County in Alabama is Bankrupt, Just Like the U.S.

The proximate cause of the difficulty goes back to December of 1993 when three citizens of the county sued the county commissioners over untreated raw sewage being dumped into nearby rivers. The suit, which was picked up by the Environmental Protection Agency in 1994, forced the commissioners to build a new sewer system. In 1997, the county began selling municipal bonds to pay for the project, with the help of a broker at Raymond James & Associates. By November of 2002, the county had raised $2.9 billion and began construction on the project.

From there, the plot thickened. The broker moved to JPMorgan and began making offers on refinancing the debt that the commissioners couldn't refuse: By using a series of exotic derivatives the $2.9 billion debt could essentially be refinanced at a lower cost, while putting some much needed cash into the county's coffers. It was a sweet deal — it was also too good to last.

When the broker involved in the deal, Charles LeCroy, was indicted on federal fraud charges in a municipal finance corruption scandal in Philadelphia in June of 2004, the SEC decided to take a look at his involvement in the Jefferson County bond deals. Come to find out, LeCroy had greatly overcharged the county for his services — between $50 and $100 million — and had paid off some friends of the commissioners to keep the deals coming his way. The corruption led to the conviction and a 15-year incarceration of the chairman of the county commissioners, Larry Langford, who received $156,000 in cash and benefits in what the SEC called a "pay to play" scheme. As Robert Khuzami, Director of the SEC's Division of Enforcement, noted at the time: "The transactions were complex but the scheme was simple: Senior JPMorgan bankers made unlawful payments to win business and earn fees." In other words, those involved in getting Jefferson County into trouble were criminals.

Things went along swimmingly until the financial crisis hit and, as Warren Buffett so famously put it, "When the tide goes out, only then do we discover those who are swimming naked." The derivatives sold the county began to unravel, the banks and insurance companies backing them failed, which left the county with huge losses.

Fast forward to today: At the last minute, Alabama Governor Robert Bentley offered a bailout of the county, but he needed a few days to look things over. What's expected is that the state of Alabama will create a new financial entity, funded with citizens' taxes, to sell new bonds to replace the old. Even if the bailout is completed, sewer rates, already exceeding $250 a month for modest residences, may be raised again. Talk about austerity!

The parallels to the current fiscal situation facing the United States are eerie to contemplate. Corrupt bankers operating an illegal cartel (The Federal Reserve) have provided financing to the federal government for projects and programs that would never have been seen the light of day through borrowing or taxation. The sweet deal offered the federal government is this: By simply creating money out of thin air and then using that money to buy government bonds, the government has been able to spend money without having to trouble the taxpayers for additional funds. Although those officials have yet to be tried in a court of law and incarcerated, the result for the country will be the same as it is likely to be for Jefferson County: default and bankruptcy. There is no bailout available for the country, however, and so the costs of profligate and illegal spending will be visited upon the nation's taxpayers, who may count on paying a whole lot more than a mere $250 a month to pay the piper and service the debt.