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# SUBNATIONAL CAPITAL MARKETS IN DEVELOPING COUNTRIES

FROM THEORY TO PRACTICE

Editors | Mila Freire and John Petersen  
with Marcela Huertas and Miguel Valadez





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## **Editors**

**Mila Freire and John Petersen**

**with Marcela Huertas and Miguel Valadez**

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# Preface

This book examines institutional aspects of subnational capital markets and presents case studies of subnational borrowing, showing what has worked, what has not, and why. As decentralization continues and urbanization spreads, local authorities need to provide more services with fewer resources from the central government. Subnational borrowing, leveraging on reliable cash flows and prudent fiscal management, can be an alternative for funding some investments, especially when the useful life of the service is long (such as schools, roads, and public utilities).

Worries that fiscal decentralization may contribute to structural deficits and fiscal imbalances are common, especially in countries where the main policy priority is to control aggregate public sector borrowing. When traditions of fiscal responsibility are weak, accountability systems are immature, and administrative discipline is poorly developed, there is a risk that lower-level governments may abuse their borrowing authority, contributing to aggregate fiscal imbalance with adverse macroeconomic consequences.

However, many analysts argue that, with an adequate legal framework and sound macroeconomic fundamentals in place, local government access to capital markets is compatible with fiscal stability and promotes development of an important segment of the financial market. Necessary conditions include effective supervisory authorities; judicially enforceable contracts; tax decentralization; civic norms that promote fiscal prudence; availability of skilled staff; and adequate accounting, disclosure, and reporting standards.

Increasing numbers of local governments are borrowing from banks and issuing bonds, although in these turbulent times the path has been neither steady nor smooth. During the 1990s 120 subnational governments in Latin America engaged in market borrowing, 150 in Eastern and Central Europe, 11 in East Asia, and nearly 500 in Africa. Domestic bond markets started to blossom in

Poland, Russia, South Africa, and Zimbabwe. However, by the late 1990s the international market for subnational debt entered a period of sustained slump. Domestic bond markets, though not immune to the troubled economic conditions and ongoing structural changes, have continued to rise in importance. The participation of subnational governments in these domestic markets—where success will be critical to reenergizing international access—is the focus of this study.

This book draws from the findings of the Global Program on Subnational Capital Markets launched in 1998 by the World Bank with the sponsorship of the governments of Austria, Finland, Japan, Spain, Sweden, and Switzerland. Led by Augusto de La Torre, Mila Freire, and Marcela Huertas under the supervision of Danny Leipziger and Guillermo Perry, the program examined the experiences of subnational governments in accessing domestic and international capital markets. The objective was a mixture of fact finding and analysis of how countries deal with subnational borrowing and how they reconcile it with budgetary and fiscal balance.

The two-year program significantly advanced knowledge in this area. Among the outputs were regional studies for Latin America, Central Europe, East Asia, and Sub-Saharan Africa, undertaken in collaboration with major universities, rating agencies, investment banks, and development banks. The findings were disseminated through seminars and workshops, international conferences, and training materials. The program brought to light the challenges of allowing subnational governments access to debt financing and the need for a regulatory framework that protects all interested parties: local governments, central governments, and bond issuers.

This book also draws on a variety of other sources and studies, consolidating that work and deriving lessons about how to improve efforts to promote credit market access. It pools information on the issuing of subnational debt and its characteristics, analyzes the role of macroeconomic conditions and market development in the success or failure of such borrowing, and offers policy guidelines for ongoing efforts. The goal is to assist the World Bank and its clients to work as

strategic partners in developing and strengthening capital markets as sources of funds for local governments in emerging economies.

The book provides a framework for analysis based on a systematic study of subnational governments as borrowers and the array of credit markets in which they may operate. Complementing the framework is a set of case studies that document the recent experience of 18 countries in developing markets for subnational borrowers.

Mila Freire  
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# Abbreviations and Acronyms

AMC	Ahmedabad Municipal Corporation
ARD/GFG	Municipal bond consulting firm
Arg\$	Argentina currency unit
AVK	Securities and Finance Ltd./Corporation
BANOBRAS	Banco Nacional de Obras y Servicios Públicos
BAPEPAM	The Securities Regulatory Body in Indonesia
BAPPENAS	Indonesia's National Planning Agency
BAPRO	Banco de la Provincia de Buenos Aires
BGN	Bulgarian Currency Unit Leva
BIS	Bank of International Settlement
BNA	Banco de la Nación Argentina
BNDES	Brazil's Federal Development Bank
BNP	Bond Dealing Corporation [Argentina]
BOCON	Bonos de Consolidación
BPP	Banks Privatization Program
BSF	Bond Service Fund
CAPMAC	Capital Markets Assurance Company
CARE	Indian Credit Rating Agency
CEF	Brazil's Federal Housing and Savings Bank (Caixa Economica Federal)
CIP	Communal Investment Program
COA	Central Office of Audit
CLF	Consolidated Loan Fund
CMC	Chennai Municipal Corporation
CMIP	Consolidated Municipal Infrastructure Programme
CPSCl	Caisse de Prêts et Soutien aux Collectivités Locales
CRISIL	Credit Rating Information Service of India, Limited
CRR	Cash Reserve Ratio
CSFB	Credit Suisse First Boston
CSN	Brazilian company

CZK	Czech local currency
DAK	Indonesia government grant
DAU	Indonesia government equalization grant
DBP	Development Bank of the Philippines
DBSA	Development Bank of Southern Africa
DFLA	Development Fund for Local Authorities
DS	Debt Service
DTC	Depository of Notes in Argentina
EBRD	European Bank for Reconstruction and Development
ECCI	East Coast Constructions and Industries Private, Limited
EMU	European Monetary Union
ESAP	Economic Structural Adjustment Program
ESR	Environmental and Social Report
EU	European Union
EUR	Euro currency unit
FCL	Fiscal Coordination Law
FDI	Foreign direct investment
FEC	Communal Infrastructure Fund
FI	Financial Institution
FINDETER	Financiera de Desarrollo Territorial
GAAP	Generally Accepted Accounting Principles
GDP	Gross domestic product
GFI	Government Financial Institutions
GoH	Government of Hungary
GOI	Government of India
GoTN	Government of Tamil Nadu
GRP	Gross regional product
GSIS	A pension fund
HCMC	Ho Chi Min City
HDFC	Housing Development Finance Corporation
HIGC	Philippines Government Guarantee
HUDCO	Housing and Urban Development Corporation
HUF	Hungarian currency unit
IADB	Inter-American Development Bank

ICICI	Industrial Credit and Investment Corporation of India, Limited
ICMS	Value-added tax in Brazil
ICRA	Indian Credit Rating Agency
IDP	Integrated Development Plan
IFI	Type of foreign debt [Russia]
IGT	Intergovernmental Transfer
IL&FS	Infrastructure Leasing and Financial Services Limited
IMF	International Monetary Fund
INCA	Infrastructure Corporation of Africa
IPTU	Brazil property tax
IRA	Internal Revenue Allotment [Philippines]
ISS	Brazil services tax
JBIC	Japanese bank
LALF	South African Loan Portfolio
LBP	Land Bank of the Philippines
LECOP	Argentinian money bonds
LGCF	Local Government Credit Fund
LGLA	Local Government Loans Institution
LGLB	Local Government Loans Board
LGU	Local Government Unit
LGUGC	Local Government Unit Guaranty Corporation
LIBID	Interest rate
LIBOR	London Interbank Offered Rate
Lpcd	Litres Per Capita Daily
LWUA	Local Water Utilities Administration
MBIA	Bond Insurance Company
MBS	Mortgage Backed Securities
MCMC Act	Indian Act
MDF	Municipal Development Fund
MFM Bill	Municipal Finance Management Bill
MLG	Ministry of Local Government
MoF	Ministry of Finance
MOHA	Ministry of Home Affairs
MUDF	Municipal Urban Development Fund

MUFIS	Czech Local Government Fund
NAFTA	North American Free Trade Agreement
NGO	Nongovernmental organization
NPA	Non-Performing Assets
NSE	National Stock Exchange
O&M	Operate and Monitor
OECD	Organisation for Economic Co-operation and Development
OMBs	Open Market Bonds
OTC	Over the Counter
OTP	National Savings Bank [Hungary]
PDAM	Local water utility
PDF	Provincial Development Fund
PNB	Philippines National Bank
POSB	Post Office Savings Bank
PPP	Public Private Partnership
PRI	Panchayati Raj Institutions
PSE	Public Sector Enterprise
RBI	Reserve Bank of India
RDA	Regional Development Authority Funds [Indonesia]
RDI	Government Loan
RSC levies	Regional Services Council levies
RTI/SCRI	Consulting Firm
S&P	Standard & Poor's
SEBI	Securities and Exchange Board of India
SLA	Subsidiary Loan Agreement
SLR	Statutory Liquidity Ratio
SOE	State Owned Enterprise
SSA	Sub-Saharan Africa
STP	Sewerage Treatment Plant
TE	Total Expenditures
TD	Tunisian currency unit (Dinars)
TNUDF	Tamil Nadu Urban Development Fund
TNUDP	Tamil Nadu Urban Development Project

TNUIFSL	Tamil Nadu Urban Infrastructure Financial Services, Limited
TR	Total Revenues
UBS	United Bank of Switzerland
UDI	Unidades de Inversión [México]
ULB	Urban Local Body
UNCHS	United Nations Centre for Human Settlements
UNDP	United Nations Development Program
UPAP	Urban Policy Action Plan
USAID	United States Agency for International Development
USD	United States Currency Unit
VAT	Value-added tax
ZAR	Zimbabwe currency unit