

Financialization Created Chicago Public Schools' Fiscal Crisis

BY

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Chicago Public Schools has constantly found itself in fiscal crises in recent years, crises that then justify brutal austerity. But those crises didn't come from nowhere: they were the logical outcome of turning to Wall Street for funding on credit instead of taxing the rich.

Chicago Public Schools (CPS) is in a deep and enduring fiscal crisis. After decades of budget cuts, Chicago's public K–12 schools have been hollowed out, magnifying the hardships of stagnant wages, rising housing prices, and more faced by the city's working class. Pundits have predictably blamed CPS's fiscal crisis on either the greedy teachers' union (Republicans' and a few austerity-minded Democrats' scapegoat) or on conservative suburban and rural "downstate" politicians in Illinois hostile to urban children's plight (most Democrats' scapegoat).

But Chicago is a one-party city, controlled by the Democrats, in a solidly blue state, where Democrats usually control the state government. In reality, CPS's endless fiscal crises and austerity are consequences of a ruling-class project to chip away at Chicago public education. This has involved a two-pronged strategy of school-choice policies and education financialization carried out by successive Democratic mayors with the backing and active encouragement of key elements of Chicago capital. School-choice policies seek to remake public education in the image of a competitive market, where schools compete for education consumers (children and their parents). Education financialization expanded the role of financial instruments, actors, and markets in public education's operations.

Together, these policies have reconfigured Chicago Public Schools. The district's funding streams now function as a rent extraction machine, channeling revenue out of the CPS classrooms that serve black, brown, and immigrant working-class neighborhoods and into the pockets of Wall Street.

A Marketplace of Schools

Public K–12 education has many uses. It provides hard and soft skills in preparation for the labor force; socialization in civic, cultural, and political norms; and acts as de facto childcare centers for younger children, reducing the cost of living for parents. Radicals and reformers have demanded tuition-free public education since the late eighteenth century. Universally accessible, tuition-free, public, K–12 education contributes to the social wage, the mix of publicly provided goods and services that add to the normative standard of living. Universal access to tuition-free public K–12 education was rolled out alongside other New Deal reforms of the 1930s and '40s — taxing the rich, the expansion of unions, and regulation of finance and industry — associated with the Keynesian period in the development of US capitalism.

By the 1970s, the Keynesian phase of US capitalism was in crisis as competitor economies in Europe and the Pacific Rim rebuilt following World War II, and high wages and high fixed costs cut into the corporate profit rate. In the 1980s and 1990s, an ideologically committed and organized capitalist class rolled back Keynesian capitalism and rolled out a more cutthroat neoliberal capitalism.

By the 1990s, an anti-tax, anti-union, anti-regulation, and anti-public-sector ideological conventional wisdom had taken root among Republicans and Democrats alike. Taxation was characterized as rent-seeking by the “parasitic state” with its inherently “inefficient” public sector. In contrast, free enterprise capitalism with open markets and light regulation was held up as the ideal institutional arrangement for organizing the production and distribution of nearly all goods and services.

In this context, the meaning of public education shifted. Public education became less about cultural enrichment and civic engagement. Under neoliberalism, the emphasis in public education was placed, first and foremost, on providing individuals with the skills and habits appropriate for the marketplace. Anyone could overcome the hardship of their circumstances so long as they were willing to work hard, first in school and later in the labor force.

Public schools were expected to operate akin to businesses and adapt to the new era of iterative austerity, doing more with less. Public education was expected to reflect and advance the same norms and practices as the prevailing neoliberal capitalism it was embedded in.

In Chicago, Mayor Richard M. Daley and his business-elite organization backers (like the Civic Committee of the Commercial Club) were ahead of the national trend in implementing neoliberal reforms of the school system. In order to make schools function more like businesses, CPS adopted school-choice reform policies (like the 1996 Illinois Charter School Law and the Renaissance 2010 plan of 2004) that would create a simulated “marketplace” of schools. Parents were encouraged to approach education like consumers and choose the best school product for their children, comparing metrics of success like shopping for toothpaste in the grocery store.



Chicago mayor Richard M. Daley in May 2010 (Chris Eaves / Wikimedia Commons)

To create this school marketplace, CPS closed putatively low-performing public schools and rolled out a portfolio of high-performing public schools (like gifted elementary, magnet, and selective enrollment high schools) with competitive admission criteria, primarily in high-value real estate markets.

CPS also privatized the school system through charter schools, schools that are privately operated but still publicly funded. These less transparent, less democratically accountable, and initially nonunionized charter schools were overwhelmingly placed in black and Latino working-class communities.

According to the Chicago Public Schools Comprehensive Annual Financial Report from 1995 to 2018 (our data source throughout), between those years, CPS opened 230 new schools, while closing 123 schools, for a net gain of 107 schools. Over half of CPS's 230 new schools were charter schools. Charter school expansion privileged the interests of charter operators, seeking a foothold for their business enterprises in the city, over what was best for the public school system as

a whole. As the CPS system was growing dramatically with a wave of charter expansion, Chicago's population of school-aged children actually declined from over 435,000 students in 2005 to 371,000 students (64,000 fewer kids) in the CPS system in 2018.

Despite this pattern of population decline, nearly 85 percent of the new charter schools were opened after 2005. By 2018, charter school proliferation consumed 11 percent of CPS's budget, up from just 3 percent in 2006.

The Financialization of Chicago Public Schools

Due to the prevailing neoliberal anti-tax conventional wisdom, the state and city governments were unwilling to raise taxes to fund CPS. So, in order to carry out these school choice reforms, CPS turned to credit markets, paving the way for education financialization. Local education administrators, financiers, and politicians partnered up to devise frameworks and investment instruments that insinuated finance capital into the funding and operation of public education as the needs and well-being of children were monetized for rent-seeking investors.

Finance capital was attracted to public education because it provided new sites for capturing profits. By the 1990s, due to overaccumulation in other markets and government deregulation of finance, capital flooded into US finance and real estate markets. Moreover, dollar-denominated US municipal bonds were comparatively safer and provided steadier returns (albeit at a lower rate of return) than other, more traditional private-sector investment instruments.

With this new, expanded access to credit markets, CPS leveraged \$8.5 billion in debt to finance its oversupply of choice schools. By 2018, CPS was dedicating \$651 million of its budget (or 10 percent of its operations budget) to make payments on its debt, up from \$133 million, or 3.5 percent of its operations budget in 1998 (adjusted for 2018 inflation).

Predictably, charter schools carved out their own niche in the financialization game. Since their finances are considered proprietary, researchers could only find data for 27 percent of all CPS charter schools in 2015 through audits filed with the Illinois State Board of Education. The combined outstanding debt from bond issuances for these Chicago charter schools totaled \$225 million. Ultimately, charter school debt becomes taxpayer debt, since charter schools receive a per-pupil stipend from CPS to cover their facility and operations expenses.



The Chicago Public Schools logo. (WBEZ)

As the debt obligations of CPS grew, the district pursued financial fixes to address debt-driven budget shortfalls. CPS leadership contracted with banks to develop new, higher-risk speculative instruments around CPS debt, including variable rate bonds, auction rate bonds, credit swaps, and options. CPS officials were hoping to deliver a financial windfall for the public sector via these high-risk, high-reward instruments.

CPS made an unprecedented \$1.5 billion bet on bonds with high-risk floating interest rates. Traditional municipal bonds have a fixed interest rate for the term of the bond. In contrast, bonds with floating interest rates have rates of interest that rise or fall in relation to some agreed reference rate (frequently the LIBOR rate at which banks lend to one another). If interest rates fell below the traditional fixed interest rate bonds, CPS would capture significant savings. Yet if interest rates rose above that fixed interest rate, CPS would be obligated to pay more for their bonds than traditional bonds.

Then, in a gambit to protect CPS from the impact of interest rates falling, the district “hedged” their risk by buying \$1 billion worth of interest-rate swap derivatives from Bank of America, Goldman Sachs, Merrill Lynch, and Lehman Brothers.

When the 2007 financial crisis hit, the Federal Reserve reduced interest rates to 0.5 percent. CPS’s interest-rate swap agreements mandated the school district pay a higher fixed interest rate on their variable rate bonds to the investment banks holding the swaps, which only had to pay a little over 0.5 percent interest rate on the variable bond. The investment banks pocketed the difference between what CPS paid them and what they owed on the bond. The *Chicago Tribune* has shown that the variable rate bonds may have cost Chicago taxpayers \$100 million more than if the schools had borrowed the debt with more traditional fixed interest rate bonds.

Meanwhile, the same banks that were reaping windfall profits from CPS’s interest-rate swap disaster were also receiving federal bailout dollars. There was no bailout for CPS. The district had to pay a total of \$254 million in penalties to terminate all their associated swap contracts in order to refinance their underlying debt at the lower interest rates now

on offer. Since CPS revenues nose-dived during the crisis, they had to turn once again to the credit markets, to borrow money (at interest) from banks awash in government bailout dollars to pay those penalties.

CPS also sold option derivatives to the Royal Bank of Canada and Bank of America on its bonds, where the contract compelled CPS to issue debt if certain conditions occurred, like credit rating devaluations. In the wake of the financial crisis, CPS's bond rating fell below the rating needed to be in good standing for those options. In turn, the banks exercised their rights to make CPS issue another \$263 million in new debt in order to protect their investments.

Altogether, CPS's fling with exotic debt instruments cost the school system at least \$617 million. Since these payments were themselves largely debt financed, the people of Chicago, via the taxes paid to CPS, will end up paying Wall Street nearly \$1 billion on these losses.

Public Education Dispossession

Chicago Public Schools' school choice reform and financializing strategies have entrenched the public schools in a cycle of austerity. Tax cuts for the rich and retrenchment of federal and state government forced local governments into footing the bill for public goods and services under conditions of fiscal austerity. CPS overbuilt public schools through a high debt leverage funding strategy. This debt-driven oversupply of schools in an era of austerity pushed CPS to use risky financial instruments that then increased the debt burden of CPS.

The rising costs associated with building and operating redundant schools, growing debt service obligations, and the fling with high-risk exotic financial instruments produced recurrent fiscal crises. The response from the mayor and CPS leaders has been to embrace more austerity for the public schools, dispossessing Chicago residents of essential public education services.

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By the mid-2010s, the school system was anticipating annual half-billion-dollar deficits. With raising taxes off the table, CPS again cut its expenditures to close budget gaps. Since 10 percent of the district's general operations budget is locked into servicing debt, this portion of the budget is off-limits to cuts, requiring CPS to make even deeper cuts to the parts of the budget associated with frontline teaching and learning.

The district cut teaching and other student-facing education professional positions. Between 2010 and 2018, CPS reduced spending on teachers' salaries by \$421 million. In that same period, CPS's debt service payments increased by \$264 million, from \$387 million in 2010 to \$651 million in 2018. Ballooning debt service payments consumed the "savings" from downsizing the teaching labor force, effectively transferring revenue from Chicago's teachers to the investor class.

CPS starved school budgets, forcing individual schools to make repeated \$1 million cuts from their budgets. Things got so bad that schools held toilet paper drives to supply their schools. Other schools have packed forty kindergarteners into single classrooms and slashed arts, language, and other enriching but noncore curriculum. The most vulnerable students with learning disabilities were not spared, as \$40 million in supports was pulled out from under them.

Dispossession was largely racialized. In 2013, under the directive of Mayor Rahm Emanuel, CPS closed forty-nine schools with low enrollments, nearly 90 percent of which were in mostly black communities.



Protesters march in the Loop on March 27, 2013 during a rally to protest the proposed closing of 54 Chicago public schools. (WBEZ / Robin Amer via Flickr)

In contrast, the affluent (and mostly white) families who sent their kids to CPS were largely insulated from dispossession, thanks to activist parents' fundraising activities. According to CPS's Internal Accounts data, CPS schools raised a combined \$33 million from parent groups and "friends of" committees that hosted whimsical holiday craft markets, teacher bartender nights, and school spirit stores in 2018.

You can't blame wealthier parents for plugging the holes in their kids' budgets. But schools in poorer communities could not equally tap into parents' or charitable community members' pockets.

When cuts and closures proved insufficient to fill in the holes in the budget, CPS doubled down on its financialization strategy and issued another \$725 million bond to pay off one year's worth of debt service and short-term operation expenses in 2016. The district was forced to borrow at an onerous 8.5 percent interest rate, since its debt burden drove down its credit rating. The dependence on debt to pay for operating expenses sealed the conversion of CPS into a rent extraction machine for finance capital.

A New Era of Education Inequality

The two-prong strategy of market-based school choice reforms and education financialization pursued by CPS has created a new era of education inequality. Compelling public education to mimic a marketplace of competition has privileged the interests of elites and the affluent over and against the interests of the working-class majority, hollowing out mostly black and Latino communities' schools so that the district could roll out exclusive enrollment schools (disproportionately serving white professional-class families) and a wave of privately operated charter schools.

Education financialization is transforming the distributive role of public schools, from taxing the rich to fund public education, to borrowing money from the rich to pay for schools. CPS's strategy of education financialization turns schools into income streams for rent-seeking finance capital, which siphons public dollars out of classrooms and communities. Those dollars are then channeled into investors' portfolios. As the burden of debt grows, debt overhang is used by austerians as an alibi to further shrink the public sector by inflicting cuts on frontline teaching and learning.

Political leaders can continue to debt finance and grind public education into dust. Or they can change course and tax the rich to raise the revenue necessary to fund public K–12 education. Clearly, taxing the asset-owning rich is the better option than borrowing money from them (through the bond market) and paying them back with interest.

Taxing the rich to spend on universal, tuition-free, public K–12 education funds quality education for all children; reduces economic inequality, channeling revenue away from the rich and raising the social wage for the working class; and demonstrates the efficacy of providing goods and services via the more transparent, more accountable, and democratically planned public sector. If we don't tax the rich to pay for public goods and services, we'll be stuck in endless waves of austerity — and working-class students, parents, and educators will pay the price.

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