COUNCIL OF EUROPE
COMMITTEE OF MINISTERS

RECOMMENDATION No. R (96) 3

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

(Adopted by the Committee of Ministers on 15 February 1996 at the 558th meeting of the Ministers' Deputies)

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.

Appendix to Recommendation No. R (96) 3

Guidelines on measures to be taken in order to avoid excessive debt jeopardising the financial situation of local authorities

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.