LOCAL AUTHORITIES' BUDGETARY DEFICITS AND EXCESSIVE INDEBTEDNESS

Report by the
Steering Committee on Local and Regional Authorities (CDLR)
and recommendation of the Committee of Ministers

Local and regional authorities in Europe, No. 58

Council of Europe Publishing, 1996

CONTENTS

Pages

I. LOCAL AUTHORITY INDEBTEDNESS FACTORS 5

- I.1. Borrowing and capital spending 5
- I.2. Adjustment and indebtedness 6
- I.3. Unsuited financial strategies 8
- I.4. Debt restructuring 9
- I.5. Borrowing conditions and indebtedness 10
- I.6. Conclusion 10

II. DIFFERENT FORMS OF LOCAL AUTHORITY INDEBTEDNESS 11

- II.1. The old system of administrative rationing 11
- II.2. The revolution in "standardized financial products" 11
- II.3. From fixed rates to variable and floating rates 13
- II.4. "Swaps", "caps", "floors" 13
- II.5. Different indices 14
- II.6. Long-term borrowing on the financial market (bond issues) 15
- II.7. Short-term borrowing 15
- II.8. Multi-option financing facilities (MOFF) 15
- II.9. Foreign currency debt instruments 16
- II.10. Loan guarantees 16
- II.11. Non bank indebtedness 16
- II.12. Conclusion 16

III. ANALYSIS OF DEBT RATIOS 17

- III.1. Total debt (capital) per head of population 17
- III.2. Other criteria 20
- III.3. Conclusion 30

IV. OBLIGATION OF LOCAL AUTHORITIES TO MAKE THEIR DEBTS PUBLIC 31

- IV.1. Maximum publication arrangements 31
- IV.2. Minimum publication requirements 33
- IV.3. Conclusion 34

V. BORROWING REGULATIONS 35

V.1. Regulations governing local authorities' direct commitments 35
V.2. Regulations on sureties 41
V.3. Conclusion 44

VI. CRITICAL DEBT THRESHOLD 45

VI.1. Main difficulties 45
VI.2. Principles of fair assessment 51
VI.3. Conclusion 52

VII. EMERGENCY PROCEDURES 53

VII.1. Monitoring procedures 53
VII.2. Recovery measures and procedures 55
VII.3. Conclusion 59

RECOMMENDATION OF THE COMMITTEE OF MINISTERS TO MEMBER STATES ON LOCAL AUTHORITIES' BUDGETARY DEFICITS AND EXCESSIVE INDEBTEDNESS. 61

I. LOCAL AUTHORITY INDEBTEDNESS FACTORS

The level of indebtedness incurred by local authorities depends on many factors.

Capital financing requirements are clearly a major consideration.

For that, authorities must first have sufficient non debt-creating flows, especially tax revenues, to be able to implement large-scale programmes without undue financial constraints: borrowing offers the scope for accommodating this command variable.

But it may also result from a budget strategy which is mismatched to the real needs as they arise during implementation.

Finally, the credit conditions themselves influence indebtedness in at least two areas: the restructuring of liabilities resulting from the evolution of interest rates, to change a high historical cost debt into a longer-term, less-costly debt; and the environmental constraints - financial, certainly, but also institutional.

I.1. Borrowing and capital spending

Everywhere in Europe - except in **Switzerland**[1] - the proceeds of borrowing must be applied to a capital expenditure; such is the case, for example, in **Austria, Germany, Italy, Norway** and **France**.

First and foremost, capital expenditure means any operation which adds to the local authority's fixed capital assets, including expenditure on "community goods" which are, by definition, a public service and hence exempt from return-on-investment constraints (schools, hospitals, nurseries, cultural centres, stadia, etc.).

It also covers any statutorily-empowered operation to promote local economic development. This is the most popular area for indirect forms of assistance, given as guarantees for the interest payments on loans contracted by commercial firms. These high potential risk operations imply a major call on funds.

The reason for this mandatory requirement that borrowing be applied to capital expenditure is to be found in the requirement of sound management: it is reasonable that the debt burden, which encumbers future generations with the cost of borrowing, should be covered by current revenue; here again, a distinction is to be drawn between interest expense, charged as a revenue expenditure, and payment of the principal, charged as a capital expenditure. In **France,** moreover, the very definition of a balanced budget prohibits any form of "bank

---

[1] In Switzerland, 26 cantons and 3,000 municipalities are sometimes subject to specific rules in this area.

accommodation", i.e., funding one loan from another and automatically charging the interest to revenue expenditure.

Local authority capital outlays are relatively high as a proportion of all spending. But the trend, except in **France**, is towards a relative reduction expressed as a percentage of the gross fixed capital formation of each State.

In **Switzerland**, municipalities' and cantons' capital expenditure in 1992 was respectively 37% and 40% of all capital expenditure.

Local authority capital investment is also very high in **Italy**, where it accounts for 20% of all capital expenditure. This is followed by the **Netherlands** with over 13%, although there is a very pronounced trend downwards. Then comes **France**, with approximately 12%, two percentage points higher than the pre-1982 situation when the policy of decentralization was introduced. The final the States above the 10% mark are **Ireland** and **Austria** close to 11%.

Then come **Denmark** with 9% and **Portugal** with 8%; other countries such as **Belgium**, the **United Kingdom** and **Sweden** are a long way below the 10% barrier; finally others have always been at a low level: **Germany, Norway** and especially **Greece** and **Spain,** lying between 4% - 7%.

In **France**, local authority capital investment amounted to FF 200 billion in 1993. The percentage financed from borrowing has declined considerably in recent years due to the rebuilding of local government savings - from 55% to a little over 40% in the space of ten years.

Taking as a yardstick the proportion of capital expenditure financed by long-term borrowing only, net of repayments, two categories of States can be distinguished:

- those who favour this type of financing: **Denmark** and **Norway** (more than half), **Ireland** (capital outlays are funded almost fully by way of capital grants from the Exchequer; however, over 50% of such Exchequer expenditure is financed by general government borrowing), the **United Kingdom** (a little under one third), **Spain** (a quarter), the **Netherlands** (less than a fifth); **France, and Sweden** (approximately 15%);

- those more cautious about it: **Italy, Greece, Germany, Portugal, Finland** (all between 5% and 10%).

To conclude, it should be said that any capital expenditure operation ultimately induces a revenue expenditure chargeable to the corresponding budget item. This normally entails a reduction in current revenue which acts retrospectively on future borrowing capacity.

I.2. Adjustment and indebtedness

Borrowing must in most cases be applied to capital expenditure, but it is not the only source of financing. This being so, the level of indebtedness is conditioned not only by capital expenditure requirements, but also by the local authority's level of current revenue, percentage of self-financing.

Hence, ***the amount of transfers*** paid, not only by the State, but also by the European Union or other public body, directly affects recourse to bank loans and the financial market.

There are two main types of financing here.

In the first, government grants-in-aid are of decisive importance.

In **Italy**, the relative insufficiency of government grants-in-aid was directly responsible for the acute debt crisis experienced by the main towns and cities in 1976 and 1977, which compelled the State to allocate new grants-in-aid[2].

In the **Netherlands**, the favoured method of equalization through the Provincial Funds and Municipal Funds encourages borrowing by the wealthiest local authorities - albeit not to excess, in order to keep up with their investment effort in capital goods, in the framework of diminishing competences. A reform of the equalisation mechanisms is planned for 1997 at the earliest.

In **Ireland**, since 1988, local authority capital expenditure has been funded almost entirely by way of full capital grants from the Exchequer, thus replacing a system of capital loans drawn by local authorities from a special local loans fund.

The second reflects a progressive withdrawal of the State.

In the early 80s, successive **United Kingdom** Governments cut back the State contribution to local authorities in a bid to curb rising public expenditure. As a consequence, there was a reduction in the relative share of the central Government grant from 60% to less than 50% of the aggregate local authority revenue by the late 1980s. However, by 1995/96 the share of grant was again approaching 60%.

The salient feature of the present situation in Europe - set in the context of attempts to reduce the general government borrowing requirement in order to meet the convergence criteria set in the Maastricht Treaty for the transition to a single currency (general government deficit equal to or less than 3% of GDP; general government debt less than 60% of GDP) - is a move to cut back central government assistance at a time when sluggishness
in the economy is reducing the real revenue-raising capacity of local government. This is yet a further reason for the resurgence in local government borrowing.

It must be said that the amount of transfers is not the only culprit. **Periods of notice** also play a key role, well illustrated in **France**, where the situation is tightened by any delay in the payment of major government support - especially the block operating grant (DGF).

---

[2] Decree "STAMMATI" supplementary Order in Council, ratified by Parliament in 1978.

The degree of income financing from local tax revenues also dictates the level of borrowing.

In the **United Kingdom**, central Government exercises strict control over local government spending. In the first half of the 80s, any overshooting of the ceiling set by the government entailed an automatic reduction in the support grant and especially a disproportionate increase in tax revenues by the application of a "multiplier" ("gearing"), for example, a 1% rise in expenditure entailed a 6% increase in the revenue to be raised from local tax. There were also various regimes of "capping", i.e. central Government imposing a ceiling on the local tax which an authority could levy. All of these measures proved to be an extremely effective restraint on local authority expenditure, and might explain the recourse to the extremely inventive alternatives ("creative accounting"), such as interest swaps, now held to be illegal.

In **France**, the principle of freely-voted direct taxation rates introduced by the Act of 10 January 1980 was rapidly qualified by a plethora of so called "containment rules" to protect certain classes of taxpayer (firms, the professions, farmers); the business tax and the undeveloped land tax rates are pegged to a central rate (the local housing tax rate, which is the most "sensitive" electorally speaking); additionally, the business tax rate is **capped** with regard to the national average for municipalities only (but not associations of municipalities, departments or regions). To that must be added a whole series of exceptions to the containment rules, i.e., the ability, prohibitions notwithstanding, to increase rates within certain limits (special supplementary rate of the business use tax, for example).

In such cases, borrowing becomes a simple adjustment variable.

The extent of that adjustment clearly depends on the available **leeway**, evaluated on the basis of savings and the relative level of prior indebtedness. In **France**, the leeway is greater for the departments and regions than for the municipalities, which has enabled them, in particular, to engage in wholesale debt restructuring operations.

I.3. Unsuited financial strategies

Local authorities must normally balance their budgets. This means neither overestimating revenues nor underestimating expenditures. Should the budget not balance at the close of the financial year, the authority must resort to borrowing.

Likewise, any delay in settling the outstanding invoices of the local authority's suppliers (commercial firms) creates a build-up of liabilities likely to imperil its solvency. This practice of **"supplier credit"** is controlled to varying extents by the State, notwithstanding that, as in France, there is no maximum credit period.

As a general rule, **any lag between the rate of receipt of revenues and disbursement of expenditures creates a potential borrowing requirement**, which can only be met by bank credit. This is particularly to be seen in those countries - like France - where local authorities are statutorily required to deposit their cash holdings, interest free, with the Treasury. This requires some financial juggling to keep non-working cash revenue to a minimum; but if forecasts go awry, this could lead the authority into costly short-term borrowing.

I.4. Debt restructuring

Debt restructuring, leading on to new borrowing, is usually done by **advance repayment**, although such operations must usually be provided for in the initial agreement.

The principle of application to capital expenditure means that the amount of any new refunding loan may not exceed that of the renegotiated outstanding principal sum; in other words, it cannot cover the full amount of interest expense accruing as revenue expenditure.

In **France**, the experience in restructuring has been spectacular: over FF 60 billion - accounting for just under a tenth of the value of the outstanding debt - was renegotiated in the space of seven years subject to the payment of fixed or actuarial penalties, enabling many local authorities to escape the trap of historically very high fixed rates.

France: trend in "restructurings"
(*in thousand millions of current francs*)

1986	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**
6,0	20,0	16,5	12,0	4,0	2,2	2,0

(Source: Crédit local de France)

The end results have not always been very conclusive, however: penalties have often been high and the reduction in annual repayments often reflects only an extension of the repayment period - simple rescheduling - with no reduction in the total cost of the loan.

The terms of credit are also important.

In **Ireland** loans repayments had been subsidised up to 100% in the case of housing and up to 60% in the case of new water and sewerage facilities. All existing capital loans for these services were written off in 1988 and an adjustment was made to the level of current grants to reflect the elimination of loan repayments. Local Authority capital expenditure is now funded almost fully by way of capital grants from the Exchequer.

I.5. Borrowing conditions and indebtedness

The terms of borrowing are clearly deciding factors.

Local government borrowing, now a commonplace occurrence, has provided the commercial banks with a blue chip customer base of solid credit standing. While the "Cooke ratio"[3] developed by the Bank for International Settlements may not have led to their being granted the same zero risk status as for sovereign risks, the award of a 0.2 coefficient to local authorities - compared to 0.8 for commercial firms - allows credit institutions to lend five times more to local councils having regard to their own "prudential" risk-asset ratio. This was clearly to be seen during the "margin wars" of 1985-1990, when banks were more than ready to lend at rates below the cost of their refinancing funds, and hence at a loss, in order to win and keep market shares.

More generally, real interest rates - i.e., nominal- and inflation-adjusted interest rates -if negative are also an incitement to borrowing, as was the case in the early 80s. A positive interest-rate gap - as today - on the other hand, with its increased interest expense, has a deterrent effect.

Going one step further, recent studies have emphasized the **"leverage effect" of debt**, which is the ratio of the **economic rate of return of capital**, evaluated not without some methodological difficulty on the net return per capital unit (payment of principal and interest, or "blended payment") to **real interest rates**. The latter having been higher than the former since 1984-1985, the result has been to reduce local authority borrowers to a state of penury which restricts any further borrowing to what is strictly necessary.

I.6. Conclusion

It seems clear that, for the past decade, statutory constraints requiring loans to be applied to capital expenditure have gradually softened. There can be no question as to their influence on budgeting and approval of the accounts. But forecasts correspond increasingly less to firm commitments: during the financial year, the local executive has a free hand to raise whatever finance is necessary; and drawings are now subject to the rules of optimum cash management. Furthermore, loans are in fact raised to finance revenue expenditure, including interest payments on borrowing, as is confirmed by the growth in short term facilities and the decreasing terms of medium- and long-term loans. The examination, however, reflects only the practice of the large local authorities with regular, large-scale capital programmes. The smallest authorities remain tied to individual, highly specific capital projects. And they remain true to the traditional practice.

---

[3] Ratio of own resources to total assets and off-balance sheet items, weighted according to risk (solvency ratio: counterpart, in own resources, of amounts outstanding on loans granted to various categories of client).

II. DIFFERENT FORMS OF LOCAL AUTHORITY INDEBTEDNESS

More or less everywhere in Europe, the resurgence of liberal thinking has led directly to major new developments in the forms of local authority indebtedness.

II.1. The old system of administrative rationing

The traditional view that local authorities were merely offshoots of the State made it essential in the interest of local taxpayers to control, if not restrain, the growth of their spending commitments; this was done through the traditional supervisory procedures of investing central government representatives with the power to authorize - or disallow - individual transactions.

The environment within which this legal supervisory framework operated, moreover, was one of functional protection for local government borrowers: the fact that institutions which specialized in local government financing enjoyed a monopoly or near-monopoly of the credit supply in fact made them an administrative mechanism for regulating financing assistance. The more so in that in the majority of cases - as in **France** - the loan was made contingent on the borrower's being in possession of a government support grant, giving the central authority the power to selectively dictate local government activities in line with its own policy.

The powers of these specialized institutions varied from country to country according to their exact status, which could be wholly government-owned (Caisse des dépôts et consignations, Caisse d'aide à l'équipement des collectivités locales in France; Caisse des dépôts, Consorzio di credito per le opere pubbliche -CREDIOP- in Italy) or mixed (Belgium's Crédit communal de Belgique, whose equity is held by the municipalities and provinces).

The networks of specialised institutions did not always oust the banks from their traditional market role, however. In the **United Kingdom**, in the 80s, less than half the local authority borrowing needs were filled by a governmental agency, the Public Works Loan Board (PWLB). Nevertheless, since April 1994 almost all local authorities new borrowing is from the PWLB.

It must also be said that some statutory bodies have been privatized - France's Crédit local - or at least been given an ordinary law status - Italy's CREDIOP - in the general move towards more competition.

II.2. The revolution in "standardized financial products"

The upheaval created by the across-the-board introduction of "standardized financial products" has gradually thrown the existing system open to question.

The regulatory constraints have been relaxed if not simply scrapped, leaving authorities with quite often substantial leeway to **turn towards trading banks**, except in **Italy**, where the specialized institutions have held onto their monopoly. But everywhere else, and particularly in the **Netherlands**, where the BNG (bank for municipalities) plays a major role, there is an undeniably steady move towards other types of banks.

Rates which were previously **subsidized**, i.e., pegged at below-market rates with the cost differential made up by the State or the specialized financial institutions, are now being brought up to market rates.

The traditional **fixed rate long-term** loan (up to 50 years in France at the end of the 19th century!, now down to a more reasonable 10-15 years) was widely favoured by authorities as offering them genuine security: the cost of fixed annual repayments for level annuity payment loans, or diminishing annual repayments on equal principal payment (EPP) loans was known in advance.

Amount of annual repayment

Amount of annual repayment

Interest

Capital

Level annuity payments

Equal principal payments

Such long-term loans still play a significant role, but change was inevitable in an unstable monetary and financial environment, and banks, never short of imagination, developed new products, focusing particularly on rates.

It should be emphasized that any form of fixed rate borrowing was, in the final analysis, effectively gambling on a rise in rates.

II.3. From fixed to floating and variable rates

Fixed rates have the unarguable advantage that the repayment pattern (both the amounts and dates of the payments) is certain beforehand and can itself be adapted to the borrower's specific needs, notably through grace periods for repayment of interest or principal; their disadvantage is to deny the borrower the benefit of any fall in interest rates.

Hence the interest of:

- floating rate loans, i.e., pegged to a preset reference rate;
- variable rate loans, i.e., pegged to a rate set at the interest payment date.

II.4. Swaps, caps, floors[4]

These new techniques led authorities into extremely sophisticated financial dealings.

Playing on interest rates made it necessary to exploit every arbitraging opportunity to minimize losses or maximize profits on liabilities. That was done using every variation on interest rate hedging techniques (swaps) to change the interest expense maturities on each. This created speculative opportunities which, in the **United Kingdom**, led the House of Lords to hold such **swaps** null and void in a case of serious losses incurred in a particular case on the grounds that such contracts were *ultra vires* the lawful exercise of a local authority's recognized borrowing powers (Hazell vs. Hammersmith and Fulham LBC). This decision affected 130 counties and districts, 80 of the world's largest banks and represents a potential loss - quoted at that time - of the order of GBP £500-600 millions gross[5]. In **France**, a circular of 15 September 1992[6] prohibited operations of this type for amounts above that of the unrepaid residual outstanding debt, thereby proscribing any exposure above the real interest rate risk.

---

4 **Swap**: exchange of rate or foreign exchange; **cap** and **floor** are the upper and lower thresholds of a rate, the infringement of which gives right to an indemnity fixed in an insurance contract.

5 BELL John, *"Les difficultés financières des collectivités locales en Grande-Bretagne"*, in **Revue française de droit administratif,** 1992-1, pp.80 and sqq. The overall net loss taking account of restitution and tax effects was probably about half the quoted amount.

6 Circular n° NOR/INT/B/92/00260/C (Economie, Finances, Budget et Intérieur).

Another possibility is simply to insure against a rate rise by purchasing a **cap**. Here, a variable rate borrower knows the maximum cost of his loan for the entire term with the benefit of a ceiling on the amount by which the interest rate can be changed over the period. Conversely, fixed rate borrowers can insure against a fall in interest rates by purchasing a **floor**.

In the former case, the bank assumes the risk of interest charges above the ceiling rate. In the latter it guarantees the payment of a sum corresponding to the amount by which market rates have fallen below the fixed rate level.

There is a cost to such operations; they are paid for by a premium set by reference to the guaranteed rate and the contract term, amongst other things. A linked operation of cap and floor is called **collar**: here, the purchaser of a collar buys a cap and sells a floor, the aim being to achieve a break-even deal as the premiums cancel one another out.

II.5. Different indices

There are two types of indices: money market indices, calculated over a 360 day year and bond indices, calculated by reference to the rate of yield of loans or bonds.

Of the former, the best known is without doubt the LIBOR ("London Interbank Offered Rate") which is the loan rate offered on the London market by a sample of the most creditworthy commercial banks, and which has its equivalents on the other European money markets (PIBOR in Paris, RIBOR in Rome).

Of the latter, most prominent in France, for example, are the average yield to maturity index of long-term French government bonds (TME) and the average yield to maturity of fixed-rate bonds for variable rate issues (TMO).

Principal rates on the Paris money market

Money market rates

TMM or T4M: average monthly interbank overnight rate (arithmetical mean of average rates weighted by the volume traded on the market; set ex post ante on the daily information posted to the Bank of France by dealers after market hours).

TAM: annual monetary reference rate (rate of yield of a monthly short-term investment renewed monthly for the past twelve months, with capitalization of the monthly interest).

PIBOR or TIOP: Paris interbank offered rate (arithmetical mean of the rates offered by the eight most representative banks left after eliminating the two highest and two lowest rates).

Bond rates

TME: average yield to maturity index of long-term French government bonds (arithmetical mean of the last twelve monthly average rates of yield on the stock market for long-term French government bonds).

TMO: average yield to maturity of fixed-rate bonds for variable rate issues (arithmetical mean of the last twelve monthly average rates of yield at issue or settlement of government-backed loans).

Note that as a rule, bond rates are higher than money market rates, but are subject to fewer shifts in the price range.

II.6. Long-term borrowing on the financial market (bond issues)

Bond issues are, in fact, the exclusive preserve of those local authorities with a solid financial capability (the *Länder* in Germany, the regions in France). Managing commitments and liabilities through public offerings is an infinitely less flexible method than bank loans, since repayments are made only at final maturity ("bullet issues"). It also entails exposure to rising interest rates which, as happened in 1987, deters borrowers from fresh market operations. The best that might be done is to consolidate issues by smaller authorities together in a "consolidated loan" (as is currently offered in France by Crédit local and Crédit agricole).

II.7. Short-term borrowing

The alternative to these long-term loans is short-term borrowing.

Such financial facilities are essential in those countries where local authorities are obliged to deposit their cash holdings with the Treasury as idle money (**this applies only to France**, where it is the quid pro quo of the benefit to local authorities of government advances against the proceeds of local taxes.

In other countries with a similar deposit obligation, the government pays interest (8.5% in **Italy**, albeit on a very feeble level of local taxation revenue).

In **France**, therefore, with no government interest paid, it is in finance officers' interest to limit their unproductive cash resources through a so-called "zero cash" system in which disbursements and receipts are smoothed out by tying the rate of expenditure to that of revenue collection. Any occasional shortage of funds is then met through short term cash advances or credit lines, within the limits set by the circular of 22 February 1989[7], which has, in the final analysis, proved extremely expensive, as certain French regions have found to their cost.

II.8. Multi-option financing facilities (MOFF)

This facility combines a short term credit line with a refinancing loan. On each drawing, the local authority has an option (between interest rates; between foreign currencies). It is a flexible arrangement affording optimum management of commitments and liabilities in tune with changing market conditions.

---

[7] Circular n° NOR/INT/B/89/00071/C (Economie, Finances, Budget et Intérieur).

II.9. Foreign currency debt instruments

Local authorities may borrow not only in the national currency, but also in foreign currency. This is not possible in the **Netherlands**. Where authorized, as in **France**, such operations remain subject to what are nowadays fairly relaxed exchange controls. Here, too, there is a swap option between two foreign currencies to manage exchange rate movements. This ensures that a fall in value of the national currency does not wipe out the capital equivalent of the anticipated gain from a cheaper foreign currency.

II.10. Loan guarantees

This description of the different forms of local authority indebtedness would be incomplete without some mention of the loan guarantees granted by local authorities to commercial and semi-public companies to promote local economic development. This is a powerful instrument of interventionist policy which, in France in 1991, accounted for some FF 250 thousand millions of outstanding debt for all local authorities together which, if called in, would have meant massive disbursements. It comes as no surprise, therefore, to find that the only remaining truly strict constraint on indebtedness in France relates to this type of loan guarantee.

II.11. Non bank indebtedness

Local authorities may contract loans with non-bank lending institutions.

One way of doing this is through leasing. Here, the **lessor** (a finance company) purchases equipment to be leased out to a **lessee** (here, the local authority) with an option to purchase at the end of the lease period for a residual - often token - value. The costs (annual rental payments) are charged directly as revenue expenditure.

The same also applies with the different methods of **public service outsourcing** (franchising, contracting-out) by which operations can be "debudgeted". Latterly, the old technique of **public works contracts** (**marché d'entreprise de travaux publics - METP**), by which the local authority pays over a lengthy period not only the construction cost of a capital asset, but also the associated operating and subsequent maintenance expenses, has reassumed a real importance in France.

II.12. Conclusion

In recent years, local authorities in many States have had to learn to accept new management rules forced on them by a sweeping trend towards "deregulation" which has led at the same time (except in **Belgium** and **Italy**) to a "disintermediation" by the specialized financial institutions and the "standardization" of financial products. Statutory bodies have even been forced to adapt within the European Union to the requirements of the single internal market, while the dynamism of commercial banks has encouraged a proliferation of techniques capable of embracing every new development in the credit market.

Local politicians are therefore entering a period of major uncertainties, in which the utmost prudence must be counselled in their choices of both capital expenditure programmes and financing plans alike.

III. ANALYSIS OF DEBT RATIOS

It is possible to analyse debt ratios only where statistics are available and centralised for the purpose.

This is not the case in **Malta, Poland, the Czech Republic, Hungary** and - more surprisingly - **Italy**. In **Estonia** the indebtedness is too recent for its consequences to have attracted attention.

In **Belgium** (Flemish Region), a system was introduced in 1994 whereby the Minister for the Interior merely suggests to municipalities when issuing instructions for the annual budget that total debt outstanding (year N) be set against total current revenue (year N - 1) so that, depending on the result obtained, they can determine their financing policy in accordance with the following recommendations:

- **if the ratio is lower than 1**: debt should not be allowed to increase faster than the mean or the anticipated increase in current revenue;

- **if the ratio is higher than 1 but lower than 1.5**: debt should not be allowed to increase faster than mean changes in the retail price index or revenue in the event of the latter increasing at a lower rate than retail prices;

- **if the ratio is higher than 1.5**: debt should not be allowed to increase until the ratio has dropped below 1.5.

The above must be seen in the context of a period spanning approximately five years, which allows, in the latter case, for an annual phase in which liabilities are increased. But these are no more than **recommendations**.

A statement of this ratio has been drawn up and broken down according to population category. For instance, the aggregate for the three largest towns (Antwerp, Ghent and Bruges) was **1.79** in 1991; the corresponding ratio for towns with between 1,000 and 5,000 inhabitants was **1.31**.

III.1. Total debt (capital) per head of population

One therefore refers, if possible, to a central concept: total debt (capital) per head of population, by which comparisons can be made between municipalities of the same size.

This ratio is the simplest to calculate, but its meaning is not invariably clear. For example, a local authority with substantial fiscal revenue is in a position to impose heavy borrowing on its population.

Statistics are either established for the whole country (Finland), or they are broken down by geographical areas (Germany), or by category of local authority (United Kingdom), possibly grouped according to demographic size (Spain, Belgium Walloon Region, France).

Finland: capital debt per head of population
(*in FIMs*)

1986	1987	1988	1989	1990	1991	1992
2,408	2,789	3,167	3,365	3,734	4,560	5,618

Germany: total debt (capital)
per head of population (excluding the city-States)
(*in DEMs*)

	1980	1986	1992*
Baden Wurttemberg	1,199	1,477	1,513
Bavaria	1,147	1,233	1,524
Brandenburg	-	-	732
Hesse	1,800	2,389	2,909
Mecklenburg-Western Pomerania	-	-	770
Lower Saxony	1,701	2,052	2,284
North-Rhine Westphalia	1,806	2,258	2,627
Rhineland-Palatinate	1,689	2,060	1,880
Saarland	1,747	2,369	2,338
Saxony	-	-	863
Saxony-Anhalt	-	-	911
Sleswig-Holstein	778	927	1,250
Thuringia	-	-	933

* *Including the new Länder (former GDR)*

United Kingdom: capital debt per head of population in 1993
(*in GBP*)

Counties	158
Metropolitan district councils	1083
Non-metropolitan district councils	318

Spain: capital debt per head of population
(*in ESPs*)

Size of municipality	**1987**	**1988**
Fewer than 10,000 inhabitants	4,348	5,777
From 10,001 to 20,000 inhabitants	10,400	12,210
From 20,001 to 50,000 inhabitants	14,661	16,298
From 50,001 to 100,000 inhabitants	15,587	17,830
From 100,001 to 500,000 inhabitants	18,870	21,311
From 500,001 to 1,000,000 inhabitants	21,362	28,250
More than 1,000,000 inhabitants	36,531	41,475
National average	**15,349**	**18,305**

Belgium (Walloon Region): capital debt per head of population in 1992, considering the size of municipality
(*in BEFs*)

From 0 to 5.000 inhabitants	From 5.000 to 10.000 inhabitants	From 10.000 to 30.000 inhabitants	More than 30.000 inhabitants
28.445	19.137	20.032	60.437

France: Main characteristics of local authority indebtedness in 1991 (Metropolitan France only)

	Municipalities with fewer than 10.000 inhabitants	**Other munici-palities**	**"Départe-ments" (excluding Paris)**	**Regions**
Debt ratio (annual payments as a percentage of real current revenue)	21,2	21,4	12,5	12,2
Capital debt per head of population (in francs)	4.020,0	6.282,0	1.853,0	373,5

This ratio of debt per head of population is also used in **Sweden, Switzerland**, **Greece** and **Cyprus**.

III.2. Other criteria

A wide variety of ratios is used.

The **debt ratio** is the ratio of annual repayments to real current revenue. But it is of little real use as it can be manipulated using sophisticated refinancing techniques which effectively extend the life of loans and reduce their cost.

Another ratio is total debt as a percentage of gross own resources. Expressed over a number of years, this ratio indicates repayment ability - it can be used to calculate how long it will take a local authority to settle all its debts while maintaining its own resources at the same level, assuming that no new commitments are incurred.

It is also possible to measure recourse to borrowing necessitated by changes in other revenue during the year, or **loan realisations as a percentage of budget forecasts**.

However, in this area each state has regulations and practices which are conditioned by its own financial management traditions. Accordingly an extremely broad range of different instruments is used.

Spain uses the following ratios, details of which are given in the table below:

Spain: local authority debt ratios
(expressed as a percentage)

	1987	1988	1989
Financial burden of debt as a percentage of current revenue			
		11,3	**11,4**
Municipalities	**11,3**		
		6,6	7,7
Fewer than 10.000 inhabitants	8,5	9,4	9,5
From 10.001 to 20.000 inhabitants	10,0	11,1	10,2
From 20.001 to 50.000 inhabitants	11,2	11,4	11,2
From 50.001 to 100.000 inhabitants	11,4	12,5	12,3
From 100.001 to 500.000 inhabitants	13,9	15,5	15,0
From 500.001 to 1.000.000 inhabitants	13,4	14,0	14,3
More than 1.000.000 inhabitants	13,4		
		16,3	16,9
General councils (ordinary status)	14,3		
General councils (special status - "*forales*")			
		2,2	3,0
- total revenue	1,3	6,9	8,7
- less transferred quotas	4,4		
		8,5	8,1
Town councils on islands	7,6		
Interests and commissions as a percentage of debts			
Municipalities			
Fewer than 10.000 inhabitants	NA ([1])	14,4	15,3
From 10.001 to 20.000 inhabitants	NA	13,3	14,1
From 20.001 to 50.000 inhabitants	NA	14,2	13,8
From 50.001 to 100.000 inhabitants	NA	13,3	13,8
From 100.001 to 500.000 inhabitants	NA	13,4	13,4
From 500.001 to 1.000.000 inhabitants	NA	14,3	14,7
More than 1.000.000 inhabitants	NA	12,1	12,6
Others (general councils, town councils on islands)	NA	NA	12,3

([1]) NA: not available

Other ratios are also used:

- total debt as a percentage of current revenue;
- debt interest as a percentage of current revenue;
- public bank debt as a percentage of total debt.

Switzerland disposes of a wide variety of ratios:

- the first group consists of traditional ratios: the interest burden as a percentage of fiscal revenue or current expenditure; self-financing capacity and the actual rate of self-financing;
- the second group consists of more specific ratios: percentage of net assets for instance.

Considerable importance must be attached to the absolute coefficient of debt-servicing which should not exceed 1:

$$\frac{\text{Variation in interest in francs}}{\text{Weighted variation in fiscal revenue in francs}}$$

Luxembourg attaches particular importance to the ratio of annual repayments to current revenue. This state justifies its preference by pointing out that local authorities are not equally able to provide public services such as gas and electricity, because there is an obvious correlation between current revenue and the proceeds from these services.

Finland uses the following ratios, details of which are given in the table:

Finland: local annual debt ratios

	1986	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**
I	369	404	448	471	569	685	730
II	0,056	0,056	0,056	0,053	0,059	0,073	0,078
III	0,03	0,03	0,03	0,03	0,03	0,03	0,04
IV	0,27	0,30	0,30	0,27	0,31	0,46	0,58

(I) per capita debt-servicing in FIMs;
(II) debt-servicing as a percentage of fiscal revenue;
(III) debt-servicing as a percentage of current expenditure;
(IV) share of capital expenditure financed by borrowing.

Sweden uses the ratio of liabilities to assets (net balance).

Sweden: net balance of local authorities
(*in SEKs*)

	1980	**1986**	**1992**
Municipalities:			
- Assets	14.833	23.043	32.406
- Liabilities (short and long-term)	6.028	8.823	12.323
- Net balance	8.805	14.220	20.083
Counties:			
- Assets	4.402	7.877	9.120
- Liabilities (short and long-term)	1.103	1.931	2.777
- Net balance	3.299	5.946	6.343

It also uses two other ratios:

- the ratio of assets to short-term liabilities (including cash), which has been used since 1990 and which amounts to just over **1** in the case of municipalities and just under **1** in the case of counties;

- net financial costs (costs less income) as a percentage of fiscal revenue).

This makes it possible to calculate the proportion of fiscal revenue absorbed by net interest: this was 3% in 1992 for municipalities.

Portugal measures indebtedness by the ratio of annual repayments to allocations from the financial equalisation fund or capital expenditure.

This state uses a wide range of indicators, which are also broken down according to local authority size.

Portugal: local debt statistics

Number of local authorities	Size of local authorities	Years	Repayment per head of population (*)	Borrowings/ Capital expenditure (%)	Interest/ Current expenditure (%)	Short-term debt (banks + third parties) per head of population (*)	Medium and long-term debt (banks) per head of population (*)	Total debt per head of population (*)	Interest + principal as a percentage of total revenue (%)	Loans as a percentage of total revenue (%)
1	from 0 to 1.000 inhabitants	1989 1992	0,0 0,0	0,0 4,0	0,0 0,0	0,1	11,8	11,9	0,0 0,0	0,0 2,1
25	from 1.001 to 5.000 inhabitants	1989 1992	3,5 3,0	7,6 12,1	6,4 5,6	11,7	19,4	31,1	8,4 5,4	3,8 5,8
76	from 5.001 to 10.000 inhabitants	1989 1992	2,0 2,3	16,1 10,9	5,4 7,8	8,2	19,3	27,5	6,8 6,5	8,0 5,2
157	from 10.001 to 50.000 inhabitants	1989 1992	0,5 1,5	10,4 14,0	4,3 7,2	7,6	14,3	21,9	3,8 6,4	5,0 5,9
23	from 50.001 to 100.000 inhabitants	1989 1992	0,5 1,0	17,4 14,6	4,1 5,7	5,0	7,8	12,8	4,3 5,2	7,1 5,4
23	More than 100.000 inhabitants	1989 1992	0,3 0,9	14,9 17,0	3,3 4,2	2,8	8,2	11,0	3,0 3,9	5,2 5,6
305	NATIONAL TOTAL	1989 1992	0,5 1,2	13,1 14,7	4,0 5,8	5,2	11,1	16,3	3,9 5,2	5,6 5,7

* = x1000 Escudos

Cyprus uses the following ratios:

- interest burden per head of population;
- interest as a percentage of current expenditure;
- percentage of capital expenditure financed by borrowings.

The **Netherlands** uses the net floating debt (loans at less than two years, less cash), expressed as a percentage of fixed capital in order to set the cash limit.

Bulgaria has not yet developed techniques for assessing local authority debt. However, it can be calculated by setting commitments against tax revenue.

In the **United Kingdom,** total debt is used as an indicator.

Greece uses the percentage of capital expenditure financed by borrowings.

Norway calculates long-term debt as a proportion of total annual income and debt-servicing, also as a proportion of total annual income. The statistics enable a detailed breakdown by population category to be drawn up.

Norway: ratios expressed as a percentage of annual revenue

Municipalities by population groups (number of inhabitants)	**Long-term debt**	**Debt servicing**
0 - 1.000	58,90	3,34
1.000 - 5.000	59,07	4,07
5.000 - 10.000	63,49	3,91
10.000 - 50.000	60,36	3,47
50.000 - 100.000	73,01	3,15
More than 100.000	66,56	3,71

In **Denmark**, the following ratios are used:

- long term debt/taxable base;
- liquidity/working and construction expenses.

As in Norway, these ratios are calculated for each population group.

Denmark: debt ratios used

(*in DKs or expressed as a percentage*)

Municipalities (by population group)	Year	Population	Tax base (1)	Long term debt (2)	RATIO (2)/(1)	Public works expenses (3)	Liquidity (4)	RATIO (4)/(3)
< 1000	1980	-	-	-	-	-	-	-
< 1000	1986	-	-	-	-	-	-	-
< 1000	1992	-	-	-	-	-	-	-
1001 - 5000	1980	71587	2008345	- 234180	11.66	1309039	202500	15.47
1001 - 5000	1986	84747	4111552	- 254992	6.20	2171463	294487	11.02
1001 - 5000	1992	72457	4451208	- 181723	4.08	3755196	306135	8.15
5001 - 10.000	1980	900062	26123349	- 2825329	10.05	15619212	1870804	11.98
5001 - 10.000	1986	897018	45481322	- 1913687	4.21	24695122	2544442	10.30
5001 - 10.000	1992	903661	60147340	- 2463750	4.08	45050420	2539806	5.84
10.001 - 50.000	1980	2398288	84570953	- 11133096	13.18	45891591	4085462	8.86
10.001 - 50.000	1986	2347882	141359035	- 9261227	6.55	70545007	6744704	8.14
10.001 - 50.000	1992	2431783	194618185	- 11100638	5.85	140791635	5668172	4.03
50.001 - 100.000	1980	687859	29538213	- 2973498	10.07	15998268	1023581	6.40
50.001 - 100.000	1986	732200	51070932	- 3330455	8.52	28740294	1462885	5.47
50.001 - 100.000	1992	685567	61272826	- 5212387	8.61	50081459	931958	1.88
> 100.000	1980	1066185	39909315	- 6938934	17.30	32008501	972423	3.04
> 100.000	1986	1054308	62971536	- 10443387	16.58	49211109	912737	1.65
> 100.000	1992	1068540	85073287	- 15236831	17.91	102751957	- 1077288	- 1.08

In **Belgium** (Walloon Region), the following ratios are used:

- an annual debt-servicing ratio according to population (1) and non-financial current revenue for the year (2);
- the proportion of annual capital expenditure financed by borrowing (3);
- annual interest payments as a percentage of total current expenditure (4).

Belgium (Walloon Region): ratios (1992)
(*in BEF or %*)

	0 to 5.000 inhabitants	**5.000 to 10.000 inhabitants**	**10.000 to 30.000 inhabitants**	**More than 30.000 inhabitants**
(1)	2.833	1.908	1.981	5.814
(2)	20,63%	16,57%	16,69%	16,95%
(3)	48,63 %	52,55%	55,63%	54,34%
(4)	13,93%	10,38%	10,16%	14,72%

Also in the Walloon Region, the Government has commissioned a study with a view to identifying a whole series of ratios.

The results of this study are summarised in the following table:

Walloon Region: ratios identified by a study commissioned by the Government

	RATIOS SHOWING THE GENERAL SITUATION
R1	Financial dimension
R2	Level of debt-servicing
R3	Debt burden
R4	Capital expenditure
R5	Fiscal revenue
R6	Overall fiscal burden
R7	Overall leeway
	BREAKDOWN OF CURRENT REVENUE
R8	Surcharges as a proportion of withholding tax on income from real estate
R9	Surcharges as a proportion of income tax
R10	The four main local taxes as a proportion of current revenue
R11	Funds as a proportion of current revenue
R12	Education subsidies as a proportion of current revenue
R13	Other resources as a proportion of current revenue
	BREAKDOWN OF CURRENT EXPENDITURE
R14	Personnel costs as a proportion of non-financial current expenditure
R15	Educational expenditure as a proportion of current expenditure
R16	Cover rate of expenditure on primary and secondary schools
R17	Security expenditure as a proportion of current expenditure
R18	Highways/sewage treatment expenditure as a proportion of current expenditure
R19	Expenditure on adult education as a proportion of current expenditure
R20	Welfare expenditure as a proportion of current expenditure
	INVESTMENTS CARRIED OUT
R21	Overall investment rate
R22	Proportion of investment in education
R23	Proportion of investment in security
R24	Proportion of investment in highways/sewage treatment
R25	Proportion of investment in adult education
R26	External financing rate
	SAVINGS AND DEBT RECORDED DURING THE FINANCIAL YEAR
R27	Current savings ratio
R27bis	Available savings ratio
R28	Debt costs
R29	Fiscal weight of debt-servicing
R30	Volumetric debt index
R31	Fiscal debt index
R32	Repayment ability
R33	Average debt burden
	CONTROL, LEEWAY AND DEVELOPMENT
R34	Theoretical budget per staff member
R35	Staffing ratio
R36	Capital expenditure realisation rate
R37	Performance of corporations
R38	Financial year's contribution to cumulated surplus
R39	Current activities as a proportion of cumulated surplus
R40	Tax collection ratio
R41	Ratio of uncollected tax

In the Brussels-Capital Region, no pre-defined ratios are used. Debt is normally expressed in relation to inhabitant or as a percentage of the total debts.

Belgium (Brussels Region): examples of debt ratio

1. Amount of debt per inhabitant

(*in Belgian francs*)

Accounts (A) from 1989 to 1992 and Budgets (B) from 1993 and 1994

	A 1989	A 1990	A 1991	A 1992	B 1993	B 1994
ANDERLECHT	3.168	3.096	1.812	2.582	5.742	1.803
AUDERGHEM	2.523	2.406	2.307	2.444	3.083	4.401
BERCHEM-Ste-AG.	4.233	4.297	3.247	3.292	3.684	3.684
BRUXELLES-VILLE	12.139	13.177	15.422	14.800	17.063	16.312
ETTERBEEK	7.477	7.251	5.859	8.941	24.015	6.612
EVERE	5.393	5.324	4.152	5.017	12.727	4.788
FOREST	10.153	6.657	4.773	6.018	17.098	3.644
GANSHOREN	3.888	3.873	2.632	7.773	6.346	2.834
IXELLES	3.505	3.430	2.219	2.965	7.016	2.180
JETTE	3.392	3.459	2.097	6.026	9.435	2.340
KOEKELBERG	4.486	4.346	2.066	5.805	2.307	1.991
MOLENBEEK	3.916	4.082	2.980	3.957	4.377	3.721
SAINT-GILLES	5.637	5.482	3.585	10.361	6.639	4.476
SAINT-JOSSE	15.717	14.980	10.198	19.086	17.720	10.157
SCHAERBEEK	4.583	4.212	2.960	4.106	11.107	2.832
UCCLE	2.533	2.433	1.888	2.328	6.765	2.576
WATERMAEL	8.458	7.360	6.273	6.357	8.148	5.330
WOLUWE-St-L.	4.355	4.630	4.218	5.352	5.024	5.653
WOLUWE-St-P.	7.138	6.279	4.980	6.312	10.328	6.659
BRUSSELS REGION	**6.003**	**5.850**	**5.083**	**6.503**	**10.016**	**5.527**

2. Amount of debt as a percentage of the total debt, excluding subsidised teaching staff

Accounts (A) from 1989 to 1992 and Budgets (B) from 1993 and 1994

	A 1989	A 1990	A 1991	A 1992	B 1993	B 1994
ANDERLECHT	14,2%	13,4%	7,3%	9,5%	16,1%	6,1%
AUDERGHEM	11,9%	10,9%	9,7%	9,7%	10,9%	14,7%
BERCHEM-Ste-AG.	21,9%	21,5%	15,3%	14,9%	13,1%	13,4%
BRUXELLES-VILLE	17,0%	17,5%	19,6%	18,4%	19,3%	17,9%
ETTERBEEK	22,4%	19,7%	14,3%	20,6%	38,3%	15,2%
EVERE	22,6%	21,3%	16,0%	17,5%	31,4%	13,8%
FOREST	31,9%	23,2%	15,8%	18,6%	37,2%	11,3%
GANSHOREN	19,9%	18,4%	12,1%	28,1%	21,9%	10,7%
IXELLES	11,4%	10,4%	6,3%	7,9%	13,1%	5,2%
JETTE	14,1%	13,9%	8,0%	19,4%	26,8%	7,7%
KOEKELBERG	19,7%	18,9%	9,1%	21,4%	6,2%	6,5%
MOLENBEEK	19,5%	18,9%	12,9%	15,2%	14,8%	12,1%
SAINT-GILLES	17,7%	16,3%	10,3%	23,3%	11,4%	10,5%
SAINT-JOSSE	33,3%	30,0%	21,6%	32,1%	18,6%	16,2%
SCHAERBEEK	19,9%	17,7%	12,2%	17,1%	29,5%	8,8%
UCCLE	12,5%	11,4%	8,2%	9,3%	21,5%	8,6%
WATERMAEL	28,0%	24,4%	19,8%	18,7%	20,0%	14,6%
WOLUWE-St-L.	19,3%	19,0%	16,2%	18,5%	13,8%	16,6%
WOLUWE-St-P.	27,2%	23,8%	19,1%	21,4%	26%	19,8%
BRUSSELS REGION	**18,8%**	**17,5%**	**14,5%**	**17,2%**	**20,9%**	**13,0%**

In **Estonia**, lending is a recent phenomenon and still at a very low level (borrowings were equivalent to just 0.24% of revenue in 1993), and no ratios for local authority indebtedness exist as yet. The same is true in **Slovakia**, where borrowings were equivalent to less than 5% of revenue (2.50% in 1991, 2.66% in 1992 and 3.67% in 1993).

III.3. Conclusion

The most practical debt ratio is also the least convincing: the ratio of total debt to population is a clear statistic which makes it possible to compare trends over time and in different geographical areas, but it cannot be used in isolation to provide an accurate assessment of the situation. It is necessary, but not sufficient in itself.

Other ratios are therefore indispensable. But the need to make further progress in harmonisation remains, given the enormous differences in accounting techniques between states.

IV. OBLIGATION OF LOCAL AUTHORITIES TO MAKE THEIR DEBTS PUBLIC

The obligation of local authorities to make their debts public - where it exists - varies in form from one country to another.

Generally speaking, large countries with a high level of economic development have the most stringent arrangements and, conversely, smaller and poorer countries have looser arrangements.

IV.1 Maximum publication arrangements

In **France** measures have been introduced recently to ensure that local authorities make details of their debt public. They were derived from sections 13 to 16 of the outline act of 6 February 1992 on local self-government and the relevant implementing decree, dated 27 March 1993.

The provisions of section 13 apply to municipalities with a population of not less than 3,500.

Section 15 of the act extends these provisions to public administrative bodies in municipalities with a population of not less than 3,500, to intermunicipal cooperation bodies comprising at least one municipality with a population of not less than 3,500 and to mixed associations composed exclusively of legal entities such as municipalities, associations and districts which comprise at least one municipality with a population of not less than 3,500.

Finally, section 16 of the act extends these provisions to *départements*, regions, interregional cooperation bodies and mixed associations comprising at least one *département* or region.

In all these local authorities, budget documents must be enclosed with a number of categories of document providing **"summary data"**.

The decree of 27 March 1993 lists the ratios which must be made public. Obligations vary according to the type of local authority concerned and its population.

For example, municipalities with populations of between 3,500 and 9,999 must produce the ratio of debt per head of population (expressed in FRF).

Municipalities with populations of not less than 10,000, "départements" and regions, which are also bound by this obligation, must also produce two other ratios: real current expenditure plus annual capital debt-servicing against real current revenue, and total debt against real current revenue.

Public intermunicipal cooperation bodies which are taxable in their own right and mixed associations including at least one municipality with a population of not less than 10,000 must produce the ratio of debt per head of population. In cases where the total population of the member authorities is equal to or more than 10,000, these bodies must also produce the other two ratios mentioned above.

When these bodies are not taxable in their own right, they must publish two specific structural ratios: borrowings as a proportion of gross capital expenditure and total debt per head of population.

Other appendices concern local authorities' associated bodies.

Details of external commitments are provided in two documents. The first is a certified true copy of the balance sheet of bodies in which the municipality has a stake, for which it has acted as underwriter or to which it has paid subsidies in excess of FRF 500,000 or 50% of the organisation's budget. The second is a table showing total outstanding loans underwritten by the municipality and accompanied by their repayment schedule.

In the **United Kingdom**, local authorities must publish a **statement of account** at the end of each year including details of outstanding debt. Authorities are also obliged to provide the Government with information on their borrowing activities each quarter. There is no specific requirement concerning guarantees.

In **Ireland**, local authorities must include a statement of their debts in their annual abstract of accounts which is publicly available.

In **Germany**, local authorities attach a statement of outstanding debts to their budget. In compliance with the act on public finance statistics of 21 December 1992, local authorities provide their *Land* with details of annual borrowings, repayments of principal and guarantees given. The *Land* authorities then draw up a report, which is made public.

In **Luxembourg**, the budget and accounts include information on direct and indirect debts (guarantees).

In **Switzerland**, a statement of each municipality's debts is published annually; in most cantons it is included in the yearbook. Details of loans taken out by the largest local authorities are included with federal statistics.

In **Sweden** and the **Netherlands** local authorities must publish statements of account.

In the **Netherlands**, the Local Government Finance Information Decree requires local authorities to submit the following information:

- prior to 15 January, a report on loans contracted, reserves and provisions;

- prior to the 15th of each month, a report on the liquidity position;

- prior to 15 January, 15 April, 15 July and 15 October, a report on variations in commitments.

In **Spain**, an economic and financial report which is attached to the budget gives a breakdown of forthcoming loan transactions and details of the financial burden.

A **statement of account** contains details of loan conditions (subscription, amortization, payment, settlement, conversion, exchange).

In **Italy**, act no. 67 of 25 February 1987 requires local authorities with a population of more than 20,000 to publish their budgets in the local and national press and to display them in a business establishment no more than three months after they have been adopted. Outstanding debts can be deduced from this information.

There is no specific requirement concerning guarantees.

In the Walloon Region and the Flemish Region of **Belgium** local authorities are obliged to publish their budgets, which contain details of direct and indirect debts outstanding.

IV.2. Minimum publication requirements

In **Turkey** and **Portugal** local authorities are under no obligation to publish their budgets; instead, they must submit statements to the authorities responsible for approving their accounts.

Local authorities in **Poland** are not obliged to publish details of either their direct debts or loan guarantees issued by them.

In **Lithuania**, local authorities prepare financial statements which provide details of debts outstanding.

In **Norway** and **Denmark** the annual accounts provide details of direct debts and guarantees. There is no obligation to publish these accounts in the press.

This is not the case in **Cyprus**, where the annual financial report is published in the Government Gazette.

In **Estonia**, municipalities decide whether to publish their various budgets.

In **Bulgaria**, local authorities are not under any obligation to make their debt situation public; municipalities are free to determine policy in this area.

The following countries do not oblige their local authorities to make their debt situation public: **Finland, Greece, the Czech Republic, Hungary, Romania and Slovenia**.

But in some cases local authorities provide the central administration (Ministry of the Interior in Denmark, Ministry of Finance in Slovenia) with statements of account.

IV.3. Conclusion

The obligation incumbent on local authorities to release details of their debts is in accordance with normal requirements of democratic scrutiny.

But this formal requirement serves a purpose only if the budget data submitted are both exhaustive and accurate. This requirement is even more vital in respect of indirect commitments (in the form of guarantees for instance) but also, in this specific case, all the more difficult to enforce.

V. BORROWING REGULATIONS

In all countries local authority borrowing is covered by a variety of procedures.

Regulations have not been drawn up just for direct commitments, but also set out the conditions in which guarantees can be given to enable private companies to raise funds more easily and cheaply.

V.1. Regulations governing local authorities' direct commitments

Various techniques are used to control local authorities' direct borrowing:

- loans are often conditional on the central administration and other higher-ranking authorities giving their prior approval;
- in certain countries only some of these loans are subject to this procedure (loans in foreign currency);
- regulations may vary according to the life of the loan (short, medium, long-term);
- in most cases the loan is earmarked for the purpose of financing capital expenditure;
- a total borrowing ceiling may be imposed; this generally corresponds to a maximum percentage of revenue or expenditure.

These subjects have already been examined in a report prepared by the Steering Committee on Local and Regional Authorities (CDLR)[8]. This report therefore merely provides additional information for each state.

Since the introduction in **France** of the act of 2 March 1982, there has been no prior authorization procedure except, depending on the amount of the issue, on bond markets, and except for borrowings in Euro-francs. In both cases ordinary law regulations apply to all domestic operators.

No loan ceiling exists, although there is a requirement that loans be used solely to finance capital investment.

---

[8] Council of Europe, *Borrowing by Local and Regional Authorities*, in Local and Regional Authorities in Europe, n° 47, table p.10.

However, short-term facilities are available. These are authorised by the circular "Intérieur-Finances" dated 22 February 1989 (credit facilities and short-term advances).

In **Switzerland**, local authorities can take out loans for any duration. But the canton's competent bodies may set conditions and negotiate if projects are deemed to be oversized. The **Centrale d'émission des communes suisses** (central issuing body for Swiss municipalities) deals on the Swiss capital market reallocating proceeds in the most advantageous conditions.

Sweden does not have specific regulations for local authority borrowing, except that municipalities are not allowed to mortgage their property. Accordingly, no lending ceiling applies.

In **Portugal**, local authorities can take out short, medium and long-term loans within certain limits:

- total short-term loans cannot exceed 10% of payments from the Financial Equalisation Fund;

- annual debt-servicing on medium and long-term loans cannot exceed the highest of the following two limits: 25% of payments from the Financial Equalisation Fund or 20% of total capital expenditure incurred in the previous year.

The largest loans must be submitted to the revenue court for approval. However, loan ceilings exist only for loans taken out with banks.

In **Estonia**, local authority borrowing is used to finance capital or current expenditure, although only short-term loans are allowed for the latter category. Debt servicing in principal and interest may not exceed 20% of current revenue; this limit does not apply in the case of loans guaranteed by the state. Municipalities with cash-flow problems can apply for bridging loans from the state budget, although this situation has not yet arisen in practice.

In the **Netherlands**, lending conditions are governed by specific rules enshrined in the Municipality Act (section 203), the Province Act (section 207) and in the Local Government Loan Conditions Decree (based on section 6 of the Local Government Finance Act). Local authorities can take out short, medium or long-term loans without restriction, except in cases where the Ministry of Finance is concerned about their financial situation and decides to make their borrowing subject to ceilings and time limits. Local authorities obtain permission to borrow from the supervisor, namely the representative of the Ministry of the Interior in the case of the provinces, the representative of the provinces in the case of municipalities and the Minister for Transport and Public Works in the case of the water boards. Loans must be used exclusively to finance capital expenditure.

However, there is a sharp difference between short-term loans on the one hand, and medium and long-term loans on the other. Normally (in the usual case of a balanced current account) only short-term borrowing is restricted, because such loans must not exceed the "cash limit" or "liquidity ratio", expressed as a percentage of the fixed debt including long-term debts, guarantee sums, reserves and provisions. This ratio is set by the government and varies according to the category of borrower (7.6% for provinces, 4.8% for municipalities and 8.7% for water boards).

This ratio aims at preventing local authorities from pushing up inflation, curbing mismanagement with local authorities by keeping the amount of short-term loans from rising to a problematic level. Local authorities should avoid this situation by consolidating short-term loans in long-term loans, which happens especially under favourable interest-rates.

Concerning long-term loans, the principal is not subject to indexation and the Minister of Finance may, if necessary, down other obligatory conditions, namely:

- early repayment of long-term loans must be possible after a maximum period of ten years. If the loan agreement allows the creditor and debtor to set a new interest rate during the life of the loan, early repayment may be postponed up to ten years after the interest rate adjustment;

- the interest rate on a loan may not be adjusted more than once every ten years.

The fact that municipalities are obliged to submit a balanced budget effectively limits increases in debt-servicing.

In **Hungary**, Act LXV on Local Self-Government (of 1990) provides for borrowing by local authorities, for investment purposes, at market rates. They may also take up loans at preferential rates from a specialist body known as the **National Savings Bank and Trade Bank**. Local authorities may not use state subsidies or sell off local authority property to cover these debts.

In **Greece**, local authorities can take out loans from the state or public bodies (section 220 of the Municipal and Communal Code). The main lending agent is the Deposits and Loans Fund. The Ministry of the Interior may also grant interest-free loans to towns with up to 20,000 inhabitants and communities in general.

The Board of Directors of the fund establishes credit conditions.

In the **United Kingdom**, local authorities can borrow for any purpose relevant to their functions, normally to finance capital expenditure but also, exceptionally, to cover temporary cash-flow imbalances.

Borrowing is subject to a ceiling set by the Government based on a formula comprising various elements, including short-term borrowing. This ceiling, known as the Aggregate Credit Limit, or ACL, reflects the credit approvals relating to capital expenditure which the Government issues to local authorities.

Authorities are free to negotiate terms and rates themselves. They may also borrow from the Public Works Loan Board (PWLB) at lower rates than they could obtain on the market.

Under the Municipalities and County Authorities Act of 25 September 1992, local authorities in **Norway** are free to raise loans for specific purposes (to finance investments and accounting deficits). They may also take up loans from Den Norske Stats Husbank (the Norwegian National Housing Bank) to finance housing purchases.

The life of loans is between five and forty years. Loans may not be taken out in foreign currency.

In the **Czech Republic**, local authorities may take out short, medium or long-term loans in accordance with general banking regulations.

In **Turkey**, municipalities and provinces can take out short-term loans (generally to cover current expenditure) and medium or long-term loans (for capital expenditure). Lending conditions are determined by a specialist institution, Iller Bankasi, whose capital is made up of a percentage of local authority revenues.

In **Bulgaria**, municipalities can borrow either from banks or from the state.

Pursuant to the Local Government and Local Administration Act of 1991, loans must be used to finance capital expenditure.

Pending the introduction of new legislation, the importance of state loans is decreasing. Special loans are available for housing construction.

Borrowing by local authorities is not subject to approval.

In **Denmark**, local authorities are allowed to borrow on a short, medium and long-term basis to finance investment in local public services (water supplies, electricity, district heating, etc.). Other loans must be approved by the Ministry of the Interior. Certain limits exist on maximum life of loans, namely 30 years for domestic and international annuity and serial loans and 20 years on bullet loans.

In **Lithuania**, local authorities with cash-flow problems can borrow on a short-term basis. Long-term borrowing is authorised on an exceptional basis, but no ceiling applies.

In **Germany** lending conditions for municipalities are set by the *Länder*. Their transactions must be within the framework of the budget. Borrowing is authorised on condition that:

- no other economically viable source of financing is available;
- loans are used to fund capital expenditure;
- loans taken out comply with debt-servicing ceilings (expressed as a percentage of revenue).

Permission must also be obtained from the authorities responsible, at *Land* level, for supervising local authority accounts. Local authorities may also be granted permission, on a temporary basis and purely for cash-flow purposes, to use overdraft facilities (*Kassenkredite*).

In **Romania**, local authorities can borrow to finance expenditure incurred in the course of their duties, in accordance with ordinary law.

In **Luxembourg**, local authorities must obtain permission from the Ministry of the Interior for any foreign borrowing (credit facilities, loans). Local authorities can use overdraft facilities in the event of cash-flow problems. All other loans (short, medium and long-term) are used to finance capital expenditure.

In **Ireland** it is the central government, namely the Ministry of the Environment, that authorises the amount, life and conditions of any loan which is granted at the lowest interest rates. The authorities may consider a number of elements concerning the loan, such as object, public utility, rentability and local authority's repayment ability.

Local authorities in **Poland** can take out loans on condition that the net cost of borrowing does not exceed 15% of their revenue. A specific rule applies to bond issues, which may not exceed 20% of expenditure.

Short-term loans, which must be repaid during the year they are taken up, are used to balance the budget.

In **Malta**, under the Local Councils Act (Act XV of 1993) local councils are prohibited from borrowing unless the Ministry of Finance and the Ministry of Local Government give their written permission.

In **Italy**, local authorities are prohibited from taking out long-term loans if the cost of debt-servicing exceeds one quarter of their resources.

Assuming that the debt-servicing criteria are met, local authorities must draw up financing plans and show how the loan is to be used. The minimum repayment period is ten years.

Short-term loans may not exceed one quarter of revenue.

In **Spain**, regulations are based on act no. 39/1988 of 28 December 1988.

As a rule, local authorities wishing to engage in borrowing must apply for permission either to the Ministry of the Economy and Finance or to the autonomous region, assuming that the latter is competent to decide in respect of these matters for local authorities within its boundaries. Local authorities do not need this permission if the following three conditions are met:

- annual interest plus commissions resulting from commitments contracted perviously and the prospective loan must be equivalent to no more than one-quarter of the local authority's current revenue;

- the amount of the prospective loan may not exceed 5% of the local authority's current revenue;

- the loan must be used to finance work and services included in the province's projects and in local economic cooperation programmes.

Short-term loans taken out purely for cash-flow purposes may not exceed 35% of current revenue.

In **Slovenia** a distinction is drawn between:

- short-term loans, used to finance expenditure of all types - current and capital, and

- long-term loans: used solely to finance capital expenditure (water supplies, local roads, energy supplies).

Two restrictions have been in force since the beginning of 1993:

- the amount borrowed may not exceed 10% of the budget;

- annual debt-servicing may not exceed 5% of the budget.

Cyprus also makes a distinction between:

- short-term loans (at less than one year) used to finance current expenditure. These loans must be repaid by the end of the financial year and the debt burden may not exceed one-fifth of revenue;

- long-term loans used to finance capital expenditure. These loans are subject to the approval of the Council of Ministers, given on the advice of the **Loan Commissioner**.

The Council of Ministers may also authorise municipalities to mortgage municipal real estate as surety.

Interest rates are set at 5-6% for loans obtained through the Loan Commissioner and at 3% for loans obtained from the private sector (short-term loans).

No maximum loan ceiling applies. However, details of borrowings are given in the budget, which is submitted to the Council of Ministers for approval before entering into force.

Local authorities in **Finland** are free to take out short, medium or long-term loans in local and foreign currency. No ceilings apply.

In **Belgium** (Walloon Region), there is provision for local authorities to engage in borrowing, on condition that funds are used to finance capital expenditure, in sections 10 and 48 to 53 of the Royal Decree dated 10 February 1945, which were incorporated into sections 25 to 30 of the Royal Decree dated 2 August 1990. No other regulations exist, but decisions taken by town councils in this area are subject to scrutiny (the authorities may revoke decisions which are against the law or deemed harmful to the public interest. It is merely recommended that local authorities conduct their finances prudently to ensure "proper" management. In practice, local authorities deal mainly with Crédit communal de Belgique, which may grant them short-term advances on the basis of receivables from previous financial years or the current financial year.

In the Flemish region, municipalities can take out a large number of loans, which are used, with a few exceptions (short-term facilities) to finance capital expenditure. Each year the Flemish Minister for Domestic Affairs publishes, for guidance purposes, interest rates broken down according to the life of loans.

In the Brussels-Capital region, the nineteen communes can draw loans to finance all types of expenses. However the revenues of the borrowing are normally reserved to finance capital investment. Specific rules do not exist. The region performs an administrative control, aiming namely to verify the respect of the balance budget principle.

V.2. Regulations on sureties

Loan sureties are a major source of potential outlay. The consequences of local authorities acquiring stakes in private companies represent an aspect no serious study of the regulations governing these guarantees can afford to ignore.

Before 1988 in **France**, local authorities could guarantee loans taken out by private companies on the sole condition that they did not exceed a ceiling determined in terms of real current revenue (40% for regions, 60% for "département" and 70% for municipalities).

Since the entry into force of the act of 5 January 1988 (sections 10-I, 11-I and 12-I), loan guarantees given by local authorities of all types must comply with three different ratios:

- the first is designed to cap the annuities guaranteed; the sum total of annuities guaranteed, plus annuities on the local authority's own debts, may not exceed 50% of real current revenue;

- the second is designed to spread the risk: the sum total of annuities guaranteed for a given legal entity may not exceed 10% of the sum total of annuities guaranteed;

- the third is designed to limit the portion of a given loan that is guaranteed. The limit is set at 50% and increased to 80% for loans to finance certain development schemes.

In addition, by virtue of the **act of 22 June 1994** municipalities with a population of more than 3,500 are obliged to set aside an accounting provision based on loan annuities for which guarantees have been given, the conditions of which are fixed by decree. However, this obligation does not apply if the municipality covers itself against the risk associated with the guarantee by paying a surety. The above provisions will not enter into force until 1 January 1997 for guarantees given on or after 1 January 1996.

In **Switzerland**, some cantons' legislation states that any sureties or guarantees given to a private company must be approved by the town council, subject to consideration by the canton. The same applies to local authorities acquiring stakes in the capital of private companies or pledging municipal property.

In the **United Kingdom**, local authorities are entitled in certain circumstances to guarantee obligations taken on by private bodies (house mortgages, economic development).

In **Belgium** (Walloon Region), under section 9, sub-section 1 of the Intermunicipal Association Act of 22 July 1986, institutions of public law associated with intermunicipal associations may accept commitments only on a separate basis and up to a predetermined amount. Within these limits, local authorities may guarantee intermunicipal borrowing commitments.

In the Flemish region, pursuant *inter alia* to section 7 of the general municipal accounting regulations, local authorities may give guarantees for loans entered into by other local public authorities and by intermunicipal or non-profit-making associations.

This covers:

- companies in which municipal authorities have a stake: subject to an opinion given by the Flemish Community's domestic affairs administration (Department of intermunicipal associations and municipal corporations);

- non-profit-making associations: under the very stringent conditions laid down by the Ministry of the Interior circular of 23 October 1964 (goal in public interest; healthy financial situation; provision by the municipality of a real surety, etc.) so as to ensure that the local authority does not run a financial risk.

Municipalities are prohibited from standing surety for private companies.

In the Brussels-Capital region, there are no rules on this matter. From 1 January 1995, the application of the new municipal accounting will require the statement of sureties granted outside the balance sheet.

In **Germany**, local authorities are, as a rule, prohibited from standing surety for third parties, but the supervisory authorities may permit exemptions.

In **Greece**, local authorities may stand surety for companies on their own authority, depending on the stake which they hold in these companies.

In **Denmark**, local authorities are, as a rule, prohibited from standing surety for private persons or firms even though the legislation makes some exemptions (persons receiving social benefits; pensions etc.).

In **Estonia**, local authorities are prohibited from standing surety for third parties.

In **Norway**, local authorities may not stand surety for private companies unless a particular municipal or county interest is at stake.

No regulations have yet been drawn up in the **Czech Republic**.

There are no transactions of this type in **Hungary**.

In **Ireland**, local authorities rarely intervene *vis-à-vis* private companies.

In **Luxembourg**, municipalities may hold stakes in private companies subject to permission being granted in the form of a Royal Decree, which also determines the conditions applicable. They may also underwrite loans on an exceptional basis.

In **Spain**, local authorities may, subject to prior scrutiny, give guarantees and stand surety. However, in general the amount of the transaction may not exceed the theoretical cost if the local authority were to finance the same transaction itself.

In **Sweden**, local authorities can provide security for financial obligations entered into by third parties. However, such operations must be of general concern to the municipality or county council. The decision to provide such security could be challenged by means of appeal to the competent administrative court.

In several countries, local authorities which hold stakes in companies are subject to ordinary law financial liability in accordance with the share held (**Finland, Lithuania, Poland**).

In **Italy**, payment is delegated and entered to certain revenue items.

V.3. Conclusion

The vast majority of states regulate local authority borrowing.

Ceilings, where they exist, are surely not unrelated to the concern to reduce overall debt levels or cut spending. Some states may view them as necessary for compliance with the Maastricht Treaty, which lays down a public sector debt target of no more than 60% of the GDP as one of the main conditions for monetary union.

Other provisions do not present any problem if their sole purpose is to improve management practice without unjustifiably undermining the principle of local self-government.

The problem remains of the system for monitoring loan guarantees, which is still in its infancy. Facilities of this type, which are certain to be developed further, particularly in major industrialised countries, need to be regulated, and substantial progress will have to be made to this end.

VI. CRITICAL DEBT THRESHOLD

The above comments give a good indication of the difficulties encountered when assessing the financial risk attached to a local authority. Perhaps a few principles of fair assessment should be adopted.

VI.1. Main difficulties

No country has specific criteria to assess the risk of local authorities getting into excessive debt.

Some states use the ratios provided for by the regulations: this is the case for **Malta, the Netherlands, Estonia, Portugal and Spain**.

Others acknowledge that they have no way of measuring excessive indebtedness: **Finland, Romania, Lithuania, Bulgaria, Cyprus** and **Belgium** (Flemish Region).

In **Belgium** (Walloon and Brussels-Capital Region), there are no criteria for excessive indebtedness. The onus is on the supervisory authority responsible for checking budgets to identify this risk and take appropriate measures.

In **Luxembourg**, excessive indebtness is assessed on the basis of the annuity/ordinary revenue ratio and repayment ability.

In practice, the only way of assessing the risk of excessive indebtedness with any degree of accuracy is to carry out a careful, methodical analysis of local budgets over several years, as in **Germany**. In this country this is the task of the *Land* competent authorities. Also in **Ireland** special attention is given to repayment ability.

The fact is that any assessment of excessive indebtness is fraught with both institutional and methodological difficulties.

First, it must be noted that the development of the mixed economy has had an important ramification for relations between local authorities and numerous private law bodies (associations, companies). In particular, in times of economic recession, there is a tendency for municipalities to offer guarantees in order to attract jobs to the locality. Therefore, if disaster strikes, local authorities may find themselves having to repay debts contracted by third parties to the detriment of their own financial equilibrium.

Furthermore, division into smaller/private units, which is a form of business and industrial management widely used by certain public services (water supplies, sewage treatment, waste disposal, public transport, etc.) results in an increased number of budget appendices or autonomous budgets and effectively separates significant amounts of revenue and expenditure from the main municipal budget, making it possible to transfer funds for the sole purpose of concealing a deficit.

In a field as complex as this it is virtually impossible to consolidate the accounts using the tried and tested techniques of private accounting in order to provide an accurate reflection of real trends, the reason being that most local authorities do not possess a clearly identifiable share in the capital of their satellite bodies.

For reform to be carried out in this area a genuine asset-based approach is needed; work on this is still in the embryonic stage in most countries. In **France**, the act of 22 June 1994 on budget and accounting provisions for local authorities has cleared the ground for decisive progress.

Another difficulty arises from the use of ratios (the relationship between two different values) which may be expressed

- per head of population or

- in terms of financial mass.

As we have seen, many states (**Germany, Sweden, Spain, Switzerland, United Kingdom, Greece, Finland, France**) use capital debt per head of population. This value, which can be used for local authorities of similar size, can be compared against the average, and excessive indebtedness can in turn be defined in terms of substantial deviations from this average.

Nevertheless, some authors believe that there is no need for the fiscal resources or assets required to cancel out the debt to be strictly proportional to the population. In fact, companies carrying out financial analysis do not proceed by dividing their debt by the number of customers[9].

Perhaps this concept is somewhat simplistic. But it has the advantage of identifying debtors in a critical situation.

---

9 KLOPFER Michel, *Indicateurs d'endettement des collectivités territoriales et procédures d'alerte*, in Revue française de finances publique, n° 35-1991.

For example, in **France** the following ratios were recorded by municipalities with populations under and over 10,000 respectively as at 1 January 1991:

France: total debt per head of population as at 1.1.1991

Municipalities with fewer than 10,000 inhabitants

Average for metropolitan France in 1989: 3.718 F, in 1990: 3.783 F (in FRF per head of population)					
Municipalities with fewer than 10.000 habitants	**Fewer than 700 inhab.**	**700/2.000 inhab.**	**2.000/5.000 inhab.**	**5.000/ 10.000 inhab.**	**Taken together**
France as a whole	**2.820**	**3.810**	**4.562**	**5.140**	**4.023**
Metropolitan France	**2.821**	**3.811**	**4.567**	**5.175**	**4.020**
Alsace	2.609	2.899	3.404	3.858	**3.137**
Aquitaine	2.487	3.342	4.828	5.351	**3.819**
Auvergne	4.057	5.068	7.202	6.517	**5.520**
Bourgogne	1.847	3.085	4.031	5.284	**3.092**
Bretagne	2.937	3.555	4.649	5.556	**4.284**
Centre	2.083	3.512	4.412	5.601	**3.652**
Champagne-Ardenne	2.223	3.494	3.551	4.453	**3.099**
Corse	6.421	6.089	5.014	7.397	**6.009**
Franche-Comté	2.560	3.256	4.121	4.940	**3.312**
Ile-de-France	2.078	3.153	3.561	3.582	**3.277**
Languedoc-Roussillon	5.997	5.280	5.765	6.911	**5.913**
Limousin	3.692	4.771	6.720	7.504	**5.204**
Lorraine	1.696	2.510	2.924	5.326	**2.891**
Midi-Pyrénées	3.207	5.349	4.455	4.681	**4.257**
Nord-Pas-de-Calais	1.478	1.987	2.877	3.466	**2.659**
Basse-Normandie	1.374	3.203	5.527	8.077	**3.360**
Haute-Normandie	1.027	2.140	4.905	5.078	**2.746**
Pays de la Loire	2.764	3.719	4.509	6.002	**4.234**
Picardie	1.508	2.487	3.493	2.832	**2.392**
Poitou-Charentes	1.955	3.382	4.643	5.032	**3.527**
Provence-Alpes-Côte d'Azur	10.056	7.849	4.980	5.719	**6.281**
Rhône-Alpes	5.970	5.627	5.984	6.009	**5.879**
Outre-mer	2.034	3.228	4.084	4.459	**4.291**

(Source: Guide to ratios from the Ministry of the Interior)

Municipalities with more than 10.000 inhabitants

Average for metropolitan France in 1989: 5.492 F, in 1990: 5.960 F (in FRF per head of population)									
Municipalities with more than 10.000 inhab.	**taken to-gether**	**10.000/ 20.000 inhab.**	**20.000/ 50.000 inhab.**	**50.000/ 100.000 inhab.**	**100.000/ 300.000 inhab.**	**more than 300.000 inhab.**	**isolated**	**satellites**	**centres**
France as a whole	**6.267**	**5.569**	**5.749**	**6.727**	**6.562**	**9.314**	**-**	**-**	**-**
Metropolitan France	**6.282**	**5.676**	**5.735**	**6.778**	**6.419**	**9.314**	**6.756**	**5.078**	**7.213**
Alsace	**4.016**	4.352	4.076	4.446	3.725	-	4.183	3.533	4.176
Aquitaine	**5.839**	7.038	4.951	6.289	6.505	-	8.856	4.046	6.894
Auvergne	**7.101**	7.154	7.953	-	6.120	-	-	7.720	6.984
Bourgogne	**5.656**	5.820	5.450	8.719	4.701	-	7.051	3.566	5.702
Bretagne	**5.722**	6.322	5.628	4.943	5.529	-	5.744	5.372	5.780
Centre	**6.791**	6.231	5.862	7.289	7.819	-	8.739	5.809	7.020
Champagne-Ardenne	**4.425**	4.135	4.789	4.910	3.877	-	-	2.960	4.531
Corse	**6.903**	-	5.026	8.129	-	-	8.129	-	5.026
Franche-Comté	**6.026**	4.350	5.991	8.090	6.433	-	-	3.118	6.143
Ile-de-France (sauf Paris)	**5.074**	4.289	5.197	5.527	3.839	-	2.883	5.118	4.625
Languedoc-Roussillon	**8.839**	6.662	7.198	10.744	10.062	-	7.041	5.779	9.554
Limousin	**8.428**	9.503	-	13.902	5.863	-	8.709	-	8.376
Lorraine	**4.524**	4.009	4.940	-	4.726	-	-	3.213	4.949
Midi-Pyrénées	**6.452**	7.033	8.120	7.098	-	4.870	7.607	8.331	5.952
Nord-Pas-de-Calais	**4.895**	4.599	5.080	4.717	5.657	-	4.465	3.820	5.770
Basse-Normandie	**5.794**	4.769	6.123	-	6.695	-	5.715	4.864	5.917
Haute-Normandie	**5.997**	6.441	5.181	8.476	5.882	-	-	4.219	6.739
Pays de la Loire	**6.045**	6.459	6.478	6.472	5.523	-	7.742	5.458	5.867
Picardie	**5.146**	5.204	4.854	5.359	5.286	-	5.111	5.327	5.138
Poitou-Charentes	**7.833**	6.566	11.068	6.308	-	-	6.343	2.526	8.201
Provence-Alpes-Côte d'Azur	**10.698**	8.970	8.042	13.755	6.704	13.182	7.178	7.568	12.359
Rhône-Alpes	**6.224**	6.220	5.555	7.759	9.819	2.702	7.402	4.248	7.365
Outre-mer	**5.941**	3.751	6.085	5.569	9.583	-	-	-	-

(Source: Guide to ratios from the Ministry of the Interior)

The debt ratio (annual payments as a proportion of current revenue) is used in **France**, **Spain**, **Luxembourg**, **Finland** and **Norway**. But the value of this ratio depends on the methods used to manage the debt: an improvement might, for example, mask a costly extension of the life of the loan; conversely, a deterioration might result from early repayments effected in order to reduce the interest burden.

Few states attach much importance to measuring repayment ability, preferring, like Switzerland, to assess self-financing capacity and the actual rate of self-financing. But it is useful to know that total debt is equivalent to X or Y years of own resources.

In practice, excessive indebtedness is inevitably assessed using a "multi-criteria" approach similar to the points system used by banks to assess customer risk.

Various indicators can be used: net savings (gross savings less amortisation of borrowed capital), fiscal potential (tax bases at the national average rate), the relative share of current expenditure, the debt ratio, the amount of loan guarantees. Used together and suitably weighted, these financial analysis concepts can identify potential problem thresholds.

In **France**, Crédit local de France, the reference institution, operates an effective points system which it uses to monitor most local authorities and to identify cases of excessive indebtedness.

In 1990 Crédit local estimated that only 2,000 municipalities, representing a total debt of FRF 8 thousand millions (of a portfolio totalling FRF 200 thousand millions), were experiencing difficulties of this kind. Of this FRF 8 thousand millions, problematic or disputed claims accounted for a mere few hundred million. Moreover, the local authorities involved fell into a small number of specific categories: suburban municipalities with major investment needs which had been deprived of fiscal revenue from private companies; regional centres facing exactly the same problems; municipalities in mountain areas with costly facilities which could not be made profitable because of climatic factors.

This points system is vital if a more ambitious risk assessment, or rating, is to be carried out. Local authorities can commission a firm of auditors or consultants to assess its risk (namely its unequal ability to ensure debt-servicing) when floating a market issue. But this firm submits an opinion, which is inevitably subjective, instead of carrying out an objective diagnosis. For instance, it takes account of the debtor's willingness - as well as its ability - to honour its debts, or of concepts such as prudent financial management policy "by local authority standards".

The rating given to each issue generally varies between AAA (claims with an exceptionally high degree of security) and D (default).

Between 1990 and 1993 ten major local authorities in France (two regions, seven *départements* and the city of Paris) applied for rating.

France: local authorities rated as at 15 janvier 1994

	Standard & Poor's-ADEF	**Moody's**	**IBCA rating**
Municipalities:			
Paris	AAA	-	-
"Départements":			
Alpes-Maritimes	-	Aa2	-
Essonne	AAA	Aa1	AAA
Guadeloupe	-	-	A
Haut-Rhin	AA+	-	-
Hauts-de-Seine	AAA	Aaa	-
Meuse	A+	-	-
Seine-et-Marne	AA	Aa1	AA1
Regions:			
Ile-de-France	-	Aaa	-
Provence-Alpes-Côte d'Azur	AA	Aa2	-

France: changes in rating in 1993

Municipalities: Paris	First rating (AAA) given by Standard & Poor's-ADEF in October 1993.
"Départements":	
Essonne	Moody's rating reduced from Aaa à Aa1 in January 1994. The other two agencies, announced that their ratings of Aaa and AAA respectively would be maintained.
Guadeloupe	First rating (A) given by IBCA Notation in May 1993.
Seine-et-Marne	IBCA Notation's rating adjusted from AAA to AA1 in February 1993.
Régions:	
Ile-de-France	1st rating (Aaa) given by Moody's in May 1993.
Provence-Alpes-Côte d'Azur	

	Standard & Poor's-ADEF rating reduced from AA+ à AA in February 1993. Moody's rating reduced from Aaa à Aa2 in February 1993.

(Source: "Finances et communications locales")

A new trend has emerged: rating is no longer invariably connected to bond issues. Some agencies offer "reference ratings" or "financial solvency statements"). There is also an increasing trend for bodies such as banks to lend their "AAA" rating to issues launched by local authorities.

VI.2. Principles of fair assessment

First, it is necessary to have comprehensive, accurate **information** on the different elements of the local authority's financial situation.

Comprehensive means - assuming that the accounts have not been consolidated - identifying and using assessment criteria (ratio of guaranteed annuities to current revenue; risk division ratio) so as to determine the degree of concentration on a given beneficiary or beneficiaries. These aspects should be taken into account before any new commitments are accepted.

Accurate means that all revenue and expenditure estimates must reflect the true situation.

This information, which must cover at least the previous three or four financial years, is used to draw up an exact balance sheet. A comparative analysis of the value of the various aforementioned ratios, weighted according to the size of the local authority's population, already provides an indication.

The next stage consists in determining the leeway.

At this point the unequal distribution of fiscal revenue is of prime importance. Clearly, rich local authorities can sustain substantial debts because their repayment ability is also substantial. Particular attention should be given to the **degree of mobilisation of fiscal potential**. This can be measured by setting real fiscal revenue (for example, revenue from direct taxes) against theoretical fiscal revenue (for example, the amount obtained by multiplying the bases of these direct taxes by the national average rates for each tax).

If this coefficient is relatively low, there is a useful way of increasing self-financing capacity, and this potential increase enables additional savings to be made which effectively reduce the number of years necessary to wipe out the debt.

An alternative course of action would be to sell off local authority assets to finance a particularly heavy debt burden.

Prospective action of this kind must also take account of interest rate trends. Liabilities management is currently taking place against a background of chronic instability on money markets. It must therefore aim to **optimise** debt charges, not merely by avoiding losses, but also by taking advantage of any opportunities to make profits. This kind of "refinancing" policy, which is widely practised by large local authorities with extensive arbitrage facilities, is infinitely more difficult to implement in smaller local authorities (i.e. in municipalities).

Of course, the existence of financial analysis methods of this type is a pre-condition for the use of emergency procedures.

VI.3. Conclusion

The concept of "critical debt threshold" cannot be assessed independently of a comprehensive financial analysis of the local authority's situation. Variations in fiscal leeway are of particular importance.

Auditing of this kind makes it possible to avoid the conclusions revealed by manipulating ratios which tend to give only a short-term picture of the situation.

VII. EMERGENCY PROCEDURES

Several states have drawn up regulations to reduce the risks of excessive indebtedness and defuse critical situations.

VII.1. Monitoring procedures

In **Luxembourg**, the Ministry of the Interior draws up an annual statement of debt for municipalities, their associations and public bodies. But it cannot force local authorities to comply with particular management standards.

In **France**, Crédit local de France is well placed to assess any difficulties which arise. It estimates that between two and three thousand municipalities are currently in excessive debt situations. The regional revenue courts (chambres régionales des comptes) also assess the management policies of elected representatives. On 26 March 1993, a circular concerning the warning system for local finances[10] was sent out to *préfet*s and accountants. The circular stated that in view of the increasing incidence of financial problems in some local authorities, it seemed that in many cases early, concerted action by the authorities, at both central and local level was the only way of bringing about a rapid improvement in difficult situations in the interest of all parties - particularly the local authorities themselves. The process consisted of preselection, followed by confirmation of the analysis and, finally, awareness-raising.

In the **United Kingdom** local authority indebtedness is monitored by an independent **district auditor** with a view to detecting any flaws in management practice. Authorities also have to take account of a **Code of Practice on Treasury Management**, drawn up by the Chartered Institute of Public Finance and Accountancy to help local authorities manage their financial transactions.

In **Spain** an associate body of Banco de credito local collects and publishes data on loans and the attached financial burden. The role of this **"Risk Information Centre"** is to centralise data transmitted by banks and savings banks.

Other parties involved:

- at internal level, the local authority's financial inspector;

- at external level, the "Tribunal de Cuentas" which is answerable to Parliament or, in the autonomous communities, other bodies with a similar status, such as Consejo de Cuentas in Galicia, Sindicatura de Cuentas in Valencia and the Balearics and Tribunal Vasco de Cuentas Publicas in the Basque Country.

---

10 Circular n° NOR/INT/B/93/00100/C (Intérieur, Budget).

Local authorities, like all other administrative bodies, must submit the general accounts for the financial year to the revenue court prior to 15 October. After the accounts have been examined, they are forwarded to Parliament and then to the Government. Copies are also sent to the legislative assembly of the relevant autonomous community.

In **Greece**, the Deposits and Loans Fund assesses insolvency risks when examining loan applications.

In **Switzerland**, each canton has a **municipal department** ("service des communes") responsible for monitoring municipal management. In some cantons, municipalities also submit each year their accounts and balance sheet for examination by an **approved fiduciary**, which remits the outcome of its investigations to the municipality concerned and the municipal department in the form of a report with comments. This report serves to initiate discussions on appropriate measures, particularly if the current budget is in the red.

In **Malta**, local government auditors are responsible for evaluating policies.

Finland does not have a specific debt monitoring organisation, but the Department of Municipal Economy and Administration and the Finnish Municipal Association collect relevant information.

A similar situation exists in **Sweden** and **Lithuania**.

None of the **German** *Länder* has specific debt monitoring authorities, and local authorities are supervised by the authorities that exist under ordinary law. These bodies assess the financial situation of local authorities but do not apply specific excessive indebtedness criteria. If appropriate, they may refuse to authorise further borrowing.

Poland does not have any specific debt monitoring body either. On 1 January 1993 responsibility for analysing local authority debt was taken out of the hands of the regional revenue courts.

Neither the **Czech Republic** nor **Hungary** has specific debt monitoring bodies.

In the **Netherlands**, responsibility for monitoring local authority debt lies with the Ministry of Finance.

In **Denmark**, the Ministry of the Interior monitors short-term debt closely. Local authorities are required to show a positive net balance.

Local authority debt in **Portugal** is monitored by the General Inspectorate of Finances, the Territorial General Inspectorate and the Audit Court. The Audit Court must authorise major contracts; beyond a certain threshold, they cannot even be signed before being submitted to the Audit Court for approval.

In **Romania**, financial and legal inspections are carried out by the Revenue Court.

In **Belgium** (Walloon and Flemish Regions), monitoring is carried out in accordance with ordinary law supervisory procedures (general system of cancellation and special system of approval, operated by the higher authorities in the Walloon Region; supervision when the budget is assessed, with municipalities obliged to estimate the impact of their investment projects on the debt burden as part of medium-term financial planning, exercised by the provincial administration in the Flemish region).

In **Ireland**, the Ministry of the Environment monitors all aspects of local finance through the reports it receives from the local authorities every three months.

VII.2. Recovery measures and procedures

Virtually no states operate emergency measures or procedures.

In **Finland**, local authorities cannot, in theory, be declared bankrupt because they have the right to levy sufficient taxes to balance the books.

In **Sweden**, local authorities cannot be declared bankrupt either. In case of urgency, the State can allocate grants or loans.

In theory there is no risk of local authorities going bankrupt in **Spain**, where debt refinancing techniques (moratoriums) are used.

The same solution is applied in **Malta** and **Luxembourg**.

In **Estonia**, some local authorities are having difficulty in servicing local authority debts contracted prior to 1994. The situation is still developing; no guarantee fund exists.

In **Germany**, where it is not possible to declare local authorities bankrupt, the supervisory authorities have broad powers to obtain information. No guarantee fund exists because it is thought that such a fund might undermine the direct responsibility of local authorities. But in the event of crisis the *Länder* may allocate subsidies to ensure that local authorities are able to carry out their duties.

In **Greece**, local authorities in difficulty can call on the Deposits and Loans Fund. There is no guarantee fund.

In **Ireland**, the Minister of the Environment maintains an overview of local authorities' financial position through regular returns by the authorities.

In the **Czech Republic** there are no specific procedures and there is no guarantee fund.

The same is true for **Cyprus**, although the Government may act as guarantor in certain cases.

However, specific procedures exist in some European states.

In **Switzerland**, when a municipality is in political or financial difficulty, the canton may appoint one or more managers in order to improve the situation within a given time limit. Under the Federal Act of 4 December 1947 debt proceedings can be instituted against municipalities and other bodies governed by canton law. Some cantons even have funds to assist municipalities incurring exceptional expenditure (for example, facilities for new districts). These funds, into which a percentage of real estate duties is paid, can be used not just to finance capital expenditure, but also to cover a portion of debt-servicing.

In **Portugal**, loans are guaranteed by the financial equalisation fund. Municipalities in difficulty can take out **"financial recovery contracts"** subject to government approval. They must then draw up a recovery plan setting out spending cuts and revenue increases. Special low-cost credit facilities can also be made available.

In the **United Kingdom**, the risk of excessive indebtedness is limited by the system of credit approvals. Moreover, local authorities are required to set aside funds for debt redemption purposes. A proportion of state subsidies received is also used to finance borrowing. Creditors may apply to the courts in cases where debts remain unpaid two months after a written demand has been sent. The Government does not indemnify local authority debt, and authorities in this position have to raise more fiscal revenue.

In the **Netherlands**, debt-servicing is a mandatory expenditure for local authorities. In the event of a local authority failing to make adequate provision for this expenditure, the supervisor will do so by reducing the amount reserved for other expenditure. In practice local authorities cannot be declared bankrupt and there is no guarantee fund. However, municipalities can apply for supplementary funds (article 12 status). These funds, which are financed by municipalities themselves, are subject to very strict conditions (spending cuts, minimal taxation, balanced books). The minister is responsible for assessing individual cases.

In **Bulgaria**, local authorities in difficulty can apply to the Ministry of Finance for new interest-free loans.

In **Hungary**, under Act LXV of 1990 and Act LXXXIX of 1992, local authorities may suspend financing of their activities, with the exception of public authority functions and basic public services. In exceptional cases, where local authorities are in difficulty through no fault of their own, additional state grants may be made available.

In **Slovenia**, local authorities which are unable to pay their debts may submit their case to the National Assembly, but they are then obliged to use grants from the state budget solely for specific items of current expenditure (not usually the case). There is no guarantee fund.

A very original system is in force in **Italy**. Legislative decree no. 66 of 2 March 1989, amended and converted into act no. 144 of 24 April 1989, sets out guidelines for settling local authority deficits. Section 21 of legislative decree no. 8 of 18 January 1993, converted into act no. 68 of 19 March 1993, vests powers in an **extraordinary liquidator** (for municipalities with fewer than 5,000 inhabitants) or in a three-member **extraordinary liquidation committee** (for municipalities with 5,000 or more inhabitants), whose task is to draw up a statement of debt and put forward a recovery plan.

Normally the state provides funds from its budget in the form of a loan, the amount of which increases according to repayment ability and the population of the municipality concerned. It may also provide aid to reduce the debt burden on borrowings contracted to finance capital expenditure.

In **Belgium**, specific procedures also exist. The regions granted extraordinary loans to municipalities when serious financial difficulties emerged in the early 1980s. The Belgian State also paid extraordinary subsidies to the municipalities of the Brussels region.

The launch of the **Fonds national d'aide au redressement financier des communes**, a State-backed national fund for municipalities with financial difficulties, was a significant development. This Fund borrowed on national and international markets and lent on the funds to municipalities in difficulty in the form of long-term loans, sometimes at lower rates. It was therefore used essentially to consolidate and spread commitments. In 1988 the Belgian State was replaced by the regions for this purpose.

The Walloon Region set up a consensual aid system for municipalities in difficulty.

On 3 June 1993 the Conseil régional adopted a decree on management plans for municipalities in financial difficulty. This plan consists of a document covering five financial years which defines the main lines of financial policy in terms of revenue and expenditure and current and capital outlays taking account of changes in each function and, above all, setting out ways of achieving an overall balance. The government is responsible for monitoring implementation of the plan.

Once the management plan has been adopted by Conseil communal de Belgique and approved by the government of the Walloon Region, a three-party agreement (involving the municipality, the region and Crédit communal) must be concluded by the communes.

The municipalities concerned then become eligible for:

- "extraordinary aid loans" to consolidate the deficits of previous years;
- a "one-off advance" to cover cash-flow problems.

These facilities are made available at preferential rates, with the region mopping up the difference.

On 23 March 1995, the Walloon Conseil Régional passed a decree setting up a Regional Centre for Assistance to the Municipalities, responsible for following up and monitoring the management plans of municipalities in financial difficulty and helping maintain the financial balance of the Walloon Region.

Under the terms of this decree, the Walloon Government is authorised to enter into a convention with the Crédit Communal de Belgique or any other financial organisation accredited by the latter in order to bring about the structural stabilisation of the situation of municipalities in financial difficulty.

In addition to monitoring the management plans referred to above, the Centre is also responsible for:

a) monitoring the receipts and payments of the CRAC (regional relief account for municipalities in financial difficulties opened with the contracting financial institution) and taking all positive financial measures in respect of the cash management of the said account;

b) examining the budgetary situation of municipalities requesting access to the CRAC;

c) helping municipalities with cash-flow management;

d) providing opinions to the Walloon Government or the ministry to which authority has been delegated with regard to the financial situation of municipalities;

e) any relevant tasks conferred upon it by the Walloon Government.

In its circular of 29 December 1989 the Flemish Region prohibited provincial governors from suspending implementation of decisions by municipalities to reschedule their debts by extending the life of outstanding loans.

Current regulations are based on the decree of 28 April 1993 on administrative supervision of municipalities.

This decree made debt-rescheduling operations, which are beneficial in the short term and costly in the long term, subject to approval. Article 22 of the decree states that decisions of this type must be submitted for approval within twenty days to the government, which then has fifty days in which to take a decision. When this limit expires, the government is deemed to have approved the rescheduling operation. It takes its decision on the basis of a financial plan spread over several years. Nowadays approval is almost never given.

There is also a **Flemish financing fund**, which was set up by decree of 20 December 1989 to enable municipalities to balance their books.

The Royal Decree of 21 September 1989 wrote off part or all of the debts contracted with the Fonds national d'aide au redressement financier des communes, representing a total of 45 thousand millions Belgian francs for Liège, 30 thousand millions for Brussels, 10.4 thousand millions for Antwerp and 6.6 thousand millions for Ghent. This was a one-off step taken by the federal government in a spirit of compromise and solidarity to help a group of municipalities facing difficult problems at the same time, with strong community colouration.

The task of the Flemish financing fund is to pay to the Fonds national d'aide au redressement financier des communes monies receivable from the beneficiary municipalities. It is also responsible for prefinancing interest generated by municipal debts. The fund's revenue consists of borrowings underwritten by the Flemish region and claims recovered from municipalities. For example, the total debt of the two largest towns in respect of the financing fund amounted to 70 thousand millions Belgian francs as at 31 December 1992, of which Antwerp accounted for 62.9 thousand millions and Ghent for 7.1 thousand millions. No complementary benefits were made available.

The Flemish financing fund concluded agreements with municipalities on measures to balance the books devised as part of a management plan along the lines of a model drawn up by the Ministry of the Interior. This plan is monitored by a Flemish Community working party and supervised on an ongoing basis by the Ministry of the Interior, which publishes an annual report containing debt statements and forecasts.

Municipalities in the Walloon Region and the Flemish Community cannot be declared bankrupt, and there is no guarantee fund.

VII.3. Conclusion

Given that local authorities are outposts of central government and often are not subject to neither the market laws nor the ordinary business regulations, the conditions in which central government may provide assistance to local authorities facing insolvency should be clearly defined.

A warning system would enable difficult situations to be tackled before they became critical. It is vitally important to create the conditions for preventive cooperation between state officials, banks and local authorities so that measures are taken in time to contain problems which raise the spectre of emergency financing.

RECOMMENDATION OF THE COMMITTEE OF MINISTERS TO MEMBER STATES ON LOCAL AUTHORITIES' BUDGETARY DEFICITS AND EXCESSIVE INDEBTEDNESS

(Recommendation No. R (96) 3 adopted on 15 February 1996)

The Committee of Ministers of the Council of Europe, under the terms of Article 15.*b* of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage and to foster their economic and social progress, and that one way of achieving this aim is to take joint action in the legal and administrative fields;

Recalling that Article 9 of the European Charter of Local Self-Government states that "Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers";

Recalling that in its Recommendation No. R (92) 5 on borrowing by local and regional authorities, the Committee of Ministers recommended that the governments of member states consider on the one hand how far it is expedient, in particular in cases prompted by the need to pursue a national monetary policy, to place limits on the amount of short-term debt (namely borrowing for less than one year) and consider, on the other hand, that the total amount of long-term and short-term loans that can be contracted by local and regional government should be limited only as part of a general programme to reduce public expenditure as a whole;

Considering that for those member states which have established a global public expenditure threshold, this limit will necessarily have an effect on the maximum level of local authorities' indebtedness;

Considering that public sector borrowing increases the tax burden in the long term unless inflation is high, and that excessive indebtedness can eventually lead to an unacceptable decrease in the proportion of the budget which goes into running public services;

Considering that, in a number of European countries, overall financial pressure has reached a level regarded as a ceiling;

Considering that all capital expenditure leads to further debt management costs and debt repayment costs;

Considering that local authorities considered to be at risk are sometimes forced by banks to agree to borrowing conditions which impair freedom of local authority management and can lead to excessive financial burdens;

Considering that local authorities should refrain from financing their capital expenditure through any financial instruments of a more or less speculative nature because of the potential risks which are involved and which conflict with the public interest;

Considering the growing part played by local authorities in the national economy, their increasing involvement in supporting local economic development, particularly during an adverse period in the economic cycle, which inevitably entails considerable financial risks, the sometimes excessive competition between local authorities seeking to increase their economic appeal and improve their reputation without always sufficient regard for the future return on this spending, and the scale of local authority commitments under separate subsidiary budgets or to mixed enterprises in which the local authorities have an interest;

Considering that specific controls by supervisory authorities can be less stringent if general principles governing debt are clearly established;

Considering that, in order to comply with the principle of subsidiarity and avoid excessive indebtedness which could jeopardise the financial autonomy of local authorities and the desirable prospect of sustained development, it is appropriate to establish a number of precautionary rules,

RECOMMENDS THAT THE GOVERNMENTS OF MEMBER STATES

establish, in co-operation with local authorities and based on the guidelines set out in the appendix, the framework considered appropriate in order to avoid excessive indebtedness.

GUIDELINES ON MEASURES TO BE TAKEN IN ORDER TO AVOID EXCESSIVE DEBT JEOPARDISING THE FINANCIAL SITUATION OF LOCAL AUTHORITIES

Appendix to Recommendation No. R (96) 3

1. In order to help local authorities better control their level of indebtedness, member states should establish a framework offering the necessary terms of reference to prevent the critical thresholds of indebtedness from being exceeded.

2. They could also establish indicators and provide regular national data enabling local and regional authorities to easier assess normal levels of indebtedness, without impairing their operational efficiency or autonomy.

Indicators could include, for example, figures for:

i. the ratio of debt burden to working capital;

ii. the ratio of debt to own resources;

iii. the total amount of security which local authorities are able to provide;

iv. the maximum security which a local authority can offer to a single borrower and/or for a single operation.

3. For the member states which have established objectives for global public indebtedness (for example member states of the European Union wishing to participate in the monetary union have agreed to maintain their public debt within 60% of the G.D.P.), the competent authorities should indicate what the effects are on the maximum level of local authority indebtedness.

4. Repayment of the sums borrowed should not normally be index-linked, except in the specific situations of economies in transition where such index-linking is the only possible way of obtaining long-term loans for financing capital expenditure.

5. The competent authorities should clearly state the consequences in the event of local authority insolvency.

6. If it proved necessary, as part of a national monetary policy, to place limits on the amount of short-term debt (less than one year) contracted by local authorities, the ceilings might be set either in relation to local authorities total debt or in relation to their total operating budgets; the state should take all necessary measures to ensure that this indebtedness is not caused by failure to meet deadlines for the transfer of funds to local authorities, particularly in cases where the local authorities have to deposit their cash surpluses with a central body.

7. Local authority access to “financial derivatives”, which do not represent a spot transaction but correspond to a forward sale or purchase deal with a price fixed at the outset, should be subject to strict regulations because of the considerable financial risks that these transactions may entail for the taxpayer, and also because it is not the role of local authorities to engage in financial speculation.

8. Any financial undertaking or guarantee of any sort given to mixed enterprises, bodies or associations in which local authorities have an interest, and which could result in financial costs outside the budget, should be described in a separate report appended to their budget documents; a statement of the outstanding debt on loans contracted by local authorities and a repayment schedule should also be attached.

4e page

Public sector borrowings increase the tax burden in the long term and can eventually lead to a significant decrease in the proportion of the budget which goes into running public services.

In order to better assess normal levels of indebtedness without impairing their operational efficiency or autonomy, the Steering Committee on Local and Regional Authorities (CDLR), on the basis of the information presented by 27 member states, has elaborated guidelines that the Committee of Ministers resumed in a recommendation to member states and which should help local authorities better control their level of indebtedness and prevent the critical thresholds from being exceeded.