

Jefferson County, Alabama files largest municipal bankruptcy in US history

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17 November 2011

Jefferson County, Alabama, home to the state's most populous city of Birmingham, filed bankruptcy October 9. The size of the debt is over \$3 billion, making it the largest municipal filing in history.

The events that led up to the municipality's crisis were intrinsically linked to the larger trends of reckless speculation that led to the global financial crisis of 2007-2008. The most recent events have sparked fears of a municipal bond meltdown across the US.

Jefferson County is not the only municipality to recently file for bankruptcy. Along with countless smaller towns, hospitals, transit and school systems, Pennsylvania's capital Harrisburg filed for bankruptcy in October of this year, and Vallejo, California, filed in 2009. Detroit city officials have threatened that without deep cuts to social programs, the city could be insolvent by April. The sheer size of the municipalities in collapse points to the possibility of a full-scale municipal bonds market meltdown.

Jefferson County's financial insolvency finds its origins in a deal made concerning the municipal sewage system. In 1996, the sewage system was found to be in such poor condition that the Environmental Protection Agency forced the county to undertake repairs. County administrators agreed upon the installation of a new water system that would cost \$250 million. The debt from the project after refinancing, however, totaled at \$3.14 billion.

The county has faced the prospect of insolvency since February 2008, when ratings agency Standard & Poor's lowered its bond rating to junk status. Moody's quickly followed with a downgrade the next month. The move inflated interest payments on the debt, which the county financed through dubious derivatives swaps with investment banks including J.P. Morgan.

Following the Jefferson County commissioners'

decision to file for section 9 bankruptcy, they submitted a 58-page document to the court. The document cites fraud, corruption and toxic Wall Street refinancing deals as the root causes of the disaster. So far, twenty-two people involved in the dealings have been convicted of corruption.

Out of a 200-page list of creditors that comprised the \$3.14 billion total, approximately \$1 billion was owed to J.P. Morgan. Other large Wall Street financial firms including Goldman Sachs and the now defunct Bear Stearns are also listed.

These firms were able to obtain permission to participate in the venture through the bribery of local officials. Under the influence of J.P. Morgan, the county refinanced its debt into auction-rate securities designed to lower their interest rates. It was precisely these auction-rate securities that exploded during the 2007 financial crisis. Prior to J.P. Morgan's involvement in the project, 95 percent of Jefferson County's debt was held in fixed rate obligations. Now, approximately 93 percent of its debt is floating rate, on which interest rates soared to 10 percent.

After racking up the total debt holdings of \$3.14 billion, the creditors then reneged on a previous arrangement to make \$130 million in concessions. This left Jefferson County no choice but to declare bankruptcy.

While the full extent of the sordid dealings has as yet to be revealed, the existence of widespread corruption is palpable. J.P. Morgan, for example, overcharged the county by \$100 million in exchange for the doling out of further bribes to the tune of \$8.2 million—which they then embedded in the very finance deal they constructed. The federal Securities and Exchange Commission charges that the bribes were paid out in

2002 and 2003 to close friends of county commissioners who worked at local brokerage firms. Numerous local officials have already been convicted on corruption charges, including former Birmingham Mayor Larry Langford.

J.P. Morgan, however, has refused to admit fault for the crisis. Instead, in a move to avoid public scrutiny or criminal charges, the firm paid \$75 million in penalties to the SEC and forfeited \$647 million in fees through a settlement agreement. No one in J.P. Morgan has gone to jail over the scandal.

In addition to the \$3.14 billion owed for the sewage project, \$814 million is owed for school construction and \$305 in other debt. The county also gave out \$1 billion to a third party to run the sewage system.

The crisis will only deepen the extent and depth of the budget cuts underway in Jefferson County. Since June 450 County employees have been laid off and more budget cuts are expected to come next month. Furthermore, Moody's credit rating agency has placed Jefferson County under review for possible downgrades.

These events will have long-term consequences for the residents of Jefferson County. Understaffed and budget-strapped public services, currently unable to meet the needs of the region, will be targeted for austerity. Both the Jefferson County and Birmingham school districts, operating for years on inadequate funding, are bracing for deep cuts over the coming year. The Jefferson County jail is staffed at a ratio of one deputy to ten inmates, with prisoners forced to sleep in hallway floors, denied communication rights, and subjected to other inhumane conditions. Transit, firefighting, libraries, and many other critical services may be cut. County commissioners are warning of steep rate hikes on city water and sewage rates for years to come.

Among those affected, the urban poor will bear the greatest burden. According to federal Census figures, 26 percent of the population of Birmingham is at or below the official poverty line; 16 percent of the population of Jefferson County as a whole lives in poverty. The unemployed number 8.9 percent of the city's population, according to the Bureau of Labor Statistics.

The city, in addition, has suffered from chronic depopulation, further straining the maintenance of

infrastructure, and the metro area is still struggling to recover from the tornadoes that struck the area in April. The state and federal governments have essentially turned a blind eye to the financial collapse of the city.



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