Local Authorities and Risk

Posted by **Lars M. Andersson** on March 2nd, 2012

The role of local authorities is to supply the citizens with local public services of good quality at a low cost. It is not to show good financial results, but to produce services as cost-effectively as possible. The resources that local authorities use for their operations are the taxpayers' money, regardless if it comes from local taxes or from state grants. Local Authorities, for that reason, should not speculate with their resources and keep the risks involved in their activities at a low level.

Of course, risk is present everywhere and a part of life that can't be excluded. No matter if you do something or not, risk is involved. Local authorities meet many types of risks in their everyday operations. They could range from the risk of not doing infrastructure investment, which would slow economical development in the region, to a risk taken in the financial markets, such as choosing between fixt rate loans or floating rate loans.

The more you understand about risks involved in what the local authority is doing, the better you can handle risk. Knowledge is key. Many problems that local authorities have faced in the capital markets derive from them not fully understanding the implications of their actions. A simple rule is that you have to understand the risks in what is planned well enough to be able to evaluate the risk and, equally important, to be able to explain the risk to others, as for example the political leadership of a local authority.

So, in meeting risks, there are certain questions that you should ask yourself, for example:

- How does the risk involved in the project work?
- Can you prise the risk?
- How big is the risk of failing?
- Do you know any risk-mitigation techniques that could be applied?

When local authorities are present in the capital markets, they are also exposed to close scrutiny from investors. Investors are, of course, cautious about where they place their money and have often very little time to make their decisions. This leads to a situation where the investors often overreact to bad news from an issuer. If we combine this with the fact that local authorities sometime tend to use media in their negotiations with central government, often describing the situation in gloomy colours to get more support from central government. An example of this is when in the late 90s, the Swedish city of Malmö told the newspapers (and the central government) that their economy was close to a total "melt-down", without being anywhere close to bankruptcy; the capital markets reacted immediately with questions from all over the world.

When there are real financial problems, like in the cases of Orange County in the US and Hammersmith & Fulham in the UK, the effects in the financial markets lingers on for a very long time and also spreads to all related entities in other countries.

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The council tax freeze offer by the government is entirely unsurprising but wholly significant. Whether councils choose to break the 'embargo' as it were is a short term irrelevance to the longer term trend these yearly freezes are now creating. Simply put, the longer the freeze continues the more difficult it is to eventually put council tax up. If your only power is too reduce the tax then I'm not sure that is much power at all.
Liam Scott-Smith, NLGN

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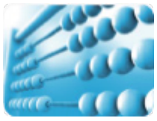

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