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Could local authorities be the real drivers of economic growth?

Posted by **Lars Andersson** on September 20th, 2011

The UK Government's new £500m Growing Places Fund recognises the crucial role infrastructure has in economic growth. Capital investment helps, not just by injecting money into the economy, but by creating the underlying supporting infrastructure needed for private sector investment and development. And importantly, new evidence shows that the majority of this investment on a European level is done sub-nationally, by local authorities and other regional and sub-regional bodies. According to a report from the Council of European Municipalities and Regions, (Feb, 2011) "the subnational public sector...most active in the area of public investments, as it represents 65 % of all of the EU's public investments".

In essence, this means that reductions in spending by local authorities will in itself lower the economic activity of society. Each public investment involves one or more contractors, who when faced with fewer incoming projects may be forced to lay off employees, which in turn will affect the social costs of the local public sector. In reverse, this leads to the conclusion that local authorities could play an important role in fighting national economic downturns.

Already, many European local authorities have experienced cuts in their central government grants. This comes at a time when the effects of the 2008 economic crises have already weakened local authorities in Europe. In a study from United Cities and Local Governments (Oct, 2009) it is reported that 61 % of the European local authorities have experienced lower income from taxes and fees, 55 % have seen lower state grants and 37 % claim that it has become more difficult to secure loans for investments purposes.

The overall cuts in state grants to LAs in the UK are around a staggering 27%, and cuts in grants for capital spending are even higher. In addition the UK Government has increased the rates of interest charged at Public Works Loan Board (notwithstanding the temporary measures for the HRA buy-out). At the same time we are already experiencing the effects of the regulatory framework of Basel III, which has forced the banks to increase the margins on credit.

With the now widely accepted positive impact that capital investment will have on economic growth, it is essential that there is a fully functional system for supplying local authorities with credit for capital investments. While a diverse and cost-effective selection of borrowing options may only be part of the solution, it is a vital part of driving local economic growth and at present in the UK this is not present.

- Issuance of bonds in the capital market. This could be done by an individual local authority or a group, formed for a single bond issue (a so called club-deal)
- Forming a local government funding agency (LGFA) for ongoing issuance in the capital markets.

However, capital markets require large borrowing needs to be efficient. This goes for both big single bond issues with sufficient liquidity and high market participation over time. Even some large cities do not have the sufficient size when borrowing to be successful in the capital markets. A club-deal could be the answer, but it is often a burdensome process and a one-off event in the market, which does not provide a permanent presence over time.

I would argue that to ensure a sustainable and affordable source of borrowing for capital investment for local authorities in the UK it will need to form a version of a LGFA, at least while the rates at the PWLB stay the same. LGFAs have been proven to work even in times of crisis. In fact in the case of Scandinavian experience, LGFAs were almost unaffected during the last crisis and were easily able to supply Local Authorities with loans for capital expenditure. The challenge for the UK will be moving to such a radically different approach. Cultural changes such as this are not easy in any sector, and in addition there are legal and political barriers to overcome. There are encouraging signs however, that we could be on the verge of this and I will watch these developments with interest.

Lars M Andersson

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Lars Andersson asks how can LGAs shape a role for themselves driving growth? *Lars Andersson, Local government advisor*

and initiator to the Swedish local government funding agency, Kommuninvest

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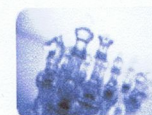
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