

# The Law, Finance, Sub-National Governments and Political Organising

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On July 3, 2012, the Oakland City Council, a municipal legislative body for the City of Oakland, California and a part of the larger San Francisco Bay Area, Silicon Valley conurbation, voted on a resolution authorising the City Administrator, a chief administrative officer of sorts for the locality, to enter into negotiations with Goldman Sachs to negotiate the termination of an agreement to hedge interest rate risks associated with municipal bonds issued by Oakland in 1998. The issue was driven by a coalition of clergy, members of the Occupy movement and Local 1021, a local affiliate of the Service Employees International Union, a union of 2.1 million health care, property services and government workers.<sup>i</sup> More so than the formal vote, which drew coverage from local and national media ranging from the San Francisco Chronicle newspaper to Forbes magazine<sup>ii</sup>, and which to this view is of mixed value, are the lessons for this story about the complexities and sheer difficulty of political organising, as well as the attention to the specific role of instruments & mechanisms like derivatives and LIBOR, or more broadly finance, in local communities. Political organising, and building cultures of accountability over economic policy decision-making, is hard.

What's the context? In 1998, to help fund its pension obligations, Oakland floated a series of bonds with a floating interest rate. To protect itself from sudden spikes in interest rates, the city entered into an agreement with Goldman Sachs where they would pay a fixed interest rate of 5.6775 percent in return for payments by Goldman according to a variable rate linked to the Bond Market Association (BMA) Index, an index which tracks movement in rates for such bonds.<sup>iii</sup> These bonds were refinanced in 2003, this time with the variable interest rate linked to the now-controversial LIBOR.<sup>iv</sup> In 2005, the outstanding US\$93.9 million in remaining debt were refinanced with an offering of bonds raising \$126.975 million. Oakland paid off the 2005 bonds in 2008, replacing them with fixed rate bonds.

To the extent that the contracts are part of a chain originating in the 1998 bond offering, the interest rate swap cannot be canceled without a payment to Goldman of \$15.5 million. Because of the 2008 financial crisis and related drop in interest rates, Oakland has paid \$4.2 million every year in interest on the bonds, \$32 million more than it owed on its original offering through May, 2012 with a potential loss of an additional \$20 million over the life of the swap. In many ways, this is also an unremarkable story of interest rate swaps.

What's the broader social context? This story is important of course because of the general lack of resources for education, health, social services and pensions or social security. In the US, as in many places, these concerns are largely funded by state and local governments. In California particularly, property taxes, the major source of revenue to localities besides indirect federal

transfers, are prevented from increases by the California State Constitution.<sup>v</sup> Looking at Oakland, the city has an annual budget of approximately US \$1 billion with annual shortfalls in their “General Revenue” fund of roughly \$60 million per year in the next few fiscal years.<sup>vi</sup> In the world of US city governments and the crucial services they provide, \$15 million dollars is a small, but significant source of revenue to write-off.

With regard to the Goldman swaps agreement, the political action chair for SEIU Local 1021 remarked that the bank knows that these swaps are ‘bad deals’ because the institution has been approaching localities with the offer of terminating these agreements for a payout.<sup>vii</sup>

In certain ways, this critique misses the mark. Viewed through the lens of basic contract theory, Oakland benefitted from the certainty of fixed interest rate payments in a climate when many thought that interest rates would only escalate, yet now shows buyer remorse in an environment very different from what its managers may have envisioned. Certainly, no fraud seems to have been alleged by or on behalf of the City of Oakland.<sup>viii</sup>

Yet maybe what this case really illustrates are the slight and obscure targets presented by the law, the complexities of political organising, high finance, sub-national government, and the painstaking, no-guarantees work of building cultures of accountability over vital policy matters.

Governments, of course, interfere in markets all the time. Market exchanges depend on measures such as monetary policy and the setting of interest rates, programs such as quantitative easing (“QE”) or literally the printing of money to ease cash flow problems in markets, or simply a battery of regulations and enforcement mechanisms (i.e. courts, regulatory agencies, master agreements provided by trade associations)<sup>ix</sup> to proceed with any certainty. What is perhaps a more important focus of analysis and organising, then, are the distributional consequences of state intervention, or the choice and structure of interventions allowed to governments.<sup>x</sup> Oakland, in this picture, loses because of measures such as TARP<sup>xi</sup>, QE and the flight to safety in US Treasury bonds in light of the ongoing Euro crisis that has left interest rates at historic lows.

Solutions to the crises of US local governments, to this view, are not particularly new, but reflect the limited social consensus or the narrow sense of “genuine” (or rather ideologically acceptable) political possibilities available to policy-makers. Funds spent on local social services and transfers typically create more demand and growth than budget-cutting, austerity measures often required by law of US state and local governments. Soaring pension costs and waste are the typical, though understandable concerns of US governors and mayors, yet there is no serious analysis of the inefficiency and sheer cost (not to mention increase in insecurity) of the federal governments aggressive foreign policy and roughly \$600 billion annual defence budget. Cost concerns are also belied by the structure of federal tax policy which allow wealthy individuals and large corporations to pay disproportionately low tax rates; think of the “carried interest”

loophole in the US federal tax code which allows capital gains to be taxed at a rate of 15 percent in comparison to much higher rates of income taxation borne by middle-income tax-payers.<sup>xii</sup>

As suggested, the Oakland-Goldman interest rate swaps deal highlights the difficulties of political organising. What are the most productive targets of such organising conceptually? What offers the best use of resources? And what is the role of critique in social justice movements?

The Oakland initiative is interesting to the extent that state and local government are obviously easier to hold accountable and influence, or even simply to access, by local organising efforts than the Federal Reserve or Congress, while also providing important services. The initiative also offers an attempt to promote public discussion about the role of finance, which is often limited by the technical and seemingly arcane concepts and instruments of this field.

Yet the law offers slight targets. The Oakland-Goldman derivatives agreement is ultimately a contract, and while easy to fall into, is not so easy to get out of. Goldman CEO Lloyd Blankfein, not surprisingly, if coldly, is said to have told an Oakland resident questioning him at a May 24<sup>th</sup> shareholders meeting that terminating the contract would not be in the interests of shareholders. The vote by the Oakland City Council involved a resolution. Resolutions are typically non-binding, and in this case, merely instructed the City Administrator to enter into negotiations with Goldman. The City also does not pursue outright repudiation of the agreement, but simply authorises the carrot of denying future city business to Goldman Sachs if they fail to terminate the agreement without penalties.

In terms of organising, while the process of building a consensus amongst Oakland institutions and communities is itself a victory, resolutions involve the painstaking work of monitoring and turning out support for the committee hearings and various hurdles of legislative procedure that are involved in securing passage of those measures. Exploring the role of LIBOR in influencing the rates available to Goldman and Oakland respectively are perhaps worth exploring as a legal matter. Here, the sheer time and expense of litigation (namely, discovering relevant and probative evidence, drawing persuasive connections between these rates and the performance of the underlying contract, identifying viable theories of law that courts might enforce, pricey and labour or time intensive law firm fees for the above) is a daunting matter. Not least, are the role of internecine struggles and differences in strategy in handcuffing collaborative organising efforts.

To state the obvious then, political organising is hard. Finding the right levers of intervention and building cultures of accountability over economic decision-making is difficult. A successful vote to make the City of Oakland enter into negotiations to repudiate an interest rate derivatives contract with Goldman Sachs seems to offer limited value in addressing the financial needs of

cash-strapped US localities, yet offers instructive lessons about the role of the law, finance, state and local government and political organising.

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<sup>i</sup>Service Employees International Union, Viewed on July 16, 2012 (<http://www.seiu.org/our-union/>). Health care workers include nurses, doctors, lab technicians, nursing home workers and home care workers. Property services workers include janitors, maintenance staff, window cleaners, doormen and security officers.

<sup>ii</sup>North, Theresa & Oakland North (2012): “Oakland City Council votes to terminate swap agreement with Goldman Sachs.” *SFGate: Home of the San Francisco Chronicle, In Oakland Blog* (4 Jul). Viewed on July 12, 2012 (<http://blog.sfgate.com/inoakland/2012/07/04/oakland-city-council-votes-to-terminate-swap-agreement-with-goldman-sachs/>); Touryalai, Halah (2012): “City of Oakland Taps Occupy Wall Street to Take on Goldman Sachs.” *Forbes* (11 Jul). Viewed on July 12, 2012 (<http://www.forbes.com/sites/halahtouryalai/2012/07/11/city-of-oakland-taps-occupy-wall-street-to-take-on-goldman-sachs/>).

<sup>iii</sup>*See generally*, Bhatti, Saqib (2012), “Supplemental Report. Goldman Sachs Swap Termination Agreement.” *City of Oakland, Office of the City Clerk* (19 Jun). Viewed on July 16, 2012 (<http://oakland.legistar.com/LegislationDetail.aspx?ID=1122881&GUID=F9C08908-F12B-40BA-86C5-F896A01BDA15&Options=&Search=>) (Memorandum to Alliance of Californians for Community Empowerment (ACCE), Oakland Community of Organizations (OCO), SEIU Local 1021).

<sup>iv</sup>LIBOR refers to the “London Interbank Offered Rate” or average interest rate estimated that leading banks in London would charge for borrowing for each other. LIBOR is used as a benchmark for uncounted numbers of financial products and contracts. It has, of course, been the subject of a rate-fixing scandal which has significant effects for the payments that typically large institutional investors pay each other.

<sup>v</sup>Article 13A. Constitution of the State of California.

<sup>vi</sup>According to the Budget Office of the City of Oakland, the city’s annual budget, across all funds, was about US \$1 billion a year for the 2009-11 fiscal years. Forty-one percent of this amount is provided by the City’s “General Fund” which finances basic programs such as the police, fire and some social services. The remaining 59 percent of the City’s budget is dedicated to specific purposes such as streets, sewers and bond-funded programs. *See generally*, City of Oakland (2012), “Budget Facts: Fiscal Year 2010-11. City Faces \$32 million Deficit; Balancing Options are Few.” *Budget Office, City of Oakland*. Viewed July 18, 2012 (<http://www2.oaklandnet.com/oakca1/groups/cityadministrator/documents/marketingmaterial/dowd009068.pdf>); Budget projections by the City Budget Office project a shortfall for the City of \$60.10 million dollars for Fiscal Year 2012-13. City of Oakland (2012), “Five-Year Forecast. General Purpose Fund FY 10-11 to FY 14-16.” *Budget Office, City of Oakland*. Viewed July 18, 2012 (<http://www2.oaklandnet.com/oakca1/groups/cityadministrator/documents/report/dowd009359.pdf>)

<sup>vii</sup>Alexander, Alysabeth (2012): *Oakland City Council Seeks to Cut Goldman Sachs Ties After Bank Profits from Lowered Interest Rates*, Democracy Now (9 Jul), Viewed on July 16, 2012 ([http://www.democracynow.org/2012/7/9/oakland\\_city\\_council\\_seeks\\_to\\_cut](http://www.democracynow.org/2012/7/9/oakland_city_council_seeks_to_cut)).

<sup>viii</sup>*See*, Touryalai, Halah (2012), *supra* note 2.

<sup>ix</sup>For example, the International Swaps and Derivatives Association or “ISDA” promulgates master agreements and offers model language for derivatives contracts that has been the subject of much consultation and review by government officials and private sector stakeholders in the association. ISDA is not a government entity. Yet, the incorporation and enforcement of these terms in contracts by courts or by internalization of these norms is necessary for derivatives markets to operate with any regularity. *See generally*, Riles, Annelise, (2008): “Relations: The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State,” *American Journal of Comparative Law*, 56: 605;

<sup>x</sup>*See generally*, Harcourt, Bernard E. (2011): *The Illusion of Free Markets: Punishment and the Myth of Natural Order* (Cambridge and London: Harvard University Press).

<sup>xi</sup>TARP refers to the Troubled Assets Relief Program, the program passed by the US Congress in October, 2008 to purchase toxic assets from struggling large financial institutions and to avoid a larger collapse of the financial system and global economy.

<sup>xii</sup>The proportion of middle-class tax-payers with any significant capital gains as a source of income is commonly understood to be low.