

The real reason why cities in sub-Saharan Africa aren't issuing municipal bonds

Cities around the world have been financing their long-term investment needs through municipal bonds for centuries. The first recorded transaction occurred in Genoa in 1150. More recently, in the US, over [\\$111bn](#) were issued in November and December last year for infrastructure, pension obligations and other critical needs across the country.

By [Jeremy Gorelick](#) 16 Feb 2018



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A bond is a debt security issued by a public agency to raise money, often for infrastructure projects. Sovereign bonds are widely used by national governments, and municipal bonds are used by many cities (particularly in the Americas).

For comparison, cities in sub-Saharan Africa have raised less than 1% of the US amount since 2004. Only a handful of local governments have successfully issued municipal bonds, almost all of them in South Africa. Yet there is a desperate need for infrastructure investment throughout the region. Current estimates place the financing gap at [\\$41.6bn](#). Municipal bonds, originated for urban infrastructure, will go a long way to addressing this gap.

Why aren't African cities using municipal bonds to raise money for capital projects?

Some international experts point to a lack of local capacity and technical ability to prepare a municipal bond. Others argue that projects are not structured in ways that ensure a sufficient return to prospective investors. Still another group insists that municipal leaders lack the interest or ability to use more transparent financing instruments.

All of these views stem from a belief that civil servants and investors in sub-Saharan Africa are not exposed to global financial best practices, or are unwilling to comply with them. Some of these assumptions are both wrong and offensive.

My [paper](#) considered this question and came to a conclusion that there is another key contributing factor that is often overlooked. This is the weakness in regulations governing the roles and powers of cities' authorities.

to raise finance and the ability of central governments to adjust these based on political whims.

This creates an uncertain environment. Prospective issuers cannot be confident that their preparatory work will ultimately lead to a transaction. And they can't be sure that their efforts can be undone at the last minute by a government.

A bridge too far for Dakar?

In my paper I argue that poor financial skills and ignorance is less of a problem than many suggest.

Take, for example, the cities of Dakar (Senegal) and Kampala (Uganda). Both recognised the need to reduce their reliance on development assistance or commercial banks. They also recognised that, to attract investment from institutional investors like pension funds and insurance companies, they would have to demonstrate their creditworthiness.

Creditworthiness can be understood as both the willingness and the ability to borrow. To achieve a satisfactory credit rating, Kampala and Dakar needed to prove that they could reliably raise and manage money from a range of local sources, including from property taxes, parking fines and license fees.

Months of dedicated work yielded positive results. Independent ratings agencies assessed the health of the cities' finance systems. Both cities received investment-grade credit ratings, meaning that prospective investors could be reasonably confident of recovering their money.

Indeed, after the cities secured these credit ratings, several local investors indicated their desire to purchase municipal bonds.

But political conflicts between the local and national levels led to Dakar's bond issuance being [cancelled](#) at the last minute. And in the case of Kampala, national regulation has [capped](#) the city's borrowing at a prohibitively low amount. This limit means that the city cannot borrow enough money to make bond issuance worthwhile.

What's the real problem?

If the issue doesn't stem from creditworthiness, technical proficiency, or financial market readiness, there must be another factor limiting municipal bond issuance.

My [paper](#) attributes the lack of bond issuance not to the municipality or potential investors, but to limiting behaviour of national governments.

While they devolve substantial responsibilities to cities, they limit their ability to raise funds. This is often driven by a fear on the part of sovereign leadership to allow cities to have a hand in holding their own purse strings. This power can ultimately lead to less dependence on the national government.

A closer look at a number of cities shows that only those in highly centralised countries – like Cameroon – highly decentralised countries – like South Africa – have been able to successfully issue bonds. The argument for the success of bond issuance in decentralised economies is well-understood in the African context and more broadly around the world. But the case for success in countries at the other end of the spectrum is less-considered but equally valid.

Cities in heavily centralised countries are not provided with autonomy for decision-making. Instead they are positioned as direct participants within an administrative machine governed by decisions from the capital. Any financial obligation entered into by a city in this political ecosystem is viewed as one explicitly guaranteed by the central government.

South Africa provides a good example of how enabling legislation can help municipalities raise money. In 2004 the country passed a law – [The Municipal Finance Management Act](#) – that sets out clearly what financial activities cities can and can't undertake. Cities are prohibited from borrowing for operational expenditures and, instead, can only borrow for long-term investments.

The law has made it safer for pension funds, insurance companies and other investors to lend to city governments. They know that municipalities cannot issue bonds without being in full compliance with existing regulations that are not subject to different types of interpretation or changes in political will.

By comparison, the cities of Dakar and Kampala have struggled because of ambiguous or contested relationships with their national governments. And both cities have spent years improving their revenue collection and management systems to achieve an investment-grade credit rating. Yet the constraints on municipal bonds are created by systems beyond the city's control.

Clarity is key

More African governments need to clarify enabling regulatory and legal environments on the sub-national level. These must explain how much cities can borrow and under what conditions. Only then will African cities be able to use bonds to finance the infrastructure their citizens so desperately need.

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