was first enacted in the 1930s in response to widespread municipal distress during the Great Depression.<sup>47</sup> Municipal bankruptcy permits cities to reduce their indebtedness and bind all creditors to a plan approved by a federal bankruptcy judge; it is intended to allow cities to resolve their debt problems while continuing to provide basic public services.<sup>48</sup> Municipal bankruptcy is governed by Chapter 9 of the federal bankruptcy code, which permits bankruptcy for municipalities only in states that explicitly authorizes it by law.<sup>49</sup> Some state laws explicitly create provisions for state-appointed entities to file for bankruptcy on behalf of a city (e.g. New York and Michigan), rather than permitting cities to file directly. A municipality must meet several criteria in order to file for Chapter 9 bankruptcy: it must be insolvent, and must demonstrate that either its creditors agree to the bankruptcy or negotiations with creditors have failed despite best efforts (*Bankruptcy Code* 1934).

As in personal or corporate bankruptcy, the driving question is who gets paid first and who will get what: bondholders, vendors, pensioners, or current employees all have claims on a city's assets and revenues, and those claims will be resolved by the judge's bankruptcy determination. The outcomes of large bankruptcy cases like Detroit's significantly reshape expectations about the order in which creditors are paid because they constitute guiding federal case law that judges may apply in future bankruptcies. A central question in the current crisis has been the fate of specific types of city contracts, in particular collective bargaining agreements and pension plans (both of which are also subject to state and federal laws). These questions have made the bankruptcies in California and the bankruptcy of Detroit pivotal cases for defining the scope of possibility for restructuring city governance in instances of crisis.

Proponents of municipal bankruptcy emphasize the leverage bankruptcy offers for dealing with employee unions, assistance with restructuring pensions and other employee obligations (see e.g. National Association of State Budget Officers 2012). Opponents of municipal bankruptcy emphasize that it scares creditors and makes municipal borrowing expensive for all cities, because investors become wary of the possibility of their bonds going left unpaid. Public employee unions oppose bankruptcy because it often results in significant job and wage cuts, in some cases significantly jeopardizing public safety (see e.g. the case of Vallejo in Morris 2012). Many political scientists and public finance experts see municipal bankruptcy as favoring cities, echoing some of the rhetoric of ratings agencies described in Chapter 4. For example, Kimhi (2008) suggests that bankruptcy is an "easy"

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<sup>47</sup> Before the passage of federal bankruptcy law, creditors could sue a city to compel it to raise taxes, subjecting a city to potentially hundreds of separate lawsuits and judgments, and giving creditors no predictable resolution.

<sup>48</sup> Unlike personal or corporate bankruptcy, municipal bankruptcy does not permit the liquidation of assets or dissolution of the entity, but may permit active management (by the judge or an appointee) of aspects of governance, especially if the local government itself requests such management.

<sup>49</sup> States have several options: they can pass no law (in which case bankruptcy is not permitted), pass a law permitting bankruptcy and leaving Chapter 9 as the sole governing law, or prescribe requirements to run concurrently with those set forth in federal law.

solution for municipalities, because unsecured creditors may not get paid back, and courts can't force cities to increase taxes, he calls it "relatively easy debt relief" (Kimhi 2008, 653). But bankruptcy is primarily viewed as favorable only when framed as an option for cutting the primary expense on which crises are blamed: employee pensions and union obligations. The description of bankruptcy on CNN.com is illustrative:

An independent judge brings all parties to a table where an agreement has to be reached – no matter how painful. *And, we need some of those painful decisions* – not just at the federal level, but at local and state levels as well. At its heart, the bankruptcies you keep hearing about these days aren't about taxes being too low or spending on city services being too high – they're about pensions...

I'm not saying bankruptcies are a good thing. But *they are a mechanism that allows us to admit an emergency and renegotiate the deals that are, well, bankrupting the country.* (Zakaria 2012, emphasis mine)

This excerpt from Fareed Zakaria's popular blog on CNN.com / TIME magazine succinctly summarizes the prevailing view about municipal bankruptcy: as a necessary evil to relieve the intractable burden of pensions and retiree benefits. In conferences on municipal bankruptcy, blogs by bankruptcy law firms, and investment shows on CNBC, this narrative is repeated as common sense. The idea that municipal bankruptcies are the next financial meltdown has been repeated throughout the recent recession, beginning with a brief run on the municipal bond market in 2010 (Alden 2010) and more recently with Warren Buffet's divestment of a significant share of his municipal bond portfolio (Ng and Corkery 2012).

Alongside the panicked voices of institutional bondholders, there is another narrative that paints bankruptcy as a vital tool in restructuring city finances. There are complex narratives about urban ruin and rebirth embedded in the national narrative around bankruptcy. In 2011, several articles about Vallejo in the New York Times, ABC News, and other sources highlighted rampant crime, prostitution, abandoned homes, and decimated public services (e.g. Farnham 2011). But by 2012, after Vallejo emerged from bankruptcy, the Washington Post touted it as a "model of austerity" (Morris 2012). Republican politicians have even pushed for state bankruptcy under federal law, to "allow states in default or in danger of default to reorganize their finances free from their union contractual obligations" (J. Bush and Gingrich 2011). Labor unions and community groups have sought to shift the narrative from pensions and bankruptcy to taxes and questionable development deals, with little success.

State governments generally see themselves as having an interest in preventing municipal bankruptcy in order to protect the credit ratings of other municipalities in the state or the state's own credit rating, particularly if a large city faces bankruptcy. State bankruptcy statutes often evolve during specific municipal fiscal crises, so the presence and details of state laws reflect both state policy inclinations and their local histories. In 2012, three California cities filed for bankruptcy in quick succession: Stockton (June 2012),

Mammoth Lakes (July 2012), and San Bernardino (August 2012). In October of 2012 Moody's declared that it would review for possible downgrade the bond ratings for 32 California cities (Moody's Investors Service 2012g). The media played up national concerns about bankruptcy in California being "contagious," and financial institutions have made increasingly fervent calls for pension reform (Chappatta and Hays 2012).

In this spirit, several cities have scrambled to tighten the limits on municipal bankruptcy since 2010. California amended its law in 2011 to limit cities' access to Chapter 9 in anticipation of a wave of city filings (*Local Government: Bankruptcy* 2011), and Pennsylvania scrambled (ultimately unsuccessfully) to close off the bankruptcy option for Harrisburg, its capitol (Natalie Cohen 2013). Currently, twelve states authorize municipal bankruptcies under the terms of Chapter 9 (i.e. without conditions): Alabama, Arizona, Arkansas, Idaho, Minnesota, Missouri, Montana, Nebraska, Oklahoma, South Carolina, Texas and Washington. Twelve others conditionally authorize municipal bankruptcies: California, Connecticut, Florida, Kentucky, Louisiana, Michigan, New Jersey, North Carolina, New York, Ohio, Pennsylvania, and Rhode Island. This latter group of twelve states accounts for a disproportionate percentage of all municipal bankruptcies, and also includes states with strong receivership laws.<sup>50</sup>

The discussions around limiting access to bankruptcy for cities in California and Pennsylvania, and the emergency manager / bankruptcy process in Detroit, demonstrate that it is a particular form of intervention being promoted to resolve city fiscal crisis. One that protects creditors, and permits the dissolving of pension and other agreements. Otherwise bankruptcy would be equally effective at solving municipal crisis, because it allows for negotiation of debt, an outside expert to make decisions, the replacement of local official decision-making, and so-called "tough decisions." These forms of monitoring, oversight, and intervention in the current crisis are not intended or able to counter revenue scarcity described in Chapter 2. Nor, I would argue, is the austerity described in Chapter 3 the primary focus. Rather, both state and financial actors are looking for means to eroding the expectation of public bargaining, not just with pensions but with the very idea of "fixed obligations."

Restricting access to bankruptcy is another way that states limit the powers of cities: Detroit pushed for the ability to pursue bankruptcy, but without the Governor's permission it could not file for bankruptcy. The city first had to relinquish its sovereignty to the state government in order to put its fate in the hands of a federal judge.<sup>51</sup>

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<sup>50</sup> Three states provide limited authorization: CO and OR permit only irrigation/drainage districts to file, IL permits bankruptcy for the Illinois Power Agency and for a city if a Financial Planning Board judges that bankruptcy is in the municipality's interest. Both Georgia and Iowa explicitly prohibit bankruptcy, with Iowa permitting a very narrow exemption. The remaining 21 states have no clear provision for municipal bankruptcy: AK, DE, HI, IN, KS, ME, MD, MA, MS, NE, NH, NM, ND, SD, TN, UT, VA, VT, WV, WI, WY.

<sup>51</sup> As it turned out, that judge struck a much harder bargain on behalf of Detroit's residents and workers than the state appointed emergency manager had been willing to accept (City of Detroit 2014).



## *State takeover*

The most concrete exercise of state power over cities, seen as preferable to municipal bankruptcy by both state governments and banks, is takeover or receivership. Receivership (which goes by many different names) refers to a state's or state-run entity's assumption of some level of fiscal and political control from the city. The state may take over full scope of city governance, or may create entities that are empowered to review or veto a city's financial decisions (as in Philadelphia), or create entities that can engage in borrowing, revenue-raising or spending on the city's behalf (as in New York City). In this section I describe some of the narratives used to justify and define such interventions, particularly in the case of Detroit during the current recession.

There is a long and storied history of state control boards governing city finances: Washington, DC (1995-2001); Miami (1996-2001); Harrisburg (Pennsylvania's capital, 2011-present), Camden (2001-2010); Atlantic City (2010); Philadelphia (1991-present); Cleveland (1980-1987) (Kobes 2009). Over 100 boards have been appointed in 13 states and Washington, D.C. since 1975, more than half of those since 2000 (Kobes 2009). At least 28 urban cities declared bankruptcy or entered state receivership between 2007 and 2013 (Anderson 2014). This tendency to use state control over city governance in response to fiscal stress has become more prevalent since 2000, and calls for increased state power have characterized this recession (Gillette 2012). In addition to a proliferation of such policies, and an expansion of the powers granted to state-appointed receivers, several states have amended their policies to remove provisions for state financial aid in the event of takeover, making these policies increasingly a stick with no carrot (Anderson 2012a).

Such laws are usually created only in response to a specific crisis the state legislature wants to manage, or in order to avert a city filing for bankruptcy. For example, Rhode Island expanded its receivership law in 2010, to take over the city of Central Falls which had attempted to file for bankruptcy (Goodnough 2011).<sup>52</sup> The state of New York has used its receivership powers to take the reins of several counties during the current recession (Braun 2012). Indiana passed an emergency law in 2012 with similar powers to Michigan's (*Emergency Manager Bill* 2012). Other cities and states tried to expand the application of laws designed for emergencies. The City of North Las Vegas used a Nevada statute written for natural disasters to declare a financial emergency and void all of its union contracts (Lake 2012).

The idea of receivership as a solution to fiscal crisis is premised on the idea that the current government lacks the political will or ability to make the decisions necessary to bring a city out of fiscal crisis; that (as mentioned above) the crisis is a matter of mismanagement and / or political impasse. Receivership mechanisms are touted as bringing investor (and employer) confidence back to the city, thus paving the way for cheaper credit (through higher ratings) and economic development that can improve the city's fiscal health. For state governments, and the financial community, control boards are

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<sup>52</sup> Speculation that Wisconsin's governor Scott Walker would propose a law modeled on Michigan's never materialized (See Ungar 2011).

framed as a better option than bankruptcy, in which the fate of bondholders will be left up to a federal judge (see e.g. Kimhi 2008).

As Detroit's crisis wore on, with the state trying to wrest control using emergency manager legislation, there was a lot of press and political discourse about the value of state receivership as the best solution for the city. Anthony Williams, the former Mayor of Washington, D.C., visited Mayor Bing during Detroit's negotiations with the state over a consent agreement, to tout Washington's recovery under the umbrella of federal oversight (Hackney 2012). The laws that permit receivership also typically provide for state-appointed actors to exercise powers that elected city governments don't have, such as the ability to dissolve contracts and collective bargaining agreements. And the language defining who can be appointed to receivership positions emphasizes the importance of financial expertise and "non-political" administrators. For example, under Michigan's law, such individuals are required to be accountants or other experts in fiscal matters, and may not be former elected officials (*Public Act 436* 2012). The language of expertise and political independence is similarly threaded throughout other states' receivership laws.

### *New York City*

The New York City recovery strategy implemented through the 1970s and 1980s still stands as the model for oversight of city finances. When the banks' refusal to issue more short-term debt put the city on an immediate path to insolvency, the mayor's first action was to ask the federal government for help, and the city was famously told to "drop dead" (Van Riper 1975). What followed was a prolonged negotiation of recovery packages involving the state, the federal government, and the banks holding New York's debt. Some oversight of the city continues today, and the institutions and mechanisms created are still held up as models.

Several institutions were created in order to manage New York's recovery from crisis, many authorized by the state's Financial Emergency Act of 1975 and made permanent by subsequent legislation. Brash calls this the "extra democratic infrastructure" (Brash 2003, 66). A Temporary Commission on City Finances (TCCF) was created to advise on taxation and expenditure policies, as well as the Mayor's Management Advisory Board (staffed by business representatives), the Setting Municipal Priorities (SMP) project at Columbia & New School, and Special Task Force on Taxation (Shefter 1992, 160; Freeman 2000). The Deputy Mayor, Deputy Mayor for Finance, and budget director were all forced to resign to pave the way for the appointment of "trustworthy" staff (Dunstan 1995).

The Governor then appointed an advisory committee to monitor the city, and the committee recommended the creation of the Municipal Assistance Corporation (MAC), an independent corporation that was authorized to sell bonds. MAC was a creation and entity of the state, formed at the home of the president of Met Life, and the Governor appointed the majority of MAC's board members (Tabb 1982). The state passed a law converting the city's sales and stock transfer taxes into state taxes, which were then used as security for

MAC bonds (Dunstan 1995). MAC initially had difficulty selling the securities, then demanded significant retrenchment.<sup>53</sup> Ultimately, the city's employee pension funds invested 40 percent of their assets in MAC. In exchange for these many layers of concessions, the city's creditors restructured their debt holdings, lowered interest rates, lengthened maturities, or swapped their holdings for ten-year MAC securities (Dunstan 1995).

The state also created the Office of Special Deputy Comptroller for New York City (OSDC), housed in the state comptroller's office and charged with auditing the city's books (made permanent in 1986). Finally, The state created the Emergency Financial Control Board (EFCB), later renamed the Financial Control Board (FCB) when it was extended through 2000 as a condition of additional federal assistance in 1978. In 2003 the FCB was made permanent; MAC only voted itself out of existence in 2008 (Lisberg 2008).

The FEA also required that the city balance its budget within three years, change its accounting methods, and create a three-year financial plan. The FCB had the authority to review and reject the plan, as well as the city's operating budget, capital budget, union contracts, and all municipal borrowing. The city also overhauled its accounting and information systems, collecting and publishing additional data on fiscal condition, increasing government technical and data knowledge, which provided potential ammunition for fiscal monitors and politically powerful actors committed to "balancing the budget" (Shefter 1992, 200). The MAC and FCB held veto power over the city's budget and spending decisions. Mayor Koch once described the city as the "indentured servant" of the FCB (Citizens Research Council of Michigan 2012, 3).

The FCB still reviews and oversees financial management of NYC and its related public authorities (*New York State Financial Emergency Act of The City of New York* 1975). The Board determines whether certain trigger events are likely to occur, and can reimpose a "control period" if certain conditions are met: failure to pay debt service, an operating deficit of more than \$100 million, issues notes in violation of the Financial Emergency Act, or the state and city comptrollers refuse to jointly certify the city's compliance with the FEA. In 2003 the Financial Emergency Act was extended until 2033 (at the same time outstanding MAC bonds were refunded with state assistance). In 2005 the city's charter was revised to incorporate many of the FEA provisions, including a balanced budget requirement, a four-year financial plan, annual audit, and restrictions on short-term debt.

The implementation of an intricate state infrastructure of oversight both fragments urban governance, by separating fiscal policy-making from other forms of urban policy, and removes elements of it from democratic oversight. Brash argues that in order to shift money to subsidies for real estate development business (the so-called "headquarters city" approach to urban policy), and away from services for the poor and wages for municipal

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<sup>53</sup> The city had to raise fees for services, subway and the university, cut other services, reduce the work force and rescind a wage increase (meaning wages did not keep up with inflation). Twenty percent of city jobs were eliminated. The state assumed the full costs of financing the city university and part of the welfare and court systems.

workers, the city's elite had to use the crisis to move "outside the realm of democratic governance" (Brash 2003, 67).

By 2007, New York's recovery—and therefore the mechanisms associated with it—became seen in retrospect as a model. State oversight was framed as central to the city's turnaround in the 1990s, while alternative explanations receded into the background, such as the high rates of inflation through the 1970s that increased city revenues and effectively reduced the size of the debt (Hackworth 2007). The praise lavished on New York's fiscal management infrastructure today omits a key fact: that New York's recovery after 1975 was complex and uneven throughout the 1980s. Not until the national economy and the financial industry (concentrated in New York) boomed through the 1990s did the city regain an investor-grade credit rating and become viewed as a successful recovery. Rapid inflation through the 1970s and 1980s also helped, by deflating the real value of the city's debt; freezing the wages of city employees in a rapidly inflating economy made it a fiscally effective, if personally cruel, strategy. And the amount of state and federal aid that eventually poured into New York was vast, when compared to the near total absence of federal support for bankrupt cities today, including Detroit.

History has shown that the infrastructure of state intervention lasts long after crises are resolved, perhaps permanently. Philadelphia is overseen by the Pennsylvania Intergovernmental Cooperation Authority (PICA), put in place as part of the state's receivership of the city in the early 1990s. Since 1991, Philadelphia has had to obtain PICA's approval of its five-year budget plan; in 2011, for the first time since its inception, PICA staff urged the board to reject the city's *five-year* plan in 2011, urging the board to require "a more rational and competitive tax system, a sustainable pension system, an efficient system of employee health benefits, competitive [i.e. lower] wages for workers, more robust economic growth, well maintained infrastructure, and improved services." Philadelphia's monitoring by PICA is regularly mentioned in ratings agency comments about the city, as credit positive. But the presence of state oversight clearly affects the city's strategies for managing fiscal stress. As the 2008 fiscal crisis deepened, that state infrastructure was repeatedly invoked. While such laws are described and justified as temporary interventions to resolve cyclical or extreme crises, in reality these models hold the prospect of permanent state intervention in city finances.

### *Detroit*

[Residents'] presentations demonstrated an extraordinary depth of concern for the City of Detroit, for the inadequate level of services that their city government provides and the personal hardships that creates, and, most clearly, for the pensions of City retirees and employees. These individuals expressed another deeply held concern, and even anger, that became a major theme of the hearing—the concern and anger that the State's appointment of an emergency manager over the City of Detroit violated their fundamental democratic right to self-governance. (Rhodes 2013, 37)

This eloquent description by the federal bankruptcy judge in ruling on Detroit's eligibility for bankruptcy reflects the political stakes of Detroit's fate. Detroit's takeover by Michigan and subsequent bankruptcy filing now represents the strongest example of state interference in local governance based on fiscal emergency. Michigan's legal efforts to expand the powers of emergency managers garnered national attention beginning in 2010, but the state has actually had three versions of an emergency manager law in play since 2008. In 1990 the state enacted Public Act 72, the "local government fiscal responsibility act," which authorized the state to intervene in local government units (including school districts) that experience "financial emergencies." Public Act 72 was used to appoint emergency managers only ten times in 20 years (Snyder 2011).

In 2010, Republican Governor Rick Snyder (elected after eight years of Democratic leadership) campaigned immediately upon taking office for a dramatic revision of Public Act 72; he signed the Local Government and School District Fiscal Accountability Act in May 2011 (*Public Act 4* 2011). The law greatly expanded the powers that state-appointed emergency managers can exercise, most significantly it created the power to dissolve government contracts, including collective bargaining agreements (*Public Act 4* 2011).<sup>54</sup> The law permitted the city to avoid an emergency manager by reaching a consent agreement between the city's governing body and state officials that preserves some local autonomy while creating powers for a review entity.

Shortly after the passage of Public Act 4, opponents began to organize to repeal it. Stand Up for Democracy was organized residents and joined in lawsuits against specific emergency manager appointments, elements of the law's implementation, and the constitutionality of the law itself (Davey 2011). Residents successfully sued over the private meetings held by the financial emergency review team in Detroit in late 2011 and early 2012, and in February 2012 a judge ruled that the review team must start over and meet in public<sup>55</sup> (Nichols 2012). Protestors disrupted State Treasurer Dillon's attempts to speak at a meeting of the financial review team (Meloni 2012).

After a year of such organizing, opponents successfully sued to place a referendum on the emergency manager law on the November 2012 ballot, resulting in the suspension of the law pending the November vote (Scott 2012). During the campaign for repeal, the Governor and several banks ominously warned of the risks to Michigan cities and their credit ratings if the repeal succeeded (*Proposal One - Michigan's Emergency Manager Law* 2012). The law had been widely praised by ratings agencies and business press as a model for other states (C. Christoff 2012; Raphael 2012). Despite heavy campaigning by Governor

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<sup>54</sup> From 2008 to 2013, the law was used to institute state-appointed emergency managers in five cities and three school districts: Flint (November 2011), Benton Harbor (April 2011), Pontiac (March 2009), Muskegon Heights Public Schools (April 2012), Ecorse (October 2009), Allen Park (October 2012), School District of Highland Park (January 2012), Detroit Public Schools (March 2009). Three cities are under consent agreements that were signed under threat of an emergency manager: River Rouge (October 2009), Inkster (February 2012), and Detroit (April 2012).

<sup>55</sup> The review team's response was to create a subcommittee that met in private, and the decision was ultimately reversed on appeal.

Snyder, in November 2012 Michigan residents voted to repeal the law, throwing the fate of appointed emergency managers, and of Detroit, into question.

### *Public Act 436*

Less than two months after Public Act 4 was repealed, a new emergency manager law was written and passed by the Michigan legislature (Michigan §§141.1541-141.1575: “local financial stability and choice act,” hereafter PA 436).<sup>56</sup> PA 436 permits cities to choose among four options: a consent agreement, mediation, emergency manager, or bankruptcy. It contains the same triggers for a financial review, including the blanket statement: “The existence of other facts or circumstances that, in the state treasurer’s sole discretion for a municipal government, are indicative of probable financial stress” (*Public Act 436 2012*).

The primary difference between Public Act 4 and Public Act 436 is that rather than facing two choices (an emergency manager or a state-approved consent agreement), local governments found to be in a financial emergency now have four choices in the event that a financial emergency is declared:

- (1) A consent agreement, in which local leaders remain in charge but must meet certain conditions in an agreement negotiated with the state. The provisions are almost identical to Public Act 4, including the controversial provision that a local government in a consent agreement under this act is not subject to public collective bargaining law.
- (2) A state-appointed emergency manager: an official who replaces the local government structure, and has broad authority to address local finances. The provisions are almost identical to Public Act 4, although the state now pays the compensation of the emergency manager, instead of the local government.<sup>57</sup>
- (3) Chapter 9 bankruptcy (which must be approved by the Governor, and can be requested by an emergency manager)
- (4) Neutral evaluation: a mediation process in which the local government and interested parties meet with a neutral party to resolve financial issues,

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<sup>56</sup> After the passage of P.A. 436, there was still considerable legal uncertainty about the law’s implementation. The State Attorney General has held that Public Act 72 remains in effect with the repeal of Public Act 4, and that consent agreements (such as the one implemented in Detroit) and emergency managers appointed under Public Act 4 remain in full effect. With the repeal of Public Act 4, all of these are considered governed by Public Act 72 until Public Act 436 takes effect in March, at which point Public Act 436 will be the sole governing law.

<sup>57</sup> (And the state may direct “private funds” toward that compensation, paving the way for foundations to pay the salary of the emergency manager, as they currently do for the manager of Detroit Public Schools)

including employee contracts. (This is similar to the kind of mediation processes required in many municipal bankruptcy proceedings.)

The law maintains the powers of emergency managers to change or terminate collective bargaining agreements, change pension boards, and sell off public assets (with state approval). The new law also includes a \$780,000 appropriation that makes it referendum-proof by voters under the Michigan Constitution.<sup>58</sup> The new law also creates an option for local governments to remove an emergency manager after 18 months, by approving the removal by a 2/3 majority (the only state concession to the public's concern over permanent takeover).

Public Act 4 received attention for the broad powers it grants to appointed emergency managers, and Public Act 436 preserves virtually all of those powers. The emergency manager serves at the pleasure of the governor, and acts "for and in the place and stead of the governing body and the office of chief administrative officer of the local government. The emergency manager shall have broad powers in receivership to rectify the financial emergency (*Public Act 4 2011, Sect. 9(2)*).<sup>59</sup> The emergency manager serves until removed by the governor or legislature by impeachment, until the "financial emergency is rectified" (*Public Act 4 2011, Sect. 9(6)*).<sup>60</sup> The emergency manager is responsible for creating a "financial and operating plan" that limits operations of the local government to the amount of resources in the emergency manager's revenue estimate; full payment of all scheduled debt service, and payments to the pension fund. The manager is empowered to sign contracts, negotiate with creditors, vendors, unions, or other governments, and to control funds from other government sources (such as federal grants) (*Public Act 4 2011, Sect. 10*). The State Treasurer maintains total approval over the financial plan, and the plan may only be modified with approval by the Treasurer; it does not require any public approval (*Public Act 4 2011, Sect. 11(4)*).

The financial plan *must* provide for the modification, rejection, termination, and renegotiation of collective bargaining contracts. The law makes clear how broadly this is to be interpreted:

[A]fter meeting and conferring with the appropriate bargaining representative... if in the emergency manager's sole discretion and judgment, a prompt and satisfactory resolution is unlikely to be obtained, [he may] reject, modify, or terminate 1 or more terms and conditions of an existing collective bargaining agreement. (*Public Act 4 2011, 12(1)(k)*)

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<sup>58</sup> Opponents of the law are now proposing a constitutional amendment to permit referendum repeal of such laws (Egan 2013).

<sup>59</sup> The governing body and chief administrative officer of the local government shall not exercise *any of the powers* of those offices" (emphasis mine).

<sup>60</sup> Or if two-thirds of the governing body of the local government votes to remove the manager (in which case the city has 10 days to sign a consent agreement with the state treasurer or move into the neutral evaluation process), which can only happen after the manager has served for at least 18 months

As with many receivership laws, the breadth of powers granted to the emergency manager exceeds, in many cases, the powers of the government that he or she displaces.

Like its predecessor, Public Act 436 outlines a broad range of circumstances under which a financial review can be instigated. I list them all to give a sense of the huge number of circumstances under which a city might face review:

- If it is requested by the local government itself, a creditor, a taxing jurisdiction that hasn't received required tax revenues, or a petition by electors.
- If the government fails to meet certain obligations: fails to make a minimum obligation payment to local government pension fund, fails to pay wages, salaries, other expenses, or retiree benefits, or defaults on bond or note payment.
- If the government commits a violation of bond or note covenants, the revenue bond act, the municipal finance act, an order issued by local emergency financial assistance loan board (part of the emergency municipal loan act), or the uniform budgeting and accounting act.
- If it is in breach of a deficit elimination plan (plans that are triggered by the state's revenue sharing law).
- By resolution of the State House or Senate.
- If it fails to timely file an annual financial report or audit (that conforms with state financial authority & uniform budgeting act)
- If a court has ordered an additional tax levy without approval of governing body.
- If the government is in a deficit condition.
- The government has been given a long-term debt rating of BBB or its equivalent [*junk ratings*] or lower by one ratings agency.

In addition to these many factors, a review team may be called for by the Treasurer in "the existence of other facts or circumstances *that in the state treasurer's sole discretion* for a municipal government are indicative of municipal financial stress" (*Public Act 436 2012*, section r, emphasis mine).

If the review finds "probable financial stress," the Governor appoints a review team consisting the State Treasurer, Department of Technology, Management, and Budget, nominee of Senate majority leader, and a nominee of Speaker of the House. That review team undertakes a "municipal financial management review" (*Public Act 436*) to determine whether a financial emergency exists, based on the following conditions:



- Failure to make payments on debt, pension contributions, wages, or other bills;
- Measures of deficit, including: the amount of accounts payable is more than 10% of total FY expenditures, there is a “failure to eliminate an existing deficit in any fund of the local government within the 2-year period” preceding the end of current fiscal year, there is projected a general fund deficit in excess of 5% of budgeted revenues, or the city has a “structural operating deficit;”
- Temporary deficit solutions, such as “borrowing” from funds to the general fund; or
- *Any other facts and circumstances indicative of a financial emergency. (Public Act 436 2012, emphasis mine)*

The breadth of this law, and its reliance on discretion by state officials and the review team (which consists primarily of state appointees) creates a landscape in which “financial emergency” is a discretionary construct, with a mixture of both measurable indicators and the idea that officials will know it when they see it.

### *Justifying intervention*

Union members and allies protested the passage of Public Act 4 (Bell and Christoff 2011). The law was referred to as “martial law” by opponents when it was passed. During the run up to the appointment of a review team for Detroit, Snyder repeatedly went on record saying that he wanted to avoid a takeover of Detroit: “My goal is to be a supporting resource and be there to help Detroit succeed by itself” (C. Christoff 2011). In January 2012, when a review team was appointed, the state’s Treasurer publicly stated that Detroit could only avoid takeover by getting concessions from unions (Neavling and Bell 2012). Just as the court was ruling whether to place a referendum on Public Act 4 on the November 2012 ballot, Snyder issued a statement on his website Michigan.gov (accompanied by a video):

Appointing an emergency manager is the last thing I ever want to do. That's why this law provides a way to prevent a financial crisis from ever getting this far. But if worse comes to worse, the state has a responsibility to protect the health, welfare and safety of its citizens. We can't stand by and watch schools fail, water shut off, or police protection disappear. Without the emergency manager law, there is precious little that can be done to prevent those kinds of nightmare scenarios. But with it, we can take positive action on behalf of the people to quickly avert a crisis.

As governor, I will do everything I can to work with local governments to prevent problems before they reach a tipping point. But when financial disaster is upon us, I will not hesitate to take action under the law on behalf

of the people of Michigan. (*Proposal One - Michigan's Emergency Manager Law 2012*)

After the referendum was placed on the ballot, the Governor's office launched a campaign to defend Public Act 4 after the August decision, aided by funds and activism from Citizens for Fiscal Responsibility. And after Public Act 436 was quickly passed, the Governor launched a public campaign to tout the "improvements" to the law. As he signed the law, Governor Snyder said: "This legislation demonstrates that we clearly heard, recognized and respected the will of the voters. It builds in local control and options while also ensuring the tools to protect communities and school districts' residents, students and taxpayers" (Oosting 2012). Snyder's website quickly posted a description of the new law, referencing the appeal:

#### WHAT IT'S ALL ABOUT: Emergency Powers in the Hands of the People

In November, Lansing heard the voice of the people, and their message was loud and clear. They weren't happy with Michigan's emergency manager law—a.k.a., Public Act 4—and they wanted a change.

So we started over from scratch, tore the engine apart, and built a new emergency manager law in line with what the people want. The basis of the new law is just that—it's all about putting power in the hands of local communities, giving them the tools they need to step outside of the box and take action to solve their financial emergencies.

Figure 5.1. Emergency Powers In the Hands of the People



Source: State of Michigan, Governor's website: [http://www.michigan.gov/snyder/0,4668,7-277-57577\\_60279-290993--,00.html](http://www.michigan.gov/snyder/0,4668,7-277-57577_60279-290993--,00.html)

Michigan's emergency manager law has been held up as a model, touted as perhaps the best in the nation by the financial press (*Bloomberg*), ratings agencies (Fitch), and legislators (Wisconsin) (Raphael 2012; C. Christoff 2012). Here's an example of the kind of praise issued by FitchRatings of Michigan's law:

Michigan recently instituted Public Act 4, which Fitch views as perhaps the strongest program in the nation, as it allows a state-appointed emergency manager to "reject, modify, or terminate terms and conditions of an existing contract."

A key consideration in a mechanism's effectiveness is its ability to address the legal and political issues as well as the financial conditions that necessitate it. In the most economically and fiscally distressed situations, where layoffs and service reductions have been exhausted and revenue raising is severely limited, achieving savings by reducing the cost of delivering services may be crucial. Yet a government's flexibility to reduce spending, even under a state-imposed control mechanism, will be affected by the strength of laws governing labor contracts, benefits (including pension

obligations), and service provisions. These laws can blunt the impact of all but the most powerful control mechanisms. (Raphael 2012).

Michigan's approach to Detroit's financial crisis has emerged as a broader model for state-urban governance that encompasses at least two other important policy trends: radical privatization of public education and the elimination of collective bargaining. Unions and community groups in Detroit and other Michigan cities have voiced significant opposition to these models, but have been unsuccessful so far. In 2013, Michigan, the birthplace of the U.A.W., became a right-to-work state, one of the biggest political losses to U.S. labor in history (The Economist 2012).

### *Detroit's takeover and bankruptcy*

In March 2013, Detroit's government was replaced by a state-appointed emergency manager (a corporate turnaround expert, Kevyn Orr). On May 12, Orr issued his financial and operating plan for Detroit, consisting of a predictable approach: privatizing the city's lighting, water, and even health services; securing private funding for basic equipment and services (such as emergency vehicles and park maintenance); increasing tax subsidies for development; selling off public assets (including the city's art collection); and lowering wage and business taxes to spur growth (K. D. Orr 2013a). In discussing the proposed contracting out of street lighting and garbage collection, Orr said "I prefer to think of it as 'upgrading' because some of these services are anachronistic...What big city still does some of these services?" (Finley 2013). These cuts, however, would only make a small dent in Detroit's deficit and debt. The cornerstone of Orr's approach was negotiating with the banks holding Detroit's debt (particularly the swap debt) and the city's unions, over the terms of pension benefits to current employees and retirees. In July 2013, Orr said that negotiations with both unions and creditors had broken down and filed for bankruptcy, which offers the possibility of renegotiating pension obligations and union contracts, as well as non-secured debt. He requested and obtained permission from Governor Snyder to file for bankruptcy on behalf of Detroit, the largest municipal bankruptcy in U.S. history (K. D. Orr 2013b; Snyder 2013).

Both Snyder and Orr emphasize the long-term nature of Detroit's troubles: "The fiscal realities confronting Detroit have been ignored for too long.... This is a difficult step, but the only viable option to address a problem that has been six decades in the making" (Governor Snyder's Office 2013). In his first public statement about the city's finances, Orr said: "Financial mismanagement, a shrinking population, a dwindling tax base and other factors over the past 45 years have brought Detroit to the brink of financial and operational ruin" (Helms, Guillen, and Priddle 2013). Despite their acknowledgment of long-standing structural challenges faced by the city, both Snyder and Orr emphasize that the city can be turned around quickly, and that the decisions facing the city are simple ones. In an interview with *Wall Street Journal*, Orr said that the emergency manager job was "just judgment calls, common sense" (Finley 2013). Referring to his negotiations with unions, Orr says "This is fifth grade stuff." The city's accumulated debt (estimated at \$18 billion in

2013) is framed as a moral choice, rather than a historical product: “We have to break our addiction to debt” (Helms and Guillen 2013).

The question about Detroit is not whether or when other cities will end up in a similar crisis, but how the solutions defining Detroit’s fiscal recovery—pension reform and state intervention—have become national models despite Detroit’s exceptional circumstances. The structural fiscal challenges created by disinvestment, uneven revenue capacity between Detroit and its suburbs, and high poverty have not been addressed. The decline of state revenue sharing and the debt accumulated primarily through large economic development projects have been largely absent from discussions about the city’s future (Bomey and Gallagher 2013). Instead it is the obligations to public workers that are turning Detroit into a discursive symbol of crisis looming problem for every American city. The city’s immediate financial crisis—the insolvency created by mounting debt, a growing deficit—may be resolved through bankruptcy (albeit on the backs of public workers), but the fiscal imbalance created by the other factors remains.

What are the implications of normalizing state intervention in city crisis: that certain aspects of governance should be subject to outside, unaccountable review? That cities cannot resolve fiscal problems on their own? I argue that such boards (including Detroit’s emergency manager and consent agreement structure) are not exceptions to “normal” budget processes but are integral aspects to how city finances and policy are being disciplined. A narrative of the “rights” of bondholders and taxpayers is used to justify state intervention, while the rights associated with urban democracy and collective consumption are rendered invisible. While residents in Detroit, subject to the most extreme form of state intervention, engaged in vibrant protests (all the way to bankruptcy court), other cities have been subsumed under a more subtle mode of intervention and takeover, with little fanfare.

These policy responses to urban fiscal crisis reflect the ideology underlying a broad set of other strategies that dominate the reshaping of U.S. cities today: austerity, privatization, “right to work,” and market-based governance that is active interference in democracy to protect markets. The narratives used to describe and justify these policies reflect an embedded belief that cities need drastic, but one-time, solutions in order to regain solvency, that elected city officials have trouble making tough decisions, and are beholden to local political interests. The structural problems leading to urban fiscal crisis are often left unaddressed by state intervention, in part because state policies limit the remedies available (such as revenue increases, state aid, or the restructuring of general obligation debt). These narratives are not limited in application to cities facing fiscal crisis; elements of the policies discussed in this chapter are closely watched and adopted by politicians in state and local governments outside the context of crisis. This is produced in part by the particular political relationships and power struggles between cities and states.

## *Red state, blue city*

The specific political dynamics of state control over city governments differs by state, but nationally, U.S. politics has increasingly been characterized by Republican-dominated state legislatures battling with predominantly Democratic cities and metropolitan areas (Baker 2012). This means cities are increasingly subject to fiscal discipline by states whose elected representatives lie politically to the right of city residents and their elected officials. The dynamics of state control over city governments differs by place, but U.S. politics has increasingly been characterized by Republican-dominated state legislatures battling with predominantly Democratic cities and metropolitan areas (Baker 2012). Nearly all U.S. Cities over 100,000 elect predominantly Democratic officials, even in states that are ruled by Republicans (Kron 2012). For example, every major Texas city, including Dallas, has voted Democratic in the past two presidential elections, defying Texas' overall shift to the right (Kron 2012). Detroit was one of the few places in Michigan to support Obama. While the number of Republican Governors has been growing, most strikingly in 2014 (Jacobson 2014), the number of Republican Mayors of large cities has been shrinking (Niquette 2013; Burns 2013).

The consequences of these divides can be significant for city finances. Republican state officials are more likely to support regressive taxes (sales taxes and fees) than more progressive revenues or other revenue increases (see e.g. Stevenson 2013). The push for tax cutting generally associated with Republican governors has had dire effects on state finances, which then affects city budgets. Party differences between city and state leadership also creates an atmosphere in which big city autonomy (and its leadership) are not valued by state policymakers or Governors for political reasons, in addition to the fiscal motives they claim publicly (R. Florida 2013; Gamm and Kousser 2013).

One of the primary drivers of this state-city divide is the often dramatic demographic and political differences in the populations of states and their largest cities. In Michigan, the state legislature is significantly more politically conservative than Detroit's residents or their representatives; the state is only 14% Black (2010 Census), while Detroit is now estimated to be 83%. This racial divide has characterized the city's political relationship with the state for decades (Desan 2014). The struggle for state versus local control in Detroit and other Michigan cities has a long history, and the debates over when the state can suspend local governments builds on that history, including the politics of labor and race in Detroit's development and the relationship between Detroit and the state (Sugrue 2005). For cities like Detroit, this has had significant impact on the state response to urban fiscal distress. In times of revenue scarcity, states exercise powers that they have always had but not exercised: to divert revenues; capping property taxes; and keeping sales taxes rather than return portion to local governments (Bowman and Kearney 2012).

Like Detroit, Dallas lies well to the left politically of its state government or residents as a whole, but its politics also reflect the fiscal independence and lack of revenue support by Texas, and the indirect effects of a legacy of lean government that sets expectations for local and state government services much lower than in other states (Graff 2008). The state's budget crisis (which surpassed California's once oil revenues began to

decline and aggressive tax cuts took effect) affected the city more indirectly, as the city already received little support from the state. The Mayor and City Manager of Dallas made no claims for state assistance, although from 2008 onwards, protests of Texas' draconian cuts to K-12 public education dominated local political debates (Mckinley 2011; Fernandez 2012).

Philadelphia's relationship with the state has been defined primarily through its governance by PICA; the state has been active in the city's pension and K-12 education funding challenges, authorizing a temporary suspension of its pension contributions. Philadelphia is 37% Black, Pennsylvania only 10.9% (2010 Census). Adams used Philadelphia to illustrate her argument that local governments were steadily relinquishing power to state governments, and thereby reducing the power of local public employee unions (Adams 2008). She also uses Philadelphia as an example of the dramatic inequalities between central cities and their suburbs.

San Jose lacks the demographic divide of the other three cities, and also hews more to its state overall political climate; the Mayor's own push for pension restructuring has been picked up by state legislators. The city suffers from California's voter-imposed restriction on revenues, which affects both city and state revenue options (statutory constraints on the state budget—some passed in ballot initiatives by voters—mean that.

Peck describes the federal policy of devolution as "urban abandonment" (Peck 2006, 306), a policy that has continued even in times of grave crisis. The limitations of the federal stimulus program, and the refusal of the federal government to offer Detroit any significant aid, represent such abandonment (Bender 2013). The White House press secretary, when asked whether the federal government would help Detroit, said simply: "I think, again, I would point you to what we have said and what leaders in Michigan and Detroit have said, which is that on the matter of their insolvency, that's something for the city and the creditors to resolve" (Carney 2013). In 2011, H.R. 344, the Fiscal Responsibility Effective Enforcement Act, sponsored by a Representative from Texas, would have prohibited the Federal Reserve Board from buying short-term municipal securities, thus reducing the ability of the federal government could "bail-out" state and local governments (Maguire 2011). The lack of federal bailout for Detroit stands in contrast to the array of state and federal assistance that flowed to New York once it had agreed to the terms of recovery. No such bargain was available to Detroit.<sup>61</sup> Federal indifference to cities could be a result of the disproportionate power of rural legislators in federal politics, of the idea that welfare and urban programs were largely failures, or simply that intergovernmental dependence and responsibility have been casualties of the neoliberal turn.

A handful of public finance experts have called for renewed attention to intergovernmental responsibilities and federal revenue sharing. Paul Posner's call for federal revenue sharing as a stimulus program in *Governing* was featured by the National League of Cities weekly publication (Posner 2009). Robert Shiller called for a return to the

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<sup>61</sup> Granted there is a strategic difference in New York's national importance versus Detroit's, but given that much of Detroit's troubles rest on legacy costs that amount in the \$10 billion range, the notion of a one-time federal fix is not unbelievable on its face, particularly given the bailout given to Detroit's auto industry.

idea of revenue sharing in the *New York Times* (Shiller 2010). Representatives of city associations in Massachusetts called for an intergovernmental policy council and state revenue sharing (Beckwith 2012). But no state Governor has taken up that mantle, and few state legislators have publicly supported the call. Philadelphia's mayor has been one of the few voices requesting state and federal aid for his city (Kerkstra 2009). The significant political and racial divides between cities and their states limit the political possibilities of such intergovernmental cooperation, and illustrate the importance of being attentive to the state as a pivotal determinant of urban political possibility, rather than just the federal government.



## CONCLUSION: Who Governs the Broke City?

Whether the fiscal crisis has only temporarily reduced the priority of social change or whether it has removed it from the public agenda for a long time is not clear. Nor is it clear what the future scope of responsibility of local government will be as localities wrestle with the causes and consequences of fiscal stress. For now, one thing is certain: The ability of urban policy makers to govern their cities while maintaining fiscal solvency is a matter of national concern, with long-term implications for the physical condition of cities and the ability of city governments to deliver services at levels necessary to sustain a civil society. (Levine, Rubin, and Wolohojian 1981, 11)

The questions Levine raised in 1981 are equally relevant today, although the terms in which “national concern” over urban fiscal crisis has been framed has foreclosed significant debate about those implications. Instead, the narratives and policy solutions emerging from the diverse experience of local fiscal crisis has produced three significant shifts in urban policy: a loss of city power relative to state governments, the framing of cities as financial actors whose risks and liabilities should be treated as any corporate actor’s, and a nationwide push to dismantle public employee benefits.

The predominant narrative of urban fiscal crisis attributes the event to one of two causes: governance failure (corruption, incompetence, lack of political will) or structural deficits (resulting from demographic changes, aging infrastructure, or economic restructuring). According to this narrative, cities are either unable to address structural economic problems (declining population, fleeing industry, etc.) or unable to make tough decisions. In either case, the solution, within the logic of this narrative, is some form of outside intervention. Something must be wrong with how cities are fiscally structured, the reasoning goes, and the only way to solve intractable fiscal problems is through some form of a “great reset” (see Florida 2009), remaking how government “does business,” forcing hard choices by invoking state or expert intervention and restructuring public obligations long held inviolable.

The fact that cities are greatly dependent on state governments for the ability to govern is ignored by the narratives about city failure that emphasize cities as isolated units, responsible for their own fates, divorced from their relations to other levels of government or cities. These narratives echo the neoliberal focus on individual responsibility that have normalized the displacement of risk onto individuals, away from collective or corporate responsibility (Hacker 2006). Devolution has become a means of fostering competition between cities and forcing an austerity localism, while normalizing the lack of state or federal assistance for cities. Despite the absence of regional solutions to fiscal imbalances (or policy strategies to promote fiscal interdependence), the idea that cities should be fiscally self-sufficient is a relatively new one, along with the rhetoric of individual

responsibility that characterizes discussions of Detroit and other struggling municipalities. It's important to remember that as recently as the 1970s, there existed, however incompletely, an ethos of national responsibility to address inequalities between and within cities shaped national policy.

Fuchs argues that New York's 1975 crisis was a pivotal moment in shifting political attention from the question of cities' fiscal sustainability to a presumption of city autonomy. After the crises of the 1980s, many argued that cities could not survive without federal assistance, but once cities had done so, it became harder to reassert the need for federal support (Fuchs 1992, 282). Her description of the changing politics of city autonomy is worth quoting at length:

New York City's near default in 1975 instilled the fear of fiscal crisis into virtually every city across the country. Mayors became obsessed with fiscal management issues, and if they did not show that they could balance their budgets and keep their cities' credit ratings high, then their political opponents would surely make this an issue in the next election. Mayors had no choice but to accept responsibility for the fiscal health of their cities, but they failed to realize that in doing so they lost the battle over federal assistance. Once their budgets were balanced it became much more difficult to argue that cities "needed" federal funds.

Thus, by accepting the terms of the political debate as it has been posed by the Reagan Republicans, the nation's mayors have unintentionally allowed the threat of fiscal crisis and fiscal instability to obscure the basic economic reality discovered during the Depression: that cities are not economically self-sufficient government units and need federal assistance to provide adequate services for their residents, businesses, work force and visitors. (Fuchs 1992, 282)

Today, the narratives of urban fiscal crisis emerging from Detroit and other cities take for granted the fiscal isolation of cities, while simultaneously subverting their political autonomy. This paradoxical treatment of city autonomy uses the ideal of democratic self-determination as a smokescreen for urban abandonment, justifying the devolution of risk without also decentralizing political power. The withdrawal of federal support has also coincided with the relentless expansion of urban entrepreneurialism and risk taking, as first described by Harvey (Harvey 1989). The complex financial networks and instruments in which cities have become embedded (often with catastrophic consequences) is an outgrowth of this entrepreneurialism. This transformation was (and is) often justified using the language of local control, democracy, and self-determination (Frug 1993). Its outcome, however, has been increased fiscal instability for cities, fewer services for residents, and a political imbalance between cities and their state governments.

In this dissertation, I have demonstrated that "urban fiscal crisis" is a constructed political narrative, one composed of specific claims and evidence that operates to produce a set of policy responses. The political stakes during times of urban crisis are high; whoever

can define and declare crisis in a way that captures the national imagination is able to shape the terms of remaking that crisis demands (no more business as usual). The recent urban fiscal crisis has impacted cities' revenues and spending in profound and measurable ways, as demonstrated empirically in Part Two. Chapter 2 illuminated how cities are constrained in their efforts to generate revenue, while Chapter 3 showed that cuts to spending, or retrenchment, in recent years evince a new willingness to cut pensions, signaling a growing sense that governments must minimize "legacy costs" and "fixed obligations," in order to stay nimble. In Part Three, I took up the subject of how municipal governance is remade by fiscal crisis, presenting evidence that the changes made in times of crisis have long-lasting effects for cities. Chapter 4 examined how the crisis has increased the role of technical financial expertise in setting urban policy. I examined how the power of ratings agencies in particular to shape a narrative of impending municipal collapse has been facilitated by the growing complexity of municipal debt and reliance of policy-makers on "technical" assessments of city fiscal health. Chapter 5 described the growing role of state power and intervention in city finances as a defining feature of the current crisis, one not fully captured by the literatures on devolution or urban politics. As statehouses become key sites for debating urban policy questions, the political and demographic contrasts between large cities and their state governments becomes especially salient.

By viewing these trends through the experience of four cities, I constructed a more complicated picture of how the dominant response to fiscal crisis was constituted and experienced locally, moving away from the tendency in research on contemporary fiscal crisis to describe national trends or focus on single cases. I demonstrated that, put in relation with other U.S. cities, Detroit appears not as an anomaly or even as an unequivocal model, but as a site where specific ideas about urban fiscal crisis are reproduced, shaped into policy arguments, and repositioned as national stories.

I hope that my research demonstrates the need for deeper investigations into city taxing, borrowing, and spending as a vital political question. Such investigations must go beyond the numbers and delve into the questions that austerity raises about the meaning of the city. There is little empirical work, for example, on anticipatory or "preventive" austerity—political and policy behaviors that cities implement in order to avoid crisis, to keep a deficit problem from becoming a fiscal crisis. Policies such as state fiscal monitoring are framed explicitly as tools for avoiding the next crisis. The literature, however, often draws a sharp divide between cities that enter crisis and those who avoid it—a dialectic of success and failure that obscures the power of definitions of crisis to shape policymaking. There are a few examples of literature that counter the notion that crisis or fiscal imbalance is the primary measure of a city's health. *Ailing Cities* is one of few texts that explicitly argues that budget deficits reflect primarily whether cities have chosen to try to spend, rather than whether they're adequately using the resources they have (Ladd and Yinger 1989). Fuchs' argues that bond-rating agencies have too strong a role over determining city spending priorities (Fuchs 1992, 289), something that can only change if the definition of fiscal responsibility is altered to incorporate other measures of governmental purpose. What would an alternative definition of fiscal responsibility entail?

Many argue that New York's crisis in 1975 was a pivotal moment in setting reduced expectations for the public sector: normalizing the idea that city government primarily exists to attract economic investment (so that large private projects next to decrepit hospitals don't seem too incongruous), and ushering in a "new era of austerity" that shrunk both the state and people's imagination of the city's possibilities. Phillips-Fein claims that "economic austerity helped generate a new political disengagement:" how do residents make claims against a government that has no money? (Phillips-Fein 2013)? Cuts to certain programs in particular directly reduced the public's involvement in city politics, as the constituency for those programs no longer had a formal claim on the city (Levine, Rubin, and Wolohojian 1981). People are more likely defend programs they already benefit from directly; political activism around the potential for additional spending (or even the reinstatement of previous programs) is rare, even in progressive cities. There is a great need for research on the spaces of contestation and counter-narratives from Detroit, Dallas, Philadelphia, and other cities. This dissertation does not take up that project, but I one of the critical forms of contestation has been the exposure of alternative explanations for crisis, exposing the "taken-for-granted" as ideology, not fact.

What's at stake in debates about retrenchment and service reduction are thus questions about what cities represent as a political imaginary, and how that imagination changes over time. City services, Frug argues, are not simply public goods, but are mechanisms for "community building" (Frug 1998, 24). This makes them not just economic questions (subject to theories of efficiency) but also political ones. As Castells argued, urban politics are fundamentally about conflicts over collective consumption (Castells 1977; Castells 1983).

The attacks on public employees and fiscal sovereignty following the Great Recession will produce a different post-crisis consensus than did New York City's crisis, as will the fallout from increasingly complex debt such as the swap agreements that ultimately led to Detroit's insolvency. If the crisis directs more attention to the financial risks increasingly being shouldered by cities and taxpayers, we may see a shift in the longstanding discourse of cities needing to emulate the private sector through financial innovation. There is a central role for scholars to play in telling that story, to avoid the tendency to compartmentalize blame and regulation of financial markets (as has happened with the fallout from subprime and foreclosure crisis, with potential homebuyers bearing the brunt of both blame and post-crisis regulation). The question of pensions and swaps offers rich terrain for exploring the financialization of cities and their budgets.

In ten years, this era will no doubt be as well-studied as the 1980s, and framed as another primary wave of "urban fiscal crisis." It will also be the new era of crisis that informs theories of how cities make choices about responding to fiscal stress. The autopsy is already being performed, I hope this dissertation serves to complicate the diagnosis.

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