Chapter 11

Monitoring and Intervening in Subnational Government Finances

A national government has a justifiable interest in subsovereign finances in general and in subsovereign indebtedness in particular.. The kinds of information required to understand the financial condition of subnational governments and subsovereign debt are much the same for governments and investors. As a result of this common interest, an active securities market is an important way to stimulate continuing interest in local financial condition. Subjecting governments to continuing scrutiny and applying pressure for greater transparency are viewed as advantages of a securities market system that relies on private capital. Furthermore, what the central government is willing and able to do to avoid and cure the financial problems of subnational governments is of fundamental concern to investors.

Financial monitoring may focus only on borrowing localities or on financial reporting by all localities, including annual budget and expenditure reviews. Much of the information needed for local debt monitoring can be generated by an active municipal securities market that demands continuing disclosure and by the availability of audited, standardized financial statements. The evolution of the credit market may be the major factor in the evolution of the relationship between the central government and its subnational partners. Once market-dictated transparency and regular reporting are achieved, there should be less need for ongoing direct supervision or regulation of subnational jurisdictions. Central government leadership in prescribing reporting practices and making reports available to the public can advance the development of private markets.

The political and financial relationships between sovereign and subsovereign governments are rich and varied. They are evolving along new lines, many of them unique to a country's tradition and position along the devolutionary scale. National government oversight and intervention in subnational government financial affairs vary fundamentally in federal systems, which leave important prerogatives to the states and their subnational governments, and in unitary governments, which have a strong sovereign center. The United States, Canada, India, and several Latin American countries, for example, have a federal system of government with specific powers and prerogatives reserved to each level. Local governments are typically subordinate to state or provincial governments, although often possessing some degree of independence. In unitary systems all powers of the state are derived from the central government, which has oversight over subnational governments. Rather than prescribe a single approach to monitoring and oversight of subsovereign conditions, therefore, this chapter first reviews international experience in developed and emerging market economies and then draws some guidelines.

Examples from the United States

Oversight and intervention by the states in the affairs of local governments vary greatly in the United States. As a general rule the older states in the Eastern part of the country (the original colonies) have tighter controls and oversight over local governments. In these so-called "Dillon Rule" states local governments are the progeny of the parent states and have only the powers expressly given to them in the state constitutions and by the legislatures.[1] Since the local governments are seen as accountable to the state, they often have strict reporting requirements to the states. If a local government gets into trouble, the state is typically in a position, if it chooses, to step in and take over government operations, including removing locally elected and appointed officials.

Direct Intervention

Because the administration and finances of local governments in the United States have been at a high level since the Great Depression of the 1930s, there are only a few examples of direct intervention. However, it can be very sweeping when used.

The state appropriates functions and monitors. In the mid-1970s the State of New York stepped in to help resolve the financial crisis in New York City, establishing a control board for the city with approval power over all financial decisions. The control board remained until the city had enjoyed two years of budgetary balance, a total of five years. The state took back the city sales tax and used it to secure the city's debts. A new financing vehicle, the Municipal Assistance Corporation, was created to sell bonds backed by the special sales tax and to refund outstanding city notes as they came due. Debt service payments on the refunding bonds had first call on the sales tax revenues; the city had access only to what remained. The federal government initially refused to provide special assistance, though it did accommodate the workout of the financial problem by providing a liquidity facility to the city. It also sponsored federal legislation that permitted the city's pension system to invest in city and Municipal Assistance Corporation securities without violating federal prudential standards. The pension systems financed most of the recovery and bought some $4 billion in Municipal Assistance Corporation bonds.

When the city of Philadelphia faced a financial emergency in the 1980s, it too came under a New York City–style state control board with oversight of all spending decisions. Washington, D.C. also had a financial control board that had to approve budgets and expenditures and that took over day to day control of key city services. Elected officials effectively lost control over spending decisions.

The state takes over. When the city of Chelsea, Massachusetts, was on the brink of insolvency in 1991 (it had little debt outstanding but was defaulting on payroll and vendor payments and there was widespread corruption), the state governor removed all elected officials and appointed a receiver. The receiver reported only to the governor and ran all aspects of the city, approving all contracts, tax levies, and the like. The state also created a special guarantee program to back the city's bonds, which were sold to fund several improvements. After three years a new city charter was written and approved by the state legislature, elections were held, and the city was turned back to elected officials. The city had to meet certain tests, including tests of financial operations, to stay out of receivership.

Similar strong approaches have been used in the small cities of Ecorse, Michigan, and East Saint Louis, Illinois. In both cities a receiver was appointed either by a state court (in Michigan) or by the governor (Illinois) to direct the financial affairs of the local government.

The state creates an oversight institution and strengthens it. When the city of Bridgeport, Connecticut, ran into financial difficulty in 1991, the state of Connecticut first tried to use a limited control board approach. The board had budget approval but no power to oversee or enforce implementation of the budget. The city overspent its budget and, at odds with the state, attempted to go into bankruptcy under Chapter 9 of the federal bankruptcy code, which has provisions for defaults by local governments.[2] The state of Connecticut opposed the city's bankruptcy petition, and the bankruptcy court ruled that the city was not technically insolvent.[3] The state subsequently stiffened the powers of the control board and provided transitional aid, and the city did not default on its debt.

The Nonintervention Tradition

Alongside this tradition of municipal intervention in the eastern United States is another tradition of much less oversight and nonintervention, in which local governments have much more autonomy. This appears to be especially prevalent in states west of the Mississippi River. When Orange County, in the state of California, had insufficient funds to pay its debt on time in December 1995, the county entered into bankruptcy (providing immediate protection from its creditors) and defaulted on $200 million in short-term debt. The state of California refused to become involved, and the county entered into extensive litigation and subsequent settlements on its own without state intervention or oversight.

In a similar case in the 1980s the Washington State Power Supply System, a large regional utility owned by several local governments (a combination of special districts and municipalities) in three states, defaulted on revenue bonds. The bonds had been sold to finance the construction of five nuclear power plants. The Supreme Court of the state of Washington ruled that the basic contract on which the borrowing had been secured was invalid and the borrowing itself was thus invalid (*ultra vires*).[4] Because of the limited obligation nature of the pledge, the bondholders were simply out of luck, having no recourse to the underlying municipal governments that were clearly not guarantors of the projects. Construction of the plants ceased, and no liability was incurred by the underlying jurisdictions.[5] None of the state governments tried to bail out the bondholders.

Examples of Monitoring and Oversight in Other Countries

Several other examples give a sense of the wide range of monitoring and intervention by higher levels of government.

Canada

In the Canadian federal system the provinces have parental powers over local governments and effectively control their finances. This is in contrast to relationships between the Canadian national government and the provinces, which are highly decentralized. Localities rely on the property tax (although legislation is at provincial level, local governments can set their own rates) and transfers from the provinces. Local government capital spending and borrowing are generally subject to provincial approval, and most borrowing is done through provincial intermediaries (bond banks) that provide additional security through provincial pledges.

South Africa

South Africa illustrates the pressure of a changing governmental structure on intergovernmental fiscal relationships in an emerging market economy. The country has moved from a highly centralized system of government to one whose constitution recognizes three spheres of government (national, provincial, and local). The rapid amalgamation of white municipalities with the less affluent black townships has led to a variety of problems, including nonpayment of property taxes and utility bills by the newly absorbed areas. Since South Africa's public sector financial structure places much of the fiscal responsibility on local governments, the nonpayment of taxes and charges has caused widespread fiscal stress. Insolvent local governments are under the control of the provinces, whose position is even more tenuous.

Responding to the fiscal problems at the local level, the national government has instituted "project viability," requiring quarterly reports from municipalities on their financial position. Distressed governments are subject to supervision. While the supervision provisions have not yet been tested, the quarterly financial monitoring is probably the most regular and frequent anywhere in the world.

Argentina

Argentina has a historically highly decentralized system of government, with significant powers given to the provincial governments. Much like the U.S. and Canadian systems, the provincial governments are the parents of the local governments. The provinces vary greatly in income and level of development. The central government raises taxes, most of which it then transfers to the provincial level to provide services. This financial structure obviously places great importance on intergovernmental transfer mechanisms. All three levels of government are permitted relatively free rein to borrow, which they have done primarily to cover operating deficits. Most of the financing has been through province-owned banks whose investment decisions were strongly influenced by the needs of state and provincial governments. The result has been large and increasing amounts of unsustainable debt, especially during the 1980s.

In the 1990s the central government stepped in to bail out the provinces and cities by replacing subnational debt with national debt. The national government essentially closed the window on provincial bank lending to provincial governments. However, the provinces have continued to borrow from private banks and to pledge future intergovernmental transfers. A recurring problem has been a lack of discipline in borrowing to cover current deficits. Since the provinces and municipalities have a high degree of independence, the central government's ability to control their behavior is limited. In a new approach, the federal government and the provinces have entered into numerous agreements intended to control provincial spending and borrowing.

Brazil

Like South Africa's, Brazil's constitution provides nominally equal status to all three levels of government. The country has had a long-standing if unsteady tradition of federalism. As in Argentina the lack of effective control by the central government led to the running up of high levels of indebtedness by the states and the two largest cities, followed by widespread defaults in the 1980s. The debts were rescheduled by the central government to convert short-term debt to long-term debt. A major problem was that the national government had no effective control over the amount of debt incurred by subnational governments. In the final analysis Brazil was unwilling to allow massive defaults. As in Argentina negotiations between the states and the central government are ongoing. Since 1998 and the passage of the Fiscal Responsibility Act, the central government has curbed imprudent fiscal behavior and set tight conditions for subnational government borrowing.

Transitioning Economies in Europe

The transitioning economies of Eastern and Central Europe emerged from highly centralized unitary systems where the subnational government subdivisions were service delivery points for the center and highly dependent on the central government for fiscal transfers. In addition, subnational governments owned various enterprises that generated revenues but that often operated at a loss. Financial reporting systems were designed for measuring levels of inputs or for tax purposes only and so provided little information on the financial condition of the government. Auditing was done by state offices and was notable for both low quality and frequency.[6]

Economies tended to operate on a cash basis with a small and highly centralized banking sector and no functioning capital markets. Major capital spending was financed by grants or soft loans and was directed by the central government or financed on a pay-as-you go basis by the locality in the case of smaller routine projects. Since subnational governments had no existence beyond the central government, monitoring and interventions consisted mainly in the removal of officials who failed to perform as instructed. Little consideration was given to coping with financial emergencies of subnational governments, although Hungary enacted legislation on municipal bankruptcies.

More recently, governments in these transitioning economies have been moving to greater local autonomy. Financial reporting systems have been put in place to provide more useful information about local conditions. These systems tend to follow the European model of full accrual accounting, and the balance sheets are often spotty and inaccurate because of unresolved questions of ownership, value of real assets, and accounts receivable. Capital financing has relied primarily on specialized loan funds or commercial banks (themselves often undergoing privatization and carrying suspect balance sheets) that have traditional relationships with the subnational governments. Recently, loans from the European Bank for Reconstruction and Development (EBRD) and grants related to accession to the European Union have become the dominant sources of long-term capital for subnational governments.

Establishing a Central Government System of Monitoring and Intervention

Establishing a framework for monitoring subnational performance—determining the appropriate institutional roles and authority to intervene and identifying under what circumstances and with what limited powers—can raise major issues of intergovernmental relationships and accountability.

As a practical matter the financial information routinely provided to the central government by subnational governments may be the primary source of centralized information about the current status of subnational debt. However, the information forms need to be carefully designed, correctly filled out, and promptly returned. Because debt issues have special information needs, careful consideration should be given to requiring subnational governments to report clearly specified information about the debt. If sufficiently detailed and frequent, periodic reporting by subnational governments can allow central government monitoring of their financial compliance with their debt obligations.

Information Needs

A system of reporting that provides complete and detailed information on outstanding subnational debt issues is basic to understanding the issuer's financial condition. Such systems can be structured in various ways. France requires that the annual municipal budget include a detailed annex on outstanding debt (see box 11.1). Romania plans to establish a public debt registry system.

For greatest effect, such a system should be integrated into a more comprehensive system that collects data on subnational finances in a form useful for analysis of financial condition. Reports on indebtedness might be required to include basic descriptions of the nature, terms, and other key characteristics of the debt; certification of compliance with the debt limitation; and information about the collateral pledged. Notification by both lender and borrower should be required in case of a payment default, and the information should be available to the public.

Having such a repository of information allows the central government to maintain a current inventory of outstanding subnational debt and makes it possible to enforce the debt service limit and monitor aggregate subnational borrowing as part of overall public debt management. The inventory, which could be updated annually through improved subnational debt reporting practices, should be open to the public and prospective lenders.

Ideally, financial oversight would come through market forces that demand the timely provision of information, which in turn determines access to the market, thereby exerting pressure for financial discipline. Where the institutions and market players are in the formative and untested stage, however, a "seed-planting" role for government is likely to be required. It is important not to discourage market initiatives or to weaken market incentives. Legal requirements that bond market participants disclose and send information to a central point help markets work more efficiently and prod subnational governments into assuming reporting responsibilities.

Formulating and Enforcing Intervention

While financial monitoring may identify problems, monitoring alone is unlikely to eliminate or cure all problems. Intervention may be needed

Box 11.1. Example of Information Provided in the Debt Annex of French Subnational Government Budgets

Every budget presented to the local, county, or regional councils in France (as well as to councils of local government associations) must include a debt annex on the status of all outstanding loans as of January 1 of the fiscal year that includes information on the following:

- Year the loan was contracted or bond was issued.
- Bank or financial institution that provided the loan.
- Amount of principal borrowed / debt issued.
- Purpose of the loan / bond.
- Maturity of loan / bond.
- Currency and rate if loan / bond is in foreign currency.
- Interest rate (fixed or floating).
- Index used to determine the rate, if floating.
- Payment schedule (annual, semi-annual, quarterly, or monthly payments).
- Grace period (number of months, years).
- Principal outstanding on January 1 of the fiscal year.
- Interest payment for the fiscal year.
- Principal payment for the fiscal year.
- Principal outstanding on December 31 of the fiscal year.

An annual total is calculated for the last four items above. These data also must be provided for loans guaranteed by the local government to a third party, with the name of the beneficiary of the guarantee.

Source: DeAngelis and Dunn 2002.

when a subnational government is in fiscal distress. What steps can higher-level governments (or others) take to protect citizens and creditors and to correct whatever is causing the financial malaise? While the remedies may be of most immediate interest to lenders and investors, their form and enforcement are questions of national policy interest since they affect issues of self-governance, the delivery of essential services, and the health of financial markets.

A viable municipal borrowing market need not have a detailed statutory intervention process. Rather, the parties can define the intervention and receivership processes contractually, and these processes can be customized for a particular deal. However, there may be constitutional restrictions on the ability of a subnational government to contract for intervention and further practical problems of having courts enforce the contract. So while subnational governments should be free to negotiate monitoring and intervention provisions with creditors, a codified national approach helps to demarcate the relationship between subsovereigns and the financial markets. To ensure greater certainty about creditors' and debtors' rights and to avoid the fallout that an individual default might have on other subnational jurisdictions, it is usually better if national policymakers develop an intervention process through law or regulation that provides a clear framework for dealing with subnational financial emergencies.

Claims after default: Who gets priority and how to collect? A legislated default cure process should include a ranking of creditors and remedies. Various options are available for establishing the priority of claims. In some countries subnational governments are able to put owners of bonded debt at the head of the line. In others, the depository bank or the higher level of government gets that position. In some countries domestic creditors come before foreign creditors, a position that is likely to discourage foreign lending. In the case of security, the first to take physical possession may have the advantage.

Options for remedies are numerous. Creditors could be given the right to intercept funds that are due to a jurisdiction from other levels of government (see chapters 5 and 7). They could have a right to trigger imposition of an additional tax within the defaulting jurisdiction or the appointment of a receiver to control expenditures or the operations of a jurisdiction. Citizens also need protection to preserve minimum essential services, such as public safety and water and sanitation. Creditors should have the right to apply to courts for execution on their security interests and for judicial intervention. Courts should be empowered to deal with insolvency and the priority of claims among creditors and to discharge debt where the local jurisdiction could not otherwise be made solvent.

Enforcing remedies in the event of default. Predictable and timely enforcement of remedies for nonpayment is essential to transform a psychology of nonpayment to a hard credit culture. That requires a legal framework that clearly lays out the negative consequences of a default. Failure needs to involve pain for the erring parties. Also important is the judicial system's effectiveness in enforcing financial and other commercial contracts and property rights. A lender will find comfort in a well-defined legal and political process that clarifies what happens in the event of a default and the conditions for which a lender can force a claim for payment or foreclose on collateral.

In emerging market economies there is often little or no experience in judicially enforcing financial obligations against defaulting subnational government debtors. Only a record of precedent will determine how the judiciary will enforce such claims. Until a system has acquired practical lending experience, including experience with defaults and remedies, it is difficult to know whether the laws on collateral foreclosure are adequate. Substantive and procedural defects in the legal framework for a remedial enforcement system may become apparent only after there has been practical experience with enforcement.

Providing for a bondholder representative. In the event of a default in the payment of a subnational bond issue, the legal framework should give bondholders the right to designate a representative to act on their behalf and to pursue remedies in concert. Otherwise, each bondholder would have to pursue remedies individually, at great cost to all parties involved. That could constrain the type of collateral pledged since it might suggest that collateral must be in a highly liquid form that would allow each bondholder to readily take possession of its share.

The way around this is to designate a representative bank or trustee to look out for the bondholders' interest and act as their surrogate. Not all trustees are alike, but as markets mature, investors will find that the role is increasingly valuable in protecting their interests. Having dependable and skilled trustees also will improve the market's perception of credit quality and lower the costs of borrowing for issuers (see box 11.2).

Recovery from insolvency. The insolvency of a subnational government raises concerns that do not apply to the typical corporate insolvency. Governments do not "go out of business," so procedures are needed for managing the affairs of an insolvent subnational government and its relationships with creditors and for helping it regain financial stability. Such procedures could be initiated by the central government, by the subnational government, or eventually by its creditors. The procedures should clearly define what constitutes subnational insolvency. Regulations need to cover setting deadlines and defining minimum service requirements, order of payments, and limitations on the competencies of elected officials.

Box 11.2. In Argentina Trustees Make a Difference

Having the right trustees can make a difference in protecting bondholders' interests. During its latest financial crisis, Argentina has gained important experience with how the selection of trustees influences the strength of a debt transaction.

In Argentina subnational governments use an intergovernmental payment, the co-participation payment, for securing loans and bonds. There are two ways to intercept this payment if used as security on a loan or bond. In the more common way, the intercept occurs at the source of disbursement—at the Banco de la Nación Argentina (BNA), the commercial bank of the federal government. In the second way the intercept occurs when the provincial bank or the financial agent of the province receives the revenues from the BNA.

Recent Argentine devaluations and widespread defaults have tested these trustee mechanisms. At the first intercept level at the BNA, every bond with a trustee has been honored. At the second intercept level hazards have arisen when province-owned banks were involved, but not when the banks had been privatized.

The Province of Chaco issued three bonds for which the provincial-owned bank (Banco del Chaco) was a trustee. When hard times arrived in 2001, the province unilaterally deferred amortization of the bonds and ordered the bank to return the funds collected in the trust escrow accounts. Bondholders brought suit against the province and Banco del Chaco. The province was sued because it had unilaterally deferred capital payments, and the bank was targeted because it broke the Argentine Trust Law by accepting and implementing the province's order.

There was a very different outcome when the Province of Rio Negro deferred amortization of all of its bonds in January 2002. The province had established a trust in its financial agent (Banco Patagonia), a former provincial bank that had been privatized. Banco Patagonia continued to honor payments to bondholders and to enforce the intercept provision. In other words, private banks have been resolute trustees, and creditors are aware of this.

During 2001 some commercial bank lenders proposed that the federal government permit interception of co-participation revenues at the Central Bank, before the funds ever got to the BNA. The private banks made the request because they believed that the Central Bank had greater independence than the BNA. The federal government rejected the proposal.

Source: Argentina case study, chapter 14.

A subnational government that defaults on its debt and other payments is likely to have poor financial management, overestimating its financial capacity and allowing expenditures to increase faster than revenues. It may require assistance in building a stronger financial base and in establishing good financial management policies and practices.

Procedures for addressing subnational government insolvency can vary considerably. Practices in Hungary and Latvia are informative and illustrate two very different approaches. Hungary relies on the court system, with almost no actions needed by the Ministry of Finance or the Ministry of the Interior (box 11.3). Latvia relies on the Ministry of Finance (box 11.4). In both cases a supervisor or trustee is appointed to assist the subnational government to prepare a financial remediation program and to supervise implementation of the program. Latvia offers the possibility of low- or no-interest financial facilities to aid in implementing the financial stabilization program. In France the Crédit Local de France often requires a financial protocol to stabilize subnational finances, including raising local taxes and reducing expenditures, as a condition for additional guaranteed loan financing for subnational governments in difficult financial positions.

Box 11.3. Debt Adjustment and Subnational Insolvency in Hungary

Under the provisions of the 1996 Municipal Debt Adjustment Act, debt adjustment may be initiated by the municipality or by its creditor through court petition. The conditions for meeting a default situation are defined from the point when an invoice or call for payments or an acknowledged debt has not been paid within 60 days, an obligation required by court decree is not met, or an obligation resulting from a previous bankruptcy decree is not paid. Once a series of notification conditions have been met by the city and the creditor and the court has determined that default conditions do exist, the court appoints a financial trustee. The trustee monitors the business operations of the local government and ensures the provision of mandated public services. The financial trustee must sign all obligations and payments, and the local government's bank cannot enforce any liens or make payments without the countersignature of the trustee.

For creditors the debt adjustment process means that all debts become due, and all claims continue to accrue interest and penalties. Debts must be reported to the financial trustee within 60 days. Deadlines are not extended, and a creditor who fails to report on time must wait until two years after completion of the adjustment process for enforcement of the debt.

The municipality's actions are severely limited once the debt adjustment procedure has been initiated. In particular, the municipality may not assume additional debt, create new enterprises, or purchase ownership interests in enterprises.

A debt adjustment committee (composed of the financial trustee, the mayor, the notary, the head of the council finance committee, and an additional council member) prepares a draft emergency budget, including a detailed listing of mandatory public functions and their financing. However, there are severe limitations. The emergency budget will not fund public health, social, and educational facilities with a usage rate of less than 50 percent or facilities whose costs are more than 30 percent higher than the national average.

Compromise negotiations are initiated to define the reorganization program and the debtor-creditor agreement, and the compromise agreement is submitted in writing to the court. If the agreement meets the requirements of the law, the debt adjustment procedure is complete and the compromise is published in the Enterprise Registry. The financial trustee may supervise implementation of the compromise. A compromise agreement may include liquidation of some assets of the local government.

Source: Hungary case study, chapter 29.

Box 11.4. Financial Stabilization to Address Subnational Bankruptcy in Latvia

The Local Government Financial Stabilization Act of 1988 lists three conditions as a basis for financial stabilization action: the inability of the local government to meet its debt commitments, a value of debts greater than the market value of local assets, and a debt service ratio greater than 20 percent.

The troubled local government, on recommendation of the chairman of the municipal council, the Minister of Finance, the Minister of Special Assignment, or the state auditor may initiate a financial stabilization process. The municipal council must vote on the proposed application for a stabilization plan. If the council rejects the plan, the Cabinet of Ministers may determine that the local government nevertheless should enter a stabilization program.

(*Box continues on the following page*.)

The Stabilization Act sets out options that local governments should review while carrying out their stabilization program: improving tax collection capacity, promoting regional development, advancing amalgamation, privatizing municipal assets, and identifying cost efficiencies to reduce local expenditures.

A supervisor is appointed to assist the local government in developing and implementing the stabilization program. The supervisor makes proposals to improve the budget (which should include finding cost efficiencies to reduce local expenditures) and to monitor budget implementation for compliance with the stabilization program. At the request of the Minister of Finance, the supervisor also can control all municipal expenditures and sign the municipality's payment orders.

Source: DeAngelis and Dunn 2002.

Notes

1. Dillon was a state of Kansas judge who in the late nineteenth century laid out the theory of expressed and implied powers for local governments under the constitution of the states.

2. The federal municipal bankruptcy chapter is permissive in that a state can forbid a subdivision from filing under the chapter. The State of Connecticut, however, did not legislate such a provision until after Bridgeport had filed for protection. Since Bridgeport was found not to be technically bankrupt, the issue of whether a state could prohibit filing after the filing had been made was not decided. Most states have opted out of Chapter Nine.

3. In expert testimony, it was pointed out that the city had $400,000 in cash balances and had not demonstrated that it could not get more by simply raising taxes or cutting expenditures.

4. The court reasoned that the utility only had the ability to charge for electricity actually produced and distributed. It did not have the legal ability to levy charges and pay for electricity not produced or received. This

pledge of payment even in the event electricity is not produced or received (a "hell or high water" provision of payment) was necessary to meet debt service in case of delays in completing construction, as happened here because of massive engineering and construction problems and environmental concerns.

5. There was, however, securities fraud litigation. This was ultimately dismissed, since the standard for proving securities fraud is a difficult hurdle for plaintiffs when it involves government officials.

6. Noel (2000, p. 15) sees auditing as possibly the weakest link in the local government budgetary framework, with the central audit office as the culprit. A difficulty in many countries is the shortage of private sector talent and the high cost of outside auditors. The costs and difficulties of financial administration at the local level often are seen as a practical argument against having direct credit market access.