Who are Detroit’s creditors?

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As Detroit’s emergency manager prepares to release his plan for reorganizing the poorest large city in America, the media is demanding that the population of Detroit ante up. Creditors must be paid, they insist.

They demand that Detroiters make “hard choices”—between recreation centers and health benefits for workers, between access to great works of art and city workers’ pensions.

Politicians and union officials echo this line, seeking to pit sections of the working class against each other. Ed McNeil, a special assistant to the president of American Federation of State, County and Municipal Employees Council 25, came out in support of the sell-off of masterpieces housed at the Detroit Institute of Art (DIA), provocatively asking, “You’re going to put some art work over [the] lives” of working people in Detroit?

In fact, the emergency manager and the banks he represents do not make any such fine distinctions. Their moves to sell off the artwork at the DIA are part of a general attack on workers, as is made clear in the report this week that trash collection will be one of the many services privatized, stripping at least 150 workers of their livelihoods.

McNeil and the rest of the trade union bureaucracy accept all of this because they are committed to satisfying the demands of Detroit’s creditors while protecting the financial and institutional interests of the union apparatus.

Who are the creditors for whom the people of Detroit must supposedly give up their jobs, wages, pensions, social services and cultural treasures such as the DIA?

The media has refused to release the complete list, but among the lead creditors currently in negotiation with Emergency Manager Kevyn Orr are JPMorgan Chase & Co., Royal Bank of Canada, Bank of America and several hedge funds.

Wealthy investors, money market bonds, bond funds, insurance companies, banks, hedge funds, and debt-traders—these are the biggest creditors, the same financial players whose economic and political power has grown in tandem with the deindustrialization of American cities, Detroit in particular.

In other words, Detroiters are on the hook to Wall Street—those who caused the economic meltdown and were bailed out, are now exploiting the fallout they caused to vastly increase their wealth again.

It should also be noted that Detroit is not unique in its level of debt. It was just the most extreme case of a general trend. Beginning in the 1980s, the municipal bond market ballooned, as cities were forced to borrow, through issuing bonds, for capital building projects such as sewers and schools, as well as to maintain city services. No small part in this crisis was played by the slashing of federal support to cities, schools and infrastructure begun by the Reagan administration and escalated by every administration, Democratic and Republican alike, ever since.

By 2008—as the financial system unraveled—US states faced $375 billion in collective budget deficits and were imposing drastic austerity budgets on cities and schools. The loss of tax revenue as unemployment grew and housing values plummeted was worsened with the systematic reduction of federal and state revenue sharing and the winding down of the short-lived Obama “stimulus.”

Last year Detroit lost $68.7 million more in revenue sharing and $64 million in grant reductions. The underlying crisis was exacerbated by the predatory lending and foreclosure crisis at the hands of Wall Street and the federal government, which made Detroit the nation’s top foreclosure city in 2007, and among the top five for years following. As a result, city tax revenues steadily declined.

So Detroit continued to add to its long-term indebtedness. But to whom it is indebted? In a previous era, it was not uncommon for ordinary Americans to be bondholders, in the sense of owning a smattering of municipal bonds, traditionally via mutual funds. That, however, has changed. Following the 2008 stock market meltdown and dramatically growing poverty in the US, households shed bonds at a record rate. Contrariwise, bank holdings doubled since 2007, and the first quarter of 2013 saw a record $374 billion in municipal bonds being held by the major banks.

Calling the shots in Detroit will be the major holders of Detroit debt, nine credit insurers and 44 other institutions. The credit insurers, like the banks, are major international financial firms. They are publicly traded for-profit companies like Assured Guaranty of Bermuda, a worldwide operation that holds $320 million in Detroit’s general fund exposures, $1 billion in sewer revenue bonds, and $804 million in water revenue bonds.

Another major holder of Detroit debt is National Public Finance Guarantee Corp. with $100.7 million in general obligation debt and $2.4 billion in revenue stream obligations. It is also publicly traded, and insures over $300 billion in debt.

Among the institutional bondholders, the banks wield decisive power. Not merely functioning as players in the debt market, the banks developed an arcane financial instrument, the municipal interest rate swap during the 2000s alongside the proliferation of sub-prime mortgages and Collateralized Debt Obligations (CDOs). Detroit first entered into these swaps during the Democratic Kwame Kilpatrick administration 2005-06.

Packaged as a cost-saving measure on the sale of municipal bonds, the swaps were widely agreed to by cash-strapped cities. However, scores of municipalities found themselves betting on the wrong side of interest-rate movement. City officials in Detroit entered swap agreements as an insurance against interest rate increases but in the aftermath of the 2008 Crash the Federal Reserve reduced rates sharply.

Today the banking industry holds $3.8 billion worth of these derivatives on Detroit debt. Like a gun to the head, the banks have the right to activate triggers forcing the city to terminate the swap "at fair value" if the city's credit rating fell below Ba3—which it has. This clause, which has not yet been activated, would compel the city to make mammoth lump-sum payments amounting to hundreds of millions of dollars. Detroit has a $439.3 million liability on derivatives for pension certificates and a $354.7 liability for government activities. Counterparties for Detroit derivative debt include Citigroup, JP Morgan Chase, Loop Capital, Morgan Stanley, and UBS/SBS.

Bloomberg news explained the pervasive and corrosive growth of this interest rate swap industry, now the largest component of the shadow banking world of derivatives: "For more than a decade, banks and insurance companies convinced governments and nonprofits that financial engineering would lower interest rates on bonds sold for public projects such as roads, bridges and schools. That failed promise has cost more than $4 billion … as hundreds of borrowers from the Bay Area Toll Authority in Oakland, California, to Cornell University in Ithaca, New York, quietly paid Wall Street to end agreements since 2008." The ongoing cost for Detroit's derivative swaps is estimated at about $45 million per year.

These wrong-way bets by American municipalities were compounded by outright criminality. Major banks internationally were colluding in the manipulation of the London Interbank Offered Rate (Libor), the international interest rate benchmark used in the swap agreements. *Bloomberg* noted that the Libor-rigging would cost US state and municipalities "more than double" the original cost, stating that Libor manipulation in the $3.7 trillion municipal-bond market cost cities "at least $6 billion."

As a result of this palpable illegality, Baltimore and other municipalities filed a class action lawsuit in 2012 for damages incurred. How much the individual banks realized in these deals is not well publicized, however JPMorgan Chase realized $1.4 billion in revenue on these swaps in 2011, making them a major profit center for the bank.

In addition to the credit insurers and the banks, hedge funds have entered into the municipal bond market in a big way. In fact, Wall Street's gambling on the debt markets, in the form of debt-focused hedge funds, has grown ever faster than bank assets, drawing $41.4 billion from wealthy investors in 2012, the most since 2007. Debt-focused hedge funds now total a whopping $640 billion outpacing stock-based hedge funds.

The role of these highly speculative derivatives was highlighted this week as the largest municipal bankruptcy in US history to date, Jefferson County, Alabama—which includes Birmingham—resulted in a deal engineered by hedge fund debt-buyers who will facilitate the county's emergence from Chapter 9 and walk away with substantial profits.

Discussing the threat to Detroit's public art and historical assets, Eric Wise, a restructuring industry partner, delicately stated, "It depends on the creditors. The real creditors here are the insurers who have wrapped the bonds, and their interest in those bonds may be purchased by other financial institutions, such as hedge funds, who may have an indifference to *reputational issues* ." [emphasis added]

In conclusion, one can only note that it is not just their reputation to which the hedge funds and banks are indifferent. With Detroit and all of its treasures being covetously eyed by the moneyed elite, workers face losing health care, pensions, recreation centers, fire service, in short, the devastation of their city.

Who are Detroit's creditors? They are the speculators and profiteers for whom Detroit's destitution is yet another potential source of profit. The defense of all of the gains of the working class in Detroit requires the overthrow of the rule of the banks. What is needed is the building of a new political movement of the working class that has as its aim the fundamental reorganization of economic power and redistribution of wealth. The vast wealth created by the labor of generations of workers must be taken out of the hands of the privileged few and placed at the disposal of the people as a whole. This is the fight for socialism.