# Wall Street swindles, not pensions, behind financial crisis in Detroit and other US cities

**Thomas Gaist**
**8 January 2014**

The political establishment and the media have relentlessly promoted the myth that the crisis in Detroit and in cities across the US is a product of overgenerous spending on social services and benefits, with public employee pension liabilities cited as the main culprit.

In reality, the driving force behind the Detroit bankruptcy has been a predatory interest rate swap foisted on the city by Wall Street bankers, which was signed by former Mayor Kwame Kilpatrick in 2005. Scores of states, municipalities, school districts and various other public entities entered into similar swap contracts over the past decade. These deals have enabled the world's most powerful banking houses to systematically plunder public budgets across the nation, creating the conditions for the rising wave of municipal bankruptcies.

The interest rate swap deals amount to complex bets on the direction of future interest rates. In the mid-2000s state and local governments entered into these bets in an environment of rising interest rates, seeking desperately to offset their growing financial costs.

During testimony last week, Orr testified that he considered the interest rate swaps to be illegal, and claimed that he even approached the Securities and Exchange Commission (SEC) about a possible prosecution of Bank of America-Merrill Lynch and Swiss bank UBS. (See: "Emergency manager acknowledges bank deals pushed on Detroit were likely illegal")

Far from intervening on behalf of Detroit and other cities victimized by these deals, however, the Obama administration and SEC have done everything to protect these financial criminals and reward them even further.

When the Federal Reserve pushed rates to near zero after the 2008 collapse, the swap arrangements forced local governments to continue paying high rates despite the new conditions. The swap deals, moreover, came with massive built-in termination fees, which cost cities hundreds of millions of dollars to "unwind" them. In Detroit, Orr is seeking to pay Bank of America and UBS $165 million in termination fees, while offering only pennies on the dollar towards unfunded pension obligations owed to 23,500 retired city workers.

Interest rates were driven down in the wake of 2008 both by the political decisions of the Federal Reserve, as well as the deliberate manipulations of the London Interbank Offering Rate or LIBOR carried out by the global banking giants. Two of the main financial players in the Detroit bankruptcy, UBS and Barclays, were both heavily involved in the LIBOR-rigging scandal.

The LIBOR index set interest rates for trillions of dollars in housing and other loans, including nearly all subprime mortgages before the 2008 crash, and financial derivatives such as interest rate swaps. American municipalities also borrowed around 75 percent of their money through financial products that were linked to the LIBOR.

The manipulation of this crucial index—which had the effect of minimizing payments owed by the banks on the swap deals and forcing cities to pay far higher interest rates—has prompted several cities to launch legal actions against the predatory activities of the financial houses.

Baltimore sued Bank of America, Barclays, Citibank, HSBC, JP Morgan, Lloyds, UBS, and WestLB in 2011 over their involvement in LIBOR rigging. Philadelphia launched a similar suit in 2013 against Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, JP Morgan Chase, Royal Bank of Canada, Royal

© World Socialist Web Site

Bank of Scotland, and UBS AG. San Diego and Sacramento counties have also sued major banks in relation to LIBOR manipulation.

The November 2011 bankruptcy of Jefferson County (Birmingham), Alabama, at the time the largest municipal bankruptcy in US history, was driven by an interest rate swap deal signed by the city with JP Morgan. JP Morgan was charged with paying millions in bribes to officials as part of the deal, including former Birmingham Mayor Larry Langford, who was subsequently convicted on corruption related charges. JP Morgan paid a fine of $75 million to the Securities and Exchange Commission (SEC), with none of its own personnel serving any jail time.

In an article for *Bloomberg*, "Wall Street Takes $4 Billion From Taxpayers as Swaps Backfire," Michael McDonald wrote, "California's water resources department this year spent $305 million unwinding interest-rate bets that backfired, handing over the money to banks led by New York-based Morgan Stanley. North Carolina paid $59.8 million in August, enough to cover the annual salaries of about 1,400 full-time state employees. Reading, Pennsylvania, which sought protection in the state's fiscally distressed communities program, got caught on the wrong end of the deals, costing it $21 million, equal to more than a year's worth of real-estate taxes."

In a 2010 article, "How Big Banks' Greek-Style Schemes Bankrupt States," Mike Elk of the *Huffington Post* wrote: "As almost all reasoned economists had predicted in the wake of a deepening recession, the federal government aggressively drove down interest rates to save the big banks. This created opportunity for banks—whose variable payments on the derivative deals were tied to interest rates set largely by the Federal Reserve and Government—to profit excessively at the expense of state and local governments. While banks are still collecting fixed rates of from 4 percent to 6 percent, they are now regularly paying state and local governments as little as a tenth of one percent on the outstanding bonds—with no end to the low rates in sight."

Elk continued, "Banks and states were supposed to be paying equal rates. However, with the fed lowering interest rates, which was anticipated, now states and local governments are paying about 50 times what the banks are paying. Talk about a windfall profit the banks are making off of the suffering of local economies."

According to economist Susan Ozawa, "the states and municipalities were entering into these long maturity swaps out of necessity. They were desperate, if not naive, and couldn't look to the Federal Government or Congress and had to turn themselves over to the banks."

Speaking to the *Real News* on the subject, Tom Ferguson, professor of political science at the University of Massachusetts Boston, said that cities and states, which he described as "public sector prey," were "basically just shoveling out millions of dollars on a decline in rates" saying that the interest rate swaps had "all the looks of the same type of deal as the mortgage story, where predatory deals were used." Ferguson further cited the "tacit collusion of the press" in this process, saying that the "daily papers didn't cover it."

The US government has made every effort to assure that the fees owed to the banks will be protected in the bankruptcy process, even as labor agreements are torn up and workers lose their jobs and pensions.

Exemptions have been embedded in the bankruptcy codes that provide a "safe haven" for the banks and ensure payment of their swap deals, using the bogus argument that if the banks are not paid in full, grave damage to the financial system will result.

Entire cities are being used as collateral, opening the way for wholesale plunder of municipal assets by the same institutions, whose criminal activities crashed the economy. The Federal Reserve's policy of lowering interest rates has provided a windfall for the banks while driving cities and cities and states over the financial cliff. This manufactured crisis has, in turn, been exploited by the Obama administration and both big business parties to hand over trillions in pension funds and other public assets to the financial kleptocracy that rules America.

To contact the WSWS and the Socialist Equality Party visit:

**wsws.org/contact**


© World Socialist Web Site