

Municipal Bonds in sub-Saharan Africa:
The Checkered Past of Debt Instruments in an Era of Incomplete Decentralization

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Abstract

Cities across sub-Saharan Africa are faced with challenges in urban planning and service delivery due to insufficient capital for long-term investment projects. Despite the success of municipal bonds as a tool to assist in closing this financing gap in much of the rest of the world, there have been limited examples of success in this region. This study looks at the universal obstacles limiting sub-national governments from using municipal bonds as a financial instrument before examining four case studies – Johannesburg, Douala, Dakar and Kampala – to better understand their approaches to municipal bond issuance. Based on the findings from research, the thesis concludes that the chief obstacle blocking the uptake of municipal bond issuance as a means for raising funds stems from a variety of elements in the constitutional and regulatory systems in each country. This represents a significant departure from the commonly-held understandings that cities in the region are not eligible for long-term debt and are ill-managed, lack capacity, or are not viewed as creditworthy by institutional investors and other purchasers of municipal bonds.

The success of municipal bond issuance appears to be contingent on strong interlinkages between central and subnational governments. This dissertation offers a critical review of the explicit and implicit powers granted to local governments under the constitutions of each of the countries, specifically the legislation that enables or prohibits municipalities from issuing bonds. Reform to the existing regulatory and legal environments across the African continent, ones that govern a financially-sustainable level of indebtedness for sub-sovereign governments, is an essential step in ensuring the future growth of Africa's cities.

Preface

The following work would not be possible without the support of many friends and family. Thank you to my supervisor, Dr. Sue Parnell, who was a constant source of information and guidance throughout the process. I would like to give special acknowledgement to my parents, Jerry and Donna, my sister, Sara, and my grandmother, Natalie. None of this would have been possible without the advice and moral support of my wife, Chantelle.

The idea for this dissertation was conceived in 2014, stemming from the frustration that I felt following the aborted Dakar municipal bond and the realization that future obstacles faced by other municipal finance practitioners might be avoided through a deeper investigation into the power of central governments over sub-national finance decisions. Cities, particularly in sub-Saharan Africa, are struggling with uncontrolled urban growth and ageing or non-existent infrastructure. Without significant financial flows to meet the needs and expectations of city-dwellers, a crisis looms in the near future. Through the intervening years until my matriculation into the University of Cape Town PhD program, I shared my observations through a handful of works published in a mixture of academic and financial journals and on commission by several agencies, including the International Institute of Environment and Development (IIED)'s annual edition on cities, the Organization for ECD's Development Matters, UN-Habitat, the UN Sustainable Development Solutions Network, the United Kingdom's Department for International Development, and the United States Agency for International Development. My research was significantly enriched by my ability to spend long periods of time in both Dakar (the better part of five years) and Kampala (intermittently for over a year) and enabled me to have more detailed conversations and access to a wider range of documents and experts as a trusted friend of the city than might have been otherwise possible.

Deep recognition is due to all of the experts who agreed to interviews with me during the course of my research, including: Beatriz Tembe, Bernard Luyiga, Christel Alvergne, David Savage, Ed Roche, Guy Essome, Herbert Asimwe, Konstant Bruinette, Leonard Mathu, Marc Joffe, Marco Kamiya, Marie Odile Sene, Matthew Glasser, Neil Walmsley, Patrick Musoke, Rodrigo Gonzalez, Ronald Balimwezo, Salim Rouhana, and Thibault Rannou. A special thank-you to my former colleagues from Dakar, including: Babacar Thioye Ba, Dieynaba Dabo Mbaye, Dieynaba Thiam Ka, Khady Dia Sarr, and Rokhaya Sarr. And a deep thank-you to the first reviewer of my zero draft, Peter Schofield.

An important issue to note for readers is the fact that I have used American spellings throughout this thesis, meaning that I have written "color" instead of "colour" or "analyze" instead of "analyse."

Table of contents

Abstract	3
Preface	4
List of Figures	6
List of Tables	7
List of Plates	7
Introduction.....	10
Situating the Problem of Local Government Finance in Africa	16
Section 1: Theory:.....	33
Determining the Factors Governing Municipal Finance.....	33
Chapter 1: Decentralization	34
Chapter 2: Municipal Bonds	53
Chapter 3: Decentralization and Municipal Finance in Africa: African Exceptionalism?.....	68
Section 2 : Practice:	89
Theoretical Reflections	89
Understanding the Complexity of Municipal Finance Through Case Studies.....	89
Chapter 4: Successful Bond Launches in sub-Saharan Africa.....	90
Chapter 5: The Senegalese Experience	102
Chapter 6: Efforts in Kampala	126
Conclusion	144
A Final Word of Caution	147
References.....	149

List of Figures

Figure 0.1: Municipal budgets in South Africa by percentage covered through available programmed funds, 2013/14–2017/18	20
Figure 0.2: Allocation of 2016/17 South African metro budgets between operating and capital expenditures (ZAR millions)	21
Figure 0.3: South African municipalities that have overspent on budgeted operating expenditures (>25%) and underspent on budgeted capital expenditures (<30%), 2013–2017.....	22
Figure 1.1: Non-revenue water per connection per day (m ³).....	46
Figure 1.3: African and European sub-national government expenditure as a percentage of GDP, 2012–2013	49
Figure 1.4: Total African infrastructure commitments by region and source, 2016.....	50
Figure 1.5: Sources of debt financing in sub-Saharan Africa, 2008–2016	51
Figure 2.1: Defaults by category (percentage), 1970–2011	61
Figure 2.2: Foreign aid to sub-Saharan Africa (percentage of donor total), 2000–2012	65
Figure 2.3: Chinese local government bonds issued, per semester (CNY billions), 2015–2017	66
Figure 3.1: Budget allocations in East Africa Protectorate (in GBP), 1900–1910	72
Figure 3.3: Allocation of central government expenditure (% of total), England, 1905	74
Figure 4.1: Spread between the interest rate on the Johannesburg municipal bond (COJ02) and a South African sovereign bond (R157) with similar maturity rates, 2003–2006	95
Figure 4.2: Funding sources (percentage), City of Johannesburg, 2015.....	96
Figure 4.3: Tax revenues transferred from Cameroon central government, relative to total City of Douala revenue (percentage), 1999–2003	99
Figure 5.1: Religious distribution in Senegal and Côte d’Ivoire	104
Figure 5.2: Francophone West African participants in CFA franc	105
Figure 5.3: Territorial organization in Senegal.....	112
Figure 5.4: Relations of central government, ministries, deconcentrated government services, and local governments in Senegal	113
Figure 5.5: District electoral results, Grand Yoff (percentage), 2016.....	117
Figure 5.6: Financial instruments considered by the City of Dakar.....	119
Figure 5.7: Expected distribution of Dakar’s municipal bonds in the primary issuance, according to CGF Bourse, syndicate lead for bond issuance	122

Figure 6.1: Sources of income for Kampala Capital City Authority, 2012–2014	137
Figure 6.2: Total income for Kampala Capital City Authority, 2012–2014	138

List of Tables

Table 1.1: Measuring sub-national fiscal autonomy	42
Table 1.2: Africa’s infrastructure deficit.....	47
Table 2.1: Bank lending versus bond issuance	63
Table 5.1: <i>Ease of Doing Business Report</i> and <i>Corruption Index</i> rankings for countries in the West African CFA franc currency bloc, 2017.....	106
Table 5.2: National credit ratings for countries in the West African CFA franc currency bloc	107
Table 5.3: Local currency bond issuance, Senegal, 2005–2015	108
Table 5.4: Financial information, City of Dakar (thousands of CFA francs), 2008–2014	115
Table 5.5: Year-end accounting, City of Dakar (all amounts in CFA francs), 2014–2015	121
Table 6.1: Financial information, City of Kampala, 2011–2015	140

List of Plates

Plate 3.1: Mapping Africa’s kingdoms in pre-colonial Africa (1858).....	75
Plate 3.2: Mapping colonial Africa (1885)	76
Plate 3.3: Mapping colonial Africa (1914)	78
Plate 3.4: Colonial legacies of modern Africa	85

Acronyms and abbreviations

ADL	Agence de Développement Local
ADM	Agence de Développement Municipal
AFD	Agence Française de Développement
CFA	Communauté Financière Africaine
CFO	chief financial officer
CNY	Chinese Yuan
CREPMF	Conseil Régional de l'Épargne Public et des Marchés Financiers
CUD Finance	Communauté Urbaine de Douala Finance
DFI	development finance institution
DFMP	Dakar Municipal Finance Program
E-K-J	Entebbe – Kampala – Jinja
EU	European Union
EUR	Euro
FDD	Fonds de Dotation de la Décentralisation
FDS	Fiscal Decentralization Strategy
GBP	Great British Pound
GDP	Gross Domestic Product
GO	general obligation bond
KCCA	Kampala Capital City Authority
MFMA	Municipal Finance Management Act No. 56 of 2003
OECD	Organization for Economic Cooperation and Development
PEFA	Public Expenditure and Financial Accountability
PRECOL	Programme de Renforcement et d'Équipement des Collectivités Locales
SDG	Sustainable Development Goal
SNG	sub-national government
UGX	Uganda Shilling
UK	United Kingdom
UNCDF	United Nations Capital Development Fund
USA	United States of America
USAID DCA	United States Agency for International Development's Development Credit Authority
USAID	United States Agency for International Development
USD	United States Dollar

WAEMU West African Economic and Monetary Union
ZAR South African Rand

Introduction

Cities in sub-Saharan Africa are growing at an unprecedented rate due to internal migration and general population growth. Urban population growth brings with it many benefits, but in cash-constrained municipalities, this can be particularly problematic as the available financial resources cannot keep pace with municipal infrastructure needs. Urban growth was not as challenging to African local governments in the past for several reasons: (1) cities were not growing as rapidly; (2) cities could rely on national governments for transfers of resources sufficient to meet municipal investments; and (3) national governments were themselves not pressured by international agreements and external, unfunded mandates to meet global development goals. In short, the confluence of these factors has widened the infrastructure finance gap in cities in sub-Saharan Africa and has made municipal leaders recognize the need to expand the variety of mechanisms available to help to close the infrastructure finance gap.

Academic literature suggests that the reasons why cities in sub-Saharan Africa have not been able to successfully access finance for capital investment in infrastructure are related to internal challenges including: (1) low capacity of municipal workers to consider different financial instruments, (2) lack of long-term capital investment plans at a City-wide level, (3) lack of financially sustainable, revenue-generating projects, and (4) a mismatch between the lifespan of municipal assets and the investment preferences of institutional investors. While these factors, which have much in common with the experiences of local government everywhere in the world, have some traction in the African context, they are necessary but not sufficient to explain the inability of municipalities to meet the demand for the requisite capital investment. I argue instead that the principal reason why cities in sub-Saharan Africa have not been able to successfully access finance for infrastructure investments is related to an extrinsic challenge: **the lack of a clear devolution of power from the central government to municipal government.**

All cities need access to capital, and the relative fiscal power of the sub national authorities is a deeply political construction. Moreover, the current configuration of intergovernmental fiscal arrangements is typically a product of past practices and power struggles. Cities, which are aggregations of human settlements, arose from the belief in “success in numbers,” whether for agricultural purposes, protection, or the idea of cost-sharing for public goods. In most societies, over time, these cities were subjugated to national polities, where power and decision-making were concentrated in a single person or agency, a trend which has continued in a number of instances to the present day. Some countries, particularly those that had profound influence over contemporary development patterns in sub-Saharan Africa based on their colonial-era dominance, have limited decentralization; this phenomenon has impacted the post-colonial

politics and practices across much of the African continent. Accordingly, and of critical importance for a more comprehensive consideration of municipal finance, this thesis focuses on the recognition that without a clear commitment to the practical decentralization of powers, irrespective of the strengthening of internal fiscal capacity of local government, utilization of the full range of tools (including bonds) for municipal finance will be limited.

For much of the post-colonial period, cities have been heavily reliant on transfers from the central government to cover the costs of urban infrastructure. Large sums of money were not involved, in part because cities were small. Yet, even at this lower magnitude, insufficient monies were allocated and there is now a massive infrastructure backlog as well as lack of clarity on how future urban infrastructure needs might be met. Where there is a shortfall, cities have considered other mechanisms: loans from municipal development funds administered by central government agencies, loans from development finance institutions, and (in rare cases) loans from commercial banks. Based on the lack of a clear devolution of power from the central government to municipal governments which would be constitutionally protected and enshrined, cities in sub-Saharan Africa have generally been barred from considering one of the most potent financial instruments widely used elsewhere in the world: municipal bonds.

Municipal bonds are arguably one of the most transparent of financial instruments available to municipalities: relative to the other tools, they require a higher degree of reporting in documents available to a wide variety and number of investors, are less subject to interference by national government or other stakeholders, and are priced at the time of their issuance based off of and driven by investors' perceptions of the creditworthiness (willingness and ability to repay debt) of the City relative to prevailing market conditions for other issuers. More importantly, bonds typically offer the longest term for financial repayment on projects that require a large injection of capital (typical conditions for urban infrastructure investments). This is particularly meaningful in sub-Saharan Africa, where municipalities face an ever-increasing infrastructure investment gap and have exhausted other avenues (transfers, loans) as mechanisms. Curiously, cities in Europe are less frequent issuers of municipal bonds than their North American counterparts; this may be a factor of both the lack of political and fiscal decentralization in Europe as well as the preference for less transparent loans over more transparent bond issuances.

Previous analyses of municipal finance claim that the reason why cities in sub-Saharan Africa do not raise funds through municipal bond issuances lies in the concept of African exceptionalism: the idea that Africa is unique and that its growth and development pathways are markedly different from those found elsewhere around the world. This thesis argues that African exceptionalism may be relevant in general terms but that, in terms of the financial decentralization required to issue a municipal bond, there is nothing particularly

unique about the African experience; the current uniqueness of Africa is not its development pattern but instead its progression along the pathway towards financial decentralization that has already been undertaken in other countries. That said, each of Africa's 54 countries is unique, and its development during the pre-colonial, colonial and post-colonial eras makes it such that there is no "one-size-fits-all" approach that would prescribe the steps necessary to unlock additional financial resources. During the pre-colonial era, African civilizations allowed for a higher level of decision-making than that allowed during the colonial era, which was driven by the desire of mercantilist European economies to extract resources with the highest level of efficiency possible. The two prevailing systems in colonial sub-Saharan Africa – the French policy of assimilation and the British one of indirect rule – both centralized power at the colonial level, not at the sub-colonial level, and this continued into the post-colonial era. The legacy left by the colonial powers hampered decentralization, which directly negatively influenced the likelihood of financial decision-making and urban planning taking place at the sub-national level; this meant that Cities until recently did not even consider how to finance needed urban infrastructure since this was handled at the national level. Former colonial powers, which themselves have issues with decentralization, have continued to exert strong influence over sub-Saharan Africa, particularly in francophone countries; this has not been as pronounced in former British colonies, which have encouraged more independence. With rare exceptions, and based on this colonial heritage which has carried over into political decision-making today, Cities in sub-Saharan Africa have largely been unable to raise finance through bond issuances.

Cities in sub-Saharan Africa have largely been unsuccessful in using municipal bonds as meaningful instruments, despite the fact that they have met many of the pre-conditions laid out above (matching investment needs with available finance, development of creditworthiness, bankable projects and internal capacity), highlighting the fact that the challenge can be found in the lack of decentralization. Cities that have been successful in issuing bonds – Johannesburg and Douala – have done so through either a significant amount of decentralization (South Africa) or no meaningful decentralization (Cameroon), such that decision-making at the local level is codified to allow municipalities to act confidently and within a larger governmental ecosystem, either as fully empowered Cities or as extensions of central government. Cities that have not been successful – Dakar and Kampala – have faced challenges because of the lack of functional fiscal decentralization to sub-national governments.

This begs the important question: why are national governments across Africa so leery of decentralization, particularly financial decentralization? Financial decentralization, on the surface, should be desirable for national governments: when done correctly, it frees up capital traditionally earmarked for cities that can instead be used in less financially sustainable areas (typically rural areas), and allows national governments to hand over responsibilities for urban management to sub-national ones. However, with this ceding of

power over financial decision-making come perceptions of increased power at the sub-national level, which can lead to political challenges in the future. Further, in financially weak countries, additional obligations and contingent liabilities taken on by sub-national governments may lead to a weakening of the national government's ability to take on additional debt in the future (although it should be noted that most cities borrow a fraction of the overall national debt, and this is generally policed by the financial markets and their demonstrated interest in taking on sub-national debt). Another critically important consideration is the relative financial immaturity of municipalities within the broader political system in Africa – a limited credit history coupled with a plethora of credit enhancements could be harbingers of a higher risk of default driven by a reliance on a safety net provided by external bodies as Cities experiment with different types of instruments. Politicians and decision-makers at the national level use these three arguments to their advantage in arguing against decentralization and to substantiate their fears over a loss of power to sub-national governments.

To demonstrate the weaknesses of the arguments against financial decentralization and to debunk the longstanding theories about the reasons why cities in sub-Saharan Africa cannot issue municipal bonds, this thesis turns for an in-depth review of two of the four cities identified above: the two that are stalled in the process. The prerequisites of decentralization, whether nearly full (as in the case of South Africa) or nearly fully incomplete (as in the case of Cameroon), led to two closed financial transactions, based primarily on the implementation of and strict adherence to constitutional systems. Less encouraging examples, those in Senegal and Uganda, serve as a demonstration of how mixed messages on decentralization at the sub-national level created confusion and, ultimately, led to failures to launch in both instances. Senegal, a former French colony, is an archetypal example of a country with a highly centralized government with limited devolution of power, despite some efforts made by forward-thinking leadership at both the national and sub-national levels. Despite the limited devolution of power, Senegal's capital – Dakar – was able to creatively finance its urban infrastructure through a series of increasingly autonomous tools. This started with an increasing reliance on transfers of funds from the central government and moved on to borrowing from a government-run municipal development fund, as a precursor to a loan from a development finance institution and, later, loans from domestic commercial banks. Although most of the conditions for a successful municipal bond issuance were met – both internally (from a financial and planning perspective) and externally (through sufficient available finance from interested investors and a favorable interest rate for bonds relative to loans) – the national government halted the transaction, citing constitutional reasons, which most understood to be politically driven.

Uganda, a former British colony, is representative of the British tradition of indirect rule, which allowed

for a higher degree of sub-national government autonomy. With the legislation introduced by the Ugandan government allowing for more power to be held in the hands of the sub-national government in Kampala, the Ugandan capital was well-poised to launch a municipal bond based on its financial strength, transparency, accountability, and comprehensive master plans coupled with investor interest. Kampala was ultimately unsuccessful in its efforts to launch a municipal bond due to constitutional limitations on the amount of money that it could borrow (the amount of debt that it could constitutionally take on was insufficient to meet its financial needs for planned infrastructure investments); the national government has, to date, been unwilling to change these limits, which some claim is indicative of its lack of full commitment to decentralization.

Ultimately, this thesis's main argument is that cities face a significant barrier in their quest to access the magnitude of finance required to meet their long-term infrastructure investment needs – namely, an inability to achieve sufficient autonomy to make long-term financial decisions as manifested through financial decentralization. Ideally, it will help to inform national policy-makers, City officials, aid workers, and other key stakeholders involved in the process to better understand the challenges facing the expansion of the financial instruments available to municipalities in sub-Saharan Africa. To address this, the thesis seeks to explore the answers to the following questions:

- 1) What are the reasons why bonds are appropriate tools for municipal leaders to use in financing their urban infrastructure needs? How do bonds differ from other tools and instruments that Cities have used, and continue to use, today?
- 2) Why have there been so few successful (i.e., closed) municipal bond issuances in sub-Saharan Africa? Is it due to internal factors, such as a lack of capacity at the municipal level to demonstrate financial responsibility and/or to launch a complex instrument, or is it driven by external factors, such as incomplete decentralization?
- 3) How, and what, does the experience of municipal bond finance add to our understanding of intergovernmental politics in sub-Saharan Africa?

Following this Introduction, Section 1 of the thesis begins with a consideration of the existing literature on decentralization, its history, and its challenges, and demonstrates that decentralization is needed to allow for financial decision-making at the local level (Chapter 1). Chapter 2 presents a literature review of the history and description of municipal bonds, drawing from examples in the global north and providing a comparison between the European approach of bank-direct lending to municipalities and the American approach of institutional investor-driven capital markets activities through municipal bonds. Having built

the argument that municipal bonds are an appropriate tool for financing urban infrastructure and that they function best within a context of decentralized, empowered local governance, the thesis turns to a review of the unique situation in sub-Saharan Africa in Chapter 3, reviewing both its ethno-cultural historical preferences as well as the European-imposed political constructs that shaped highly centralized nation-states, with little power constitutionally designated to the local level. Armed with this information and the full abstract theoretical picture of the difficulties encountered by those local governments in sub-Saharan Africa that are considering municipal bonds, the thesis moves on to Section 2, in which the experiences of four cities with mixed successes in municipal bond launches are reviewed in greater detail: Johannesburg, South Africa, and Douala, Cameroon (Chapter 4), Dakar, Senegal (Chapter 5), and Kampala, Uganda (Chapter 6).

Ultimately, it is my hope that this thesis will explore and unpack the question of how municipal bonds can be meaningfully used to finance urban infrastructure needs across sub-Saharan Africa as well as why they have been facing opposition in instances where their issuance has been attempted. It is important to remember that municipal bonds are not the only way for cities to raise capital for their projects, but they do represent a rational and reasonable solution that has, to-date, been under-used.

Situating the Problem of Local Government Finance in Africa

Today, one-half of the world's population lives in cities, which generate more than 80% of global Gross Domestic Product (GDP) (Trujillo & Parilla 2016).¹ During the period from 2006 to 2020, all ten of the fastest-growing cities are projected to be located in the global south (City Mayors Foundation n.d.). The future development of the global south now depends significantly on how well urban population growth is managed in cities (Dobbs 2012). If well-managed, cities can be engines for economic growth and for expanding access to basic services for large sections of the national and regional population; sound management can also ensure that existing high levels of urban poverty are reduced, particularly in Africa (Swilling 2017). But to date, the correlation between urbanization and economic growth has been weaker in developing countries than in developed countries (Fox 2012; Gollin, Jedwab & Vollrath 2016). This can most notably be seen in Africa relative to other parts of the world, where rates of unemployment have risen and real average wages have fallen (International Labour Organization 2018). This can partially be attributed to a fundamental mismatch between the expectation that urbanization is necessarily accompanied by industrialization, as elaborated by Potts in her argument that some urban areas are simply enlarged rural settlements without the key characteristics of urban centers, which themselves carry with them new job functions and economic opportunities (Potts 2017). Notwithstanding the challenges of defining urban areas, “urbanization promotes proximity between diverse activities that feed off each other in various ways” (Turok 2016: 34).

There is abundant evidence that countries in sub-Saharan Africa are struggling to face the challenges of urban population growth (Ebeke, Nstama & Mireille 2017; Edoun 2017; Glaeser 2014; Onjala & K' Akumu 2014). In line with the previous paragraph, urban population growth can increase substantially in the absence of urban economic growth, which further compounds the problem and can lead to dramatically high rates of urban unemployment (Crankshaw & Borel-Saladin 2018). The typical emerging City lacks control of land use or provision of adequate services.² This means that traffic congestion wastes productive time and pollutes the air (Cervero 2013); poor populations are concentrated on sites subject to a myriad of hazards (Satterwaite et al. 2007); and disparities between rich and poor create social tensions and

¹ It is worth noting that this figure understates the total value of urban economies, as it does not account for the informal economy (i.e., those economic activities that fall outside of the purview of official regulation). Informal employment, which includes informal employees in formal enterprises, accounts for more than 66% of non-agricultural employment in sub-Saharan Africa (Vanek et al. 2014).

² The differentiation of the city from the City is an important and sensitive academic device dealt with in this thesis with the understanding that the “city” references an urban settlement while the “City” indicates its governing authorities, as discussed by Cirolia (2018) in her analysis of the application of the terms in a study of Kisumu, Kenya.

insecurities that can turn the hopeful vision of life in a modern city into a nightmare, especially for the poor (Webb 1998). The economic potential of cities will not be fully realized until City governments have both the tools to manage the development challenges being thrust upon them and the resources to improve economic, environmental, and social conditions. Municipal leaders recognize the importance of financial management and long-term capital investment planning, but are often constrained in their abilities to prioritize strategic investments that match future growth when they are unable to successfully source the financing required to meet their operational budgets (UCLG GOLD 2010).

Urbanization in sub-Saharan Africa has rapidly increased over the past decade (UNDESA 2014). Africa has increasingly become an urban continent, with the average urbanization rate reaching 37% in 2014, an increase of about 10 percentage points since 1990.³ During the period 1990–2000, the average annual growth rate of the number of urban dwellers was 3.3%, the highest in the world (Pieterse 2014). Labor has rapidly moved away from traditional sectors and rural areas to take up job opportunities in urban zones, in a manner that has not always led to an improvement in living standards, nor to economic growth in general. One of the main consequences of rapid urbanization has been the rapid development of the informal service sector in many African economies (Obeng 2011).

Another direct implication of the rapid urbanization process in Africa has been the growing size of primal cities (i.e. the largest city in a country). As discussed by Brückner (2012), the average primacy in Africa is much higher than in other regions; in particular, it is much higher than in industrialized countries. According to Brückner, increases in the urbanization rate have had a significant average negative effect on GDP per capita growth in Africa. Ades (1995) highlighted the association of a high incidence of dictatorship and political instability with large primal cities. The urbanization literature has also demonstrated the negative effect of large primal cities on aggregate economic growth (Brückner 2012; Henderson 2003). This is consistent with negative externalities arising from increases in squatter settlements in large primal cities; these are exacerbated by the confluence of a rapid increase in the number of squatter settlements, the constant growth of the number of families in these settlements, and the increases in the growth rate in these communities driven by rural-to-urban migration (Hardoy & Satterthwaite 2014).

A recent study published by the World Bank in its *World Development Report* (2013a) indicated that not all countries experienced higher levels of GDP when a larger share of the population moved to urban areas. Henderson (2005) finds no econometric evidence linking the extent of urbanization to either economic or productivity growth or levels. Importantly, Henderson (2003) finds that large primal cities exert a negative

³ World Development Indicators data set (<https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS>, accessed October 2018).

impact on aggregate growth. In a multivariate analysis of cross-country panel data from 1970 to 2000, Bloom, Canning, and Fink (2008) found no evidence that the level of urbanization affects the rate of economic growth. Gollin, Jedwab, and Vollrath (2016) distinguish between two types of urbanization developments which have distinct developmental implications. One pattern is that urbanization can occur with structural transformation and therefore cities are “production cities”, with a mix of workers in tradable and non-tradable sectors.⁴ The other pattern is associated with an increase in urbanization not linked to structural transformation. In these countries, urbanization takes place in “consumption cities” where the mix of workers is heavily skewed toward non-tradable and low-productive service sectors (Gollin, Jedwab & Vollrath 2016).

As a result, unfortunately, the world at large still under-invests in the infrastructure required to meet long-term growth expectations. To cope with massive population growth, human development needs, and climate change as well as to sustain economic growth and productivity, more needs to be done to boost and retrofit infrastructure capacity. The world must invest an estimated USD 1 trillion more than its current allocations per year for the foreseeable future to meet basic infrastructure needs. These figures translate into global infrastructure needs of 3.8–6.6% of GDP: 3.8% in the global north, 6.6% in the global south (Dobbs 2013).

Increasingly, institutional investors, companies, and foundations have been approached to provide private capital to help fill this financing gap. One important source of funds, particularly in rapidly growing cities in sub-Saharan Africa, is municipal debt. This is because municipal bonds lend themselves to the lengthy repayment period required by sub-national governments, which in turn is determined by the willingness and ability of end users (citizens) to pay for the costs of the investments. Case studies of two cities in sub-Saharan Africa presented later in this thesis will demonstrate that, even with sound financial management, constitutionally mandated and predictable transfers from national government, and annual tax collection, municipalities do not have access to the type of funding required for the delivery of capital-intensive projects; in a 2017 interview with the author, Marco Kamiya of UN-Habitat shared that “the availability of finance for critical infrastructure is insufficient to meet the pace of rapid growth in sub-Saharan Africa”.⁵ A noteworthy observation here is that municipalities in Africa, regardless of their British colonial heritage (which provides for tax collection from individuals by agents of municipalities directly for municipal accounts) or French colonial heritage (which provides for tax collection from individuals by agents of the

⁴ The term “production cities” refers to those cities where a large fraction of workers are engaged in manufacturing or in tradable services, such as finance; this is in contrast to “consumption cities,” where a large number of workers are employed in non-tradable services, such as commerce and transportation or personal and government services (Gollin, Jedwab & Vollrath 2016).

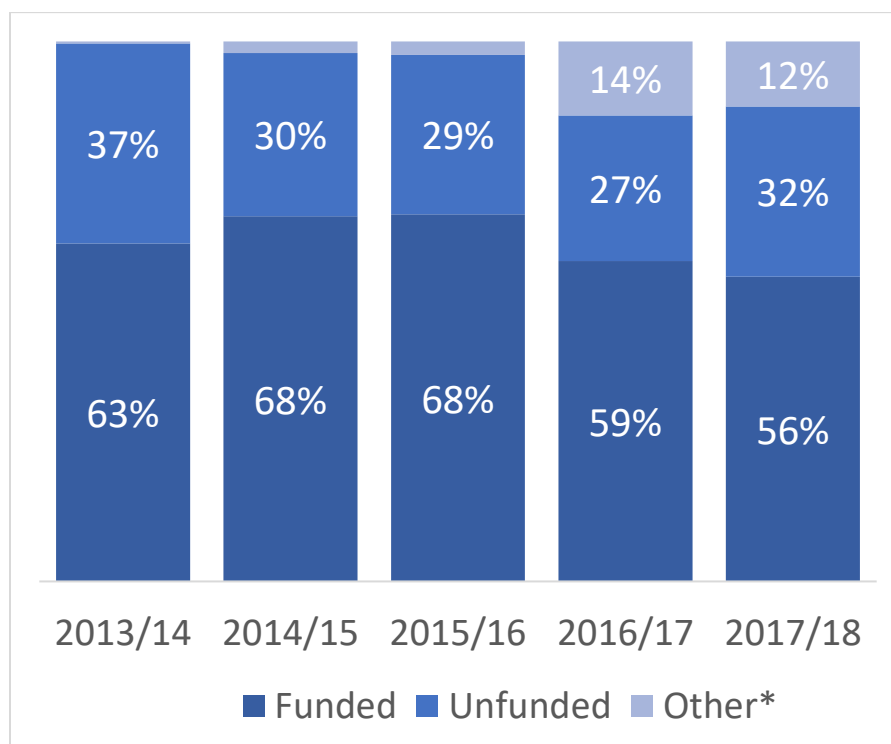
⁵ Interview with Marco Kamiya, 19 June 2017, Nairobi, Kenya.

central government indirectly for municipal accounts), are all coming to the conclusion that municipal bonds represent one of the most efficient and effective tools in the search for long-term, competitively priced funds for infrastructure (Siddique 2015).

Municipal finance is especially important in the global south because of (1) the relatively recent decentralization of power away from central government towards provinces and cities; and (2) the rapid unplanned urban population growth found in the world's low- and lower-middle-income countries. Many politicians, whether at the national or municipal level, conflate municipal finance with municipal bonds, and further think that "the best way to ease the pressure on the shrinking national fiscus will be through the introduction, en masse, of municipal bonds to cash-strapped districts."⁶ But municipal bonds are not a development panacea. In countries across sub-Saharan Africa, the challenges and obstacles associated with accessing repayable finance at the municipal level to fully close the financing gap between public funds and those available from the private sector can be highly damaging, because sub-national governments have clear mandates to provide certain public services and infrastructure. While the responsibilities delegated to local governments by law vary considerably from one country to the next, Cities in the global south often have mandates to provide a wide range of services covering: (1) local basic services and infrastructure, including water, sanitation, public transportation, public lighting, and solid waste management, among others; (2) resilience building, and climate mitigation and adaptation, including energy efficiency, flood management, and retrofitting of public buildings, among others; and (3) local social services and infrastructure, including health, education, and childcare facilities, among others. These services, however, are expensive and require investments that typically far exceed municipal budgets. Within the African context, the easiest place to see this discrepancy is in South Africa, where a growing number of municipal governments have chosen to adopt unfunded budgets. According to figures from South Africa's National Treasury, in 2017, of the country's 257 municipal councils, 81 voted to adopt unfunded budgets, an increase of more than 15% from 2016's tally of 69. Figure 0.1 underscores the point: approximately one-third of each budget is unfunded and therefore at high risk of financial distress.

⁶ Interview with Herbert M. Asimwe, Director Banking and Non-Banking, Ministry of Finance and Economic Planning, Financial Sector Development Department, 11 October 2018, Kigali, Rwanda.

Figure 0.1: Municipal budgets in South Africa by percentage covered through available programmed funds, 2013/14–2017/18

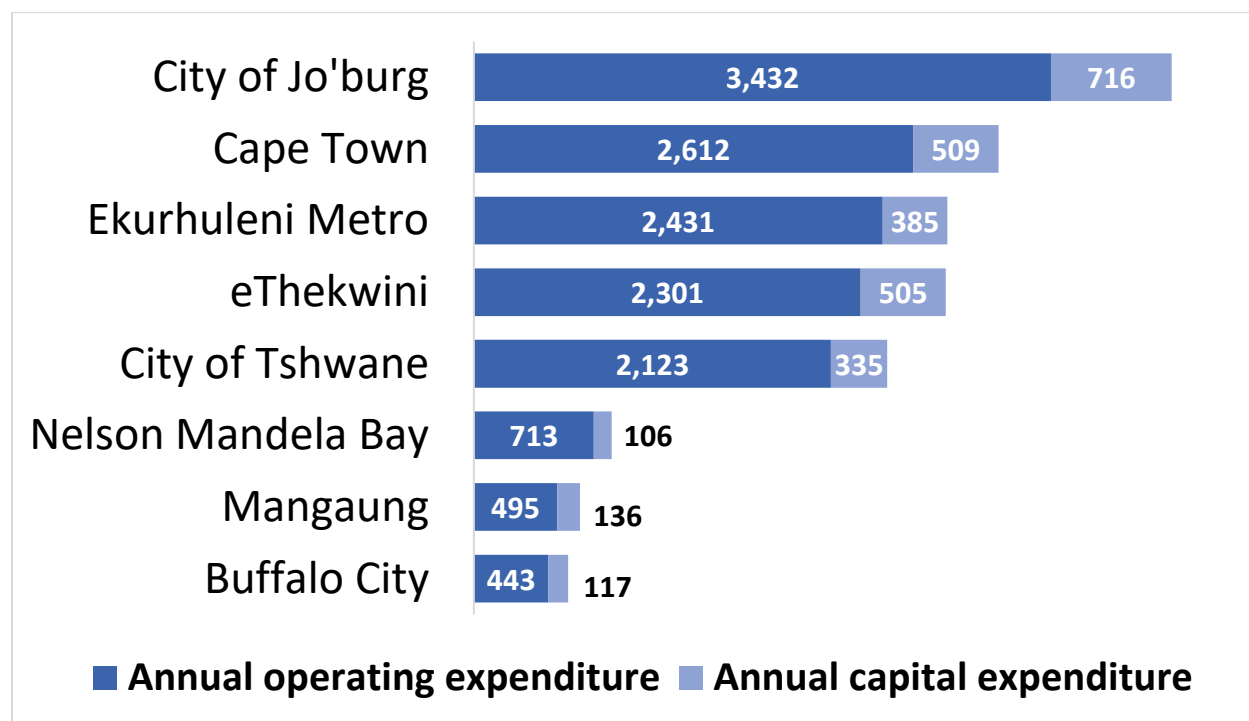


Source: National Treasury, Republic of South Africa (2018a)

Note: The category “other” here refers to amounts that are provisional or based off of municipal performance in their efforts to meet goals set by external development partners who provide “performance-based finance”. In instances where the local government fails to meet those goals, the development partner retains the right to pay only a portion of the anticipated funding package.

The situation is further compounded when considering the budgetary allocation between operating expenses and capital (investment) expenses. Operating expenses (or OpEx) refers to the day-to-day expenses incurred by a city; the largest OpEx for a city is typically for salaries and building maintenance. Capital expenditure, on the other hand, is for longer-term purchases, which have a functional lifetime for longer than the fiscal year in which they are purchased. Cities are often governed by regulations that stipulate that all obligations under operating expenses need to be met prior to capital expenses. This often leads to a situation where, as Figure 0.2 shows, cities program to meet their funded budgets, and are left with a shortfall for their capital expenditure – a gap that is rarely filled without the injection of capital from outside sources through repayable financial instruments like municipal bonds.

Figure 0.2: Allocation of 2016/17 South African metro budgets between operating and capital expenditures (ZAR millions)

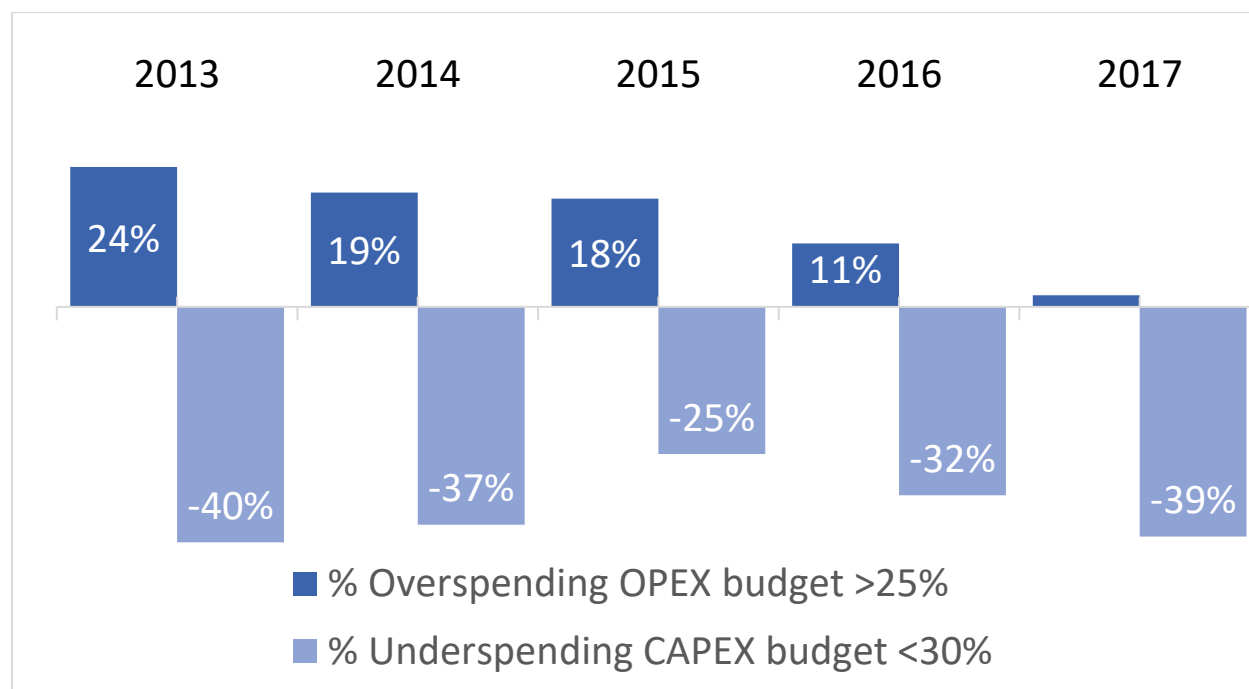


Source: National Treasury, Republic of South Africa (2018b); SACN (2017)

Most telling though, as Figure 0.3 vividly depicts, is the finding that sub-sovereign governments across South Africa have continually overspent on their operating accounts while underspending on their capital expenditures, driven by the lack of funds available to meet their expenses in both categories without additional injections of capital. An underspend on the capital budget occurs when a municipality struggles to find sufficient cash-on-hand to meet its basic obligations for function, such as salary, utilities, and other basic expenses; when pressed to make a decision about the ways to spend limited resources, municipal leaders will “rarely prioritize investments in future projects over payment for today’s expenses.”⁷

⁷ Interview with Patrick Musoke, KCCA, 3 June 2019 (Kampala, Uganda), and 28 July 2019 (London, England).

Figure 0.3: South African municipalities that have overspent on budgeted operating expenditures (>25%) and underspent on budgeted capital expenditures (<30%), 2013–2017



Source: National Treasury, Republic of South Africa (2018c)

The use of South Africa as a case here is helpful as it shows financial performance and decision-making for large- and medium-sized cities; in much of the rest of sub-Saharan Africa, this information is either non-existent or unaudited, which calls into question the reliability of the data. However, South Africa should not be used as a proxy for the entirety of the African continent, and is helpful to illustrate a point, not to make a definitive case. Effectively, South Africa is an appropriate case study as it has the highest number of reporting municipalities with audited statements in sub-Saharan Africa. There is a risk that, in other parts of sub-Saharan Africa, the problem is even more pronounced, but insufficient data makes reaching definitive conclusions nearly impossible.

This phenomenon is not limited to cities in the global south; cities in Canada, the United States, Italy and Australia have been shown to teeter on the brink of bankruptcy or austerity budgets for the same reason (Klingelhofer, Erasmus & Mayo 2015). Most cities across sub-Saharan Africa are significantly resource-constrained and have difficulties in meeting their budgetary projections on essential services, leaving no additional funds available for investment in non-essential or long-term projects. As an example, for the past eight years the City of Dakar has approved an average municipal budget of approximately USD 75 million but shows, through its year-end accounting, that it has barely been able to cover the costs of its average annual operating budget of USD 35 million, leaving the municipality with no residual flexibility to pay for

any of the items on its ever-growing list of desirable capital investments.⁸

The inadequacies of government transfers and the growth of urban areas make functional decentralization more viable and more necessary, particularly as countries around the world often suffer from insufficient budgets to support Cities with capital investment needs that may not be priorities for decision-makers at the sovereign level (Ahrend, Curto-Grau & Vammalle 2013; Devas & Delay 2006). This is particularly pronounced in sub-Saharan Africa, where local governments are forced to compete against other political entities, including line ministries (which are often led by political appointees and cronies of the national government) (Fox & Goodfellow 2016; Resnick 2014a). From a financial perspective, fiscal devolution is critical in allowing cities to demonstrate to potential sources of capital their commitment to City-level accountability for financial management and municipal efficiency in service delivery, which can help them to secure crucial investment. In some instances, this can also help to better institutionalize citizen expectations of government accountability and democracy (Cabannes 2004; Mberu, Beguy & Ezeh 2017).

While urban needs and aspirations may grow, the financial options available to cities in most countries in the global south have not kept pace with the growth and increasing complexity of the Cities themselves. Cities are stuck in a vicious cycle of limited resources leading to a constrained response, while the population of the city and the demand for services continue to expand. Ironically, many local government capital investments have high economic and social returns, and therefore should be attractive to governments (seekers of capital) as well as to businesses (sources of capital) (Canning & Bennathan 1999). For instance, there is strong demand for electricity and housing in most African cities, and investments in these sectors could plausibly offer commercial returns. Therefore, in a number of countries across sub-Saharan Africa, Cities are looking to domestic capital markets as a potential additional source of finance; for sub-national governments, these transactions take the form of municipal bonds. This phenomenon, indicative of a fundamental shift towards acceptance of and eagerness for repayable funds as a way to close the infrastructure finance gap, has been captured in the growing work being done, primarily by international donor agencies, on financialization, which explicitly incorporates a broader range of stakeholders, including financial institutions and other intermediaries, as relevant and interested parties with influence over political and economic functions (Pike & Pollard 2010).

The conditions required to provide local governments with capital market access were not designed with 21st-century Africa in mind, and in some respects are not fit for purpose. Sub-national bonds were tested and developed in Europe and North America, initially in Italian city-states in the pre-Renaissance era and

⁸ City of Dakar Financial Statements – Provisional Budget and Year-End Accounting, 2008 – 2016.

with a more recent resurgence as early as the first decades of the 18th century for the construction of New York's Erie Canal (Temel 2001). In these instances, municipal bonds were successful due to a strong interest in the financial instrument shown by all parties concerned: the sub-national government seeking finance, the investors seeking a reliable and steady return on their capital invested, and the national government seeking alternative ways to source the financing required for significant capital investments rather than through direct transfers to sub-national government. Although there are now more investors with larger magnitudes of money and with more appetite to diversify their investments into new and unfamiliar geographies and projects, the historic successes of Italy and the United States are unlikely to be replicated without a commitment from the national government to devolve power to the sub-national level.

Borrowing at the municipal level is quite different from borrowing by senior levels of government. Unlike central and state/provincial governments, which can and do borrow to meet operating requirements (such as to pay wages and salaries, purchase materials, etc.), municipalities can generally only borrow to make capital expenditures. In most countries, municipalities are not allowed to run a deficit in their operating budgets. When the benefits of a capital investment, such as the construction of a water treatment plant, are enjoyed over a long period, it is both justifiable and efficient to fund the project partially through borrowing so that benefit and cost streams are balanced as the debt is paid. Nevertheless, local access to capital markets is often heavily restricted in the global south. Smaller municipalities, even in countries with well-developed capital markets, may be able to borrow only through a financing authority or state/provincial body, partially to reduce borrowing costs by pooling the requirements of different municipalities. In principle, provided there is no central subsidization of such borrowing (e.g. through guarantees, explicit or implicit), this method of financing capital investment is a good idea. In practice, however, many countries in the global south have experienced substantial difficulties that have resulted in tighter restrictions being imposed on sub-national borrowing.

In most countries, some form of limitation is placed on the amount of funds that can be borrowed by local governments. For example, the central government may limit long-term borrowing to capital projects (Rodden, Eskeland & Litvack 2003). It may limit the aggregate amount of long-term debt to a fixed share of the local tax base. Some central governments place limits on debt charges, for example that such debt charges (principal repayment plus interest) cannot exceed a specified percentage of expenditures or own-source revenues. Municipalities need to be concerned about maintaining a sustainable level of borrowing or optimal level of debt, relative to future operating budgets and anticipated population and economic growth; each municipality has its own level of tolerance for debt. In doing so, they take account of the statutory limits set out by the senior levels of government, competition with other municipalities in accessing capital markets, and maintenance of a good credit rating.

Borrowing may occur in one of two ways: (1) by taking a loan from a commercial bank or other specialized financial institution in a process known as *financial intermediation*; or (2) by issuing debt obligations (bonds), calling on the public's savings in a process known as *disintermediation* or *direct funding*. Whatever the system – with or without intermediation – for a long time, competition between potential providers was distorted by tax breaks, central government guarantees, legal protections, and access to subsidized funds. This remains largely the case in many countries. For instance, in the United States, interest income received by holders of municipal bonds is exempt from federal taxes and from many state and local taxes, and several public sector loan funds provide subsidized loans for certain types of infrastructure and services investments. In Europe, most countries have had (or still have) specialized municipal finance institutions that enjoyed a de facto monopoly on loans to local governments; these institutions also received highly preferential terms, preventing competition from all other financing sources. This situation originated in central governments' desire to furnish long-term funds, often with subsidized, below-market interest rates, for local infrastructure investments; it also helped central governments to control and supervise local governments' borrowings. The municipal credit market has only recently become completely commonplace in a limited number of countries, where local governments can freely borrow from commercial banks and specialized institutions via loans or from capital markets directly via bonds, either individually or in groups. Local governments can make lenders compete, and may choose between direct and intermediated financing according to their best interests and the financing characteristics they require.

No objective reason to favor one system over the other appears evident. Direct financing has been presented as the ultimate stage in the system's evolution (Inter-American Development Bank 2002), but this opinion hardly seems well founded. On the contrary, European countries show that bank loan financing and bond issuance together furnish optimum efficiencies in a non-distorted market; competition drives rates lower, and borrowers can decide which type of financing is best suited to the type of investment planned. From a central government's perspective, both systems share the virtue of collecting and using local savings. In the least developed countries, direct municipal debt financing on capital markets is not widespread. Its viability depends on the existence of adequate legislative and regulatory infrastructure, sufficiently developed capital markets, and technically and financially adept bond issuers. In African countries, these conditions rarely coexist; developing this mode of financing represents a crucial challenge, not least for its potential to collect and transform local savings.

Donors continue to play a preponderant role in the financing of capital investments on the African continent. In most cases, they provide financing to central governments or to ad hoc financial intermediaries, when present; the funds are then reassigned to local governments as a loan or a grant. In some cases, donors make central government-guaranteed loans directly to local governments. There are a few, very rare examples of

what are known as *sub-sovereign* loans, which are loans without a central government guarantee made by donors directly to municipalities or other local governments. But for a few exceptions, commercial banks remain absent from the municipal credit market, and the number of local governments that have issued bonds can be counted on one hand. It should be noted that some countries' statutes prohibit local governments from borrowing. In many cases, the funds that local governments could borrow from a bank or raise on capital markets would have prohibitively expensive characteristics, such as high interest rates, short durations, no grace period, and so forth. In general, access to borrowing remains very limited in Africa, primarily because most local governments are insolvent or have too weak or too random repayment capacities. Commercial lenders see no market, a too risky market, or a market that costs too much to service.

Methodology and Research Questions

The audience for this thesis is threefold: (1) political economists interested in decentralization and its impacts on financial autonomy and decision-making; (2) financial practitioners with a particular focus on the tools available for City leadership; and (3) Africanists who are considering the exceptionalism of sub-Saharan Africa in the broader context of human development. The first half of the thesis frames each of these subject areas, building – through desk review – on the experiences and observations of others, while the second half deeply examines the confluence of these three issues in two cities in sub-Saharan Africa: Dakar, Senegal, and Kampala, Uganda. To be able to gather the necessary data, the researcher used the case study approach within the broader field of qualitative research. Data were collected from publicly available documents and a series of interviews with individuals directly involved in questions of municipal finance. The researcher was also able to use information gathered in his role as an advisor to the two in-depth case study cities in Senegal and Uganda: he was the Lead Technical and Financial Advisor to the City of Dakar from 2011 to 2016, and has served as the advisor to the City of Kampala's Nakawa Division since 2016.

The credibility of findings and conclusions extensively depends on the quality of the research design, data collection, data management, and data analysis. This part of the chapter will be dedicated to the description of the methods and procedures followed in order to obtain the data, how they will be analyzed and interpreted, and how the conclusion will be arrived at.

Before addressing the specifics of the methodology, it is helpful here to reiterate the research questions that the thesis seeks to answer, which are namely:

- 1) What are the reasons why bonds are appropriate tools for municipal leaders to use in financing their urban infrastructure needs? How do bonds differ from other tools and instruments that Cities have used, and continue to use, today?

- 2) Why have there been so few successful (i.e., closed) municipal bond issuances in sub-Saharan Africa? Is it due to internal factors, such as a lack of capacity at the municipal level to demonstrate financial responsibility and/or to launch a complex instrument, or is it driven by external factors, such as incomplete decentralization?
- 3) How, and what, does the experience of municipal bond finance add to our understanding of intergovernmental politics in sub-Saharan Africa?

The first part of this thesis, which addresses the theory behind decentralization, municipal finance and African exceptionalism, helps to lay the groundwork for the relevance of each of the cases explored in the second part of the thesis. Based on the nature of the information available on the topic of the thesis – municipal bonds in sub-Saharan Africa – research was conducted using a qualitative approach, relying heavily on non-numerical information available through a wide variety of media (Rossman & Marshall 2010). Within the area of qualitative academic studies, the researcher opted to follow the case study approach to substantiate his thesis, particularly as the use of examples helps to demonstrate successes and failures in attempts to experiment with municipal finance in instances where incomplete decentralization has been the largest obstacle.

Understanding the case study approach

Within the larger field of qualitative approaches, case study research involves the study of an issue explored through one or more cases within a bounded system (in this instance, municipalities interested in issuing bonds, and their associated opportunities and constraints) over time, through detailed, in-depth data collection involving multiple sources of information (e.g., observations, interviews, documents, and reports). The data are fused into a case description from which the researcher draws results and recommendations. In a collective case study (one which uses more than one case, as in this thesis), a single issue or concern is the focus of the research (Stake 1995), but the researcher selects more than one case for study to illustrate the issue – in the present thesis, the cities of Dakar and Kampala. In this thesis, the researcher also uses the cities of Johannesburg and Douala as examples against which the case study cities can be measured. Some academics (Merriam 1998; Yin 2003) suggest that the multiple case study design uses the logic of replication, in which the inquirer replicates the research procedures for each case. As a general rule, qualitative researchers are reluctant to generalize from one case to another because the contexts of cases differ. To best generalize, however, the inquirer needs to select representative cases for inclusion in the qualitative study.

Although there are several ways to conduct a case study review, this thesis employs Stake's approach (Stake 1995):

1. Determine if a case study approach is appropriate to the research problem; this is achieved by identifying bounded cases that can easily be compared.
2. Select cases that help to demonstrate the issue under consideration through “purposeful maximal sampling” (Creswell & Clark 2007: 112).
3. Conduct extensive research, drawing on multiple sources of information, including documents, archival records, interviews, direct observations, and participant-observations (Yin 2003).
4. Interpret the findings from research through analysis and comparison of cases, collected as lessons learned and recommendations for the future (Lincoln & Guba 1985).

Challenges of the case study approach

Case selection

Intrinsic to the case study approach is the selection of the cases to be analyzed through purposeful maximal sampling, a phenomenon which displays the researcher’s bias and may seem like a *fait accompli*, with cases being chosen that help to concretize the underlying thesis. Identifying the cases requires that the researcher establish a rationale for his purposeful sampling strategy for selecting each case and for gathering information about the case. Not having enough information to present an in-depth picture of the case limits the value of some case studies. In this thesis, the researcher has been able to provide a detailed picture of the two cities considered in Section 2, because of his roles and responsibilities in each of the two cities profiled there.

Researcher biases

The present researcher has committed much of his professional career to supporting municipalities in sub-Saharan Africa in their efforts to launch municipal bonds. This bias has impacted the thesis in three ways:

1. The researcher enters the discussion from the point of view that municipal bonds are, *de facto*, an under-used but necessary tool for municipalities to use to raise the money that they need to reach their goals of financing much-needed infrastructure.
2. The participants in the interviews spoke to the researcher with the knowledge that he was both conducting research on municipal bonds for his thesis and sympathetic to the idea of municipal bonds.
3. Despite efforts on the part of the researcher to conduct a balanced set of interviews, only those interviewees who were themselves interested in supporting municipal bonds agreed to participate.

These conditions influenced the narrative and the conclusions of the thesis, as the analysis it presents is firmly entrenched in the argument that municipal bonds are appropriate tools which are challenged exclusively by existing conditions outside of the control of sub-national governments.

Issues of consent and confidentiality

Among the significant issues that were considered in the planning of the case study research were questions of consent, confidentiality, and data protection. These issues were identified in advance so as to prevent problems that could have arisen during the research process. As some elements of the claims made in the argument of this study include conversations with public officials and financial intermediaries on the topic of municipal bonds, the researcher explained to each informant that all opinions would be bundled and kept confidential, without any specific attribution of comments to individuals. Specifically, the researcher sought to gather proprietary or confidential information from respondents on various issues, including: (1) the deliberations of municipal councils prior to the decision to pursue municipal bonds as a tool for meeting long-term capital needs; (2) the appetite of various potential institutional investors for municipal bonds from Cities without a demonstrable credit history. Maintaining anonymity was necessary in order to ensure the privacy as well as the security of the participants.

The problem of bad data

In undertaking data collection and subsequent review for the two cities that chiefly constitute the case studies in this thesis, the researcher was faced with a dilemma core to the problem: the existence of both bad data and limited knowledge and/or capacity on the part of the participants and municipal representatives which made it difficult to effectively and correctly assess the financial performance of the respective cities. Both of these elements were the impetus for requests for support made by the Cities to charitable foundations (the Bill and Melinda Gates Foundation) and bilateral and multilateral development agencies (the World Bank's Public-Private Infrastructure Advisory Facility, the Agence Française de Développement (AFD), the United Kingdom Department for International Development, the United States Agency for International Development (USAID), and the United Nations Capital Development Fund (UNCDF). This support, received on a rolling basis from 2010 to 2016, came mostly in the form of financial underwriting of additional resources, experts, and consultants who could externally review the process of data collection in the Cities rather than involve themselves in the process of data collection in the municipalities themselves. As an example, municipal ratings conducted by local ratings agencies (Global Credit Ratings in Kampala, Bloomfield and Moody's in Dakar) relied exclusively on the information provided to them by the financial departments of the Cities, without significant ground-truthing of the data through verification at the source. The researcher reviewed the data on the basis of which the analyses were

made, which were often derived from audited statements from the City, but recognized on further review that two challenges stemmed from this approach: (1) the numbers were conflated by ratings agency in a way that demonstrated the potential inappropriateness of a methodology standardized for corporate borrowers in the case of municipalities;⁹ and (2) the numbers were occasionally miscalculated in the audited statements and were not reflective of the actual year-end calculations of the municipalities, as municipalities sought to avoid demonstrating large deviations from the projected budgets set at the end of the previous fiscal year. As a solution to this problem, the researcher reviewed the publicly available ledgers of the financial departments for each City to insure the accuracy of an independent review. The researcher had an advantage in accessing this information, as the collection and cleaning of bad data were part of the larger roles and responsibilities of his project, the Dakar Municipal Finance Program (DFMP), in the City of Dakar, and these challenges were acknowledged, if not fully addressed, during the lifetime of this program sponsored by external donors.¹⁰

Similar to the challenges of bad data from a numerical perspective was the problem discovered by the researcher that many of the practitioners charged with addressing municipal finance were uneducated about basic terms. A key example of this can be found in the failure to distinguish between operating budgets (which cover the revenues and costs of basic municipal functioning, such as fees collected from citizens for civil ceremonies and certificates or salaries for municipal employees) and investment budgets (which cover the revenues and costs derived from long-term City investments, such as rents derived from publicly owned buildings or borrowing for capital-intensive projects). This inability to meaningfully discuss fundamental principles of municipal finance led the researcher to spend significant amounts of time during the interviews working through some of the more elementary ideas underpinning economics and finance with interviewees, and may have led some of the respondents to answer in a biased way. This was a particular concern in regard to their indications that increasing the amount of money available in the investment budgets would have strong positive impacts on the City, without fully grasping the implications of these increases for the City's debt obligations or financial capacity.

Core to the methodology of this thesis is an understanding of the rationale underlying the presence of bad

⁹ Although related to the question under discussion, this point tangentially addresses the separate issue of the struggles of ratings agencies to accurately distinguish between the performance of different sovereign countries in a single currency bloc (as in the case of the eight West African Economic and Monetary Union (WAEMU) countries, of which Senegal is a member). This manifests itself in the fact that there is no differentiation between the risk profile of Côte d'Ivoire, a stable and rapidly growing economy, and that of Niger, which suffers from lower performance metrics on economics and growth. Further, and of major significance in relation to issues raised in this study, this inability to distinguish between different countries' performance means that prospective lenders are challenged in attempting to accurately price the risk – accomplished through the setting of interest rates – of different countries in the bloc and in creating a yield curve that differentiates between short-term and medium-term debt.

¹⁰ The DFMP is discussed in detail in Chapter 5 of this thesis.

data. Sandefur and Glassman (2014: 1–2, 23) explain this as the perverse incentives of the development system, insisting that

[this] misrepresentation of statistics does not occur by accident or due to a lack of analytical capacity – at least, not always – but rather that systematic biases in administrative data systems stem from the incentives of data producers [in this case, the municipal governments] to overstate development progress... These inaccuracies appear to be due in part to the perverse incentives created by connecting data to financial incentives without checks and balances, and to competing priorities and differential funding associated with donor support.

While this argument may be appropriate in the case of competition for international aid, it fails to adequately correspond to the presence of bad data when seeking to borrow from financial institutions with expectations of repayment. When comparing the financial picture that would be shown to donors – namely, the demonstration of a municipality with weak performance and a need for external support to deliver on core development goals – with that for the financial sector – the demonstration of a municipality with strong performance and both the willingness and the ability to meet its obligations over a sustained period of time – the argument could be made that the presence of bad data would stem as much from poor capacity and knowledge as from intentional efforts to mislead.

In summary, in the execution of the data collection and analysis presented in the following chapters, the researcher considered the quality of the data sources, and their motivations in presenting information in a certain way, and performed significant independent research to confirm the validity of all financial reporting.

Conclusion

Resulting from the recognition of the points listed above, this thesis argues that municipal bonds in sub-Saharan Africa are one of the best tools for Cities to use in meeting their long-term financial goals, while these Cities are simultaneously plagued with challenges in the execution of these goals due to incomplete devolution of political and financial autonomy through decentralization of power from the national to the local level. Although explored tangentially in works by many other scholars exploring how Cities grow and finance themselves in response to rapid urban development, particularly in sub-Saharan Africa, there has been little focus on attempts to introduce one of the most appropriate instruments – municipal bonds. Even more important, there has been no focus on the impediments to municipal bond issuance or the fact that the interrelated issues of insufficient political and fiscal decentralization with relation to financial autonomy at the sub-national level circularly yields insufficient urban development and infrastructure.

Through an investigation of decentralization, municipal finance and the current situation of sub-national governments in sub-Saharan Africa, this thesis fills the gap between the practicalities of municipal finance and the abstractions of political theory.

Section 1: Theory:

Determining the Factors Governing Municipal Finance

The intent of this first substantive section of the dissertation is to review the foundational elements of municipal finance from a theoretical perspective. The first chapter examines decentralization, with a particular focus on the reasons why it may not always be achieved in its fullest form and how this negatively impacts the autonomy needed at the sub-national level to contemplate sophisticated financial instruments required for long-term, economically-sustainable urban growth. It leads directly to a closer review of municipal bonds, considering the instances where such tools help to meet the imperatives of urban development at a pace and level of repayment manageable by municipal governments. The section concludes with a criticism of the idea of “African exceptionalism,” arguing that Africa is at a different point in the global development trajectory, but not particularly unique.

Chapter 1: Decentralization

“Centralization is now a word constantly repeated but is one that, generally speaking, no one tries to define accurately” – Alexis de Tocqueville¹¹

The first of three major themes in this thesis – decentralization and its impact on financial autonomy and decision-making – is explored in detail in this chapter, starting with an exploration of the initial development of cities within a larger context. This is followed by a consideration of the root causes of, and arguments relating to, modern decentralization. It is placed as the first of the three academic areas of interest in this thesis as it is arguably the underlying cause of challenges faced in the application of a wide variety of financial tools at the City level (in the case of this thesis, specifically municipal bonds) and lays the foundation for the thesis’s argument – that the reason why municipalities in sub-Saharan Africa are not using municipal bonds is the distrust of decentralization at the national level, not inherent weaknesses in municipalities and their financial management at the sub-national level.

According to the *Social Science Encyclopedia*, a city is defined as a “reasonably large and permanent concentration of people within a limited territory” (Hannerz 1996: 86–88). However, the word is imbued with myriad connotations and expectations relating to size, population density, and purpose, and today’s academic debate proposes multiple reasons why cities exist and how they should function as part of a larger political macrocosm involving other tiers of government. Social scientists have long debated the definition of a city as well as the reasons that first gave rise to the agglomeration of people in cities. Tilly argues, in *Cities and States in World History*, that cities are not simply a matter of dense populations within a geographical area where services are provided for the public good, but instead are also centralized based on a strong level of trust such that there is a “relation in which at least one party places a valued enterprise at risk to the malfeasance, mistakes or failure of another party” (Tilly 2010: 266). A direct theoretical descendant of the tenets of Locke’s social contract (Locke [1689] 2016), popularized during the Age of Enlightenment and intended to address questions about the legitimacy of the state’s authority over the individual, this approach assumes that civilization sprang from a collective recognition of the power of the group to respond better to problems than individuals. Other theorists promote different approaches, suggesting that people may have banded together to form cities as protection against hostile enemies; or that, upon the success of the Neolithic revolution in introducing more advanced technology for agricultural

¹¹ Tocqueville ([1835] 1969: 87) .

purposes, human civilizations no longer traveled in search of food and could instead create dense, settled populations; or that higher yield and better crop production led people to view surplus food as a store of wealth and that this wealth would be best maintained by creating facilities where excess food could be safely kept (Boix 2010; Ortman, Cabaniss & Sturm 2014) . Later hypotheses continued to refute these theories well into the 20th century: in *The Economy of Cities*, Jane Jacobs (1970) argued, based on findings from the Turkish settlement at Çatalhöyük, that cities pre-dated that agricultural revolution, implying that cities were essential to the production of a surplus (in food and other quantifiable goods) rather than the other way around. More specifically, she argued that the first substantial human settlements were stateless societies formed by egalitarian bands of hunters and gatherers well before the development of early civilization's agrarian societies. Regardless of the reason that initially sparked the development of cities in early human civilization, the model proved desirable enough for people to choose to continue to congregate on a permanent basis in places that were optimal for agriculture and trade. Well-functioning cities have an interconnected framework of planning, designing, connecting, and financing patterns. These patterns have contributed to the success stories of cities, such as New York at the beginning of the 19th century, which in the span of two generations moved from extreme poverty and urban chaos to wealth, prosperity, and a complex and vibrant order with highly livable communities (Swilling et al. 2018). In his seminal book on the topic, *A Pattern Language*, Christopher Alexander described how, when viewed holistically, each pattern forms a word or thought of a true language rather than being a prescriptive way to design or solve an urban problem:

Each solution is stated in such a way that it gives the essential field of relationships needed to solve the problem, but in a very general and abstract way, so that you can solve the problem for yourself, in your own way, by adapting it to your preferences, and the local conditions at the place where you are making it. (Alexander 1970: xi)

The purpose of this chapter is, principally, to introduce some of the most critical concepts in the debate about what the ramifications of incomplete decentralization might be. To understand incomplete decentralization and its challenges, though, the discussion needs to consider the evolution of the city, why the city exists as it does within a larger national context, and how decentralization has come to be central to the discourse of political economy in the 21st century. By the end of this chapter, a reader should have a clearer understanding of the salient points argued by both sides – the proponents and opponents of decentralization – and be able to see how this argument factors into the practice of decentralization, and is later manifested in the attempts of incompletely decentralized Cities to raise finance based on challenges from national government.

The earliest human civilizations functioned as small City-states where finances were aggregated by the ruling family and used to cover the costs of basic infrastructure, whether in Mesopotamia or in early Greco-Roman societies (Hasel 1994). As time passed and centralized power became a universally accepted concept similar to today's concept of the nation-state, leading families in medieval and Renaissance civilizations took responsibility for governance and for raising funds for basic infrastructure to ensure that cities would function at optimal capacity (Abulafia 1997; Goldthwaite 2009). However, and regardless of the magnitude of the funds that cities were able to raise on their own, in all but a few instances (predominantly City-states around the Mediterranean, including those of ancient Greece and Carthage as well as the more modern Renaissance Italian City-states [Gabrielsen 2013; Jones 1997]), cities required more than their own-source revenues to finance all of their needs, whether these revenues were derived from the largesse of charitable works by leading families or taxes collected from businesses operational in the cities themselves. This financial dependence on other bodies, whether kings in traditional societies or national governments in modern societies, led to the subsumption of the City throughout much of human history, a phenomenon that has been challenged through the recent rise of demands for decentralization. This fundamental tension between the City as an independent, decision-making entity in control of its political and economic destiny and its reliance on external financial support builds the argument for decentralization, as modern Cities have access to tools that can largely transform their financial reliance on the nation-state.

Understanding fiscal decentralization

The debate over decentralization has political, administrative and fiscal dimensions. The philosophical debate can be traced to Alexander Hamilton and Alexis de Tocqueville in the 18th and 19th centuries (Oates 1998). Fiscal decentralization, which entails shifting some responsibilities for expenditures and revenues to lower levels of government, has been successfully introduced as part of a larger framework of decentralization. It is generally a response to unsatisfied political demand for greater regional or local autonomy, or the result of a large economic divide between rich and poor.

Fiscal decentralization, when viewed as a process and not simply an outcome, varies from country to country. Unitary and federal governments differ in the ways that the central government interacts with local governments. In unitary governments, some degree of decentralization is possible, depending on the framework for interaction among central and subordinate levels of government. In comparison, federal governments by definition are composed of sub-national governments with greater levels of autonomy constitutionally institutionalized (Hart 2016).

Public services are allocated to local or regional governments based on the combination of different criteria,

including population size, fiscal capacity, development needs, and other factors. The cost of the provision of public services is covered through a mix of own-source revenue (typically taxes and tariffs), transfers from the central government, partnerships with the private sector, and a diversity of other financial tools.

The theory and practice of fiscal decentralization differs greatly from country to country and region to region. The post-Soviet model embraces a shift in power originating from the late medieval era but constrained by financial limitations at both the sovereign and sub-sovereign level (Matei 2014; Moroz, Semstov & Kukel 2016; Stoilova 2010). In contrast, Chinese efforts at decentralization are driven by top-down thinking and largely conform to expectations of minor reform introduced in Beijing (Dexu & Wenlong 2017; He 2018). While the African experience of decentralization, which is still relatively recent, forges its own path based on the unique combination of colonialism, tribalism, and relatively low wealth compared to other societies, the theoretical challenges of financial decentralization are not markedly different, as discussed below and demonstrated in later chapters, particularly when enshrined in constitutional law and local practice.

The rationale for (and against) decentralization

Political scientists, policy-makers, and other observers of governance have expressed a variety of justifications for decentralization. First among these is an assumption that decentralized government is “closer to the people”, and one key corollary holds that decentralized government will thus be more progressive and participatory. For some, decentralization can signify deeper local democracy based on increased grassroots mobilization. Accordingly, one of the powerful normative arguments in favor of decentralization is the proper representation of local voters. Limited knowledge of individual preferences on the part of central government officers has often translated into sub-optimal decisions on the best allocation of public resources. This line of thought is an extension of Hayek’s defense of the market economy, which argues that local bureaucrats and political leaders are likely to know more about people’s preferences than are central government officers (Hayek 1945). A variation of this argument is that, while centralization is associated with the homogeneous provision of public services for all citizens across the nation, this may collide with heterogeneous local preferences across jurisdictions. Thus, devolution of fiscal and political powers to lower tiers of government would be a way to promote an efficient allocation of resources through which local demands are fully understood and properly attended to at the local (sub-national) level of government (Oates 1972).

A second corollary for others is that sub-national governments will exhibit higher levels of state efficacy and effectiveness than central governments, since decentralization can trim bloated central states. Empirical evidence of the “failure of the centralized state” is seen as tantamount to a need for decentralization;

theoretically, decentralization promotes fiscal federal ideals wherein local jurisdictions can approximate market-based competition by offering different clusters of public goods and taxation rates to current and prospective inhabitants. Decentralization thus enables high-performing sub-national governments to distinguish themselves from others, and facilitates better matching of societal demands with public supply of goods, whereas centralized governance fails to do so; local political jurisdictions operate in the same way as an efficient and competitive private market. Local governments come to exist in the same way as private firms enter a particular industry, in response to demands from a particular community. Likewise, they can eventually be removed from the “local public goods industry” if the administrative cost of operating a particular jurisdiction becomes too high with respect to residents’ tax revenue-generation capacity. Local jurisdictions may become “spatialized” by providing specific types of local services in the same way as different firms produce different varieties of products in line with differences in consumer desires and intended uses of market products (Tiebout 1956). Autonomous jurisdictions would compete in the provision of local public services, tailored for different communities based on their own preferences. Conceptually, voters would “reveal their preference” for local public goods through the political process, by supporting good performance of local governments, and holding them accountable for the quality of local service delivery. This “accountability advantage” would be diluted at the national level, in which political responsibilities are widespread, and voters’ capacity to oversee government performance is weaker (Seabright 1996).

An alternative view depicts the government as a “rent-seeking” economic agent trying to take advantage of its power to extract Ricardian rents from taxpayers. Following this line of reasoning, decentralization may be seen as an institutional device to protect individuals from governments in the same way as central banks safeguard monetary policy from undue influence by government (Brennan & Buchanan 1980). National governments are regarded as being no different from private monopolies, to the extent that they are the sole entities collecting taxes or delivering public goods. As a result, they would tend to charge higher prices (taxes) and deliver lower-quality public goods relative to a competitive situation. As voters become more aware of the dangers of the “Leviathan”, this theory predicts that the median voter will automatically bias his political preferences towards more decentralized institutional arrangements. This partly explains why high-income countries tend to be more decentralized (Panizza 1999). In line with this hypothesis, an extensive empirical literature has attempted to provide evidence that fiscal decentralization leads to a lower tax burden, without conclusive results.

A third purported advantage of decentralization is the concern that sub-national government in the developing world is historically underdeveloped, and that continued centralization due to low local capacity will create a vicious circle that will only lead to fewer options in the future (Caldeira, Foucault & Rota-

Graziosi 2015). A final argument claims that decentralization improves political socialization, with stronger local government serving as the basis for future national leaders in politics and society (Riedl & Dickovick 2014). In brief, with sub-national governments being closer to the people than the central government, increasing the scope of sub-national governments relative to the center will improve local access to political decision-making, and result in improved responsiveness and accountability, as local elected officials face incentives to reply to local demands.

Opposing viewpoints on decentralization, particularly in fiscal terms, focus predominantly on the idea that a decentralized fiscal system poses a threat to macro-economic stability (Shah 2005). Practitioners challenge three major assumptions of theories that treat the dynamics of the “local public goods industry” as equivalent to those of private competitive markets. These alternative views question the arguments that (1) local governments are genuine representatives of their constituencies and try to compete to please residents through the best possible combination of prices (taxes) and local public good quality; (2) the “local public goods industry” is broadly competitive, with no externalities among jurisdictions, and with all costs and benefits fully internalized by local residents; and (3) local voters not only vote at the ballot box, but also do so with their feet by choosing the jurisdiction where they want to live, taking into account the type of local government that they want to have (Shah 2005).

At the core of these challenges is the reality that the revelation of citizens’ preferences may be rather imperfect, seeing as how many national and local governments do not face the necessary incentives to compete or maximize the welfare of their constituencies. This is because a well-functioning democracy, with transparency in decision-making and citizen representation, is not always in place at both the national and the local levels, particularly in the global south (Batley 2004). Moreover, decentralization in imperfect democracies could result in excessive closeness between local authorities and big local private interests, which may lead to corruption and elite capture. Finally, there is some empirical evidence pointing to stronger professional qualifications and better availability of information for central government officers relative to local authorities (Prud’homme 1995).

Additionally, the assumption of high mobility across jurisdictions is not confirmed by empirical evidence. First, family and labor ties may prevent citizen mobility (i.e., changing their location in search of better employment opportunities or access to basic services) to maximize their individual utility. Political scientist Daniel Treisman argues that poorly performing local governments are unlikely to be disciplined by residents’ mobility, as the quality of local services is mainly capitalized into property prices, making “voting with their feet” a costly affair for homeowners and tenants. Moreover, sub-national governments may not have the necessary incentives to target the local poor, for whom mobility is more costly. In addition,

excessive mobility across jurisdictions could also be a problem, as it may translate into additional fiscal pressures on local governments showing above-average performance because of an increasing number of potential beneficiaries coming from other jurisdictions (Treisman 2007).

Decentralization in its purest sense is intended exclusively to denote increases in sub-national autonomy, as devolved from central government to sub-national government. By contrast, a number of donor agencies have promoted governance projects as decentralization that primarily involves direct transfers from donors to local governments, or support for institutional development of sub-national governments. The essence of decentralization must be a political process of change whereby power and/or resources are moved from the center to those levels of government beyond the center (Eaton 2011). Far from denying the center a major role in the process, this justifiably places intergovernmental relations – and not simply the empowerment of sub-national governments – at the heart of decentralization. National governments must be viewed as key players in decentralization schemes, in order to ensure improvements in the all-important linkages between levels of government. Improving decentralization involves greater cooperation and incorporation of central governments, not less.

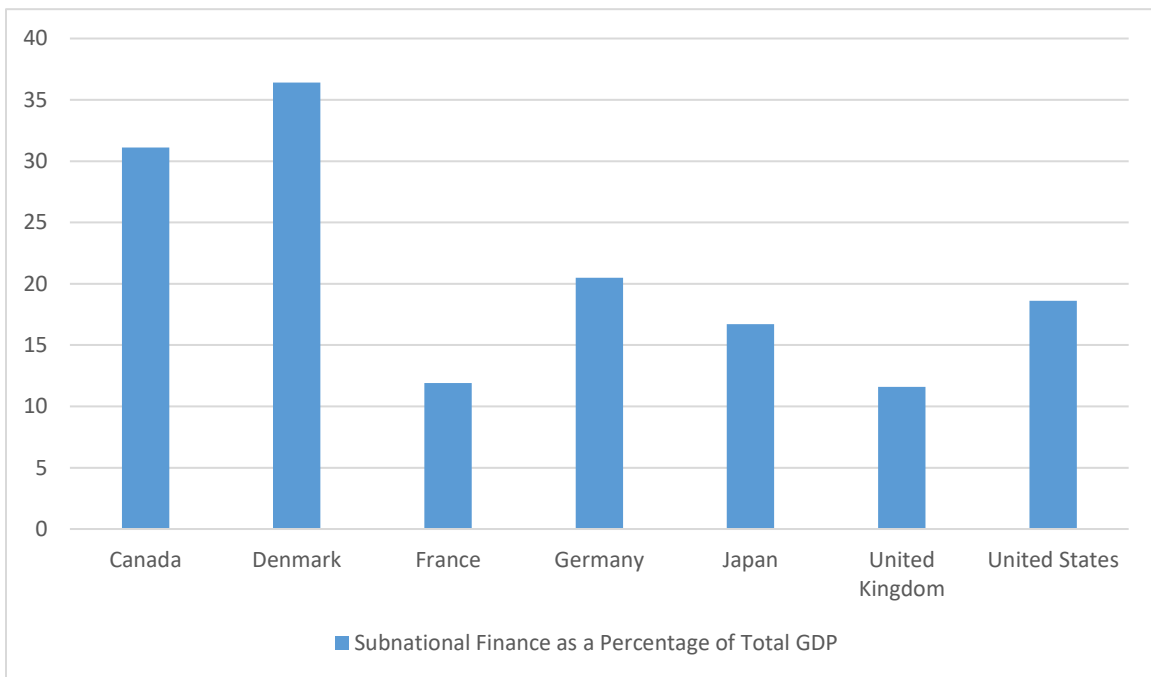
However, there is an inherent problem with an exclusive reliance on donor-driven decentralization found within the application of the theory itself: donors currently imagine that

Africa's disorder is a result of broken institutions, or at a slightly more sophisticated level, perverse incentive structures. They have the idea that discrete interventions and aid can mend these malfunctioning institutions, and provide different sets of incentives. By doing so, democracies will function and market-led, pro-poor growth will occur. (Kelsall 2005: 76)

This statement underscores questions around decentralization posed by African decision-makers that are largely ignored; namely, if decentralization of powers – politically, functionally, and fiscally – is so desirable, why have the donors that are encouraging decentralization in Africa not embraced it in their own countries?

As a sidebar to the debate on decentralization in Africa, it is important to remember that the lack of decentralization in Africa can be attributed to the lack of decentralization in the European countries that directly controlled the destiny of African countries for a century. The United Kingdom is currently among the least decentralized of the world's most developed countries: when comparing the percentage of sub-national finance to total GDP in the United Kingdom with its peers (viewed as the most objective indicator by practitioners and academics), it fares poorly (Figure 1.2).

Figure 1.2: Sub-national finance as a percentage of total GDP



Source: Adapted by the author from OECD, Subnational Government Expenditure as a Percentage of GDP <https://stats.oecd.org/Index.aspx?DataSetCode=SNGE>, accessed August 2016.

In *Federal Britain*, Philip Booth asserts that the United Kingdom needs to decentralize to survive politically and financially; he cites the differences between the needs of unemployed welfare recipients across the country as evidence that a centralized policy is ineffective and inefficient. Further, he points to a recent analysis of local government financing, which concludes that “[r]ecent work comparing the UK with the USA and Europe has concluded that the lack of devolution and local discretion in the UK is a constraint on economic performance, particularly in the cities” (Booth 2015: 6).

In the 1980s and 1990s, a wave of decentralization swept across much of the developing world. Along with democratization and economic liberalization, decentralization became a major theme in the relocation of political and economic power. The wave affected a wide range of countries; in Africa, democratically inclined governments in small, unitary states have increasingly looked to decentralizing power to overcome the pathologies of centralized rule. Political scientists have long recognized that the power to govern depends on the control of fiscal resources, regardless of the level of government in question (national or sub-national): questions about which level of government controls fiscal resources have profound implications for the most fundamental theories about where power lies. Sub-national fiscal autonomy, or the ability of local governments to act independently of the central government, can be used as a barometer for decentralization. Dickovick (2011) indicates three types of autonomy and the types of questions that can be used to perform a comprehensive analysis, as set out in Table 1.1.

Table 1.1: Measuring sub-national fiscal autonomy

Type of autonomy	Measurement
Revenue autonomy	<ul style="list-style-type: none"> - Do sub-national governments [SNGs] have taxation authority? - Do SNGs receive guaranteed transfers from the central government? - Are SNG revenue guarantees constitutionally protected?
Expenditure autonomy	<ul style="list-style-type: none"> - Do SNGs operate free of spending mandates? - Can SNGs set independent budgets? - Is spending by SNGs free of monitoring by national ministries?
Contractual autonomy	<ul style="list-style-type: none"> - Are SNGs legally autonomous from central governments? - Can SNGs contract debt in capital markets? - Can SNGs negotiate labor costs with civil service?

Source: Compiled by the author based on Dickovick (2011).

Although this is a good illustration of the types of questions that need to be considered when reviewing questions of autonomy, even positive answers to all of these questions are still insufficient when validating the enabling environment in a country in order to better understand the freedom of sub-national governments to enter into financial obligations, as will be demonstrated later this work through examinations of the experiences of the cities identified for case studies.

The impact of incomplete decentralization on the mobilization of capital for urban infrastructure

Regardless of the level of decentralization, cities need to find a way to meet their financial requirements. In the least decentralized of systems, cities simply rely on the national or state/provincial government to fully fund their budgets through direct transfer; however, even in the most decentralized of systems, cities receive some portion of their budget from transfers from government.

As summarized in the World Bank's 2014 publication *Municipal Finances: A Handbook for Local Governments*, municipal finance, especially as a concept linked with decentralization, is pivotal in looking towards the future of global urban development (Farvacque-Vitkovic & Kopanyi 2014). While no country is free from the challenges of municipal finance, the dangers of a failure to act are more pressing in the global south, and are primarily driven by two key phenomena: (1) the relatively recent decentralization of power away from central government towards sub-sovereign levels; and (2) the rapid increase in urban population growth rates found in the world's least developed countries. The shortcomings of municipal finance in the global south can be highly damaging, because sub-national governments have clear mandates to provide certain public services and infrastructure (which can often be chief among the factors driving internal migration from rural to urban areas, as found and documented by the International Observatory on Participatory Democracy and the Observatory of Conflict and Violence Prevention's *Migrants on the Margins* initiative).¹² While the responsibilities delegated to local governments by law vary considerably from one country to the next, cities in developing markets often have mandates to provide the following services: (1) local basic services and infrastructure, including water, sanitation, public transportation, public lighting, and solid waste management, among others; (2) resilience-building, and climate mitigation and adaptation, including energy efficiency, flood management, and public building retrofitting, among others; and (3) local social services and infrastructure, including health, education, and childcare facilities, among others. These services, however, are expensive and require investments that are often far more expensive than what a municipal budget can support from its own resources or from transfers from higher levels of government.

The United Nations' Sustainable Development Goals (SDGs) and New Urban Agenda¹³ underscore the recognition that cities are critical in the successful management of human development, particularly through the designation of one goal – Goal 11 – as specifically devoted to making “cities and human settlements

¹² Interview with Beatriz Tembe, International Observatory on Participatory Democracy, June 2016, Maputo, Mozambique.

¹³ See <http://habitat3.org/the-new-urban-agenda>, accessed in October 2018.

inclusive, safe, resilient and sustainable.”¹⁴ In fact, during the lead-up to the finalization of the Goals, critics argued that there is a flaw in this conceptualization, namely that there should not be a unique goal that applies specifically to cities, but rather that all of the objectives of the SDGs should be applied in cities and viewed as underpinning the successful achievement of all 17 of the Goals by 2030 (Commonwealth Local Government Forum Pacific n.d.; Peirce 2014; Scruggs 2015a, 2015b). They argued that the growth of cities and towns makes functional and fiscal decentralization more viable and more necessary, and in many countries, local autonomy is growing. Increasing the capacity of local officials not only improves urban resilience and quality of life; it empowers cities and towns to contribute in important ways to national social and economic development goals. From a financial perspective, fiscal devolution is critical in allowing Cities to demonstrate to potential sources of capital their commitment to City-level accountability for financial management and municipal efficiency in service delivery. In some instances, this can help to better institutionalize citizen expectations of government accountability and democracy, particularly when coupled with participatory budgeting (Cabannes 2004; Mberu, Beguy & Ezech 2017).

In the past, most cities in the global south would not have had the autonomy, information technology, or knowledge of trends in the urban sector worldwide to embark on significant development projects or to prepare multi-year investment plans. But with a growing number of cities in the global north successfully using a wide range of financial instruments that form the basis of best practices, and a more well-educated cadre of investors and municipal practitioners reversing the “brain drain” by returning home with skills picked up overseas, cities in the global south are more well-prepared to demonstrate their readiness to raise funds (Brown & Kirkpatrick 2002; Mapulanga-Huston 2014). The amount of borrowing by public and private entities alike has grown exponentially since the dawn of the 21st century, and the number of non-local currency-denominated transactions (i.e., USD, EUR, etc.) has grown even more significantly.

In the simplest terms, cities finance themselves in a number of different ways: taxes, tariffs, transfers, and external debt. The most traditional method is finance through the contribution of everyone who lives within the City’s limits by means of property taxes, whether directly paid by the occupant or indirectly paid to the property owner in the form of rent. If everyone contributes an equal share, this reduces the possibility of a “free rider” problem (Miceli 2011). However, it fails to accommodate the fact that different property owners will, by definition, have properties of differing values. As a result, an alternative approach to taxes, whereby property taxes are based on assessments of value, has taken hold in capitalist societies. Imposition of taxes goes back to the beginning of recorded history, since all states require economic resources to project their power and to provide internal security and other services. The role of taxation in the development of modern

¹⁴ See <https://sustainabledevelopment.un.org/sdg11>, accessed in October 2018.

nation states, and its relation to the rise of democratic institutions, is significant within the broader history of financial distribution and the critical task of raising funds for the provision of services that benefit the collective good, most notably within the context of this thesis for infrastructure. Acquisition of taxation powers by the sovereign, and later by legislative bodies, developed along with limits on the power of monarchs, suggesting strongly that taxation played a crucial role in the shift of power from the governing toward the governed. An important debate has emerged about the nature of, and causality among, the major factors that underlie the historical evolution of fiscal systems and their relationship to democratic institutions (Dincecco 2011; Epstein 2000; Schumpeter [1918] 1991). Although they pursue different goals, non-democratic governments face similar economic constraints in creating tax systems to those faced by democratic ones. Different objectives will lead to different outcomes, however. Some proponents of socialism, for example, theorize about how a government that attempts to maximize revenues would structure a tax system to exploit the private economy (Marx 1848; Ellman 2014). In actuality, non-democratic governments will have more complex goals, since they must also concern themselves with maintaining power in a given political setting (Brennan & Buchanan 1980). Other theorists view economics as the basis of a theory of dictatorship, where taxation is one of the means used to stay in power (Wintrobe 1998).

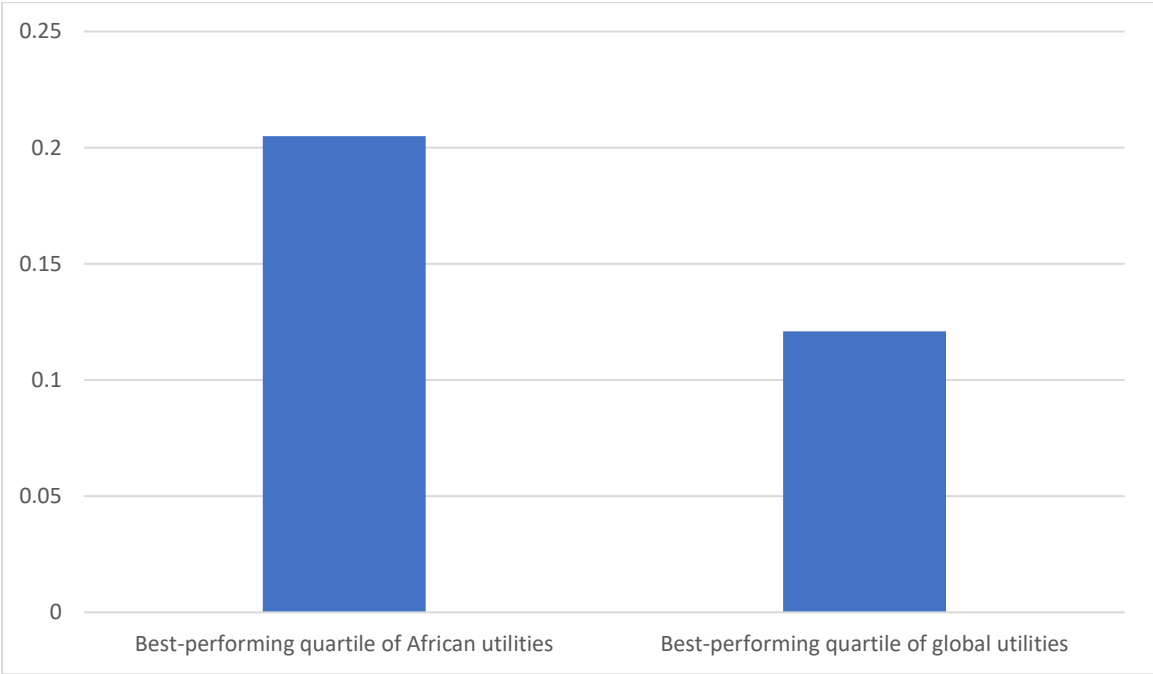
There are two main principles around which systems of taxation can be arranged. One is the “benefit principle”, a long-held idea put forward by public finance theorists, which argues that “an equitable tax system is one under which each taxpayer contributes in line with the benefits which he or she receives from public services” (Musgrave 1989 : 219). This approach ties taxation to public service delivery, helping to develop a close correlation between the money generated in tax revenue and the money spent delivering the particular good or service.

The “benefit principle” can be contrasted with an alternative approach: the “ability-to-pay principle”. As the name suggests, this principle entails that “each taxpayer is asked to contribute in line with his or her ability to pay” (Musgrave 1989: 219). The difference between this and the “benefit principle” is that in this case there is no direct connection with what is being paid for. Citizens contribute according to their ability, without necessarily seeing the result of their contributions. In reality, most tax systems combine elements of both approaches, with wealthier citizens contributing more, but some contributions being directly linked to services. The advantage of this approach is that linking taxation to services helps to generate a social contract between citizens and the government, such that citizens know what they are contributing to and are able to witness its effects (Rosen & Gayer 2014).

Regardless of the level of state control, billing efficiency (the ability to accurately assess users of city

services, often manifested through taxes on property owners for their proportionate share of the budget based on the assessed value of their homes) and collection efficiency (the ability to collect the correct amounts from the users of services, again viewed through the common example of tax collection from property owners) is weaker in sub-Saharan Africa than in most other parts of the world. Using water utility companies as a proxy, particularly since access to water is essential regardless of the status of home ownership, even the best-performing utilities in Africa struggle to meet global benchmarks for operational and financial performance. More specifically, the traditional metric used in measuring efficiency for water utilities is the level of non-revenue water, or water that fails to generate revenue for the utility due to either physical leakage or failure of the utility to either bill or collect. As shown in Figure 1.1, in a study conducted by the World Bank (Van den Berg & Danilenko 2017), the level of non-revenue water in Africa in aggregate for the best-performing quartile of African utilities is significantly higher than that of the best-performing quartile of global utilities.

Figure 1.1: Non-revenue water per connection per day (m³)



Source: Compiled by the author based on Van den Berg & Danilenko (2017).

A separate and equally striking comparison, conducted as part of a larger study by the Organization for Economic Cooperation and Development (OECD), highlights the fact that tax revenues themselves are poorly collected across Africa relative to other sovereign countries. While tax revenues count for over 33% of GDP in OECD countries, they correspond to less than 20% of GDP in sub-Saharan Africa (Carter & Cebreiro 2011).

The above data highlight the disparity between the performance of utilities or governments in sub-Saharan Africa and that of their peers around the world; they indicate that cities in sub-Saharan Africa are not collecting as much revenue as their peers in other parts of the world. Donor agencies, foundations, and development finance institutions are attempting to solve this problem through the introduction of cadastral mapping, improved information management systems, etc., but the pace of uptake on this technology and new practices is unlikely to be sufficient to meet the immediate financial needs of the countries concerned (Floater et al. 2017; Moinuddin 2010). (Part of the reason why cities in the global south face such significant challenges with even basic delivery of services, let alone collection of revenue for the services provided, can be found in the limited knowledge of the existence and placement of homes, as demonstrated by the failures of systems for identifying streets, buildings and plots, which have been unable to keep up with the pace of urbanization. According to a comprehensive study completed in 2005, 50% or more of the city streets in the global south “have no names or addresses, and the problem is particularly acute in the poorest neighborhoods” [Farvacque-Vitkovic et al. 2005: vii].)

When Cities are mandated to provide services to their population they will typically charge for those services, both to cover the costs of the services directly provided as well as to use such services as a cost center to cover municipal expenses that are not directly revenue-generating themselves. A World Bank study has shown that the infrastructure deficit in sub-Saharan Africa is far greater than that of other its peers elsewhere in the global south; in every metric used in the study, Africa’s infrastructure lagged well behind that of its peers (Yepes, Pierce & Foster 2008). Table 1.2 summarizes this information.

Table 1.2: Africa’s infrastructure deficit

Normalized units	Sub-Saharan Africa low-income countries	Other low-income countries in the global south
Paved-road density	31	134
Total road density	137	211
Main-line density	10	78
Mobile density	55	76
Internet density	2	3

Generation capacity	37	326
Electricity coverage	16	41
Improved water	60	72
Improved sanitation	34	51

Source: Yepes, Pierce & Foster (2008: 2)

Note: The table does not include standardized measuring units but instead tries to approximate the relative amounts between low-income countries globally and those in sub-Saharan Africa. The intent of the table, and the study, is to show the striking difference between sub-Saharan Africa and the rest of the world using indicative numbers.

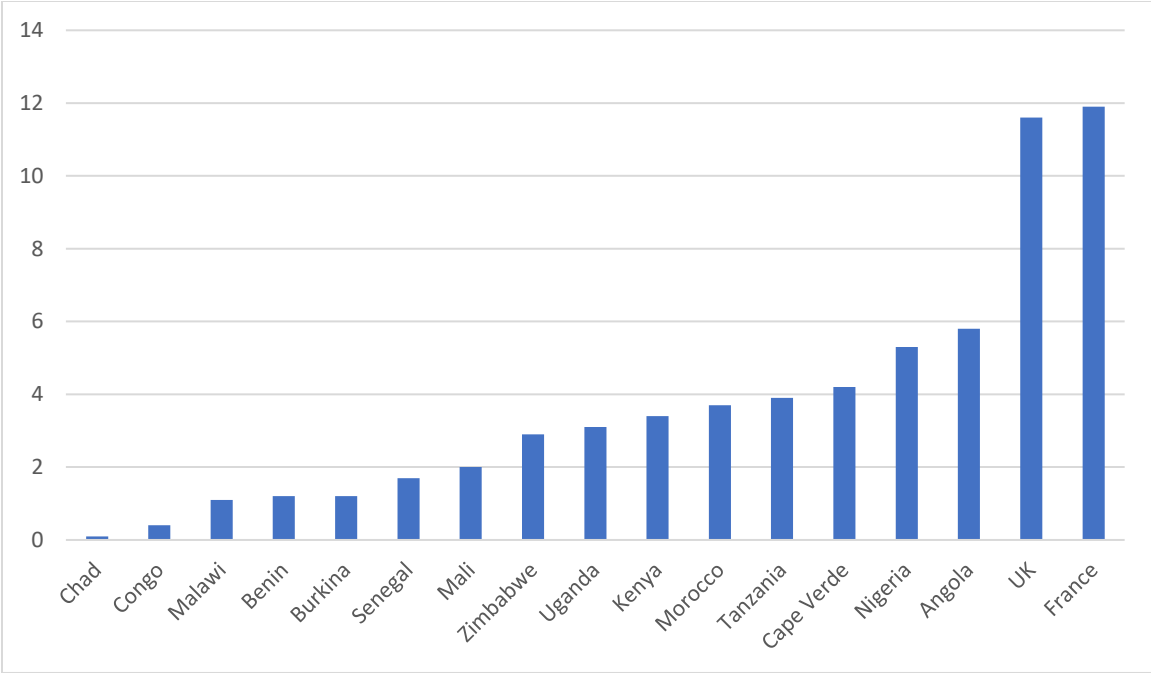
Compared to taxes, it is generally easier to tie user charges directly to the cost of producing services so that a perpetual funding shortage can be avoided. These charges are thus a more self-sustaining source in the long run. Imposing user charges can be politically sensitive, especially for sectors such as water supply where the services are often viewed as entitlements that should be subsidized. Despite potential public hostility, however, user charges can be the key to unlocking private sector capital and attracting innovative, self-sustaining financing solutions in the long run. Better-quality service, more service options catering to specific users, user vouchers, and automated collection systems are a few potential solutions that can help to incentivize users and increase their willingness to pay.

City governments around the world benefit from transfers from central and state/provincial/county governments. These transfers are typically derived from a formula that combines the amount of money collected from a City with a weighting of the demonstrated need and the (often) subjective preference of the layer of government making allocation decisions. Interestingly, the amount of money sourced from local governments for local government projects is not closely linked to the development status of the country (Devas 2008; Devas & Delay 2006).

Regardless of the examples set in Western Europe and North America, the biggest challenge for Cities in sub-Saharan Africa is not the level of funds that these Cities typically have available for financial commitment to their capital-intensive investment needs, but the fact that they cannot adequately predict the timing of the transfers allocated by central government. Nonetheless, it can be instructive to compare the level of sub-national government expenditure as a percentage of GDP of the two countries in Western Europe that left an indelible stamp on sub-Saharan Africa with that of sub-Saharan Africa itself (Figure 1.3). Notably, there is more money spent at the sub-national level in the two Western European countries, but it represents money that was collected and then redistributed, whereas national and municipal

governments across sub-Saharan Africa are being strongly encouraged to rely more heavily on own-source revenue (Bird 2010; Shi, Hendrick & Park 2018).

Figure 1.3: African and European sub-national government expenditure as a percentage of GDP, 2012–2013



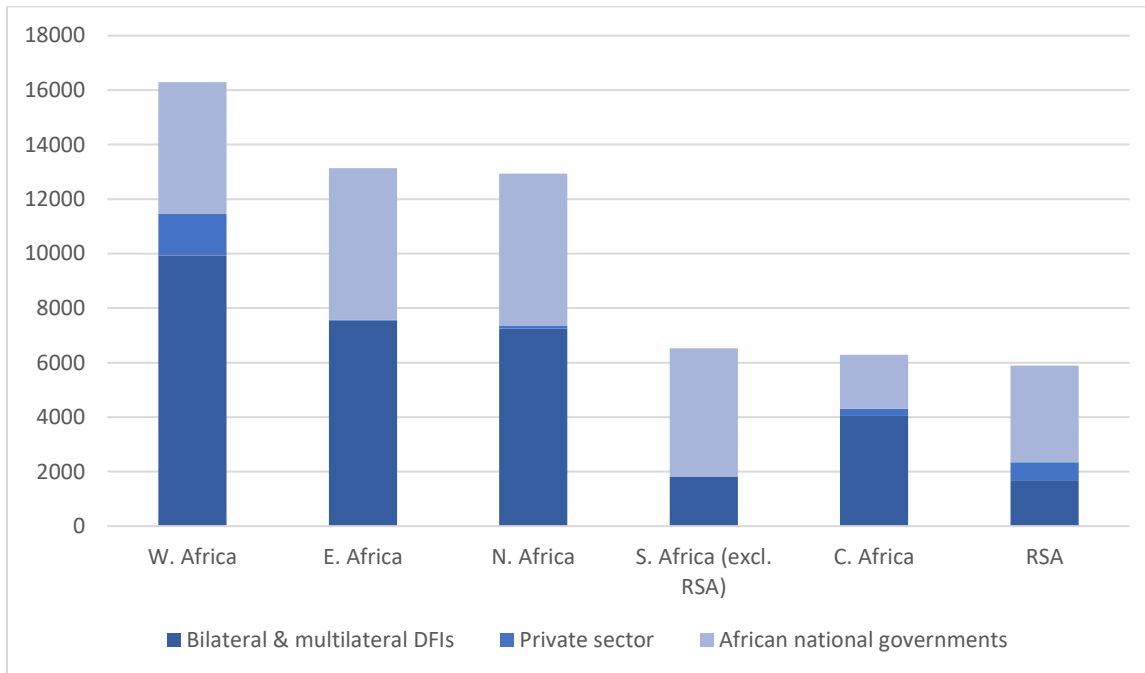
Source: Compiled by the author from the UCLG’s Global Observatory on Local Finance (OECD/UCLG 2016).

In the face of insufficient finance from taxes, tariffs and transfers, Cities have developed creative instruments that can be used to cover the cost of their financial needs by borrowing from a number of different sources of capital: financial institutions, civic-minded citizens, and others. Public sector financing is almost always 100% debt financing (i.e., fully leveraged with no equity capital at risk). The cost of this debt financing is significantly lower relative to the private sector due largely to taxes and other public assets that effectively serve as collateral on the debt. Taxpayers are thus de facto equity holders of government investments, and any risks associated with these investments are ultimately borne by the taxpayers. These risks, however, are not reflected in the debt financing costs per se because they are considered relatively risk-free, implying that taxpayers are obligated to make the debt holders whole in one way or another. Traditionally, this borrowing has taken the form of loans (most typically, bilateral instruments between a sole borrower and a sole lender through a negotiated transaction between both parties) or bonds (most typically, instruments with a sole borrower and multiple sources of capital through a public transaction, refereed by a financial regulator and an advocate for the prospective bondholders, or a trustee). Municipal infrastructure is largely supported by this type of investment around the world, with more experiences of

success in the global north than the global south.

Cities in sub-Saharan Africa are increasingly benefiting from loans from bilateral and multilateral development finance institutions (DFIs) at concessionary rates, but this type of financing is ultimately not reliable in the long term as DFIs are increasingly challenged by shrinking budgets for investment. Unfortunately, in nearly all cases, the amount of money contributed by DFIs outweighs the amount of money invested by national governments in infrastructure (Figure 1.4).

Figure 1.4: Total African infrastructure commitments by region and source, 2016

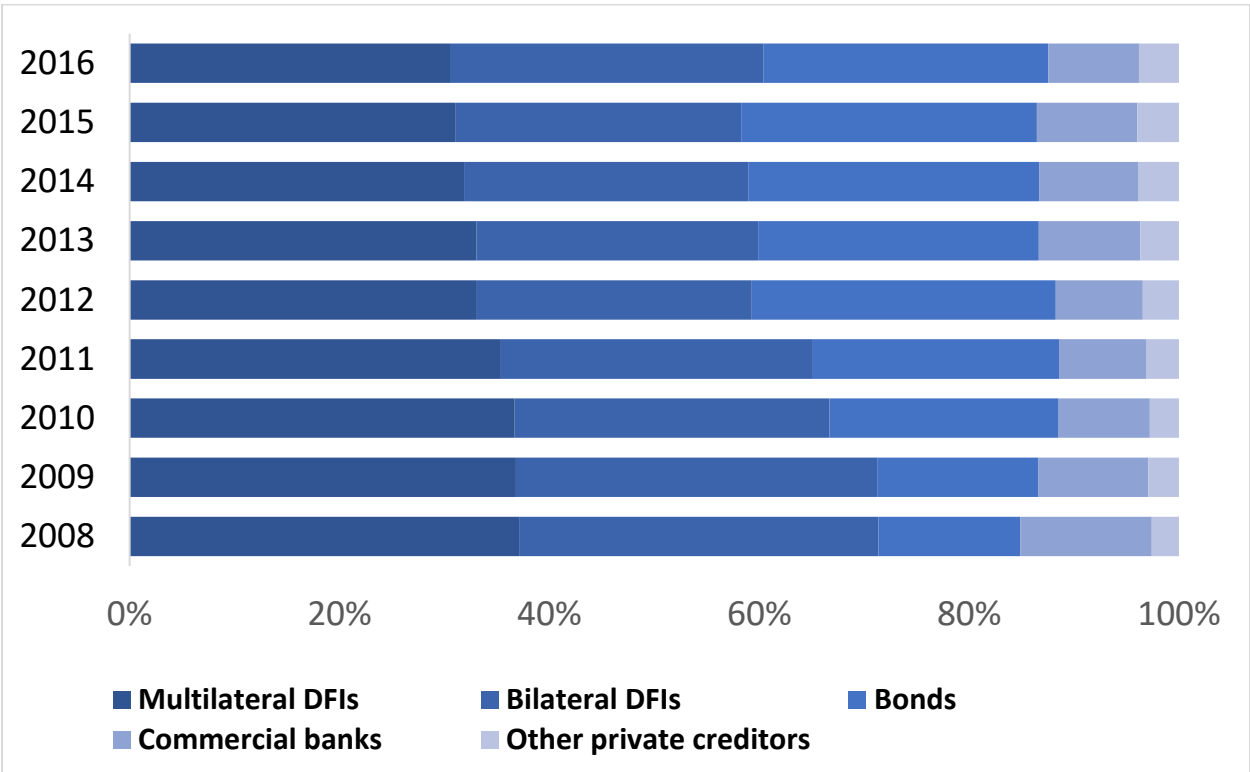


Source: Infrastructure Consortium for Africa (2016)

Note: The DFIs referred to include the Infrastructure Consortium for Africa (ICA) bilateral members e.g. G8 countries (Canada, France, Germany, Italy, Japan, Russia, the UK and the USA), and multilateral members e.g. the World Bank Group, African Development Bank Group, European Commission, European Investment Bank and Development Bank of South Africa.

More challenging than the unsustainability of concessionary-rate financing is the inability of Cities in sub-Saharan Africa to launch municipal bonds. However, across sub-Saharan Africa, the use of bonds at the national level as a mechanism for raising debt for long-term infrastructure projects has nearly doubled over the past eight years (from 14% to 27% of total debt), as shown in Figure 1.5.

Figure 1.5: Sources of debt financing in sub-Saharan Africa, 2008–2016



Source: World Bank Group (2017)

The next chapter of this thesis will demonstrate the power of municipal bonds as financial instruments for Cities, and highlight the fact that such bonds are less expensive options for Cities to consider than other sources when looking for creative ways to cover their financial costs.

Conclusion

This chapter has argued that, while their needs and aspirations may grow, the financial options available to Cities in most countries in the global south have not kept pace with the growth and increasing complexity of the cities themselves. Cities are stuck in a vicious cycle of limited resources leading to constrained responses, while the population of the city and the demand for services continue to grow. Ironically, many local government capital investments have high economic and social returns, and therefore should be prioritized both by decision-makers at the local and central government levels (seekers of capital) as well as by the businesses that may ultimately benefit from a more productive workforce (sources of capital). For instance, transportation signals that reduce congestion free people’s time and reduce time in commute, improving their quality of life and work-life balance. Investments in drainage that reduce flooding in commercial areas reduce trading days lost to post-flood recovery. In these cases, domestic private capital

should be available to finance municipal investments that cannot be financed through grants. At the heart of the challenge for cities still remains the lack of autonomy, often through the incomplete attempts at decentralization common among governments in the global south (Gorelick 2018).

Within the context of the thesis, this chapter introduces the idea that decentralization can be beneficial both for sub-national governments that are eager to take on additional responsibilities and act responsively to their citizens and for national governments that are overburdened with a host of responsibilities which, often, relegate concerns about urban infrastructure to a diminished status. Adding the ideas of decentralization with the other two theoretical areas of municipal bonds as a mechanism to raise funds and the concept of African exceptionalism, theories of decentralization constitute one of the three pillars of the theoretical exploration of this thesis.

Chapter 2: Municipal Bonds

“In this world, nothing can be said to be certain, except death and taxes.”

– Benjamin Franklin¹⁵

Closely linked with the previous chapter’s focus on decentralization and its impact on financial autonomy and decision-making, this chapter builds on many of the initial points raised and begins to explore the idea of municipal bonds themselves as an appropriate tool for the financing of urban infrastructure in geographies like sub-Saharan Africa. Without understanding the reasons why decentralization faces detractors, the debate about municipal bonds would, at an initial glance, deal primarily with the financial preparedness of a sub-national government; with the backdrop of decentralization firmly established, the implications of a municipal bond issuance as a manifestation of a devolution of power over decision-making become clear, with the City starting to rival the once-exclusive power of the national government (in activities like bond issuance). In essence, this chapter helps the reader begin to think about the fact that the often-quoted indicators of municipal creditworthiness and readiness for issuing a bond are fundamentally dependent on the creation of an appropriate enabling environment for such a transaction, and that non-decentralized governments where there is ambiguity about the roles of cities create a poor situation for such financial experimentation.

Mobilizing resources to finance investments and improve services at the municipal level is one of the most challenging aspects of local development, especially if the goal is to provide resources in market-like conditions in a sustainable manner, for instance from loans or bonds. Even when government transfers are predictable and generous (which is the exception), they are rarely adequate to finance major infrastructure improvements in growing cities (Arezki & Sy 2016). The capital investment financing that is available to local governments is often provided by national agencies whose own access to capital is highly constrained. Winning funding allocations from national budgets requires local governments to compete with line ministries and other priorities of the government in power. Regardless of the source of funds for central governments – whether own-source or from an outside body – the amount of money spent by local governments in the global south on capital expenditure is inadequate (UCLG 2010). Therefore, in many

¹⁵ Franklin (1789).

countries in the global south, cities are increasingly looking to the capital markets as a potential additional source of finance; for sub-national governments, these transactions take the form of municipal bonds.

The conditions required to provide local governments with capital market access have been tested and perfected in North America and Europe, initially in Italian city-states in the pre-Renaissance era and with a more recent resurgence as early as the first decades of the 18th century for the construction of New York's Erie Canal (Temel 2001). And yet, these conditions have not so far been met in sub-Saharan Africa, largely because of incomplete decentralization. However, there are other extenuating factors that further complicate matters for these cities in their ongoing quest for finance, although the argument in this thesis is that these come into play only once the issue of decentralization and national government commitment to encouraging financial autonomy has been dealt with.

Lack of a framework for investment

Because financial institutions want to be reasonably secure in their decisions on long-term capital investments, the establishment of a transparent and sound regulatory framework for investment is a prerequisite for attracting capital flows (Kantrow 2014). Such a framework ensures that financial obligations are upheld for all parties to transactions. In the absence of this framework, institutional and individual investors lack confidence in domestic capital markets.

Sources of capital have responsibilities as well. To be effective investors in municipal projects, institutional investors should be prepared to mobilize adequate resources to meet local governments' investment needs, be transparent about their expectations by creating risk/return trade-offs that are clearly understood by and agreeable to all parties, and encourage the involvement of capable intermediaries, analysts, and trustees who are prepared to facilitate transactions in both the primary market and throughout the lifetime of the bond (i.e., through providing liquidity in secondary markets). These conditions are often absent in sub-Saharan Africa due to the nascent nature of the financial markets, lack of investor confidence, and lack of tools to mitigate risks. Effectively, these factors come together in a catch-all term – financialization – which references the growing influence of capital markets, their intermediaries, and processes in contemporary economic and political life (Gorelick 2016).

Lack of creditworthy local governments and bankable plans/projects

With few exceptions, Cities are political entities led by politicians who serve at the pleasure of the electorate, and this can have significant impact on the ability to raise finance from risk-averse investors. Cities cannot pierce the sovereign ceiling established by the economic and financial performance – the creditworthiness – of their respective countries. Accordingly, the potential pool of capital sources for cities

is limited to those investors who already view the sovereign government as offering an acceptable return, commensurate with the investors' respective perceptions of the risk of default. Further, because most central governments in sub-Saharan Africa are responsible for tax collection from residential and commercial properties, with subsequent transfers to municipal governments, all purchasers of municipal obligations need to analyze the likelihood of regular and in-full payments to cities; this typically manifests itself in the form of a premium over the stipulated returns pledged by the sovereign government in its debt issuances (viewed in aggregate as the sovereign bond treasury curve).

For most cities in sub-Saharan Africa, achieving access to capital financing at a reasonable cost from sources other than transfers and own revenues will require sustained attention to improving the policies and practices underpinning both their creditworthiness and the projects requiring funding. A World Bank study found that only a small percentage of the 500 largest cities in developing countries could be deemed "creditworthy" – about 4% in international financial markets and 20% in local markets (World Bank 2013b). Municipal bonds can either finance specific investments (such as a water treatment facility, a parking garage, or a convention center), or finance an investment plan or a program of capital investments that vary in size and sector. With the former, local governments would often repay the transactions from revenues associated with the investment itself (water tariffs, parking fees, or convention costs); in the latter case, repayment would be from all municipal taxes, fees, tariffs, or other sources that capitalize a general account from which the principal and interest related to debt service can be withdrawn.

To make a convincing argument for a municipality's commitment to its most bankable projects, cities often need to demonstrate that they have a larger "wish-list" of projects that constitute a more ambitious capital investment program. From that overall list, and in concert with a more comprehensive vision, municipal leaders need to garner support for this vision from the general electorate to ensure the longevity of a master plan beyond any given municipal administration. Simultaneously, Cities need to commit to building their own local capacity to: (1) provide accurate information about the operational and financial activities of the local government; (2) identify and prepare sustainable bankable projects; (3) provide a strong repayment stream and demonstrate or mobilize local willingness to pay; and (4) manage the financed projects during the life of the bond issue or other financing to ensure continued operation and maintenance of the investments, and collection of associated revenues, where relevant. The magnitude, sophistication, and linkages between all of the projects that are elements in the overall master plan help to underscore the creditworthiness of the municipality itself (Kaganova 2011).

Lack of capacity to accurately assess financing options

Even if a City is successful in creating the template for a bankable project (either independently or with

technical assistance from an outside agency), municipal leaders are often at a disadvantage when considering the most appropriate financial instrument to use to deliver their long-term financing goals. Approached from all sides by development finance institutions, investment banks, and other well-meaning but often contradictory advisors, Cities are challenged by the need to make swift and responsible decisions without being accused of corruption or other undue influence. Further, success in designing a pioneering issuance, particularly if executed with the help of an external aid agency or foundation, is not a guarantee of future success without the institutionalization of a process for subsequent issuance and sufficient capacity-building to address these concerns.

All of these challenges to the enabling environments of municipalities are amplified through the use of municipal bonds, which are among the most public and transparent of financial instruments at the disposal of municipalities in sub-Saharan Africa (Noel 1999). However, it is this free flow of information between all stakeholders in and observers of such a transaction – one which shows the inconsistencies in the enabling environment or the weaknesses in municipal financial management – that reminds all participants of the need for a clear policy on the role and responsibility of the City, particularly in a decentralized system. It can also, in many cases, be revealing about policy-makers’ lack of education about and awareness of the pivotal role and impact that municipal bonds in particular can have in closing the financing gap between available resources and capital investment needs in the municipal budget. Nonetheless, as previously highlighted, this thesis argues that the challenges listed above are ones to consider only once the enabling environment has been created. More importantly, these issues can be fixed on a bespoke basis as cities mature and are able to see that improvements in their financial planning and creditworthiness can lead to a definitive and measurable result. During an interview with Babacar Thioye Ba, the legal advisor to the mayor of the City of Dakar, following the failure of the City of Dakar’s bond to launch, he shared that municipal leaders “cannot commit to a long-term strategy of improved financial performance” which “carries with it a re-allocation of funds from more demonstrable and immediately impactful social investments” unless there is “confidence that the long-term result will lead to permanent and easily explainable outcomes”.¹⁶

The history of municipal bonds

To better see how municipal bonds could be introduced in sub-Saharan Africa, it may be instructive to look at how they were first deployed elsewhere. The first recorded municipal bonds were originated in autonomous city-states, where there was little sense of national identity and princes held power in the

¹⁶ Interview with Babacar Thioye Ba, 10 August 2017, Dakar, Senegal.

absence of kings. In 1150, the Italian city-state of Genoa structured a transaction to improve its central business district. The municipality owned some stalls in the public marketplace, which it rented out to money exchangers. Needing 400 lire for capital improvements, the municipality ceded the rental income to private investors for 29 years upon the expiration of which, having returned the original amount of the loan to them, it reacquired possession of the stalls. If the municipality wished to reacquire possession before the 29 years were up, however, it would have to pay the creditors 500 lire (capital repayment plus a penalty of 100 lire for loss of income up to the date contracted to in the original agreement).

In two contracts dated 1150, the municipality was given the right to repossess its income stream at a date earlier than that in the agreement by paying a higher sum of money than the sale price – in other words, a loan paid back with interest.

Nos consules comunis Ianue Capharus, Obertus Spinula, vobis Guillelmo Vento, Oberto Turri, et vestris consortibus nominative vendimus ab ista proxima Purificacione sancte Marie usque ad annos viginti novem expletos usufructum de banchis comunis Ianue; precio accepimus a vobis consortibus libras quatuor centum denariorum Preterea nos predicti emptores, gratuita et bona voluntate et amore Comunis Ianue, ... volumus ut si Comune Ianue infra predictos viginti novem annos dederit nobis libras quingentas ... vendemus Comuni Ianue pro precio de suprascriptis libris D usufructum quod nobis de predictis banchis deinde pervenire deberet.¹⁷

We, Caffaro, Oberto Spinola etc., consuls of the municipality of Genoa, sell to you, Guglielmo Vento, Oberto Torre and to your consorts the income from the municipal stalls for 29 years, starting from the 2nd of February, for the price of 400 lire. And we, the purchasers, out of goodwill and love for the City, agree that upon payment of 500 lire the municipality has the right to repossess the public stalls even before the end of the agreed 29 years.¹⁸

Soon enough, these financial operations acquired a characteristic configuration that remained unchanged over time. The two parties to the contract were the municipality, which received a loan amount for a determined length of time, and one or more lenders who, in exchange for their loan, obtained the right to cash revenues from a tax (either one pre-existing or a tax set up specifically for the purpose) which would provide a yield proportional to the loan capital. In practice, the ceded tax revenue represented the interest on the loan and also acted as a lien for reimbursement since, if the agreed deadline for repayment was not

¹⁷ *I Libri Iurium della Repubblica di Genova*, Vol. I/1 a cura di Antonella Rovere, Genova, 1992, Number 125.

¹⁸ Unless otherwise indicated, all translations are by the author.

met by the state, the creditors would keep on benefiting from the revenue stream until the state paid them back. The revenue received by the creditor could vary from year to year, depending on the economic situation, sometimes increasing but more often than not diminishing with respect to the sum initially envisaged. This brought an uncertainty to the relationship between capital and interest, and stopped creditors making an automatic illicit profit. Hence the use of the term “*compera*” (purchase, derived from “*comprare*” [to buy]) to define the purchase of a tax income of variable amount in exchange for a fixed sum of money (the corresponding capital).

To avoid confusion, each *compera* was named after either the sum of money involved (*compera* of 20,000 lire), the purpose of the loan (*compera* for maritime armaments), the tax on which it was based (*compera* of 1% on insurances), the name of a saint (*compera* of Saint Peter), and so on. Each *compera* had its own legal personality, surviving over time even if its creditors were to sell their shares to a third party. In most cases it managed directly the revenues on which it had been funded, and was administered in turn by “trustees” elected from amongst the lenders themselves. In order to simplify calculations on such large sums of money and attract investment, the capital was divided into shares with the same nominal value and the same privileges, and the subscriber could sell them on to a third party in exchange for cash. During the early 13th century public debt (“*compere*”) was divided into shares (“*luoghi*”, in Latin “*loca*”) with a nominal value of 100 lire. The *luoghi* could be disposed of at the owner’s will and, shortly after their issue, became tax-free and could not be confiscated by the state. These shares could be further sub-divided into smaller tranches or could be added together, as the subscriber desired. The amount of interest reflected the standard value of the share itself. Hence, a *compera* with a nominal value of 30,000 lire consisted of 300 *luoghi*, and a profit of 7 lire on each *luogo* meant a 7% profit. Basically the currency-to-*luogo* ratio was 100:1, to simplify the administrators’ calculations. The same 100:1 ratio can be found in many financial instruments negotiated up until the Second World War, both in Europe and in the United States. The *luoghi* were not material instruments, in that their existence was simply validated in writing within the public debt ledgers (“*XY loca tres, sive £300*”) and subsequent spin-off documents relating to purchases, legacies, etc. However, the *luoghi* were very similar to modern bonds because they were registered, transferable, and encumbered at the owner’s will. Furthermore, thanks to the fact that the state could not confiscate them, *luoghi* became popular instruments of exchange, sought after (as investments or speculation) by the upper class, religious institutions and private organizations. The market for *luoghi* would survive more than five centuries, until the fall of the Republic of Genoa.¹⁹

The first recorded United States municipal bond was issued by the City of New York in 1812 for the

¹⁹ Archivio di Stato di Genova (A.S.G.), Manoscritti, no. 539, c. 668. A.S.G., Archivio di San Giorgio, no. 92.

construction of an almshouse and other public improvements (Durand 1938). A much larger transaction, and one often incorrectly quoted as being the City's first municipal bond, occurred later in the year and was specifically designated to construct canals from the Hudson River to Lake Erie and Lake Champlain. Although the bond was issued for a specific purpose, payment was guaranteed by the City's entire budget (and not specifically viewed as a corporate finance transaction, marking it as a general obligation bond and not a revenue-generating one).

The canals, once complete, dramatically enhanced access to and from New York City and are in large part responsible for securing the City's status as the United States' financial hub, as it is known today. The legislative act that allowed New York to sell the bonds in order to finance the canals' construction specified a maximum interest rate of 6%, which ended up being the interest rate that the bonds actually paid. By 1843, when US cities had about USD 25 million in outstanding debt due to rapid urban development, bonds had grown in popularity to help finance both urban improvements and a growing system of free public education (Cockren, Vecchiotti & Zerbo 1979).

Differentiating between general obligation bonds and revenue-generating bonds

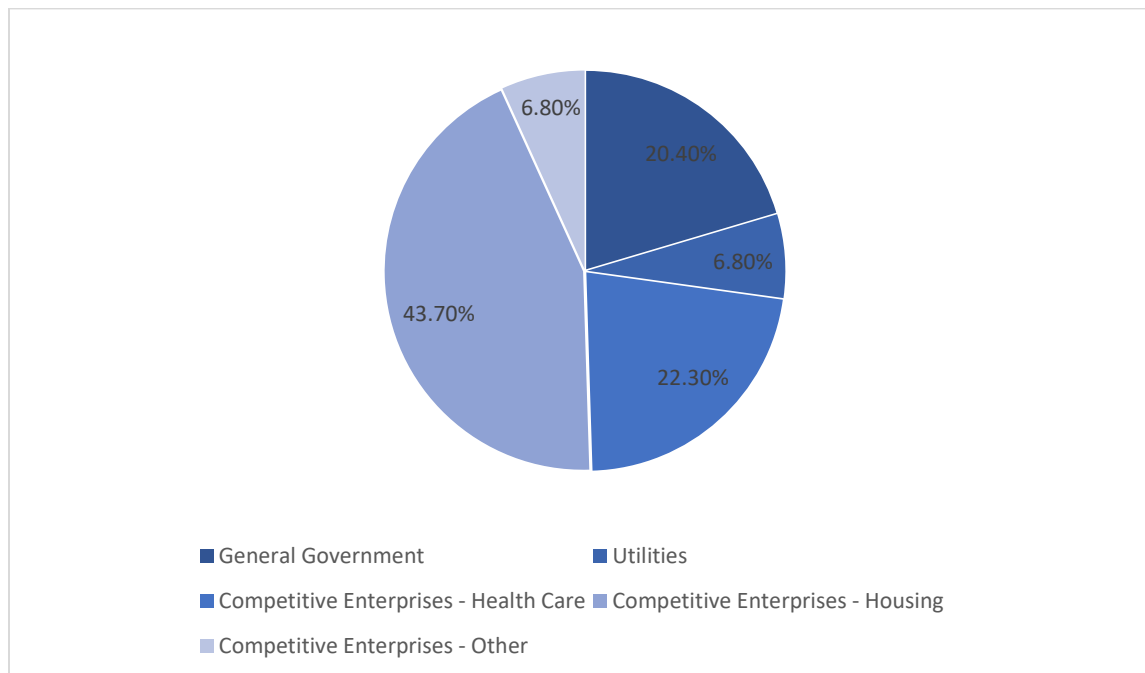
Municipal bonds – or the debt issued by states, cities, and counties to fund projects – fall into several categories, with the two most frequently used being general obligation bonds and revenue bonds (Amadeo 2019). The key difference between these two types of municipal (also known as muni) bonds is the source of the revenue used to make interest and principal payments.

General obligation bonds, also called GOs, are bonds that are backed by the “full faith and credit” of the issuer, with no specific project identified as the source of funds. In other words, the municipal issuer can make interest and principal payments using any source of revenue available to it, such as tax revenues, fees, or the issuance of new securities. This means that if the municipality encounters fiscal difficulty, it can raise taxes to offset the shortfall. GOs are therefore seen as being relatively safe, and defaults are rare. It is far less likely that an entire municipal government will face serious financial difficulty than that a specific municipal project will fail to generate its anticipated income.

Revenue bonds are bonds that are backed by the revenue generated by the specific project being financed by the bond issue. In other words, the money raised by the bond offering finances the project, and the project – once complete – generates the revenues to pay the interest and principal on the bond. Projects could include hospitals, airports, toll roads, housing projects, convention centers, bridges, and similar endeavors. Revenue bonds are generally higher-risk than GOs, and as a result, they typically offer higher yields. Within the revenue bond category, there are also essential services revenue bonds, which include projects related to water, sewer, and power systems. Since the revenue from such projects is seen as being more reliable, essential services revenue bonds are seen as being lower-risk than bonds financed by revenue from non-essential services. That perceived lower risk is reflected in the slightly lower returns of essential services bonds compared with the returns of other revenue bonds.

Institutional investors typically view municipal bonds as being relatively safe stores of wealth, with predictable returns on investment higher than that pledged by the central government. This pick-up in yield is counterbalanced by the potential for the City to be unable to satisfy its debt service obligations, which is manifested in either an outright default or a less contentious restructuring. The likelihood of default is exponentially higher among municipal services offered as competitive enterprises (hospitals and housing), particularly when viewed as revenue-generating bonds, when compared with municipal services as part of general obligation or utility transactions, as shown in Figure 2.1 (Moody’s Investor Service 2017).

Figure 2.1: Defaults by category (percentage), 1970–2011



Source: Moody's Investor Services: *U.S. Municipal Bond Defaults and Recoveries, 1970–2011*.

Municipal defaults, while uncommon, are oft-referenced events. The 1975 near-default of New York City, which caused a dramatic rift between municipal and federal officials and would only be conceivable in a federal system where the central government offers no guarantee to sub-national borrowers, culminated in a speech by then-President Gerald Ford, in which he opined:

What I cannot understand – and what nobody should condone – is the blatant attempt in some quarters to frighten the American people and their representatives in Congress into panicky support of patently bad policy. The people of this country will not be stampeded; they will not panic when a few desperate New York City officials and bankers try to scare New York's mortgage payments out of them...

I can tell you, and tell you now, that I am prepared to veto any bill that has as its purpose a federal bailout of New York City to prevent a default. (Ford 1975: 2301-3)

The speech by Ford was captured in the New York *Daily News*' cover headline – “Ford to City: Drop Dead.”²⁰ Over the past 30 years, other borrowers have defaulted, or threatened to default, on their

²⁰ Van Riper, F., “Ford to City: Drop Dead.” *Daily News*, 30 October 1975. <http://www.nydailynews.com/new-york/president-ford-announces-won-bailout-nyc-1975-article-1.2405985>, accessed June 2018.

obligations; recent examples include Detroit, Michigan (2013) and the Commonwealth of Puerto Rico (2016). The increased occurrence of sub-national defaults in the United States has, however, not been a deterrent to the prospect of municipal bond issuance in Africa, due to the presence of guarantees (whether implicit or explicit) from national governments as well as the realization that urban finance needs cannot be met without a diversification of tools and instruments beyond traditional grants from donors or concessionary-rate financing.

A more interesting case, perhaps, can be found by looking at the performance of municipalities in Argentina following the default in coupon payments by the national government. As sub-national governments are constrained by the rating ceiling set by their sovereign government, the default by Argentina in 2001 was particularly damaging to investors' collective perceptions of the likelihood of repayment by cities like Buenos Aires in the aftermath of the default (Hebert & Schreger 2017). As a result, even if municipal leadership and financial management in Argentina's cities was strong, the default of the national government on its debt meant that all public entities, particularly sub-national governments with heavy reliance on fiscal transfers from the national government, would also receive a credit rating indicating the existence or high likelihood of default. Such a credit rating would prohibit any issuing city from receiving a competitive interest rate from investors, significantly limiting the necessary flow of funds from sources of finance to municipalities seeking to invest in their urban infrastructure needs.

Municipal bonds versus loans

Separate from the question of municipal default is a view on the preference for bonds versus loans. Unlike North America, where municipal bonds have been the foundation of municipal borrowing, Europe relies on bank lending to fund municipal infrastructure. In Europe, banks have traditionally been viewed as the source of finance for city development, regardless of whether the banks were corporate entities or controlled by a single family (as in the case of the Medici in Renaissance Italy). In recent years, some European cities have experimented with municipal bonds. And yet, while the rationale of municipal leadership the use of banks to meet financing needs differs from country to country, some common themes have plagued many European countries attempting to diversify to include municipal bonds in their toolkit of available instruments. These challenges include: (1) an overly strong relationship between bankers and City management, such that City treasurers would leak insider information to bankers, with an expectation that entire bond transactions would be wholly placed at a single financial institution rather than widely dispersed through allocations to a number of banks and institutional investors; and (2) a reticence among City managers to match financial planning with long-term city development plans, where capital-intensive projects requiring a longer repayment period would benefit from the terms offered by a municipal bond

(Bordignon, Griglio & Turati 2015).

Table 2.1: Bank lending versus bond issuance

	Lending (Europe)	Bonds (North America)
Link between lender and borrower	Relationship banking	Competition among lenders
Monitoring system	Delegated (performed by bank)	Third-party (not performed by lender)
Pricing of transaction	Bundled (lump-sum)	Unbundled (itemized pricing)
Interest rate	Floating (tracks benchmark treasury curve)	Fixed (set at issuance by benchmark treasury curve)

Source: Compiled by the author.

Local capital financing through bond issuance is markedly different from that offered by banks in terms of the relationship between the lender and the borrower, the level of monitoring and transparency expected by the sources of finance, and the way in which the pricing is determined (Table 2.1). With regard to the link between the lender and the borrower, municipal bond underwriters try to achieve a long-term working relationship with their municipal clients. However, each bond is viewed as a freestanding instrument that does not necessarily build on a past history with a particular source of finance; neither institutional nor individual purchasers of bonds need to have a long-term relationship with the issuer. Similarly, the expectation of a confidential dossier on the borrower (as would be beneficial in a traditional banking relationship) is not required as it is made irrelevant through the higher level of transparency of a municipal bond transaction. Whereas banks typically seek to build loan departments that possess proprietary information and proprietary methods of analyzing creditworthiness, in a municipal bond market information on local financial conditions is provided by issuers to the market. To avoid information asymmetry, bond markets rely on public disclosure of municipal financial information to function effectively. Most financial systems utilizing bond issues have extensive public disclosure requirements that issuers must comply with, as well as requirements specifying accounting standards and independent audits of financial statements. Credit-rating firms have developed a presence in every municipal bond market of significant size. They report the content of their credit analyses publicly, and exert considerable influence over the market,

including the risk premium that municipalities have to pay for borrowing, based on their financial condition and credit history.

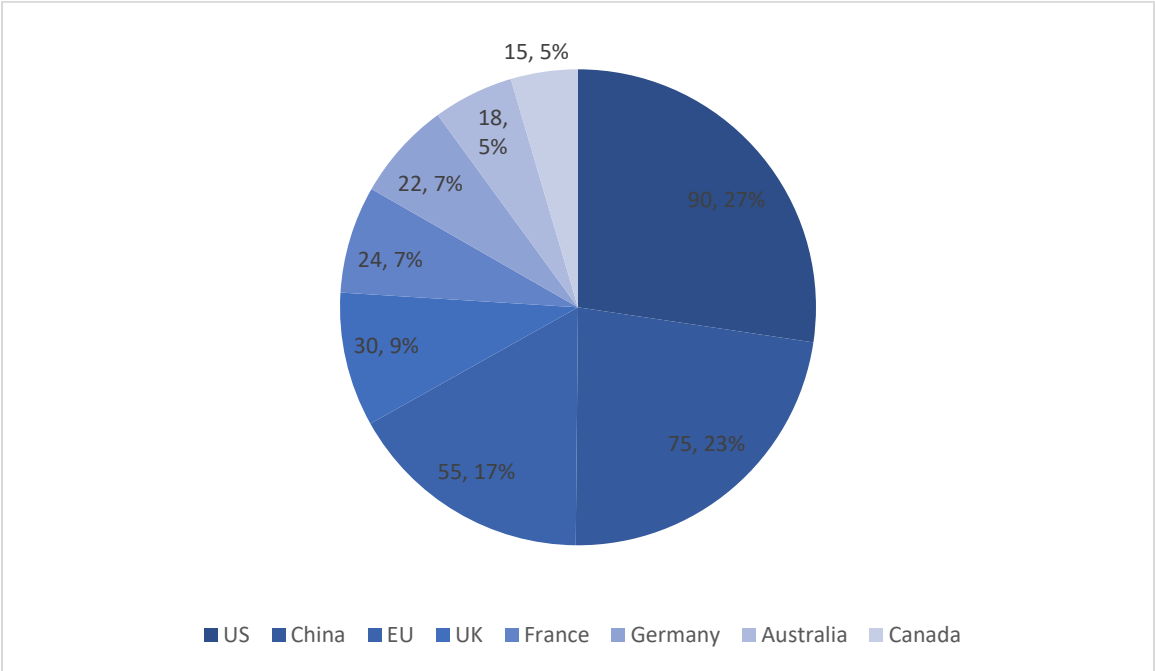
Beyond questions of relationship between a source of capital and the City, a municipal bond also encourages a significantly higher level of autonomy for a municipality relative to a loan. More specifically, a municipal bond market unbundles the various support functions that a municipality can receive from a traditional banking relationship. Local governments can make separate decisions about where to maintain their liquid deposits and where to obtain financial advisory services or technical assistance on project design. Bidding for each of these support activities can be competed for separately in their sub-markets.

From the point of view of a City treasurer, the most striking difference between a municipal bond through the capital markets and a bank loan from a market-rate bank is in the interest rate that a City is likely to face. As previously stated, in most cases, a municipal bond will lock in the prevailing interest rate at the time of issuance, keeping that rate fixed for the entire duration of the bond's lifetime, while a bank loan is likely to fluctuate based on the performance of the underlying benchmark interest rates or national treasury curve. In an environment where interest rates are anticipated to decrease due to a flight of capital from the debt to the equity markets (typically driven by an increased appetite for well-performing stocks) and where a City designs a project that can be repaid in a relatively short period of time, the City would be likely to opt for a bank loan, betting on the assumption that interest rates will be lower than the fixed coupon pledged by a bond issuance. The cost of capital for a bank loan in an unpredictable environment, particularly when viewed over a long period of time, creates a more rational argument for a bond issuance, and can be viewed as part of the argument for the prevalence of municipal bonds in the United States relative to their use in Europe (Peterson 2003).

Despite the longstanding preference in each of the two regions analyzed (Europe and North America) for bank loans and bonds respectively, there has been an increase in the diversity of tools used by municipalities to raise money to meet their financial needs. In the United States, where cities have traditionally used municipal bonds to finance their infrastructure and development needs, there has been a noticeable uptick in the amount of direct lending by commercial banks and other financial institutions to municipal borrowers. This is driven by (1) a low-interest rate environment in which cities can refinance outstanding bond debt at more favorable terms than the coupon on bonds; (2) the relative pricing of origination fees for loans over bonds; and (3) the lower level of transparency required by bank loans. Nonetheless, cities across the United States continue to rely heavily on capital markets for finance (80% of municipal finance is in the form of bonds) because banks tend to avoid taking on long-term debt, which is necessary for large infrastructure projects (Farmer 2014; Malpezzi & Unkovic 2014). Central to this discussion is the fact that cities in the

global north have the power to make a decision about which instrument they prefer to use to raise external debt; cities across sub-Saharan Africa do not have the autonomy to choose between different forms, and are typically further handicapped by the fact that their constitutions mandate that the national government explicitly approve any borrowing prior to transactions. From a geopolitical perspective, the presence of bond issuance as the preferred method of raising capital for municipal infrastructure investment in the United States is important for sub-Saharan Africa because American aid to Africa has traditionally represented the largest source of donor investment by a single entity. Interviews with City officials in Dakar who participated in the Dakar Municipal Finance Program (DFMP) indicated that the decision to solicit funds from the Bill and Melinda Gates Foundation and a credit enhancement from USAID, and not from the European Union or the Agence Française de Développement, was partially driven by the strategic calculation that municipal bonds were the preferred method for capital-raising for cities in North America, while loans were prevalent in Europe.²¹

Figure 2.2: Foreign aid to sub-Saharan Africa (percentage of donor total), 2000–2012



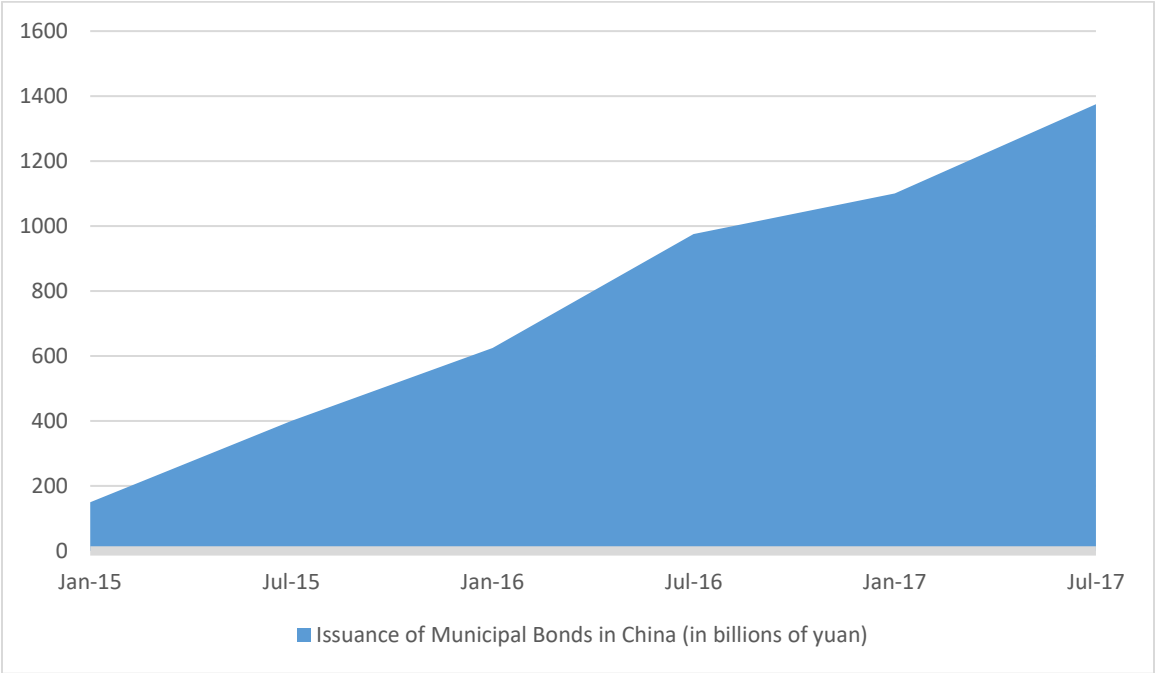
Source: Compiled by the author using OECD (n.d.: Table 29).

Governments from the global south, particularly China, have become considerably more active in the foreign aid donor community since 2010 (Figure 2.2). By 2015, these emerging aid programs, rivaling those of the traditional donors from the global north, had already started to diminish the ability of the United

²¹ Interviews with Dieynaba Thiam Ka, 14 August 2017, and Khady Dia Sarr, 16 November 2017, Dakar, Senegal.

States and Europe to leverage foreign aid to influence policy abroad (Collins 2015). As American influence in sub-Saharan Africa is eclipsed by China, African leaders are beginning to consider ways in which they might follow Chinese government policy. The Chinese themselves have only recently begun their own experiments with decentralization, which have resulted in inconsistent growth across the country and uneven success in achieving fiscal autonomy at the municipal level (Dexu & Wenlong 2017). That said, the Chinese government has mandated the introduction of municipal bonds as a mechanism to raise capital for cities while simultaneously offering an alternative instrument to keep Chinese investors from expatriating their money (Figure 2.3). Accordingly, municipal bonds in China are important because (1) they provide additional sources of capital to support City growth beyond the central government; and (2) they provide additional opportunities for Chinese investors to park their money domestically rather than invest it overseas, which can significantly reduce the instances of capital flight. In 2015, the equivalent of over USD 676 billion of Chinese liquid assets were invested outside of China by yield-hungry investors seeking better rates than those available domestically (Institute of International Finance 2016). As a result, in 2016, Chinese legislators introduced strict measures to stop these outflows, and high-net worth individuals and institutional investors started to shift their resources into municipal bonds denominated in yuan. Since the introduction of this policy and the recognition by the Chinese government that municipal bonds can be a particularly effective tool for both financing cities and keeping yuan in China, cities have successfully launched approximately CNY 8 trillion (equivalent to approximately USD 1.17 billion) (Borst 2018).

Figure 2.3: Chinese local government bonds issued, per semester (CNY billions), 2015–2017



Source: Compiled by the author from Bloomberg Data, February 2018.

An increase in the number of municipal bond investors in China who become comfortable with investment in sub-sovereign issuances and who learn how to assess the creditworthiness of a City, regardless of the country, is likely to increase the appetite for all sub-sovereign issuances in creditworthy countries. This could have an important impact on overseas investors in sub-Saharan African city issuance. China's development aid to sub-Saharan Africa has steadily grown over the past 15 years, matching the country's appreciation for relatively low-cost natural resources (French 2014). China's development approach is in stark contrast to that promoted through European and American bilateral philosophies: this is particularly pronounced in the respective attitudes towards decentralization and desire to institutionalize democratic processes (high in the West, low in the East) (Brautigam 2010; French 2014; Moyo 2009).

Conclusion

Regardless of whether leaders in sub-Saharan African cities choose to follow the rationale for municipal bonds set forth by the United States or China, or whether they adopt the European system of using bank-originated loans, it is increasingly clear that municipalities cannot afford to deliver on their long-term capital investment plans without bringing in additional funds from external sources through debt instruments. Based on the arguments set out above, and the consideration of the additional transparency and high-profile nature of municipal bond issuance relative to bilateral borrowing (loans) from banks, it is more likely, and already proven across the global south based on sheer numbers of transactions, that Cities will have higher levels of success in loan origination than bond issuance.

The first two themes of this thesis – decentralization and municipal bonds – juxtapose the experiences of countries that have undergone full decentralization against those of countries in sub-Saharan Africa. However, this analysis would be incomplete if it did not include a look at the factors that have shaped Africa, particularly given that the overarching argument of the thesis is that there is nothing exceptional about the way that African governments have been addressing decentralization and municipal bonds. Chapter 3 offers an examination of these factors.

Chapter 3: Decentralization and Municipal Finance in Africa: African Exceptionalism?

*“I believe in American exceptionalism, just as I suspect that the Brits believe in British exceptionalism and the Greeks believe in Greek exceptionalism.” – Barack Obama*²²

Thus far, this thesis has argued that municipal bonds are likely to be the most appropriate financial instruments for cities in sub-Saharan Africa to use to reach their long-term investment goals, and that this is likely to be best achieved in tandem with political and fiscal decentralization. To understand why this has not yet happened, it is imperative to look at the political and historical trajectory of sub-Saharan Africa, particularly at the degrees of political autonomy at the local level and the attendant exceptionalism of Africa.

The arguments in favor of African exceptionalism assert that sub-Saharan Africa, unlike its peers in the global South, lack good governance (or even an understanding of what good governance entails), prefer informality, and are trapped in a vicious cycle of poverty (Engel 2005). The prevalence of neopatrimonialism, a concept which legitimizes the idea of informal and non-transparent decision-making, is claimed to be more prevalent in Africa than in other parts of the world and is asserted to be the fundamental impediment preventing countries across the continent from socio-economic progression and development (Darnton 1994). The concept of African urban exceptionalism was first introduced in 2000 through a World Bank Policy Research Working Paper that theorized that sub-Saharan Africa had suffered from a widespread phenomenon of rapid urbanization without similar growth (Fay & Opal 2000). However, the notion that, contrary to other regions, Africa has experienced “urbanization without growth” is probably overstated, holding true only for small African countries at low levels of urbanization or failed states that are experiencing “push” as opposed to “pull” rural-to-urban migration (Annez & Buckley 2008). But while the “urbanization without growth” paradigm is misleading, the region has experienced urbanization with lower levels of shared growth. Ravallion, Chen and Sangraula (2007) note that urbanization in sub-Saharan Africa has been associated with less poverty reduction than has been the case in other regions. And, alongside Latin America, sub-Saharan Africa experiences the highest levels of urban inequality in the world. However, this chapter demonstrates that, despite all of these discouraging pieces of data, there is little case

²² Obama (2009).

to be made for African exceptionalism and, instead, that sub-Saharan Africa should be viewed as part of a longer continuum of development relative to other regions of the world. To say this is not to discount the unique history of Africa, but instead to help to use it as part of a contextualization of the reason why sub-Saharan African cities are more constrained than their sub-national peers around the world.

To build the historical narrative that more definitively sets up the narrative of the latter part of this thesis, this chapter addresses the question of the evolution of the political enabling environment through which sub-Saharan African cities access finance, by looking at the impact of colonial heritage on creating two distinct systems – the French concept of assimilation under a paternalistic state and the British approach of indirect rule and limited decentralization – across sub-Saharan Africa for internal political management. While other European countries also participated in the colonization of Africa (including Portugal, Italy and Belgium), the French and British represented the majority of the colonial holdings during the period from 1880 through 1960 (see Plates 3.1–3.3). In the years prior to colonization, sub-Saharan Africa was governed by political units led by kings and chiefs that controlled well-defined areas with highly desirable attributes, including arable land or easily navigable ports and rivers. These societies had collectively appointed leaders playing clearly defined roles who were responsible for the public goods that would have been beyond the feasible financial responsibility of individual members of society. Functionaries collected taxes (in the form of crops or other goods with tangible value) and ensured that families and clans had access to what was required to meet their basic needs, and to defense against other rival political units. With the arrival of European colonizers and the redrawing of borders to match colonial metropolitan needs and not those of the colonized, many of these political units disappeared and administration became more highly centralized over larger tracts of land. It is only during the post-colonial period that African sub-sovereign entities, created within the artificial lines drawn by European colonial forces, have begun to exercise their power once again and follow the path towards a multi-level system of governance of the kind that had been in existence for centuries. However, under the influence of the European systems and style of governance imposed during colonialism, the institutional direction of cities has been changed to reflect foreign ideas, particular those connected to the English or French system of rule. Relating back to the central question of this thesis, whether one system or another provides more fertile soil to engender municipal finance, this chapter will argue that the British system of indirect rule created a more natural transition for municipal finance decentralization through its institutions and political heritage than the French conceptualization.

The purpose of this chapter is to argue that the political management of pre-colonial Africa through chiefs and kings who ruled over smaller areas was negatively impacted by European colonialism, and that the financial devolution of power and responsibility to cities across sub-Saharan Africa was subsequently profoundly impacted by the colonizers, who themselves hailed from highly centralized countries and

introduced systems that were both familiar to them and created a system of straightforward governance from their collective perspective (Breuillard 2016; Ebinger 2011; Jamet 2007; Sferlea 2013). The chapter begins with a contextualization of pre-colonial Africa, using the Ashanti of Ghana as an example to demonstrate power-sharing on a local level. From there, it reviews the political administration of the colonies and the expediency of centralized rule over large land areas before looking at the differences between the French approach of assimilation and the British approach of indirect rule. The chapter closes with a brief discussion of decentralization in the post-colonial era, and a look at how the failure to decentralize has significantly slowed the process of accessing much-needed finance by municipalities seeking to plan for their future growth.

Pre-colonial Africa

As late as 1870, there was little indication that the European powers were about to leave their isolated positions on the coast of Africa and partition the interior of the continent among themselves. Instead, it seemed more likely that indigenous political entities would consolidate their authority and eventually develop into nation-states. Pre-colonial Africa contained political organizations of diverse types and, concomitantly, customary leaders with a wide range of powers. The most well-known distinction between types of organization is that made by Meyer Fortes and E. E. Evans-Pritchard in their book *African Political Systems*, published in 1940. Fortes and Evans-Pritchard compared societies with centralized authority, pyramidal judicial institutions, and paramount rulers who monopolized the use of organized force, to societies without these attributes. The latter societies, often referred to as stateless societies, were instead organized around different families or lineages, with leaders emerging to lead the group as a whole only during fleeting moments, such as times of war. Although anthropologists often focus on the stark contrast between stateless societies and centralized states, most pre-colonial African societies fell somewhere in between these two polar opposites (Fortes & Evans-Pritchard 1940).

With the introduction of colonialism, African rulers became subject to higher-level leaders appointed by the colonial powers. Rulers' initial reactions to this arrangement varied widely. In many places, they vigorously resisted incorporation and were only subjugated by conquest. In others, they sought alliances with Europeans in the hope that this would give them an edge in their military and political relations with other African rulers, not fully anticipating the reductions in their own autonomy this would precipitate.

In West Africa, for example, the Kingdom of Ashanti had profited from its wealth in gold and the slave trade, and had acquired a central government, an advanced system of roads, well-defined boundaries, and a national language. More importantly, the Ashanti state featured a sophisticated bureaucracy which allowed for effective devolution of power to federalized levels of government (Valsecchi 2011).

The Ashanti government was built upon a sophisticated bureaucracy in the inland City of Kumasi, with separate ministries to handle various state functions. Particularly interesting is Ashanti's Foreign Office, based in Kumasi; despite its small size, it allowed the state to pursue complex negotiations with foreign powers. The Foreign Office was divided into departments to handle relations with each of the leading powers of the day – the British, the French, the Dutch and the Arabic states (Davidson 1992). In contrast to European despots of the pre-colonial era (i.e., during the 18th and 19th centuries), the king of Ashanti, the Asantehene, was not an absolute ruler; instead he shared power with those holding office at lower levels of government. Below the king, local power was invested in the *obirempon* of each locale. The *obirempon* (literally “big man”) was responsible for handling the region's administrative, economic and judicial affairs, serving as the Supreme Judge, and directly responding to the needs of his constituents. Citizens were able to express their desires and, whether or not they felt that these desires were all being met, the political provider-client relationship was arguably more functional than in Europe at the same time (Baldwin 2016).

Elsewhere in West Africa, the Kingdom of Benin likewise was divided into smaller city-states which were autonomous and merely paid a small tax, often referred to as a tribute, to the king. All rulers of city-states within the kingdom needed to pledge fealty to the king, and were publicly executed if they failed to demonstrate their loyalty; but they were otherwise independent in their rule and were able to make decisions about how to finance and execute projects for the public good (Osae, Nwabara & Odunsi 1968).

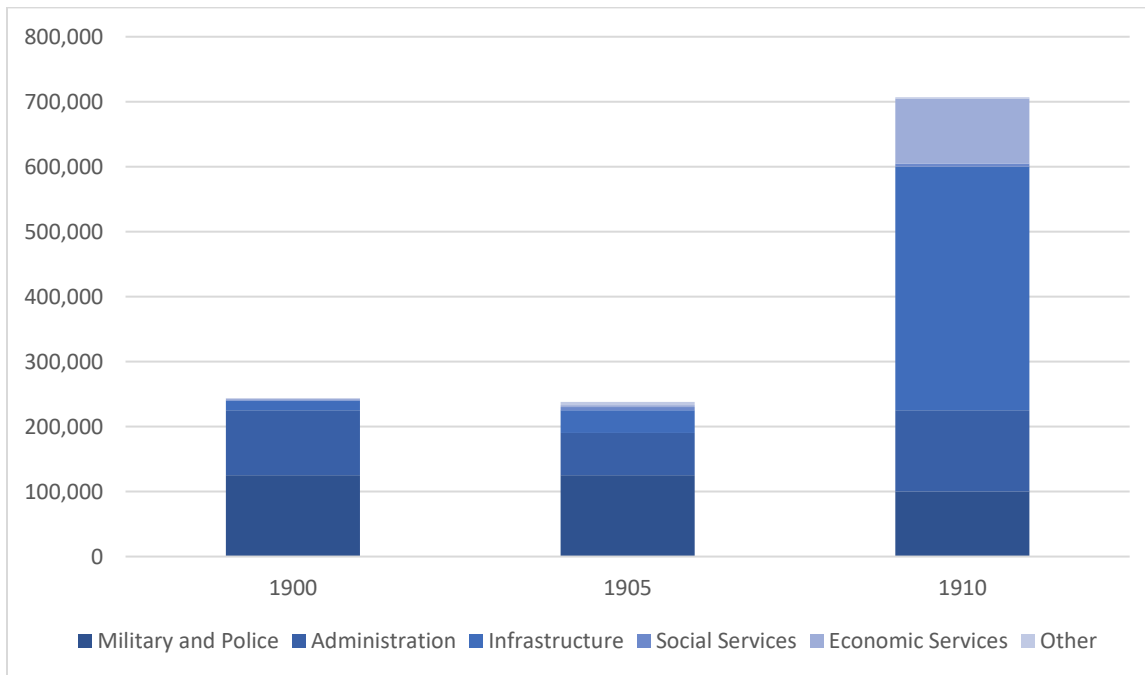
Further south, the Shona tribe established a trading hub to control the export of gold from Zimbabwe to overseas neighbors across the Indian Ocean, settling a large territory in the 12th century and continuously building it up into an empire until its collapse in 1600. Although the archaeological record is inconsistent, historians claim that the City from which this empire was governed was both the economic and political center of the kingdom, and that the king did not allow for devolution of power to allow for a more independent urban area (Beach 1980; Mufuka 1983).

Although there are limited mentions in the historical record of taxation or financial management at the local level in sub-Saharan Africa, there is also no reason to assume that, had the territories not been colonized, cities across sub-Saharan Africa would have failed to develop a system of municipal finance similar to that found in the global north. In fact, given the level of diplomatic and cultural exchange between the Ashanti government and those of Europe and the Middle East, national-level borrowing would have been highly logical; the as yet unmined gold in the Ashanti Kingdom could have been used as a collateral pledge against future debt service.

Understanding colonial Africa

Colonization effectively meant that cities in sub-Saharan Africa would not be able to develop independently and that, more importantly, there would be a level of centralization that would stifle any efforts they made to develop and to prioritize their own needs for financial investment (and which muted the need for municipal finance during the entire era). This is particularly evident in looking at the budgetary allocations made by the colonizing country, and intended to be sufficient to meet the economic needs of the mercantile system, both independently and in relation to the budget of a European country. Figure 3.1, lifted from an analysis of the *Blue Books of the East Africa Protectorate (Kenya)*, shows that colonizers saw public expenditure in terms of commitments in large categories, not according to geographical divisions. However, investments in infrastructure were directed towards the areas where colonizers anticipated the highest return; public investment was targeted to benefit regions that colonial administrations believed would produce increased revenue with improved transport or other infrastructure (Gardner 2012).

Figure 3.1: Budget allocations in East Africa Protectorate (in GBP), 1900–1910

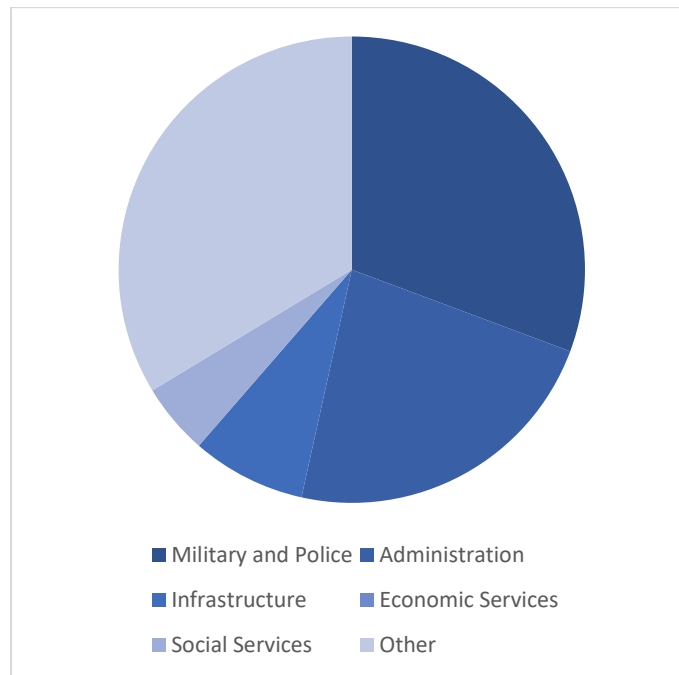


Source: Compiled by the author from *East Africa Protectorate Blue Books (Economic Commission 1919)*.

Comparisons between the budget allocations of the East Africa Protectorate for public services and those of Great Britain (Figures 3.2 and 3.3) further highlight the fact that the British sought to maximize the welfare of their citizens at home (through both education and social welfare, which are not captured in Victorian accounting as social services but instead would be categorized as “other”) while deprioritizing

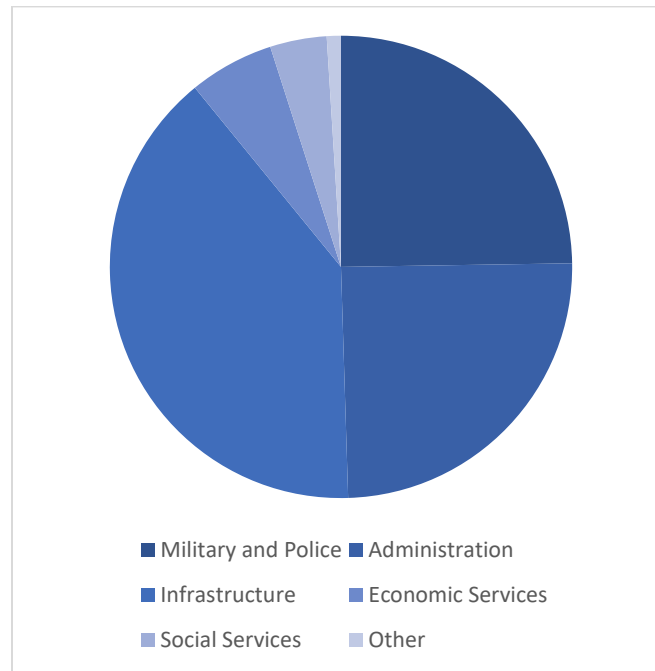
the improvement of the quality of life for those living in British colonies. Essentially, the British government, as was the case for most of the colonial powers, saw its colonial holdings as properties to be exploited, only making minimal infrastructure investments to bring out the Protectorate's vast mineral resources and raw materials.

Figure 3.2: Allocation of central government expenditure (% of total), East African Protectorate, 1901–1910



Source: Compiled by the author from East Africa Protectorate Blue Books (Economic Commission 1919).

Figure 3.3: Allocation of central government expenditure (% of total), England, 1905



Source: Compiled by the author from Mitchell (1988).

The change in the approach of the colonial powers to sub-Saharan Africa – from one of opportunistic trade in support of European corporate interests to one of direct territorial control – dramatically changed the administration of the land and populations across the region. Plates 3.1–3.3 present three maps which show the change in the political landscape of Africa in the course of the 19th and early 20th centuries. The first map (Plate 3.1), depicting Africa in 1858, shows the continent as consisting of several large swaths of demarcated territory including Ethiopia, Soudan, South Africa, Senegambia, Upper Ghana and others. Although highly simplistic, and failing to take into account the presence of the kingdoms and sub-national entities in existence at the time, the map highlights the fact that European powers were largely non-existent on the continent from a political perspective, although there were some strategically placed colonies that were critical elements in the success of the European spice trade.

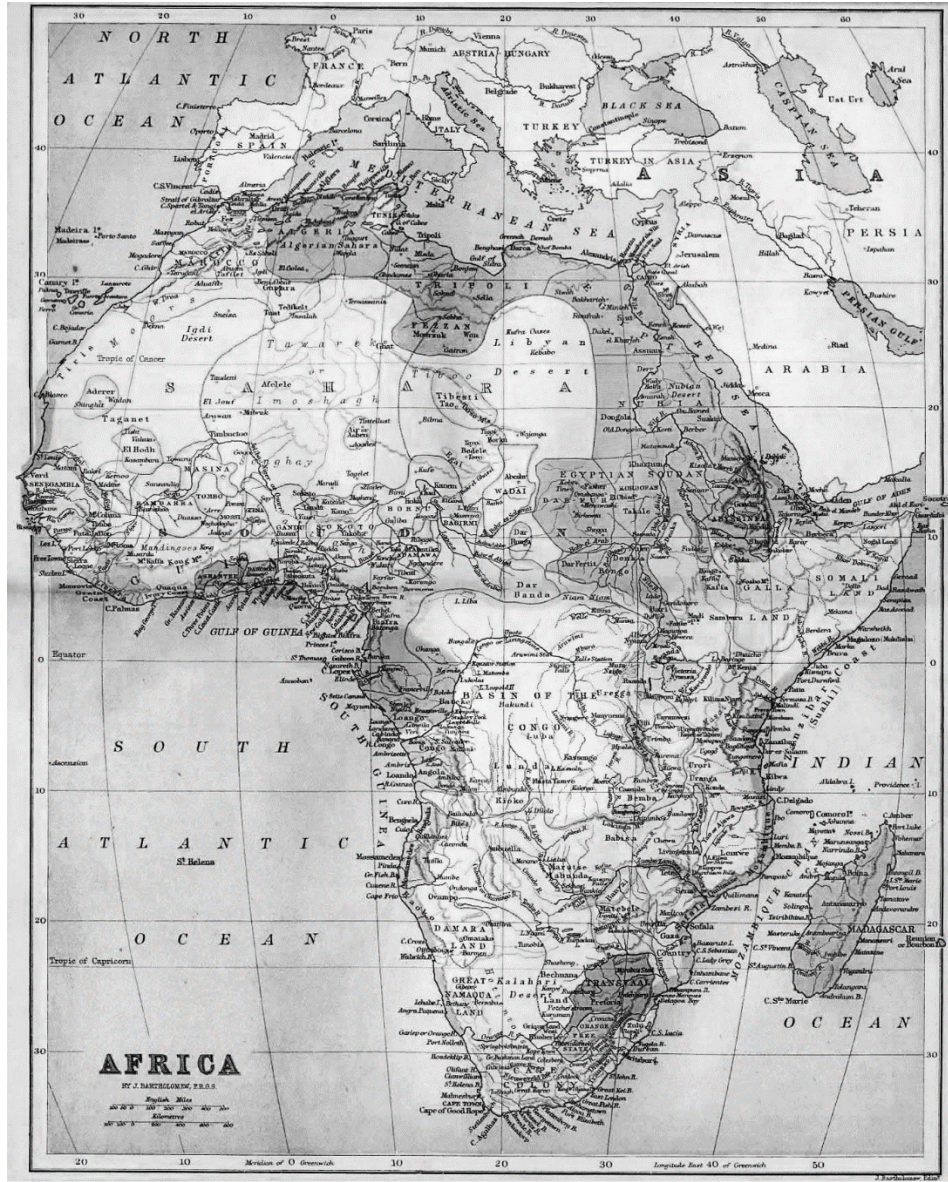
Plate 3.1: Mapping Africa’s kingdoms in pre-colonial Africa (1858)



Source: Mitchell’s School Atlas (1863), “Map of pre-colonial Africa, 1858”. <http://etc.usf.edu/maps/pages/000/32/32.htm>, accessed October 2018.

The second map (Plate 3.2), drawn in 1885, shows the start of the “scramble for Africa”. It highlights the fact that most of the continent was viewed as being available for settlement and colonization by Europeans and as otherwise unoccupied by humans. While this vision is inaccurate, it undoubtedly created a strong visual impression for European strategists imagining their conquest of these resource-rich territories.

Plate 3.2: Mapping colonial Africa (1885)



Source: J. Bartholomew (n.d.), "Historical map of Africa in 1885", Maps of Africa to 1900.
<http://www.nationsonline.org/oneworld/map/africa-historical-map-1885.htm>, accessed October 2018.

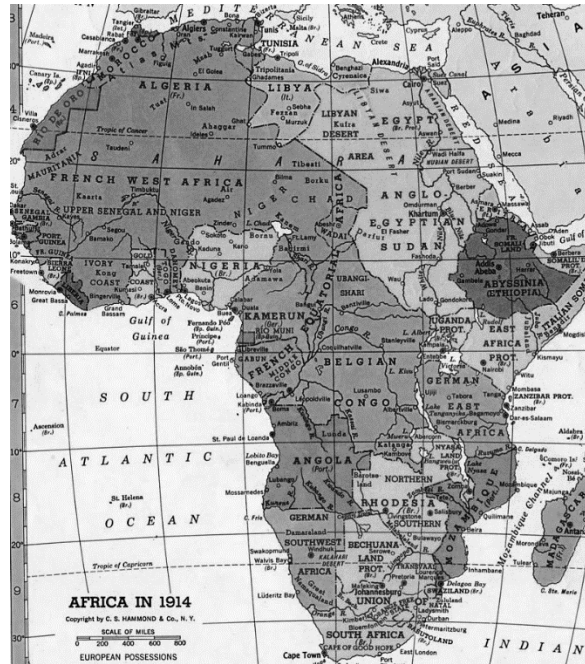
By 1914, sub-Saharan Africa was entirely occupied by European powers. The map shown in Plate 3.3 is particularly relevant for the argument of this thesis, namely that the centralization of power, whether in a European capital city that remotely sets policy for a distant territory or in a post-colonial, highly centralized state, has negatively impacted the growth of sub-sovereign powers for the purposes of municipal finance. Even more interesting is the aggregation of over a dozen countries into a single large polity – French West Africa – without the sub-divisions that one finds in the protectorates of the British African holdings like the

Uganda Protectorate, the East Africa Protectorate, the Somaliland Protectorate, Nigeria, the Gold Coast, Rhodesia, or the Bechuanaland Protectorate. To this day, French West Africa is run in many ways like a federation of states, in that each country does not have its own currency or monetary policy (the countries all use the West African CFA franc, which is pegged at a fixed rate to the euro that succeeded the French franc as the currency of France) and all countries in the region support free trade and movement of peoples across borders under the auspices of the West African Economic and Monetary Union (WAEMU).

Academics have been fascinated by the European colonial enterprises in Africa (Hodgkin 1956; Jallow 2014). The colonial incorporation of tropical Africa was not so much remarkable as curiously disjointed, proceeding at an uneven pace for much of the 19th century until the much more rapid European penetration of the interior after 1880. A great change occurred in the attitude of European powers towards Africa at around this time. Prior to the end of the 19th century, Great Britain had led the way in the mass production of goods by machines in factories, in what became known as the Industrial Revolution. For many years, British goods met with little or no competition in markets throughout the world, and the raw materials of all parts of the world were at Britain's disposal. This unique position led Britain to advocate and champion free trade. But then, after about 1870, the position changed. European countries, in particular France and Germany, began to industrialize rapidly and to challenge Britain's hitherto privileged position. The industrial and commercial competition and rivalry which followed led to the feeling that, if each of the great industrial powers could monopolize the markets and raw materials in specific areas of Africa and Asia, it would be ensuring its advantage in a highly competitive world, where success was sometimes jingoistically measured in terms of the size and wealth of natural resources in a country's colonial empire. In other words, the acquisition of areas of influence and of colonies was considered very conducive to the promotion of European commerce and industry (Butler 1997; Philips 1989).

Other factors beyond economic competition and sustainability encouraged European expansion in Africa, including (1) the psychological aspect of the scramble for colonies; and (2) missionaries and their religious fervor. A kind of national prestige came to be associated with the possession of colonies, although in reality some colonies were by no means assets to the colonizing powers. Britain was seen by others to be a great country, and this greatness was connected with its possession of colonies, which likewise drove other peer countries in Europe to follow similar paths (Lewis 1987; Pakenham 1991). Operating on a parallel track but at a smaller scale, European missionaries located in various parts of Africa normally wished to be left alone to pursue independent action. However, when threatened in one way or another, they would petition their home governments to protect them and safeguard their interests by annexing the areas in which they were operating (Harries 2012; Taiwo 2010).

Plate 3.3: Mapping colonial Africa (1914)



Source: C. Hammond (1917) “Africa in 1914: European Possessions”, Hammond’s Comprehensive Atlas of the World. <http://pages.uoregon.edu/kimball/ggr.frn.MPR.gnr.htm>, accessed October 2018.

The impacts of colonialism: political theories in francophone and anglophone Africa

Although there are many reasons why colonialism was such an irredeemable exogenous shock to Africa, for the purposes of this analysis, the impact of colonialism can be found in the reshaping of Africa’s political structure from smaller political units governed with appreciation for local concerns into remotely ruled larger polities without any accommodation for constituent expectations. John Mukum Mbaku (2003: 103) expressed the sentiment as follows:

Colonialism was a cruel, exploitative, repressive and despotic system used by the Europeans to extract resources from the African territories for their benefit and that of the metropolitan economies. As a consequence, colonial institutional arrangements were not designed to maximize African values and interests or enhance the ability of the indigenous peoples of the colonies to govern themselves effectively. Instead, they were imposed on Africans and used primarily to maximize the objectives of the resident European population and those of the metropolitan economy.

To enhance the ability of resident colonial officers and European entrepreneurs to manage

the new territories and their resources, the colonialists brought together through force the many ethnic groups within each colony to form a single political, economic and administrative unit. The language and culture of the resident European power, as well as its political and economic systems, became dominant. Traditional African practices were either banned, stunted or minimized by the new institutional arrangements. Each colony, thus, represented a gathering of indigenous communities that were kept together through the use of a significant amount of coercion. Peaceful coexistence was not secured or achieved through voluntary (and mutually beneficial) social arrangements but through the use of force.

Africans believed that independence would be preceded by or coincide with the elimination of colonial institutional arrangements and the subsequent establishment of a new dispensation with laws and institutions that enhanced their ability to govern themselves and create the wealth that they needed to deal more effectively with mass poverty and deprivation. The new post-independent leaders were expected to engage the people in state reconstruction through democratic and consultative constitution-making to produce new governance structures that were based on African values, aspirations, traditions and customs. Unlike those prevalent in the colonial period, these new institutions would be developed by the people themselves. That is, rule-making in the immediate post-independence period would be bottom-up and not top-down; inclusive and not exclusive; as had been the case during the colonial period.

European colonizers brought with them their own legal systems, which slowed the progress of smaller African polities towards well-functioning decentralized systems. The introduction of these foreign legal systems was driven by a wide variety of concerns, but never by consideration of the needs or expectations of the colonized people. Deng comments on this in his study on the impact of colonialism with regard to centralization, noting that

[far] from recognizing the diversities of the African states and their legitimizing cultural characteristics, imported Western-oriented constitutions fostered the model of a homogenizing, centralized unitary state that was unscrupulously intolerant of the political and cultural aspirations of the numerous component identity groups within the state. Western legal systems, the English common law, and the French civil code were adopted as the law of the land, with Islamic law and customary law accommodated mainly in personal matters. Overall, there was no African cultural flavor to constitutionalism, the administration of justice, or governance. (Deng 2008: 20–21)

In some instances, concepts of control over colonies were driven not by political ideology but by financial inevitabilities. The following excerpt from a missive from Nigeria to London highlights that colonial unprofitability was a function of the fact that expenditure exceeded revenue, which was partially driven by two separate and competing interests which both manifested in the need to police borders: internal struggles between ethnic and tribal units and external threats of land grabs from other European colonizers. The missive further argued that centralization was politically and economically expedient, as this form of governance would eliminate local rule as was traditionally envisioned.

Upon Northern Nigeria devolves the task of policing about 1,800 miles of French and German frontier as well as of controlling the Fulani, whose armies formerly laid waste the frontiers of both Southern Nigeria and Lagos. A very large force has in consequence to be maintained (and this may not unjustly be considered part of the Imperial defense scheme) while it enables the southern territories to dispense with any force except such as is required for policing their own comparatively limited areas.

It appears obvious that the original proposals at the time that the inland fiscal frontiers were abolished should be given effect to, now that the administration of Northern Nigeria is sufficiently advanced to admit of it, and the revenue collected in all three Administrations should be spent in the interests of Nigeria as a single and indivisible entity. This can only be effected by complete amalgamation under a single Administrator.²³

Consideration of reports and arguments produced by colonial administrators often prompts a reader to ponder whether complete “ownership” of another country, with its attendant increase in responsibility for the colonizer, was the most expedient management style, particularly when so many of the decisions were made with an eye towards profitability. Walter Rodney proposes that the “non-monetary” benefits for the European colonizer were far greater than those in the domain of economics and finance; the prestige of expanding the “mother country” to include vast territories outside of Europe was dramatic, particularly for small countries with large holdings like Portugal. He writes:

Analysis of the non-monetary benefits of colonialism to the colonizers can of course be carried out most readily within the framework of relations between each colony and its mother country. Using the conventional approach of European metropole in relationship to

²³ Administration of Tropical Colonies. Colonial Office File containing letters by Sir F. D. Lugard and Sir Charles Bruce and responses by A. Lyttleton, Secretary of State for the Colonies, 1905. Viewed at the Johns Hopkins University Milton S. Eisenhower Library and online at <https://libweb.grinnell.edu/vufind/Record/.b1700066x>, accessed January 2017.

its own colonies, one finds a wide range of positive effects, although the benefits varied in extent from colony to colony. Portugal was the lowliest of the colonizing powers in Africa, and it was nothing in Europe without its colonies: so much so that it came to insist that Angola, Mozambique and Guinea were integral parts of Portugal, just like any province of the European country named Portugal. France sometimes propounded the same doctrine by which Algeria, Martinique and Vietnam were all supposedly overseas France. Neither Britain nor Belgium put forward any theories of a greater Britain or an overseas Belgium; but in practice they were as determined as other colonial powers to insure that sustenance should flow from colony to metropole without hindrance. Few areas of the national life of those Western European countries failed to benefit from the decades of parasitic exploitation of the colonies.(Rodney 2012: 185–6)

When Europeans conquered new African territories during the late 19th century, they did so with little forethought as to how these colonies would be ruled. The two major colonial powers, Great Britain and France, espoused two opposite administrative philosophies. In respect of order, power in the colonies rested explicitly (as in the case of the British) or implicitly (as in the French) on the power of the native chiefs. British “indirect rule” sought to exercise power through African authorities. Local leaders – usually identified as chiefs – were granted political power and privileged access to resources, so long as they followed the instructions of their British advisors. Frankema (2011: 136) claims that “the British Empire’s much-discussed policy of ‘indirect rule’ emerged as a matter of practical necessity in the early years of colonial rule, when the European establishment which could be supported by local revenue was skeletal at best”. The French alternative to indirect rule was assimilation, an ambitious policy which aspired to rule Africans directly, thereby integrating them eventually into a larger French state. Such a policy had the potential to transform African societies culturally and politically to the point that they might one day constitute “100 million Frenchmen” (Ekpo 2010: 234).

The principles of indirect rule were most clearly and eloquently articulated by one of Britain’s greatest colonial administrators, Lord Lugard, in his book *The Dual Mandate in Tropical Africa*. Certainly, no other book of its time had such a profound influence on the formation of British colonial policy. To Lugard, the two most important administrative principles to rule subject peoples were “decentralization” and “continuity”. In his view, British district officers needed to maintain a balance between supporting the traditional and customary elements in African societies and at the same time encouraging the economic and legal innovations that served to support and justify British rule. Such a system required African authorities to be given the latitude to make political decisions based on local historical precedent. The role of the British officers, except in such critical areas as taxation, military forces, and the alienation of land, was to advise,

not to demand. To Lugard, the key to this system's success was the strong relationships it would engender between British officials and the "native" rulers. Thus, continuity of personnel was critical to its success, as only colonial officials with lengthy experience with "traditional" peoples could be trusted to strike this delicate balance. Executed correctly, Lugard argued, such a system would slowly but surely advance the political maturity and economic prosperity of colonial peoples (Lugard 1965).

Historian Sara Berry (1993) asserts that Lugard's philosophy was predicated on the misconception that Africans lived in static, "tribal" communities. By treating them as such, indirect rule served to institutionalize existing conflicts and frictions. In thus arguing, Berry engages with a body of scholarship that has emphasized what Terence Ranger has referred to as the "invention of tradition" (Hobsbawm & Ranger 2012), the manner in which Europeans manipulated or, in some cases, manufactured symbols, rituals, institutions and identities to give indirect rule a gloss of historical legitimacy. For Berry,

[the] effect of indirect rule was neither to freeze African societies into precolonial molds nor to restructure them in accordance with British inventions of African traditions but to generate unresolvable debates over the interpretation of tradition and its meaning for colonial governance and economic activity. (Berry 1993: 32)

Thus, ironically, indirect rule's reliance on "traditional" authorities did not encourage security, but rather

promoted instability in local structures of authority and in conditions of access to productive resources. (Berry 1993: 25)

Mahmood Mamdani posits a similar argument, stating that indirect rule reshaped society in such a way that it was neither reflective of the lines drawn by the colonized populations nor centralized within the boundaries set by the European colonizers. He writes:

If direct rule aimed to assimilate elite groups through a civilizing mission, the ambition of indirect rule was to remake the subjectivities of entire populations. It endeavored to shape the present, past, and future of the colonized by casting each in a nativist mold, the present through a set of identities in the census, the past through the driving force of a new historiography and the future through a legal and administrative project. Through this triple endeavor, the colonial state created a system of state-enforced internal discrimination – for which it claimed the mantle of tradition – thereby effectively fragmenting the colonized majority into so many administratively-driven political minorities. (Mamdani 2012: 45)

In analyzing the obstacles to democratization in post-independence Africa, Mamdani's *Citizen and Subject*

offers a bold, insightful account of colonialism's legacy – a bifurcated power that mediated racial domination through tribally organized local authorities, reproducing racial identity in citizens and ethnic identity in subjects. Many writers have understood colonial rule as either “direct” (French) or “indirect” (British), with a third variant – apartheid – as an exceptional case. This benign terminology, Mamdani shows, masks the fact that these were actually variant forms of despotism. While direct rule denied rights to subjects on racial grounds, indirect rule incorporated them into a “customary” mode of rule, with state-appointed Native Authorities defining custom. By tapping authoritarian possibilities in culture, and by giving culture an authoritarian bent, indirect rule (decentralized despotism) set the pace for Africa; the French followed suit by changing from direct to indirect administration, while apartheid emerged relatively late. Apartheid, Mamdani shows, was actually the generic form of the colonial state in Africa (Mamdani 1996).

Some authors further argue that indirect rule encouraged a deeper sense of underlying community:

People from particular villages, meeting together for mutual assistance, self-help and recreation, became aware of affinities with others who spoke different versions of their language. Consciousness of a wider common identity as members of a working class, though retarded by stronger loyalties to the village communities to which most African workers intended eventually to return, made some precocious appearances. Although trade unions nowhere enjoyed full legal recognition, laborers and government employees had taken effective industrial action in some West African towns since the nineteenth century; there were well-organized railway strikes in Sierra Leone in 1919 and 1926, in Nigeria in 1921, and in Senegal in 1926. (Hargreaves 1988: 15)

France, the other great colonial power in Africa, initially sought to rule its African empire through a policy known as “assimilation”. The policy's principles and goals were articulated by Hubert Jules Deschamps, a former governor of Côte d'Ivoire, who contrasted French and British approaches to colonial rule in a speech he delivered shortly after the independence of France's colonies in sub-Saharan Africa (Deschamps 1963). At one point, he refuted this argument, referencing a piece by an English author that claimed

the French had for their goal the political and cultural integration of the colonial peoples whereas the British have always had as their final goal the preparation of their colonies for self-government and independence. (Deschamps 1963: 296-7)

The bulk of his speech, however, focused on the argument that the colonized Africans lacked cultural and political evolution of their systems and institutions; he closed by arguing that colonization had failed for

both the British and the French, for different reasons but with much the same outcome. The theory of the failure of assimilation is borne out in recent scholarly studies that assert that there is a marked difference in the success of the French approach in Canada (New France) relative to that in Africa, arguing that “as a settler colony, New France’s population became overwhelmingly European in short order” while Africa required policies that were “more stringent, less tolerant, and ostensibly more oppressive” (Bigon & Njoh 2018: 949).

Mamdani, writing with the benefit of historical perspective, differentiates between the European and African systems, explaining that the pre-existing societal expectations in each context created both a paradigm within which the Europeans could assume control and a mindset within which the Africans could be susceptible to colonization.

The two legal systems – that of the colonizing Europeans and that of the colonized Africans – were entirely different in orientation. To understand the difference, one only needs to contrast English common law with colonial customary law. English common law was presumed to change with circumstances. It claimed to recognize different interests and interpretations. But customary law in the colonies assumed the opposite. It assumed that law must not change with changing circumstances. Rather, any change was considered *prima facie* evidence of corruption. Both the laws and the enforcing authorities were called “traditional”. Colonial powers were concerned first and foremost with establishing the credentials of their native allies as traditional and authentic. They were preoccupied with defining, locating and anointing the traditional authority – in the singular. We need to remember that African colonies did not share with early modern Europe the political history of an absolutist state. This means that the rule-making authority was not in the singular but always the plural. Instead of a centralized state authority whose writ was law – in all social domains – the practice was for different authorities to define the convention in different domains of social life. Besides chiefs, the definers of tradition could come from women’s groups, age groups, clans, religious groups, and so on. (Mamdani 2012: 49)

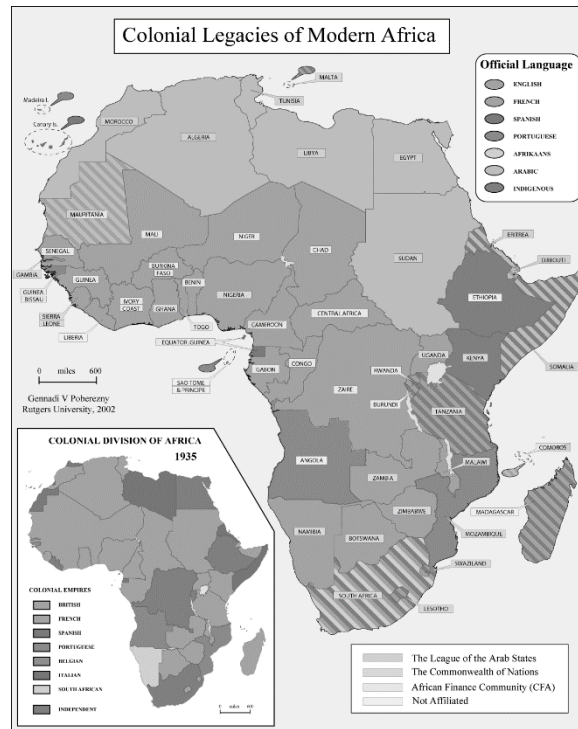
The political and constitutional legacy left by the British and the French is summarized thus by Mamdani:

The difference between early British and French colonial experience is summed up by the following: unlike the British, who in Nigeria and Uganda worked out alliances and “treaties” with rulers of precolonial kingdoms, the French were more often than not in direct conflict with these great aristocracies. When the majority of the great African states, like the kingdoms of Segou and Sikasso and the state of Samory, refused to submit to French claims,

they were suppressed. (Mamdani 1996: 83)

The primacy of the political administration systems introduced by the European colonizers is still in effect, to varying extent, today – at least 50 years after the first wave of decolonization, as Plate 3.4 shows.

Plate 3.4: Colonial legacies of modern Africa



Source: *Colonial legacies of modern Africa*, 2015. <http://mapmaker.rutgers.edu/studentprojects/ColonialLegacy.png>, accessed October 2018.

The French precedent of a highly centralized state has remained in effect; this was particularly pronounced during the first 25 years of independence (from 1960 to 1985).

Actively schooled in the French political tradition and habituated to French legal and institutional norms and forms, the African leaders were not likely to reject the political culture in which they themselves had been nurtured. Most attractive, of course, were the provisions for a dominant presidency, a model consonant with both African leaders’ personal admiration for De Gaulle and their preference for strongly centralized leadership and control. (LeVine 1986: 84–5)

Similarly, even as the British government permitted sovereignty amongst its African holdings, it simultaneously set forth the political terms for these newly independent political units.

The constitutions of Ghana, Kenya, Nigeria and Tanganyika had to be signed by the British monarch with the same stroke that granted independence. The native political elite who took part in constitution-making or lent their support to the new constitutions were themselves eager to draw upon metropolitan models. (Go 2002: 561)

Inherent to this rediscovered independence was, for many African nations, a curiosity to introduce measures of decentralization, both politically and financially. As the colonial era ended, different countries experimented with decentralization of power differently, in response to both their colonial heritage and the demands of their citizens. Political leaders and academics alike considered whether or not decentralization was desirable, feasible, and economically sustainable. There was considerable fear that political decentralization would lead to destabilization across the continent; Marina Ottaway summarizes the general attitude and explains that

thirty years ago, many African leaders predicted that Western-style, multi-party democracy would divide their countries along ethnic lines, encouraging tribalism and undermining the building of the nation. The fear of ethnic division was one of the major justifications provided for the adoption of more authoritarian styles of government. (Ottaway 1999: 88)

From a financial perspective, there was a more balanced range of responses, with healthy debate on either side of the question. Supporters claimed that financial decentralization would have multiple benefits, including: (1) improved efficiency due to the fact that “decisions about public expenditure, that are taken by a level of government closer to the people that it is serving, are more likely to reflect the actual demand for local services, and thus appropriate resource allocation, than a one-size-fits-all approach more typical of a central government”; (2) improved political and financial accountability because “to the extent that sub-national services are financed through own-source revenues, citizens tend to closely monitor sub-national authorities”; and (3) improved effectiveness stemming from the fact that this shift in power may “encourage experimentation and innovation in public policy and service delivery as individual jurisdictions have both the incentive and freedom to develop and implement new approaches or have incentives to copy successful sub-national governments”. Detractors warned of the potential for: (1) macro-economic instability caused by non-sustainable debt incurred by sub-national bodies; (2) declined investment in social infrastructure as in instances “(i.e. roads) whose benefits go beyond their geographical boundaries”; (3) increased horizontal inequities and conflicts where “some sub-national jurisdictions generate more revenue than others and provide to their citizens more or better quality services than is provided in poorer sub-national governments”; or (4) increased corruption (Feruglio & Dallas 2008: 7–8).

Although this was more fully explored in Chapter 1 of this thesis, on the history and politics of

decentralization, it is helpful to think through the traditional tools that are typically used by policy-makers to anticipate and project the types of revenues that could be used by sub-national authorities. They are summarized as follows:

Sub-national governments seek guaranteed access to high levels of revenue. Access to revenue can come from own-source tax collection or from intergovernmental transfers from other levels of government. Among intergovernmental transfers, or revenues collected by the central government and distributed to sub-national governments, the most important are automatic, legally-mandated transfers. Transfers mandated by constitutions are the most desirable, followed by transfers outlined in ordinary law, and then by transfers over which the central government exercises discretion, since the latter may in principle be revoked by the center at any time. Alongside transfers, sub-national governments may seek tax authority. If the central government grants sub-national governments the right to enact taxes that were not previously authorized, this is treated as a move decentralizing revenues. (Dickovick 2011: 17)

If financial decentralization is viewed as a logical goal in the abstract, why are there so few examples of it across sub-Saharan Africa in reality? In many African countries, an important impediment to decentralization has been a lack of financial and human resources; these two deficiencies work interactively.

Local governments find it difficult to raise enough revenue to meet the needs for both investments in internal capacity and long-term infrastructure investments, which therefore renders them unable to hire able administrators and other officials to manage programs. To ensure the provision of essential services, local leaders often have no alternative but to fall back on funds from the center. The combination of the lack of managerial resources, inadequate finances and poor access to markets implies that the concept of independence at the local level is illusory, with the center dictating the development agenda and local bureaucrats continuing to be beholden to the line ministries (Godola 2003).

Comparing the British system of indirect rule with the French conceptualization of assimilation, it is not surprising to see that the anglophone lineage has led to more instances of successful financial and political decentralization than has been the case in francophone Africa. This can be specifically attributed to the relatively higher amount of power that rested at the sub-administrative level in British colonies than in French ones which, coupled with the oppressive centrist power of the French state, has led to complicated relationships between central and local governments in the former French colonies to this day (Bekker & Fouchard 2016).

The [final] political impact, and a very negative and regrettable one, is the delay that colonialism caused in the political development and maturity of African states. If colonialism meant anything at all politically, it was the loss of sovereignty and independence by the colonized peoples. This loss of sovereignty, in turn, implied the loss of the right of a state to control its own destiny; to plan its own development; to decide which outside nations to borrow from, associate with or emulate; to conduct its own diplomacy and international relations; and above all, to manage or even mismanage its own affairs, derive pride and pleasure from its successes, and derive lessons, frustrations and experience from its failures. (Boahen 1987: 99)

Conclusion

Underlying the argument throughout this chapter, and forming part of the overall thesis, is the demonstration that experiences in sub-Saharan Africa are not necessarily unique, whether one is considering the rate of colonial expansion in the late 19th century, the administration of colonial holdings through much of the 20th century, or the course of post-colonial history and its inconsistent efforts at decentralization. This chapter rounds out a discussion of the three major themes of Section 1 – decentralization, municipal bonds, and sub-Saharan African history – and shows how they are all interwoven. This interconnectedness will be demonstrated further in Section 2 of the thesis, in terms of the practical application of municipal finance in the case study cities discussed in Chapters 5 and 6. Effectively, the failure of the majority of sub-Saharan African governments to fully commit to decentralization in the post-colonial era has had damaging impacts on the introduction of municipal bonds as instruments for City finance. Without a constitutionally guaranteed enabling environment created by decentralization, municipal leaders in sub-Saharan Africa will not explore ways to raise money through the issuance of municipal bonds.

Section 2 : Practice:

Theoretical Reflections

The first section of the thesis, which broadly introduces the academic literature and theories that make up the argumentation for the appropriateness of municipal bonds for cities across sub-Saharan Africa, creates the backdrop for the second section of the thesis, which reviews four cases: Johannesburg, Douala, Dakar and Kampala. In each instance, the respective experimentation from each City is driven by an appreciation and successive compilation of the nuances of these fundamental elements: (1) fiscal decentralization as part of a match to political devolution of power, (2) municipal bonds as a natural manifestation of the mechanism to deliver the finances required to meet the funding needs arising from decentralization and (3) the historical colonial legacy and how Africa's past, exceptional or not, continues to frame the future.

Understanding the Complexity of Municipal Finance Through Case Studies

As a counterpoint to the first substantive theoretical section, this part of the dissertation provides a series of useful practical examples of both successes and failures in experiments in municipal bond issuance led by cities across sub-Saharan Africa. It starts with a consideration of how the prerequisites of decentralization, whether nearly full (as in the case of South Africa) or nearly fully incomplete (as in the case of Cameroon), led to two successful bond issuances, based primarily on the implementation of and strict adherence to constitutional systems. It then turns to two less-encouraging examples, those in Senegal and Uganda, as a demonstration of how mixed messages on decentralization at the sub-national level created confusion and, ultimately, led to failures to launch in both instances.

Chapter 4: Successful Bond Launches in sub-Saharan Africa

Experiments to launch municipal bonds across sub-Saharan Africa have met with mixed success, often driven by the challenges identified in the first section of this thesis. To demonstrate this point, the argument continues in Section 2 with an intensive review of two cities – Dakar, Senegal, in Chapter 5, and Kampala, Uganda, in Chapter 6 – which have been chosen for their attempts to source debt finance through the issuance of municipal bonds for long-term, revenue-generating, capital-intensive projects.

However, before presenting an in-depth consideration of Dakar and Kampala and their politically and constitutionally driven challenges with bond issuance, this section opens with an overview of the experiences of two other Cities: Johannesburg, South Africa, and Douala, Cameroon. Both of these Cities are instructive examples as they are placed at diametrically opposite ends of the sub-national government autonomy spectrum: South Africa creates an enabling environment where well-performing municipalities are expressly permitted to enter into long-term debt without government guarantees, while Cameroon’s government dictates a system where the sub-national government is only an extension of the national government. The location of these two Cities at two poles of the spectrum, with Dakar and Kampala being located closer to the middle (with insufficient devolution of power in both cases) underscores the argument that municipal governments cannot issue bonds without a full commitment to constitutionally empowered decentralization on the part of national leadership.

Case study 1: Johannesburg, South Africa

The City of Johannesburg sets a strong example in the sub-Saharan African context of a City that has successfully sourced finance for capital investments through bond issuance on the domestic capital markets. To understand why this is the case, one must consider several factors including, but not limited to, the constitutional enabling environment, the political will of national and sub-national leaders, and municipal financial viability. The confluence of these elements in the post-apartheid era allowed the City to experiment, and ultimately achieve success, with the use of this tool.

Understanding the context

Constitutional enabling environment

Alone in sub-Saharan Africa, South Africa explicitly and constitutionally enshrines the right of municipalities to borrow, through the Municipal Finance Management Act (MFMA, Act No. 56 of 2003). The MFMA, implemented in 2004, ensures that borrowed capital is used only for infrastructure

investments, as long-term debt can only be raised to finance capital expenditures and not to fund current expenses. Thus, a bond issuance cannot be used to balance the budget due to a shortfall in any given year. From the outset, there is no ambiguity about municipal debt, including bonds: the schedule of terms in Chapter 1 of the MFMA defines debt as “a monetary liability or obligation created by a financing agreement, note, debenture, bond or overdraft, or by the issuance of municipal debt instruments”. Chapter 6 of the Act, which deals with municipal debt, differentiates between short-term and long-term debt, stipulating that short-term debt may be incurred “only when necessary to bridge shortfalls within a financial year during which the debt is incurred” or to meet “capital needs within a financial year”, while provisions for long-term debt are more permissive, allowing debt for “capital expenditure on property, plant or equipment to be used for the purpose of achieving the objects of local government” or for “re-financing existing long-term debt”. Through this legislation, municipalities became free to pursue transactions in the capital markets, with the understanding that “neither the national nor a provincial government” would “guarantee the debt of a municipality or municipal entity”, except in certain clearly defined circumstances. Therefore, unlike what happens in most of sub-Saharan Africa, local governments across South Africa were given significant latitude to creatively pursue municipal debt through capital market transactions, while simultaneously understanding that there would be no safety net in the case of an inability to meet the debt service requirements stipulated in the transaction documents (Bloch 2000). It is important to note, particularly when considering the difficulties faced by the Cities of Dakar and Kampala, that the system of local governance introduced in South Africa was almost revolutionary when compared with previous practices (Bond 2000) and that this makes replicability of these progressive constitutional reforms difficult to imagine in other countries.

The explicit discussion of the powers of municipalities relative to finance in the Constitution makes decision-making about investing at the sub-national level easier for sources of capital. Zoya Sisulu, a member of the debt capital markets team at Standard Chartered Bank, asserted in an article in *Africa Business* that

a lack of maturity in bond markets rather than stubbornly centralised governance is often the factor holding back municipalities from the bond market. I think it’s more a matter of regulatory and market maturity – in South Africa we have a highly regulated environment which quite clearly sets the base for municipalities issuing and the rules and regulations around how they can issue. I think it’s more about developing that framework for central governments to become comfortable to start having municipalities issue independently. (Thomas 2015:418)

Political will of national and sub-national leaders

Historically, South Africa had a centralized form of governance, but the system of intergovernmental relations changed substantially as a result of the 1996 Constitution (Act No. 108 of 1996), adopted by the Constitutional Assembly on May 8, 1996, and signed into law on December 10, 1996, which stipulated the creation of a quasi-federal system, consisting of national, provincial and local tiers of government.²⁴ The Municipal Structures Act (Act No. 117 of 1998) stipulated the creation of metropolitan governments for major cities, and there are currently eight metropolitan governments in South Africa.

Strong local government is an integral part of the 1996 Constitution, which states that each level of government is distinct, and that all levels are interdependent and interrelated. The principle of cooperative governance underpins this non-hierarchical system of intergovernmental relations. Section 151(3) of the Constitution stipulates that a municipality has the right to govern on its own initiative the local community's administrative affairs, subject to national and provincial legislation as provided for in the Constitution. Section 151(4) states that national or provincial government may not compromise or impede a municipality's right or ability to exercise its powers or perform its functions.

Manor (1999) observed that introducing new local governments without sufficient financial resources was a recipe for disaster. In turn, Cameron (2007) claimed that one of the consequences of the decentralized system was the emergence of local clientelistic and patronage interests that have not promoted service delivery to communities. Interestingly, at the metro level, Cameron (2012) notes that the strength of the Constitution has kept national-level politics out of local decision-making, citing the fact that the longstanding control of the Western Cape Province by the Democratic Alliance (the main opposition party at the national level) has not had negative repercussions for the delivery of services in cities in the province. This is important, as it demonstrates to prospective long-term financiers of City investments that the political system is secure and can be expected to withstand changes in leadership without impact on ability and willingness to repay.

Municipal financial viability

Even with the right preconditions, met in large part through a trusted constitutional and political enabling environment, the underpinning of a City's ability to launch a municipal bond is in the real and perceived levels of investor confidence, as manifested through analyses of the municipality's financial viability. Underscoring this confidence is the presence of experienced and competent chief financial officers (CFOs)

²⁴ *Constitution of the Republic of South Africa* (Act No. 108 of 1996).
<http://www.justice.gov.za/legislation/constitution/SACConstitution-web-eng.pdf>, accessed October 2018.

in municipalities. Across South Africa, academics have documented that there is, unsurprisingly, a positive correlation between the length and stability of those in the top financial management position of the City and its audit outcome, which is viewed as a key indicator of the City's ability to responsibly manage its finances; this phenomenon holds true whether considering the country's largest cities – metropolitan areas like Johannesburg or Cape Town – or smaller units of local government – intermediary cities like Polokwane or Rustenburg (Palmer, Moodley & Parnell 2017). The City of Johannesburg, at the time of its initial consideration of a bond issuance, was no exception; the CFO, Jason Ngobeni, had held the position of City treasurer at the time of serious contemplation of bond issuance in 2003, moving on to serve as the Municipal Manager for the capital City of Tshwane for five years, until his resignation in 2016.²⁵

According to the financial statements for 2003 (which were incorporated into the prospectus), the City of Johannesburg had outstanding debts to banks totaling ZAR 1,153 billion (approximately USD 173.6 million). The financial institutions involved included commercial banks (Standard Corporate Merchant Bank, Absa Bank, Nedcor Group, Rand Merchant Bank, First National Bank) and development banks (Development Bank of Southern Africa). The City was current on all of its debts at the time, but faced severe difficulties in trying to originate any new loans.

The City's annual revenue for the fiscal year, which ended immediately prior to the bond issuance, totaled ZAR 4,651 billion (approximately USD 700.45 million), with primary sources of finance being assessment rates, refuse removal fees, and subsidies/transfers from national and provincial governments. The two borrowings of 2004 – in aggregate ZAR 2 billion (approximately USD 308 million) – represented slightly less than 50% of the total annual revenue of the municipality. There was only a nominal discrepancy between the City's budgeted revenues and those actually collected.

It is important to note that the City had spent the better part of the previous ten years (from the end of apartheid in 1994) working on improving its overall cash flow position and demonstrating its creditworthiness to investors. However, the City still faced challenges in distribution of wealth and provision of wide-spread access to basic services, particularly for some of the most vulnerable members of society (Parnell 2004). Because most investors are concerned more about the likelihood of repayment than the uses of the proceeds, concern about municipal allocation to urban infrastructure was not as critical as the need to find alternative methods of raising capital to meet pressing financial needs (Schwarcz 2012).

²⁵ Ndlazi, S., "Why I Quit as Top Tshwane Official," *IOL*, 30 August 2016. <https://www.iol.co.za/news/south-africa/gauteng/why-i-quit-as-top-tshwane-official-ngobeni-2062396>, accessed October 2018.

Issuing its first municipal bond: oversubscribed and highly replicable

The main motive for the initial consideration of bond issuance derived from an attempt to diversify the City's funding sources beyond an almost exclusive reliance on commercial and development banks. As banks were over-exposed to Johannesburg, the City of Johannesburg had reached its credit limits with nearly every bank and was forced to issue at least one municipal bond to obtain more funds for capital investment.²⁶ During the apartheid era (pre-1994), the City had successfully launched a number of municipal bonds, but this was in the context of prescribed asset requirements, whereby insurance companies and other institutional investors were required to hold 54% of their assets in instruments such as municipal and other domestic government bonds (Ngobeni 2008).

The City of Johannesburg, with its April 2004 issuance, marked the beginning of the post-apartheid municipal bond era in South Africa. The locally denominated, six-year transaction of ZAR 1 billion (approximately USD 159 million) was viewed as highly attractive for investors, particularly because it was offered at a rate that was 230 basis points over the government benchmark bond, or at a nominal interest rate of 11.95%.²⁷ This relatively high price, coupled with a sense of national pride at pioneering Africa's first municipal bond, generated overwhelming demand, and the bond was oversubscribed threefold at primary issuance (Coetzee 2013; Mantso & Blaauw 2009). The minimum increment size was ZAR 1,000,000 (or USD 159,000), signaling an intention on the part of the City to have investors that were either institutions or high net worth individuals. Only two months later, the City issued a second bond, seeking to raise a total of ZAR 1 billion. To reassure investors that Johannesburg was not taking on an unsustainable amount of debt, and to extend the maturity to 12 years, the municipality solicited an aggregate guarantee of 40% (with two matching guarantees of 20% each from the International Finance Corporation and the Development Bank of Southern Africa). Due to the credit enhancement, and despite a doubling in the bond's length, the premium paid by the City over the benchmark treasury curve was reduced to 164 basis points, with a nominal interest rate of 11.9%, again based on prevailing interest rates at the time.²⁸

Figure 4.1 highlights the fact that municipal bonds, particularly those with external guarantees to reduce risk, will often track closely against sovereign bonds when considering yield to maturity. The second bond

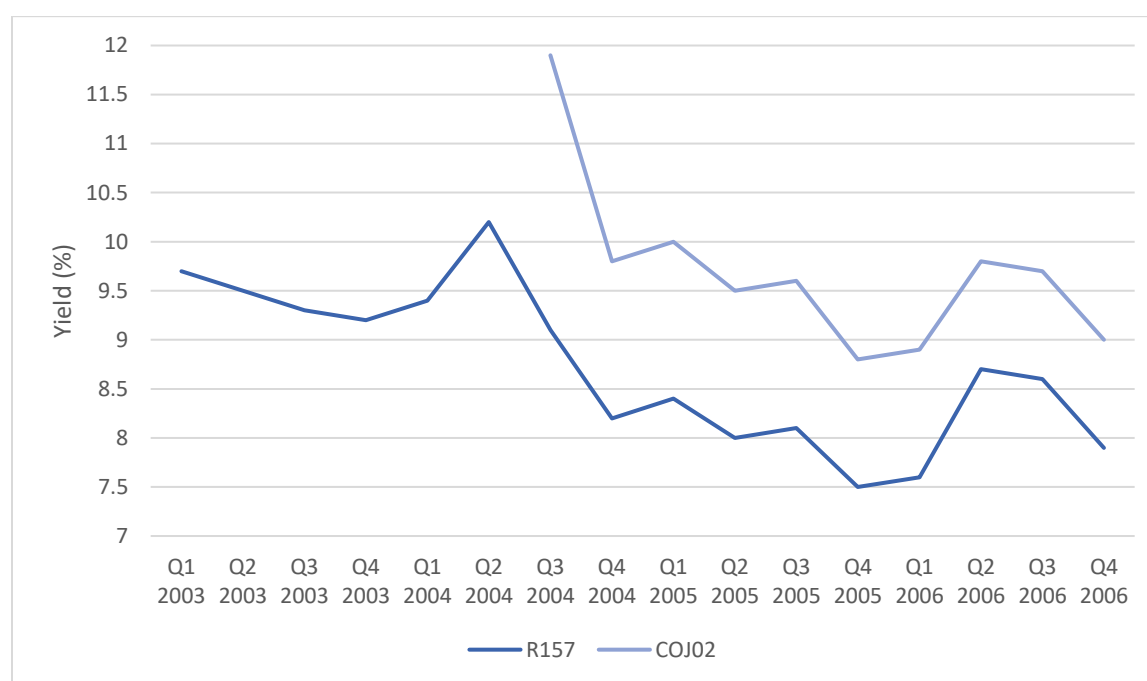
²⁶ Interview with David Savage, Advisor to South African National Treasury, February 2017, Cape Town, South Africa.

²⁷ Interview with Matthew Glasser, Advisor to South African National Treasury, February 2017, New Delhi, India.

²⁸ A key difference between interest rates on bank loans and on bonds is that the covenants governing bank loans often allow for fluctuations in interest rates reflective of prevailing conditions in the financial markets, whereas bonds are traditionally issued with fixed interest rates throughout the entire period. This rate setting allows municipal leaders to make more predictable estimates of their long-term budgets, capital investment plans, and existing debt capacity.

from the City of Johannesburg was priced at 11.9% at the time of issuance in June 2004, and moved in line with the corollary sovereign government bond expected to mature in 2010. Although this is not always the case, it adds to the argument that municipalities will make to potential investors about the predictability of the performance of municipal bonds in the secondary (post-issuance) market.

Figure 4.1: Spread between the interest rate on the Johannesburg municipal bond (COJ02) and a South African sovereign bond (R157) with similar maturity rates, 2003–2006



Source: Compiled by the author from Bond Exchange of South Africa data.

Only 40% of the proceeds of the first two bonds were used to finance the City’s capital expenditure program.²⁹ The rest was used to refinance existing, more expensive debt that Johannesburg had accrued in the late 1990s, when it was experiencing financial distress. The refinancing of the onerous debt arrangements through the bonds is anticipated to have saved the City interest payments of about ZAR 20 million (approximately USD 3.25 million, calculated on average amounts per year based on fluctuating interest rates) annually over the six years from bond issuance to maturity (2004–2010).

Investor appetite for municipal bonds issued by cities in South Africa remains strong more than a decade later. In 2011, Francesco Soldi, a Moody’s vice president, noted that “among the factors driving investor interest in bonds issued by large municipalities are strong investment-grade ratings on the South African national scale, their large and diversified budgets, and their above-average management expertise” (Soldi

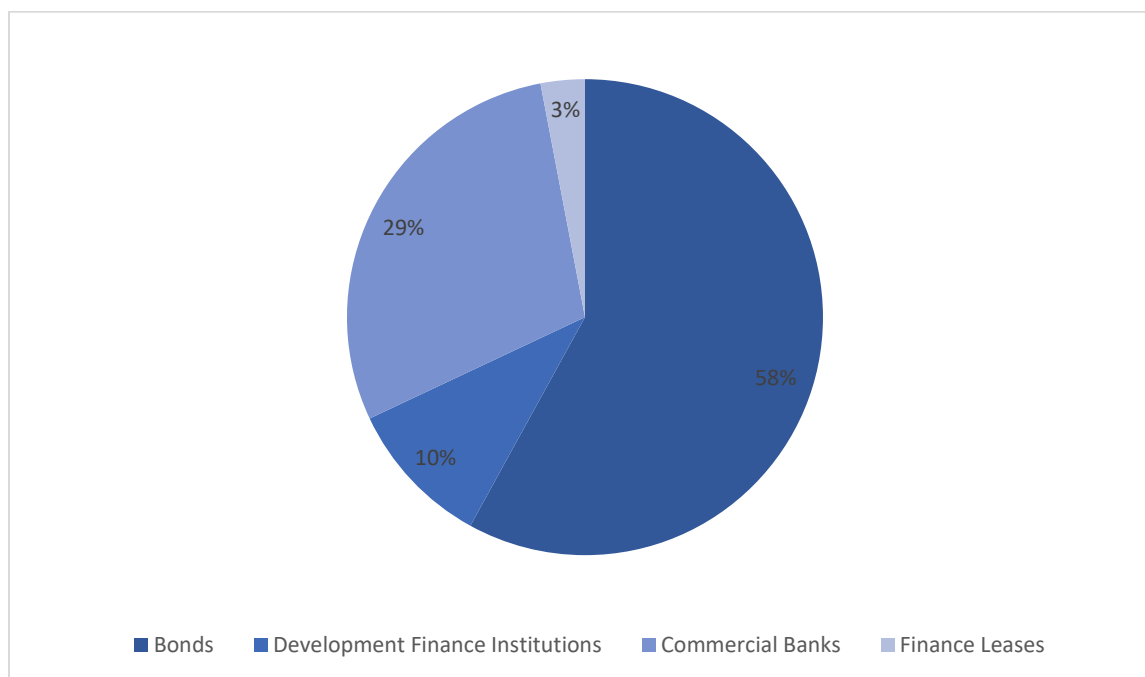
²⁹ Interview with Konstant Bruinette, Development Bank of Southern Africa, January 2018, Pretoria, South Africa.

2011). Municipalities across South Africa continue to increase the level of sophistication of the financial instruments that they use to access capital for projects that are compatible with their visions for long-term growth. This is evidenced through the City of Johannesburg’s successful completion of a green municipal bond transaction in 2014 (Thomas 2016), which was followed three years later by the City of Cape Town’s issuance of a similar bond in July 2017. In an interview with Neil Walmsley, head of partnerships at the Climate Knowledge and Innovation Community, he shared that “the initiative demonstrated by South African cities in launching green bonds at the sub-national level sets an example for the rest of the world,” but he lamented the fact that “other cities in sub-Saharan Africa are unlikely to be able to issue green municipal bonds if they are not successful in launching any municipal bonds, regardless of the color or intent”.³⁰

South Africa’s impact on municipal bonds in sub-Saharan Africa

The City of Johannesburg has successfully transitioned away from exclusive reliance on loans from development finance institutions and commercial banks to source its long-term debt. As of 2015, more than half of the City’s long-term debt was sourced from the bond market (see Figure 4.2):

Figure 4.2: Funding sources (percentage), City of Johannesburg, 2015



Source: City of Johannesburg Presentation, delivered at the Urban Investment Partnership Conference, 27–28 August 2015.

³⁰ Interview with Neil Walmsley, April 2018, Paris, France.

Since the issuance of the first municipal bond in 2004 by Johannesburg, other large cities in South Africa have been relying on capital markets investors to provide financing for infrastructure as part of a larger suite of financial tools. South Africa's success has inspired other countries across sub-Saharan Africa to look more closely at their experience and the potential for its replicability. Unfortunately, many opportunities for replication are thwarted in inception due to the lack of corollary commitment to a more complete devolution of financial decision-making power from the national government to sub-national government (ideally enshrined in the Constitution).

Case study 2: Douala, Cameroon

Of the four countries under review in this thesis, and in line with the central argument relating to the role of decentralization in municipal bond issuance, Cameroon demonstrates the lowest level of constitutionally-empowered devolution of power. Yet, it is one of the only examples of municipal bond issuance in sub-Saharan Africa. It is important to note that while the high concentration of power at the central level allows the national government to maintain a firm grip on any sub-national indebtedness, it also curtails local decision-making and ultimately does not provide a model for replication elsewhere on a continent that is increasingly attempting to devolve power to municipal governments.

Constitutional enabling environment

The 1972 Constitution created a highly centralized system in which cities are administered not by mayors but instead by political appointees; this is similar to the systems in a relatively small proportion of other countries in sub-Saharan Africa (including Liberia and the Seychelles³¹). Part X of the Constitution, on Regional Authorities, indicates that “regional and local authorities ... shall have administrative and financial autonomy in the management of regional and local interests”, but that the most senior officers in municipalities shall be “delegates, appointed by the President of the Republic”. These delegates shall “exercise the supervisory authority of the State” (Constitute Project 2008). Any funds borrowed by a sub-national government are explicitly guaranteed by the central government and, accordingly, are viewed as financial transactions whose debts accrue to the national, not sub-national, government.

Political will of national and sub-national leaders

Unlike the situation in the other cities and countries reviewed in this thesis, there is little room for dissension at the local leadership level, driven by the fact that the mayor acts not as a representative of the electorate

³¹ For Monrovia, Liberia, see <http://monroviaCity.blogspot.com/> ; for Victoria, Seychelles, see http://www.statehouse.gov.sc/news.php?news_id=3252.

in the City (bottom-up) but instead as an appointee of the national government (top-down). Cameroon has, in general, been plagued by a lack of democracy and freedom of political thought; as recently as 2017, many Cameroonians felt disenfranchised by the system (Letsa 2017). This is a trend noted by several academics reviewing the centralization of power across Africa; in 2013, Roger Southall noted the drift towards authoritarianism and the emergence of a self-serving political elite that substitutes its own interests for the interests of the masses, and becomes focused on its own extraction activities (Southall 2013).

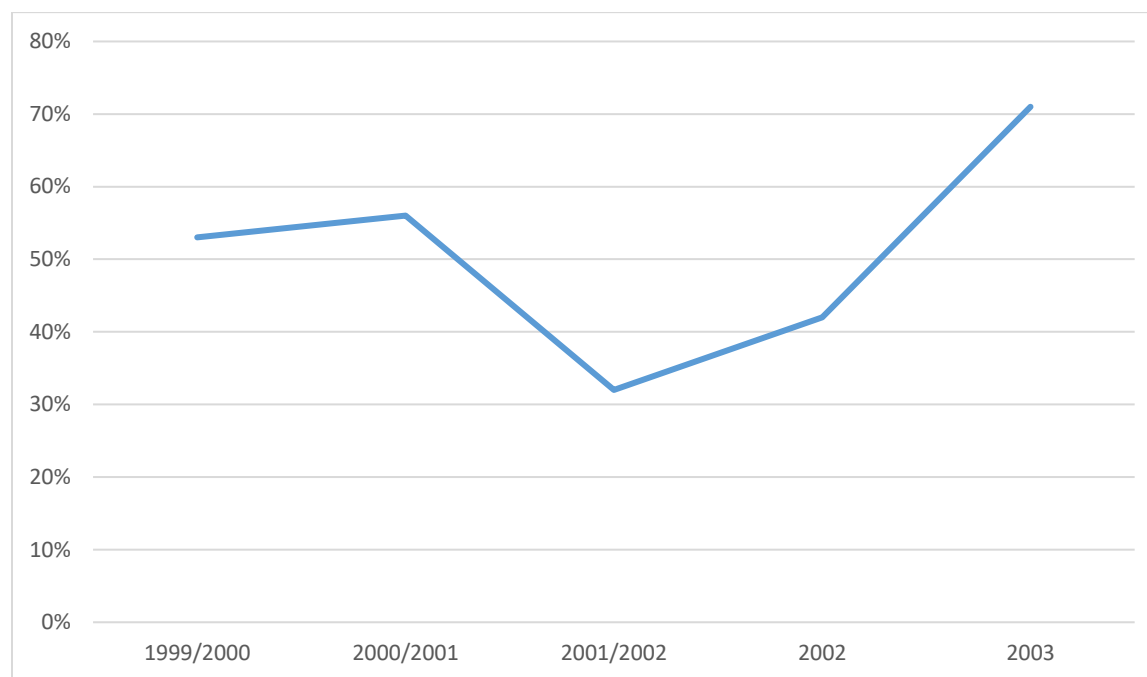
Municipal financial viability

According to the financial statement which was incorporated into the prospectus issued by the City of Douala in 2004³², the City of Douala's total receivables for its most recent audit were CFA franc 13 billion, or USD 17.7 million (from fiscal year 2003). Investors noticed, worryingly, that the actual revenue significantly deviated from the estimated revenue as proposed in the budget by nearly 50%³³; the budget called for revenues of CFA franc 23 billion, whereas the actual collections were only CFA franc 13 billion. This discrepancy underscored system-wide inefficiencies in accurate financial projections and collections, and could be viewed as indicative of a potential eventual inability to meet the debt service obligations called for in the bond agreement. Further, two of the City's three main sources of revenue – transfers and taxes – that help to cover its operational and investment expenses are derived from the central government. In the years leading up to the bond issuance (from 1999 to 2003), tax revenues collected by agents of the sovereign government and transferred to the City represented – on average – more than 50% of the City's total revenue, as shown in Figure 4.3.

³² Prospectus for City of Douala CUD Issuance, 2004.

³³ Interview with Marco Kamiya, UN-Habitat, April 2018, Paris, France.

Figure 4.3: Tax revenues transferred from Cameroon central government, relative to total City of Douala revenue (percentage), 1999–2003



Source: Administrative Accounts of the City of Douala; Prospectus for City of Douala CUD Issuance 2004

Under the leadership of the central government-appointed delegate, the municipal council recognized that it was well positioned to raise finance in the newly formed stock exchange, particularly with the explicit guarantee of the national government. Prior to the bond launch in 2005, and as part of the documentation required to attract investors, the City’s financial advisors conducted a cost–benefit analysis to compare the costs of commercial bank financing and a municipal bond issuance, which helped to inform the ultimate decision taken.³⁴ According to the prospectus made available to investors, the City planned to use the funds raised from the bond issuance for road infrastructure, waste water management, storm drains, solid waste management, and mass transit. The City and related City corporation had no direct loans from any commercial banks at the time, although it received financing in the form of concessionary finance from the World Bank and the Agence Française de Développement totaling approximately CFA franc 94 billion, or USD 128,000,000. These long-term funds were used for infrastructure improvements around the City, particularly around the port. The City’s successful servicing of this loan was an important indicator for potential investors who had little exposure to successful sub-national issuance in sub-Saharan Africa outside of South Africa.

³⁴ Interview with Guy Essome, Director of Structured Credit Products, May 2016, via Skype teleconference, from Dakar, Senegal, to London, UK.

Issuing its first bond: corrupt and one-off

Because of the favorable conditions, which included responsible financial management, strong corporate governance of both the City and its municipal development corporation, and encouragement by the central government for Douala to diversify its sources of finance for capital investments, the City of Douala issued a five-year bond in 2005 through a special purpose vehicle called Communauté Urbaine de Douala Finance (CUD Finance). This was designed to assist the municipality in raising funds for urban management and development. This CFA franc 16 billion bond (approximately USD 22 million) was jointly initiated by the central government and its representation in Douala in an effort to diversify the City's financial resources. It was fully backed by the central government, in accordance with the constitutional constructs of Cameroon's unitary government. The transaction was unique in that it represented not only the first municipal bond in the region, but also the first issuance at the Douala Stock Exchange since its inauguration in April 2003.³⁵

Unlike the bond issuance in Johannesburg, the smallest increment for the Douala bond transaction was far more accessible to retail investors; the minimum increment was CFA franc 1,000,000, or USD 1,400 (compared with Johannesburg's ZAR 1,000,000 minimum size, or USD 159,000). Additionally, the bond issuance was completed in three tranches, which differed in terms of the interest offered. The first tranche was offered with a fixed interest rate, the second with a variable interest rate, and the third without any coupon payments, but with a premium paid at the time of maturity. This approach afforded the City an opportunity to defer some of the costs of borrowing and helped to make the bond more appealing to a wider pool of investors. Effectively, through the creation of three different tranches, institutional investors with limited risk appetite looking for regular returns (i.e., pension funds and insurance companies) purchased the first tranche while commercial banks and investors with optimism about the direction of interest rates on fixed-income instruments were able to purchase the second tranche. The third tranche, without coupon payments, is a forerunner for Sukuk financing, which prohibits interest payments under Sharia law.

Unfortunately, the City's bond issuance was plagued with questions of financial and regulatory irregularities that ended in the dismissal and imprisonment of the national government's delegate, Etonde Etoko, within 18 months. Allegations of fraudulent exchanges between tranches and improper licensing of the financial arranger of the transaction were investigated and deliberated in Cameroonian courts for months. Although this did not hamper the City's ability to honor its debts, and investors received their

³⁵ Espesse, J (2005), "La CUD lance l'emprunt obligataire," Cameroon-Info.Net, 17 March, available at <http://www.cameroon-info.net/article/developpement-la-cud-lance-lemprunt-obligataire-92235.html>, accessed October 2018.

principal and interest in full and on time, perceptions of illegality have given municipal leaders reason to doubt the likelihood of a follow-on financial transaction (Nguemegne 2011).

Cameroon's impact on municipal bonds in sub-Saharan Africa

Curiously, the bond issuance in Douala is not referenced in most of the academic literature on municipal bonds in sub-Saharan Africa, which in itself is concerning as, despite the outcome of the transaction, it still demonstrates the fact that bond issuance can occur when sanctioned by the central government. Despite the fact that it has not been replicated elsewhere in Cameroon or in francophone Africa, and despite the corruption charges and other legal issues associated with the transaction, it was nonetheless an example of a bond issuance originated by a municipal authority that fulfilled its financial obligations at maturity. However, based on the relative obscurity of the transaction, it would be reasonable to assume that it did not have any significant influence on the development of the African municipal bond market.

Conclusion

Although almost all African cities lack the power and authority to access the required resources to put in place the infrastructure necessary to drive economic growth or deliver a healthier environment for citizens, a few have turned to raising municipal bonds as a way of leveraging the cash needed for large-scale investment. For those that have attempted to issue bonds (and the even smaller sub-set of those that have succeeded in their efforts), the case of Douala is instructive in considering the impact of decentralization on the potential for bond issuance at the sub-national level in sub-Saharan Africa. More specifically, the two examples in this chapter, arguably success stories, do not represent the type of success that would be easily replicated across the region. To replicate South Africa, with its well-developed legal system, would require a constitutional overhaul that is unlikely to be easily achieved in other countries, particularly given the reticence around decentralization. Conversely, to replicate Cameroon would, in essence, be a recognition that the best opportunities for sub-national governments to raise finance through the issuance of municipal bond lies in an effective abrogation of the rights of municipalities to function independently, from a financial perspective, from their national governments. The two case studies presented in the next two chapters – Dakar and Kampala – strengthen this argument by showing that the failure to launch was driven not by insufficient capacity or a lack of financially sustainable projects, but instead by an incomplete devolution of power for financial decision-making and execution of instruments to the sub-national level.

Chapter 5: The Senegalese Experience

Well-planned infrastructure, with long-term financing sufficient to match the useful life of assets, is a prerequisite for sustainable economic growth (Alm 2015; Castells-Quintana 2017; Frick 2018). As demonstrated in previous chapters, however, cities across sub-Saharan Africa are struggling to make use of appropriate instruments that will realize and maintain these goals (i.e., to raise sufficient amounts of money to, at best, cope with growth or, at least, provide services to meet the current demands of their constituents). Effectively, without introducing financial tools that can be used as frequently and responsibly as needed and that are enshrined in national constitutions, African cities may find themselves unable to meet the needs of ever-increasing populations. One of the most striking examples of a nearly successful attempt at financial innovation can be found in Senegal's capital City of Dakar, which made tremendous progress towards the introduction of a financial tool that would enable significant capital investment in urban infrastructure, designed to be in accordance with the City's master development plan. Ultimately, the objections of the national government to the concept of a long-term financial obligation, originated and promoted by a quasi-autonomous sub-national government, were driven largely by the failure to fully decentralize, which kept the City from using one of the most well-suited tools at its disposal.

This chapter opens by making the case for why Dakar needs money to address its developmental needs. It then sets out a review of the conditions that made Senegal, viewed in aggregate, an appropriate host country for more progressive financial experiments at the sub-national level than some other sub-Saharan African countries: namely, its position as a stable democracy, its financial literacy, its position as part of a common currency bloc with clearly prescribed rules and regulations for publicly listed financial instruments, and its history of encouraging decentralization. Following this section, the chapter continues by considering the driving factors at the City level that indicated Dakar's readiness for a municipal bond launch, including the integration of support from external aid agencies in institutionalizing best practices for financial management, strong leadership from the mayor and his municipal council, and steady progress in introducing long-term capital investment planning that featured the use of long-term debt instruments. The chapter proceeds with a more careful review of the work of the Bill and Melinda Gates Foundation-funded Dakar Municipal Finance Program (DFMP), a five-year initiative intended to culminate in the launch of the City's first bond, and closes with a review of the challenges that the bond faced and the reason why it was ultimately unsuccessful.

The chapter points out the curious disconnect between the City's progress and the outcome of its nearly

successful efforts at the bond launch: although the City had followed all of the rules set forth by the market regulator and complied with Senegalese law, Dakar was still unable to realize its aspiration to use this new instrument to fund needed urban infrastructure.

Why Dakar needed large-scale investment

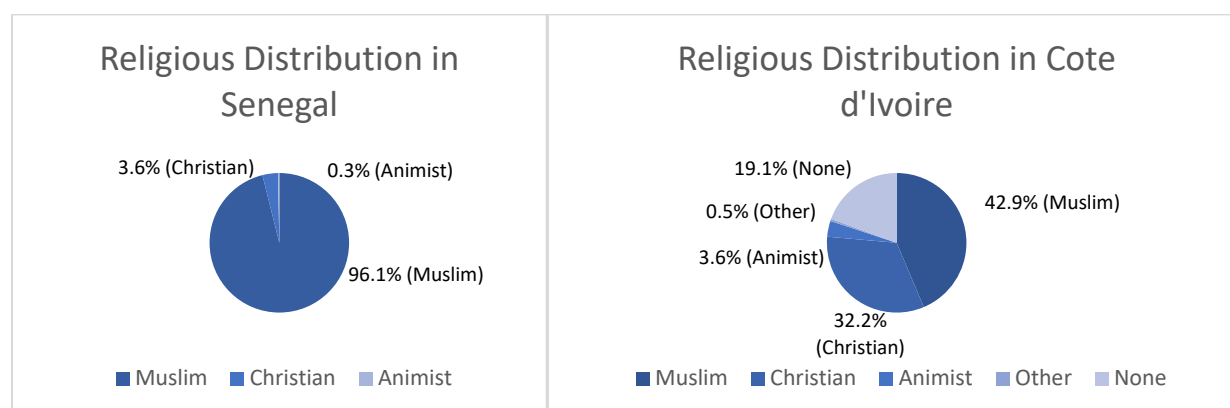
At the time of the proposed bond issuance in 2014, the City of Dakar was able to provide basic services (water, sanitation, power, health, education) to approximately 80% of its citizens. In the ensuing four years, this number has dropped to approximately 75%, and is likely to continue to trend lower based on a mismatch between available finances for rudimentary infrastructure services and rapid population growth, estimated at approximately 5% per year (Agence Nationale de la Statistique et de la Demographie 2018).³⁶ This shortfall is indicative of the cost of operation and maintenance, with slight expansion, of existing capital infrastructure; it does not, however, allow for the type of large-scale investment in major network expansion or social service infrastructure required to meet the needs of such a rapidly growing population. Concessionary lending from development finance institutions like the Agence Française de Développement (AFD), whose loan (discussed in detail below) was able to help with incremental, socially focused and non-essential infrastructure, is insufficient to meet the City's requirements, and is further evidence of the need for larger capital injections like those provided through municipal bond issuances.

Senegal as an appropriate breeding ground for municipal finance in francophone West Africa

Although the archaeological record from the pre-colonial period is relatively sparse, academics have argued that the pre-colonial period in Senegal was one that was dominated by a significant amount of commerce and international exchange between both neighboring African kingdoms and external European traders. This exposure both knitted together the Senegalese people into what later became a stable, heterogeneous nation-state and, at the same time, allowed for the primacy of a predominantly Wolof-speaking, Muslim country (particularly if the more contentious Casamance region is viewed separately) (Richard 2013). Today, Senegal is a relatively homogeneous society, especially when compared with the other economic powerhouse in the region, Côte d'Ivoire (Figure 5.1).

³⁶ Interview with Thibault Rannou, French Development Agency, September 2017, Dakar, Senegal.

Figure 5.1: Religious distribution in Senegal and Côte d'Ivoire



Source: CIA Fact Book, <https://www.cia.gov/library/publications/the-world-factbook/geos/sg.html>,
<https://www.cia.gov/library/publications/the-world-factbook/geos/iv.html>, accessed 15 April 2018.

This fact is compelling when considering that political stability is typically a prerequisite for the flow of funds from private investors to the public sector. The impact of uncertainty on fiscal flows is demonstrated by the difficulties faced by nearby Côte d'Ivoire in the months following the restructuring of its public debt in 2009, after its initial default in 2000 subsequent to internal political clashes (El-Khawas & Anyu 2014; Furness 2017). (Even though the majority of Senegal's population is Muslim, the first post-colonial leader, Léopold Sédar Senghor, was Catholic; his presidency lasted for 20 years – from 1960 to 1980 – and his policies helped to shape the Senegal of today. He was also the first post-colonial African president to leave office voluntarily, handing the reins of power to his successor, a somewhat uncommon occurrence in countries in the region with a long-entrenched political leader. Although he favored centralization of power in the capital, he did encourage a degree of independence that expressed itself through the creation of agencies focused on sub-national development, described in greater detail below [Valantin 2016]).

Financial maturity in Senegal around the independence process

As countries across francophone West Africa began to declare their independence from France in the years immediately following the Second World War, the French government offered to create a currency bloc by means of which these countries would be able to ensure financial stability, through a direct peg which fixed the exchange of the French franc to the CFA (Communauté Financière Africaine) franc, ensuring total and free convertibility (Figure 5.2). Although this arrangement has been argued to limit francophone Africa's growth (Malanda 2008), it has created a tightly-knit set of countries with open borders and free flows of internal investment.

Figure 5.2: Francophone West African participants in CFA franc



Source: Wikimedia Commons, https://commons.wikimedia.org/wiki/File:CFA-Franc_BCEAO_in_Africa.svg, accessed October 2018.

Among its peers in the currency bloc, Senegal is one of the strongest performers, with steady growth of approximately 7% per year, which bolsters investor ease with Senegal.³⁷ Investor confidence in Senegal is further strengthened by its relatively strong performance in the World Bank's *Ease of Doing Business Report* and the annual *Corruption Index* published by Transparency International (Table 5.1).

³⁷ See <https://data.worldbank.org/country/senegal>, <https://data.worldbank.org/country/cote-divoire>, accessed 15 April 2018.

Table 5.1: *Ease of Doing Business Report* and *Corruption Index* rankings for countries in the West African CFA franc currency bloc, 2017

	<i>Ease of Doing Business Report</i> ranking	<i>Corruption Index</i> ranking
Benin	151, of 190	85, of 180
Burkina Faso	148, of 190	74, of 180
Côte d'Ivoire	139, of 190	103, of 180
Guinea-Bissau	176, of 190	171, of 180
Mali	143, of 190	122, of 180
Niger	144, of 190	112, of 180
Senegal	140, of 190	66, of 180
Togo	156, of 190	117, of 180

Source: *Transparency International (2017); World Bank (2017a)*

Investors rely on more than general indicators to make decisions about how best to allocate their portfolio, and view credit ratings by ratings agencies as critical indicators of the likelihood of borrowers' willingness and ability to repay their debt. More specifically, a credit rating relies on three pillars to evaluate the performance of the rated entity, with many sub-pillars (GCR 2018):

1. Socio-economic environment (GDP growth, economic diversification, employment levels, income levels, household wealth, demographic composition, provision of social services, rate of urbanization).
2. Legal and institutional framework (laws, regulations, and practices that govern ability to generate income/raise funding, assumed support from national government, undue political influence, low degree of fiscal and operational independence, corporate governance, strength and capabilities of oversight bodies, extent to which corrupt or wasteful activities are investigated and guilty parties held to account).
3. Income/expenditure/financial forecasts (internally generated income (rates & taxes, services) versus external sources (grants & subsidies), diversification of sources of revenue, economic base, identification of new sources, reliance on grant funding, ability to collect on debtors critical to cash

flow, relationship between discretionary expenses (non-essential capex) and non-discretionary expenses (such as debt service payments), staff cost to total cost ratio, repairs and maintenance versus depreciations, analysis of published budgets, accuracy and reliability assessed based on the historical performance of an entity relative to forecast).

Unsurprisingly, Senegal and Côte d’Ivoire are the highest-rated of the countries in the West African bloc, performing at the high end of the speculative scale based on the above commonly accepted criteria. National credit ratings are graded on the international scale; the least risky issuers – like the United States government – are awarded AAA by S&P and Fitch, and Aaa by Moody’s. A rating of Ba3 by Moody’s for Senegal is equivalent to a rating of BB- by S&P or Fitch, and is higher than a score of B1 (Moody’s) which tracks to a score of B+ for S&P or Fitch. For S&P or Fitch, a score of B+ is higher than a score of B or B- (correlating to a Moody’s score of B2 and B3, respectively).

Table 5.2: National credit ratings for countries in the West African CFA franc currency bloc

	Moody’s	S&P	Fitch
Benin			B
Burkina Faso		B	
Côte d’Ivoire			B+
Guinea-Bissau			
Mali			B-
Niger			
Senegal	Ba3	B+	
Togo			

Source: Countryeconomy.com ratings (2018).

Note: The chart lists all member countries of the West African currency bloc, despite the fact that some of the countries have, as of the date of writing, not commissioned credit ratings.

From a financial maturity standpoint, and of crucial relevance to the argument of this chapter, Senegal’s regular issuances in the local currency market (regulated by the Conseil Régional de l’Epargne Public et

des Marchés Financiers [CREPMF]) depict the country as a well-regarded borrower able to repeatedly find a willing cadre of investors eager to purchase national debt. Since 2005, Senegal has borrowed in local currency six times for a total of CFA franc 377.04 billion (EUR 573.3 billion) with a nearly constant nominal interest rate that fluctuated from a low of 5.5% to a high of 6.75%.³⁸ The Ministry of Finance, through its constitutional mandate, keeps “close watch on debt service ratios” and makes sure that the country’s indebtedness never exceeds 40%; the country’s current debt to GDP ratio is approximately 39% (Agence Nationale de la Statistique et de la Demographie 2018.).³⁹

Table 5.3: Local currency bond issuance, Senegal, 2005–2015

Date	Amount (CFA franc)	Coupon (nominal interest rate)
August 2005	45,000,000,000	5.5%
December 2010	76,800,000,000	6.75%
October 2012	88,103,000,000	6.7%
June 2013	66,937,180,000	6.5%
December 2015	100,200,000,000	6.3%

Source: Compiled by the author using Bloomberg Data.

What emerges from tracking the growing national borrowing profile of Senegal is an increasingly robust and sophisticated engagement within the regional fiscal system, denominated in the regional CFA franc and governed by a regional regulator. The same governance structure dictating the rules for the Senegalese government in the local market, developed and implemented by the regulator, is designed to apply to all public entities, including sub-national governments. More specifically, the CREPMF, established in 1996, has firmly established rules and regulations governing the issuance of debt by any public entity, and clearly allows for sub-national entities to borrow in the market once it can demonstrate that it has met prevailing conditions (CREPMF 1996). In theory, therefore, there are no barriers to municipal borrowing. What is unclear is how the configuration of powers and functions and the less formal devolution of power impact

³⁸ See <http://www.crepmf.org/Wwwcrepmf/Emetteurs/Liste.aspx>, accessed 15 April 2018.

³⁹ Interview with Ed Roche, US Treasury Office of Technical Assistance Senegalese Lead, February 2016, Dakar, Senegal.

on what cities, even large cities like Dakar, are actually able to initiate on the fiscal front.

Contextualizing Senegal's decentralization

Sovereign demonstrations of financial strength and maturity are positive indicators when considering the appropriateness of a pioneering sub-sovereign financial instrument; the juxtaposition of an ever-increasing level of decentralization against financial strength at the City level helps to underscore the likelihood of Dakar's success in attempting a municipal bond issuance as a pioneer in francophone Africa. The French political model, which favors intense centralization (Gilbert & Taugourdeau 2012), was the cornerstone of Senegal's post-colonial Constitution; it took over a dozen years for the creation of functional lower levels of governance (*communautés rurales*) across the country in 1972. The 1972 creation of the rural communities was a top-down move that nevertheless established a precedent of modern government and the principle of two tiers of government. The 1960s and 1970s also saw pressure for increased urban autonomy, which in Senegal manifested itself as demands from local leaders across the country for more power over decision-making and more assurance of regular fiscal transfers from the central government, particularly for unfunded mandates (Ndegwa & Levy 2003). Throughout these decades, demands for local autonomy were most acute in the capital City, Dakar (Dafflon & Madies 2012). The City had the only truly viable City budget; whereas other cities floundered when required to perform such basic tasks as constructing and subsequently maintaining rudimentary urban infrastructure, Dakar found the requisite resources more easily. This is, in particular, borne out in the relatively low collection rate of the Senegalese government's initiative to fund municipalities – the Programme de Renforcement et d'Équipement des Collectivités Locales (PRECOL) – through which the government collected only 54.5% of its outstanding debt; a significant portion of this loan repayment was from the City of Dakar.⁴⁰

The primacy of Dakar is not merely a function of its economic preeminence, but also of its political centrality. The threat posed by Dakar's autonomy to national party leadership was already in evidence in 1964, when Senghor suspended the City's municipal status, bringing it directly under national control and thereby avoiding any political competition from rival factions with a strong local power base. Throughout the following decades this tension continued to grow, with token efforts by the national government to transfer power to municipalities. For example, the ruling party passed laws reforming the government structure in 1996 by creating elected regions and by delegating major public service responsibilities to sub-national governments (OECD 2016). The 1996 reforms were acclaimed in Africa as a “major advance in

⁴⁰ PRECOL was initiated by the Agence de Développement Municipal, following successful predecessor programs where the City of Dakar was the main borrower (the Compte du Crédit Communal and the Programme d'Appui aux Communes). The information on the recovery rate was current as of May 2017, included in a presentation delivered by Amadou Ndiaye of the Agence de Développement Municipal in Somone, Dakar.

decentralization”, but on the whole the reforms decentralized responsibilities without transferring the revenues necessary to realize these functions.⁴¹ In fact, most government activity, including the payment of civil service salaries, remained in the hands of state-appointed administrators. The laws were, in effect, a set of unfunded mandates; in cases where local areas were ruled by opposition parties, the central government used these laws as a means to reduce the autonomy of local government where they were performing well (Resnick 2014b).

One of the achievements of this legislative decentralization was the creation of a Decentralization Fund – Fonds de Dotation de la Décentralisation (FDD) – intended for distribution as grants to all local governments. The FDD was coupled with the legal dispositions of Law 96-07⁴², which made local government responsible for the provision of basic services in nine major social service areas, including health and education.

Similarly, as previously referenced, the Senegalese government created two national agencies to support local governments in accessing finances for long-term, capital-intensive projects: the Agence de Développement Municipal (ADM) and the Agence de Développement Local (ADL). Although well-capitalized through the financial support of international donors like the World Bank and supplemented by allocations from the central government, both organizations have suffered from limited recovery of funds on-lent to subnational governments (with Dakar being a major exception) (Paulais 2014). Senegal provides an interesting comparison with other countries experiencing their own forms of fiscal decentralization at the same time; South Africa, as discussed in Chapter 4, saw a much greater devolution of power whereby municipalities took control of their financial decision-making and were able to prepare for experimentation with a wide variety of tools, including municipal bonds, based on constitutional changes and political empowerment. (In contrast, Brazil, through its constitutional revision of 1988, pursued a different path that created 1,016 new City governments, some of which suffered significantly due to the loss of benefits derived from economies of scale, a phenomenon likely of interest to decision-makers in Dakar [Lima & Silveira Neto 2018].) The divergent paths taken by South Africa and Senegal with regard to empowerment of local governments had direct implications for their ability to consider municipal bonds decades later.

As a result of the 1996 decentralization, local governments across Senegal were encouraged by the central government to seek financing from a plethora of sources. A World Bank review of sub-national financial autonomy in Senegal outlined the legal empowerment of the country’s sub-national governments, but noted

⁴¹ Interview with Babacar Thioye Ba, 10 August 2017, Dakar, Senegal.

⁴²<http://www.servicepublic.gouv.sn/assets/textes/loi-transfert-region.pdf>, accessed 10 April 2018.

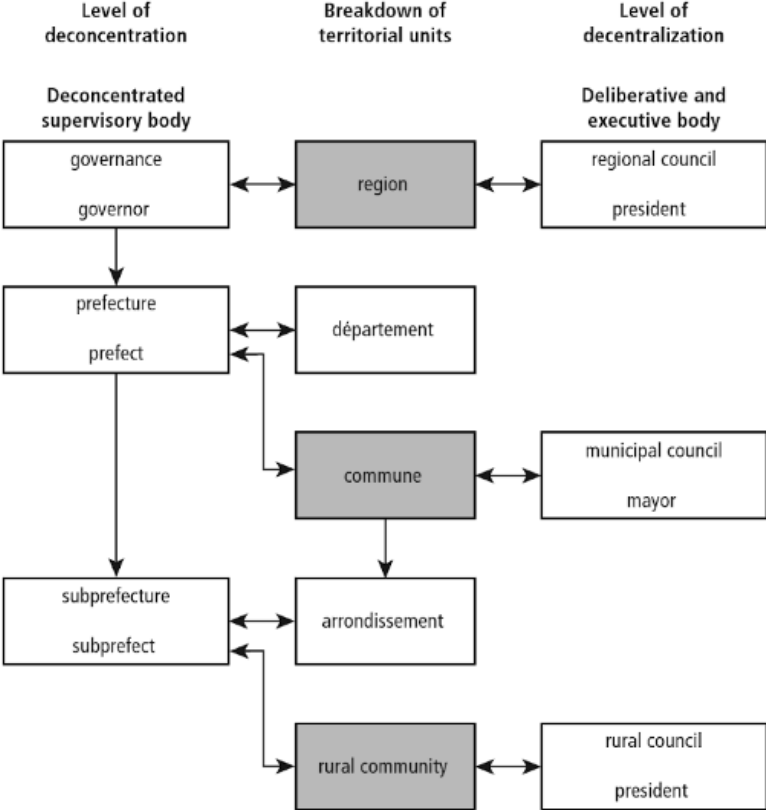
the practical constraints that somewhat invalidated this power:

The sub-national governments are quite free to borrow from the banking and capital markets. However, this possibility is subject to prior approval by the central government through its local level representative when the borrowings reach CFA franc 100 million (approximately USD 170,000) and when they result from a loan agreement through international cooperation. This provision, which restricts the binding force of these decisions taken by the sub-national governments, represents progress compared to the situation that prevailed before 1996, since control is no longer exercised by the central authority but rather by the state's representative at the local level. (World Bank 2000 : 29)

Yet, the apparently sanguine reaction of local governments to the idea of greater financial autonomy does not obscure the fact that the change simply shifts responsibility for monitoring borrowing from the central government in Dakar to the central government agent outside the capital (Resnick 2014b). This is a deconcentration, rather than a devolution, of power. State representatives have numerous prerogatives with respect to sub-national loans, with the center (acting through deconcentrated officials at the regional level and below) retaining the right to view borrowing schedules a priori, and to approve any guarantees offered on the loans.

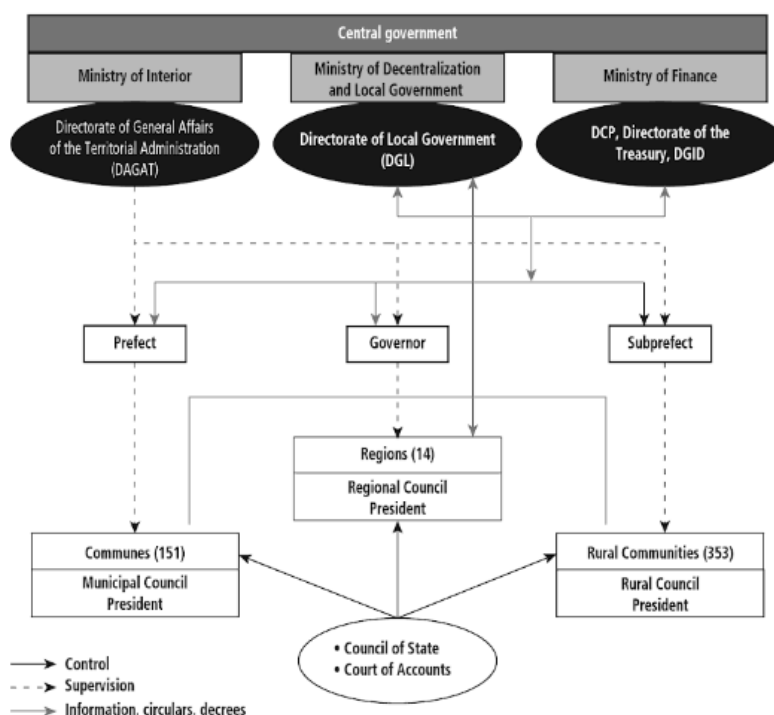
Despite reforms, the autonomy of the sub-national state was further undermined, as the structure of revenue distributions did not allow sub-national governments to generate the revenues necessary to repay the loans. Since the annual FDD distributions were entirely for use on current expenditures, sub-national governments would have to rely on own-source tax revenues to repay any debt obligations. The theoretical right conferred on a City by national government to enter into capital market contracts was thus largely irrelevant; only guaranteed transfers of funds for capital investment or the transfer of tax authority will increase sub-national borrowing autonomy. While distinct, each area of autonomy constitutes a part of a whole fiscal system, and a lack of autonomy in one area can moot an otherwise high level of autonomy in another area. In this case, the lack of revenue autonomy can render de jure borrowing autonomy irrelevant without a similar expansion of budget authority for the municipality as a whole. Figures 5.3 and 5.4 demonstrate the chain of authority relating to local government issues, and highlight the fact that, even with decentralization, there is still significant national oversight of all local government decision-making. As the figures show, with specific reference to the argument in this chapter, the prefect retains authority to review and approve all budgets developed by the municipality prior to execution, particularly those that show any debt obligations; this point will become critical in later considerations of the municipal bond transaction in Dakar itself.

Figure 5.3: Territorial organization in Senegal



Source: Gilbert & Taugourdeau (2012: 214)

Figure 5.4: Relations of central government, ministries, deconcentrated government services, and local governments in Senegal



Source: Gilbert & Taugourdeau (2012: 215)

Of additional interest is the role of the *percepteur*, an official appointed by the Ministry of Finance to validate financial decisions in the City of Dakar through reviews of the budget-making process as well as comprehensive periodic reviews of progress against financial indicators. Effectively, despite being permanently embedded in the City on a day-to-day basis, the *percepteur* is ultimately responsible to the national government and functions as a safeguard on municipal financial decision-making in a way that prohibits unsustainable borrowing.

Dakar as a municipal leader in francophone West Africa

Amongst the international financial community, Senegal is considered “a highly competent country with the ability to regularly source funds through the domestic market based on investors’ perceptions of the country’s stability and ability to repay its debts”.⁴³ Further, the political decentralization process created an environment within which a city like Dakar would be able to meaningfully replicate the success of the national government. However, the presence of these conditions does not guarantee that the City will be

⁴³ Interview with Rodrigo Gonzalez, Head of Debt Capital Markets, Standard Chartered Bank, 15 August 2016, New York, United States.

capable of issuing a municipal bond. The indicators of success are found within the City itself, namely in its own efforts to demonstrate the strength of its internal financial management, its political leadership, and its ability to develop and implement long-term master planning schemes in line with a multi-year budget.

Financial management in Dakar

Because of the relative stability of the Senegalese economy and the forward-thinking approaches of municipal leadership, international aid agencies and charitable foundations have often viewed Dakar as a natural partner for experimentation with the idea of a municipal bond in sub-Saharan Africa, building off of the success of South African city issuances. In 2008, the World Bank's Public-Private Infrastructure Advisory Facility underwrote a diagnostic review of the City's financial management system using the Public Expenditure and Financial Accountability (PEFA) assessment tool. The findings from that report were incorporated into the City's financial management practices, and provided the backdrop against which the City would be able to borrow from a wider pool of lenders (Diou, Caprio & Chomentowski 2009). Initially, the national government was explicitly supportive of the PEFA process, requesting the World Bank's support in helping to make Dakar more financially independent and able to access finances from willing lenders/investors).⁴⁴ The results of this commitment by the City can be seen through a review of its financial performance from 2008 to 2014, as shown in Table 5.4.

⁴⁴ Interviews with Babacar Thioye Ba, legal advisor to the mayor of the City of Dakar, 10 August 2017, Dakar, Senegal; Dieynaba Thiam Ka, administrator for the DFMP, 14 August 2017, Dakar, Senegal; Salim Rouhana, World Bank, January 2017, Dakar, Senegal.

Table 5.4: Financial information, City of Dakar (thousands of CFA francs), 2008–2014

	2008	2009	2010	2011	2012	2013	2014
Row 1 - Operating revenues	24,188	26,118	22,459	27,839	36,583	26,804	27,525
Row 2 - Operating expenses	16,017	16,536	18,461	22,843	25,199	26,192	21,103
Row 3 - Gross savings	8,171	9,582	3,998	4,996	11,383	612	6,422
Row 4 - Loan repayments	0	0	0	1,232	2,359	2,525	2,652
Row 5 - Net savings	8,171	9,582	3,998	3,765	9,024	-1,913	3,770
Row 6 - Investment income	0	0	1,876	6,800	6,972	8,019	10,726
Row 7 - Capital expenses	7,195	3,965	5,791	11,199	9,023	9,235	11,881
Row 8 - Investment requirement	-7,195	-3,965	-3,915	-4,399	-2,051	-1,216	-1,154
Row 9 - Year-end balance	976	5,617	83	-634	6,974	-3,129	2,616

Source: Compiled by the author from City of Dakar Financial Statements (2008–2014).

In essence, the City's internal financial performance opened up external financial markets for Dakar; through demonstrations of the likelihood and willingness of repayment, new sources of finance for urban infrastructure investments began to appear. The information in the above table is particularly important when considering three important elements:

- 1) The city's operating revenues (Rows 1 and 2) have remained relatively stable, with minor variation, during the period analyzed, demonstrating strong financial management and reassuring investors.
- 2) The city has effectively budgeted for its long-term investment needs (Row 8), with a shortfall of

less than 3% of the city's total revenue (sum of Rows 1 and 6).

Dakar experimented with municipal finance through transactions as early as 2008; as one of his final acts in office, Pape Diop, then mayor of the City of Dakar, had signed a loan with the AFD to fund a EUR 10 million program to furnish the City with street lights along well-traveled thoroughfares. This loan was the first of its type from the AFD to a West African capital city without a central government guarantee of repayment. It demonstrated a belief on the part of external lenders that the City of Dakar could be viewed as a creditworthy borrower. This loan was possible without a central government guarantee because language in the Constitution granted municipalities across the country the power to enter into long-term debt obligations without central government intervention. Subsequently, the City borrowed from other concessional lenders (like the West African Development Bank, which agreed to a loan of CFA franc 1.2 billion for the rehabilitation of roads) and from commercial banks (like the Islamic Bank of Senegal, which provided a loan of CFA franc 2.65 billion for the installation of traffic lights at the City's busiest intersections) (Gorelick 2018). All of the financial undertakings were directly supervised by the respective mayors in Dakar, as each recognized that the City's sustainability and potential responsiveness to future growth depended on its success in raising funds from a diverse market.

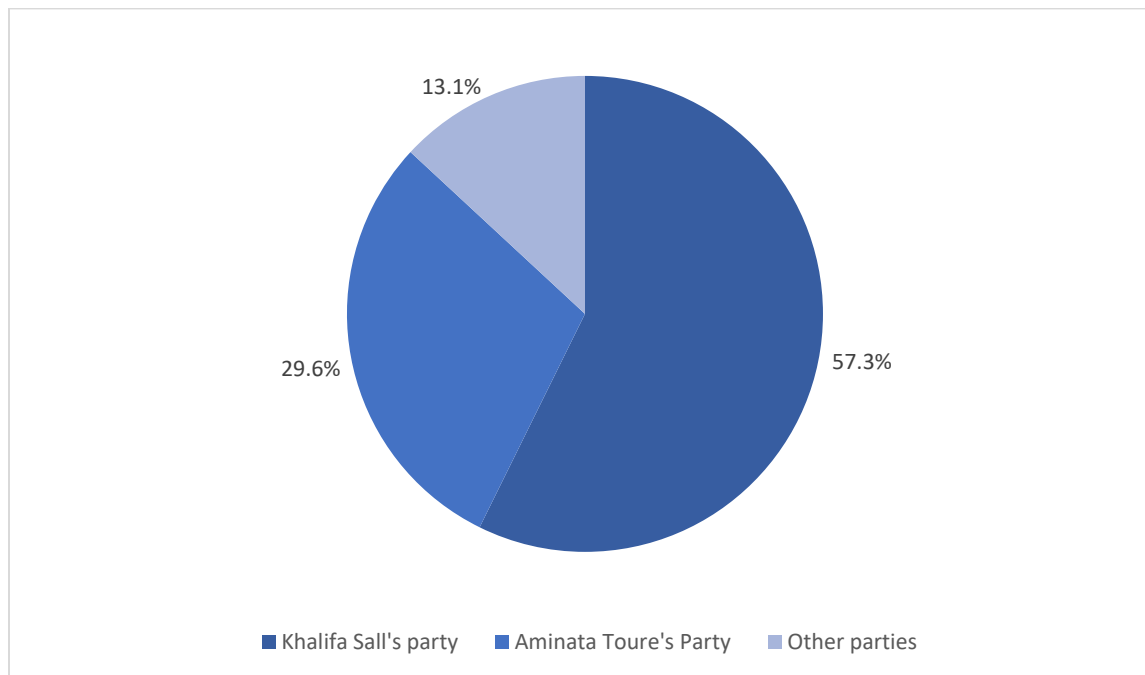
Political leadership in Dakar

Since independence, Dakar has been led by progressive leaders who have rallied for and embraced increased levels of political autonomy at the sub-national level. Current (2018) mayor Khalifa Sall has endeavored to continue this tradition by introducing and institutionalizing processes of participatory budgeting, ensuring that the typically disenfranchised urban poor have a role in long-term decision-making across the City and that it would be politically unpopular for the national government to re-legislate and remove these powers (Cabannes 2014).

An interesting and telling clash between the national and local government occurred in the 2016 municipal election cycle. To be elected mayor of the City, as per the abovementioned act of decentralization of 1996, a candidate must first win his/her district (*arrondissement*). In an effort to ensure that Khalifa Sall would not be eligible to continue as mayor, Senegalese president Macky Sall strongly backed his prime minister, Aminata Touré, in her ultimately unsuccessful challenge to Khalifa Sall in Grand Yoff (Figure 5.5).⁴⁵

⁴⁵ Ba, D. "Senegal Prime Minister Sacked After Losing Election". *Reuters*, 5 July 2014. <https://www.yahoo.com/news/senegal-prime-minister-sacked-losing-election-194520227.html>, accessed 10 June 2018; internal Electoral Results Review document made available to the author in February 2018.

Figure 5.5: District electoral results, Grand Yoff (percentage), 2016



Source: Compiled by the author from Agence Nationale de la Statistique et de la Demographie (2018).

In 2012, under the leadership of Khalifa Sall, Dakar established a sub-municipal agency specifically tasked with City planning: the Department of Sustainable Development (Paice 2016). The department's first tasks were to develop a long-term master development plan to ensure that the City's growth strategy was well-orchestrated, and, in conjunction with the City's treasury, to appropriately sequence the timing of the City's investments. The idea of Dakar as a well-planned City was of course not a new one; the French had introduced the idea of master planning in the mid-19th century during the initial years of their colonial occupation, encouraging the development of the strategically located peninsula from a sparsely populated area into a major trading hub (Bigon & Hart 2018). This new plan focused on an incorporation of capital planning, with an eye towards the concern that "infrastructure needed to respond to the rapidly growing population" while "marrying capital planning to capital investment planning", to ensure that growth and development plans were not "designed in a vacuum" or based on the assumption that "large sums of finance were ... available".⁴⁶ One of the additional benefits of the new plan was a view towards integration with the larger region, an idea championed by many academics (Beall, Parnell & Albertyn 2015; Pelling & Wisner 2012; Watson & Odendaal 2012).

⁴⁶ Interview with Rokhaya Sarr, Department of Planning and Sustainable Development for the City of Dakar, January 2017, Dakar, Senegal.

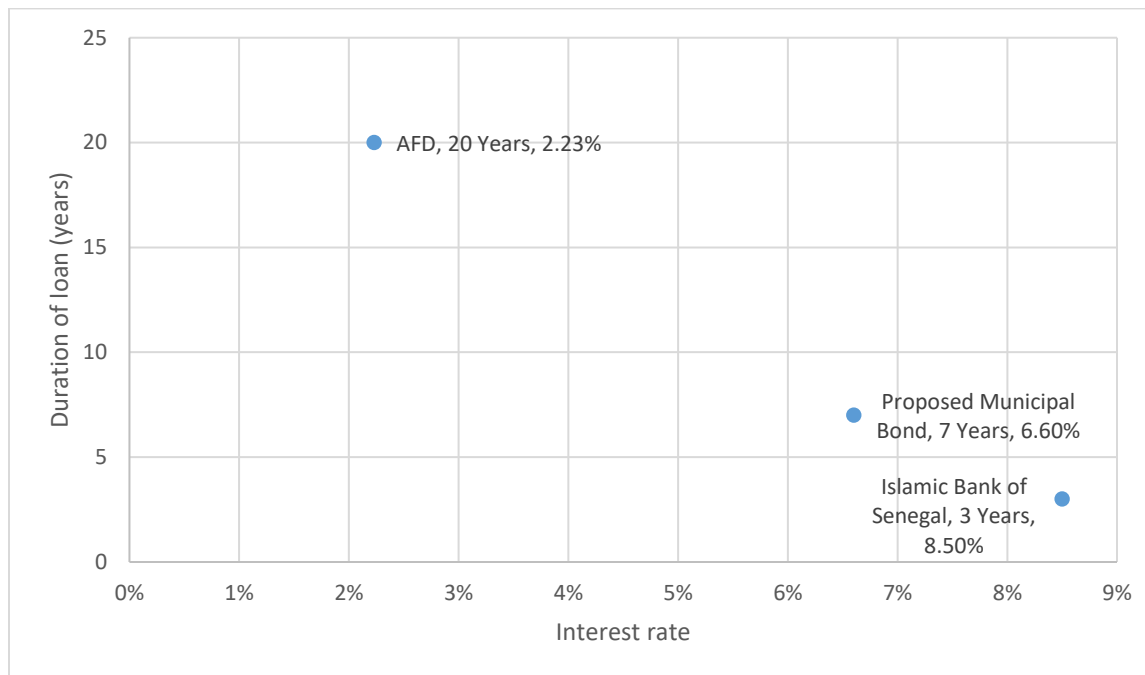
Putting the pieces together: a municipal bond in Dakar

Having borrowed successfully from lenders in bilateral transactions and demonstrated its creditworthiness (particularly in its ability to repay a market-rate loan from the Islamic Bank of Senegal), the leadership of the City of Dakar was confident that it would be able to successfully source finance from the debt capital markets for long-term debt.⁴⁷ More importantly, a municipal bond would help to fill the gap between commercial bank lending (which was relatively more expensive and shorter-term than a municipal bond) and development finance institution lending (which was more restrictive and did not allow for a single large injection of capital into a project).

As part of the overall review of financial instruments, the City of Dakar compared the financials of the above-mentioned loans from the AFD (at a rate of 2.23% over 20 years) with the loan from the Islamic Bank of Senegal (at a rate of 8.5% over 3 years). When plotted graphically, the proposed municipal bond falls between the commercial loan (Islamic Bank of Senegal) and the development finance institution's loan (AFD) (Figure 5.6). Using the same logic discussed in the first part of this thesis, reviewing not only the terms of the loan but also the terms of disbursement of funds, the City recognized that a bond issuance would be more attractive than a commercial loan and would be a better fit for the capital-intensive investment envisaged by the City.

⁴⁷ Interview with Dieynaba Dabo Mbaye, Coordinator for DFMP, January 2017, Dakar, Senegal.

Figure 5.6: Financial instruments considered by the City of Dakar



Source: Compiled by the author from City Archives, City of Dakar.

Because of the financial strength and stability of Senegal in the region, the clear powers allocated to the sub-national entities under the Constitution, and the financial maturity of Dakar and its regular repayments to lenders in traditional one-on-one relationships, the City was well-poised to demonstrate its readiness to issue a municipal bond. Notwithstanding, the municipal bond path was fraught with difficulties, and an international donor stepped in to assist in mediating and ensuring that Dakar as an early adaptor was successful.

The lead-up to bond issuance

Building off of its demonstration of success in on-time and in-full debt service, the City embarked on a process to launch a municipal bond, which started in late 2011 after a careful review of the Constitution, and confirmation with expert lawyers and government representatives that a municipal bond issuance was legal and fell under the definition of rights provided in the legal codes governing the rights of cities. In 2011, the City of Dakar received a USD 500,000 grant from the Bill and Melinda Gates Foundation to analyze the feasibility of launching a municipal bond. Dakar was presented as being uniquely positioned amongst its peer primary cities in the region due to (1) its visionary leadership, (2) its adoption of a strategy to address urban planning, and (3) its past performance as a borrower from external sources (Paice 2016).

The Bill and Melinda Gates Foundation provided an aggregate grant of USD 5.5 million (which included the USD 500,000 for a project feasibility study) for a period from 2011 through 2017, with the intended outcome being an improvement in the quality of life for the urban poor through the mobilization of domestic finance via a transaction in the regional capital market. Throughout this period, international experts worked alongside City staff to improve the City's financial management systems, its approach to comprehensive planning, and investors' perception of the City's creditworthiness. Part of this process included investor-sounding exercises, through which the City learned that it would be most likely to achieve full capitalization of the transaction with the aid of a credit enhancement (i.e., a guarantee from an external body); after a thorough cost-benefit analysis, the City opted for a 50% principal guarantee from the United States Agency for International Development's Development Credit Authority (USAID DCA). In a 2014 speech on the US government's commitment to supporting development finance, then-USAID administrator Raj Shah explicitly referenced the catalytic impact that the agency's guarantee was anticipated to have on municipal finance across sub-Saharan Africa (Shah 2016). The international development community was encouraged to see the City's progress, and was committed to ongoing support, particularly because they viewed a success in Dakar as being one that could be replicated elsewhere in sub-Saharan Africa. This support was tied in with a "strong belief" that the "City of Dakar was part of an ecosystem driven by the central government" and "stood to benefit from the pathway of ever-increasing decentralization started under Senghor and continued under Dakar's successful performance under the ADM and the ADL financing programs."⁴⁸

Perhaps most crucial in this process were two elements that directly tie in with the concept of decentralization within a unitary state as described above: the explicit agreement and recognition of the proposed bond issuance by both national departments and intermediate oversight agencies. In May 2012, the City concluded its negotiation with the national department overseeing local governments (*Le ministère de l'aménagement du territoire et des collectivités locales*), which culminated in the receipt of a letter of non-objection to the proposed bond launch by national government. This non-objection was discussed and reconfirmed on an annual basis with national government. Similarly, the budget in the year preceding the bond launch included an accommodation for the repayment of the interest associated with the bond as part of future municipal obligations. As previously stated, by law, all municipal budgets must be approved and validated by the central government's representative, the prefect, as well as the appointed representative from the Ministry of Finance, the *percepteur*.

⁴⁸ Interview with Dieynaba Dabo Mbaye, Dakar Municipal Finance Program Coordinator, June 2017, Dakar, Senegal.

By 2015, the City had successfully completed all regulatory steps required to issue a bond in the Abidjan-based capital markets, and built sufficient demand from institutional investors through roadshows and other individual appeals to be confident that the transaction would be a success (Gorelick 2017). Further, the 2015 credit rating, conducted by Bloomfield Credit Ratings (a local ratings agency based in Abidjan), showed increases in revenue, decreases in operating costs, steady repayments of loans, and a net surplus relative to the prior year.

Table 5.5: Year-end accounting, City of Dakar (all amounts in CFA francs), 2014–2015

	2014	2015
Operating revenue	26.8 million	27.5 million
Operating expenses	26.2 million	21.1 million
Loan repayments	2.5 million	2.7 million
Surplus/Deficit	-3.1 million	2.6 million

Source: Compiled by the author from City of Dakar records.

Although the City’s rating remained unchanged over the period of time when the municipal bond was being actively considered (2011–2015), its capacity – both objectively and relative to its municipal peers in the region – significantly increased, as noticeably demonstrated by the ratings of the City of Dakar (investment grade) in comparison with that of the Ivorien capital of Abidjan.⁴⁹ According to Babacar Thioye Ba, legal advisor to the mayor of the City of Dakar, “the City of Dakar recognized that, at the start of this [municipal bond issuance] process, it would need to change its approach from ‘business as usual’ and instead learn to be more transparent in its decision-making and activities. This shift in mentality was particularly important for the activities of the City’s Financial and Administrative Department, and required a redoubling of the City’s commitment to the efficiency of its human capital.”⁵⁰ Dieynaba Thiam Ka, administrator for the DFMP, observed that the “municipal bond was an impetus for change in the City” and that the “opportunity to diversify the City’s funding sources came at an opportune time when loans from development finance institutions and commercial banks were insufficient to meet the funding demands of the City”. Additionally, she observed that “launching a bond requires a long-term municipal strategic plan and ... it requires

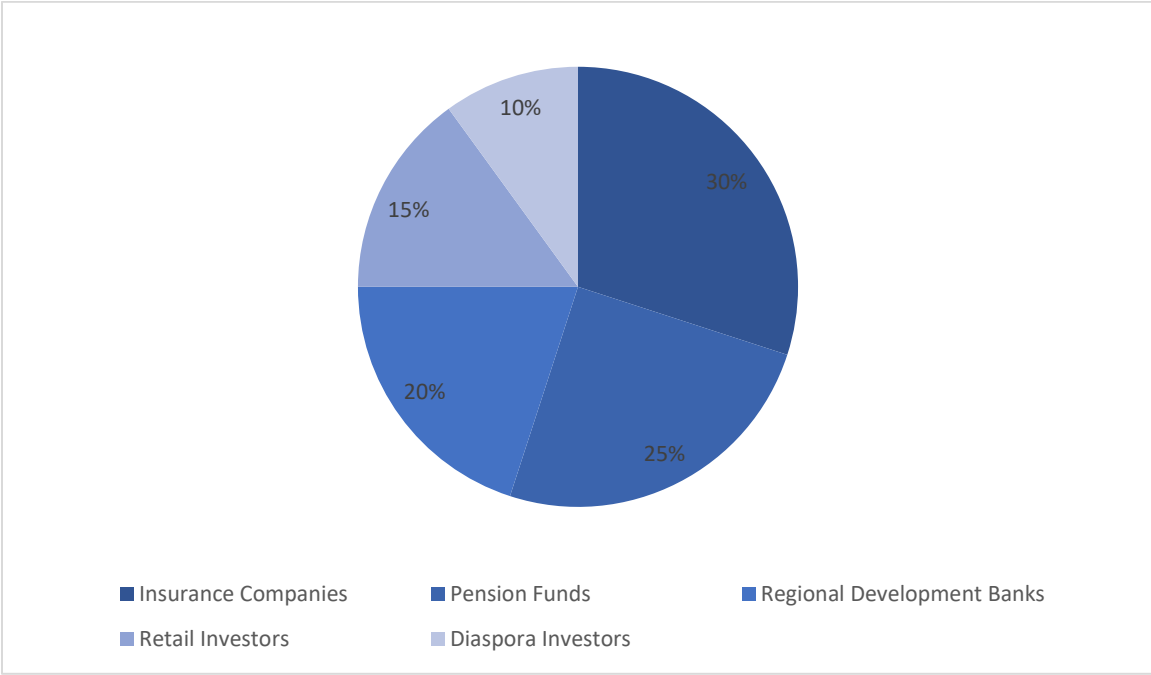
⁴⁹ Tonga, J. 2013, 2014, 2015. *Rating for Dakar; Rating for Abidjan (Plateau)*, <http://www.bloomfield-investment.com/credit-rating/?lang=en>, accessed June 2017.

⁵⁰ Interview with Babacar Thioye Ba, 10 August 2017, Dakar, Senegal.

coordination between many of the City’s departments, including administration, finance, planning, urban development and communication. The DFMP’s legacy is apparent beyond the transaction itself.”⁵¹

Designed for full accessibility to retail investors, the Dakar bond’s minimum increment was CFA franc 10,000 (or approximately USD 18). Large institutional investors had the option, however, of placing a large order at the time of subscription; this asset class, based on pledges to purchase from these investors (also known as soft orders), made up approximately 72% of the total demand for the transaction on the eve of issuance (Figure 5.7) (Forster 2015). Marie Odile Sene, managing director of CGF Bourse (the transaction arranger), explained that there was “significant investor appetite for the transaction” because of the “relative lack of fixed-income instruments available in CFA franc for institutional investors”. This pent-up demand in the market, coupled with the guarantee from USAID and the international aid community’s commitment to Dakar, “made the transaction of strong interest for many local pension funds and insurance companies”.⁵²

Figure 5.7: Expected distribution of Dakar’s municipal bonds in the primary issuance, according to CGF Bourse, syndicate lead for bond issuance



Source: Interview with Marie-Odile Sene, managing director of CGF Bourse, 21 August 2017.

According to the filing with the local market regulator (the CREPMF), the City planned to use the funds

⁵¹ Interview with Dieynaba Thiam Ka, 21 August 2017, Dakar, Senegal.

⁵² Interview with Marie-Odile Sene, 21 August 2017, Dakar, Senegal.

raised from the bond issuance for the installation of a new marketplace, with stalls and kiosks offered for rent at subsidized rates to provide a wider range of opportunities to the city's many street vendors.⁵³ Approximately 25% of the funds would be spent on the acquisition of the centrally located parcel of land (already demonstrated to be under contract to the City) with the remaining 75% used for the design and construction of the physical marketplace.

The failure of Dakar's municipal bond

Unfortunately, the City of Dakar ultimately did not launch its bond in 2014 as originally planned, because of a last-minute intervention by the central government.⁵⁴ This unexpected challenge, based first on questions of constitutionality and later amended to reflect concerns about the impact of the bond on the country's overall level of indebtedness, derailed the entire process (Forster 2015). External agencies like the World Bank, USAID, and the Bill and Melinda Gates Foundation immediately sprang into action, attempting to negotiate an outcome whereby the City could proceed with its proposed bond issuance while still allowing the national government to save face on its initial opposition.⁵⁵ When these talks did not end in an agreement between all interested stakeholders, the City filed a lawsuit against the central government in the country's Supreme Court. The case, which was repeatedly delayed until finally heard by the adjudicating bench, found in favor of the central government, placing an indefinite hold on the prospective bond launch.

Although the City was unsuccessful in overturning the central government's opposition to the bond issuance, the situation has left the door open for future attempts to introduce municipal bonds in Senegal (Neureiter & Jordan 2017). Some claim that a new attempt, with even more integration of national government stakeholders, would be more successful, if only because of the fact that a "joint effort between national and sub-national leaders would be difficult to derail".⁵⁶ Others, including some of the mayor's top advisors involved in the transaction from the municipal side, are less circumspect, insisting that "Dakar's failure to launch a municipal bond was not a function of poor underlying financial fundamentals but instead

⁵³ Filing of City of Dakar with CREPMF, submitted in August 2013. Accessed, from CREPMF, in June 2017.

⁵⁴ City of Dakar. "*Financement des Collectives Locales: Khalifa Sall Preconise L'Emprunt Obligatoire*". <http://villededakar.org/pages/financement-des-collectivit%C3%A9s-locales-khalifa-sall-pr%C3%A9conise-l%E2%80%99emprunt-obligatoire>, accessed August 2018.

⁵⁵ Interviews with Dieynaba Thiam Ka, administrator for the DMFP, 14 August 2017, Dakar, Senegal; Dieynaba Dabo Mbaye, DMFP Coordinator, June 2017, Dakar, Senegal; Rokhaya Sarr, Department of Planning and Sustainable Development for the City of Dakar, January 2017, Dakar, Senegal.

⁵⁶ Interview with Christel Alvergne, United Nations Capital Development Fund, 15 August 2016, New York, United States.

driven by fear of Dakar’s mayor as a potential challenger for the presidency”. One of the advisors further shared that “the failure of the bond to launch is not only a problem for Mayor Khalifa Sall and his political allies to introduce a new financing tool,” but is a “blow for the intended beneficiaries: poor street vendors who looked at the creation of a new, less expensive marketplace as an opportunity for a new life”.⁵⁷

Interestingly, the outcome of the aborted bond launch, coupled with other issues, had a surprising impact on the political trajectory of the mayor of the City of Dakar. With this failed launch as his banner, the mayor was simultaneously imprisoned on charges of embezzlement of public funds and elected to the national legislature, showing overwhelming support from his constituency even in the face of discord with the presidency.⁵⁸ The local passion for the mayor, both personally and in his role as the face of the city, was further demonstrated by the previously mentioned overwhelming success of his bid for re-election in 2016 against a nominee hand-picked by the president. The mayor’s conviction and sentencing to a five-year prison term has been rejected by his supporters due to a lack of evidence, with many claiming that this is yet another attempt by the national government to thwart Khalifa Sall’s efforts to be elected president.⁵⁹

The City of Dakar’s experience is perhaps the best exemplar of the immediate and negative consequences of the political friction between national and sub-national government, particularly when there are presidential aspirations involved. However, to argue that the sole motivation for the decision to block a successful municipal bond issuance is political and first-person would ignore the framework of decision-making in a francophone country. Effectively, regardless of the desire to maintain a firm grip on the presidency, Macky Sall would have been unable to reasonably object to the transaction attempted by the City of Dakar were it not for the underlying expectations of Senegalese society which, as a francophone country with a strong French centralist tradition, favors a top-down approach to governance. As is the case in most unitary states, despite the level of localized grumbling, the expectation is that power will be concentrated in the hands of the ruling elite in the presidential palace.

Conclusion

Beyond the question of the issuance of a municipal bond in the City of Dakar, the failure of a bond launch in Dakar sets back potential bond issuances by other primary cities across francophone West Africa. This

⁵⁷ Interview with Babacar Thioye Ba, Legal Advisor to the Mayor, 10 August 2017, Dakar, Senegal.

⁵⁸ Christensen, S., “Corruption Trial Underway for Ambitious Dakar Mayor.” *VOA News*, 25 January 2018. <https://www.voanews.com/a/corruption-trial-dakar-mayor/4224851.html>, accessed March 2018.

⁵⁹ Musiyi, V., “Senegalese MP in Detention Over ‘Scathing’ Remarks on Judges in Khalifa Sall Case.” *AfricaNews with Agence France Presse*, 31 March 2018. <http://www.africanews.com/2018/03/31/senegalese-mp-in-detention-over-scathing-remarks-on-judges-in-khalifa-sall-case/>, accessed April 2018.

is driven by two preponderant circumstances: (1) there are high barriers to entry for cities that would consider bond issuance that are often difficult to incorporate into already strapped municipal budgets, for example the need to demonstrate creditworthiness through transparency and credit ratings, and the engagement of long-term institutional investors; and (2) the failure of Dakar to launch a municipal bond, even with the support of well-endowed global foundations and bilateral aid agencies, scares off future charitable contributions or undermines the political self-direction and imperative from within cities to financially program such transactions. The result is that the leadership in cities, particularly those that are driven by sensitivity to political pressure and fearful of repercussions from experimentation with non-traditional financial instruments, are likely to opt to rely on transfers from central government, and occasional loans at concessionary rates from development finance institutions or at market rates from commercial banks. In this way, the prevailing attitude that runs contrary to decentralization continues to triumph over most innovations that rely on sub-national autonomy stemming from financial decentralization. The following chapter, which focuses on Kampala's attempts to issue a bond, tracks a different path followed by that City, driven primarily by the national government's alternative approach to municipal leadership (i.e., co-rule by an elected mayor and an appointed City manager), but with a very similar outcome to that in Dakar (Gorelick 2018).

Chapter 6: Efforts in Kampala

Having explored the situation in Dakar, and understanding the interplay between national politics and municipal finance in the Senegalese context, the thesis now moves on to a similar consideration of Kampala and its placement within Uganda. Although this chapter will underscore the striking similarities between Dakar and Kampala in terms of the overarching theme of the municipality's inability to issue a municipal bond, due to the conflicted relationship between the national and sub-national government as well as each City's commitment to, and demonstrated results in, increasing its own-source revenue since the recent devolution of power, it will also show that there are differences between the experiences in Senegal and Uganda, and examine the way in which these differences have manifested themselves. What the Ugandan case reveals that is distinctive is the particularly challenging interplay between the national and sub-national government when there is power-sharing at the municipal leadership level between an appointed City manager and an elected mayor. Unlike the situation in Senegal, this dynamic creates an opportunity for tacit approval of innovations like a municipal bond, but only when there is accord between the elected and appointed individuals filling the positions accompanied by a direct endorsement from the appointing body, the office of the president.

As in the case of the previous chapter, this one begins with a consideration of Uganda as a nation-state, reviewing its history from the pre-colonial era through to the modern one, with a particular focus on the progress made towards decentralization. Following this review, the chapter moves on to a review of the country's financial status and activities in the capital markets, highlighting the fact that investors are comfortable with Ugandan debt and that the country itself is poised for continued economic growth due to the discovery of fossil fuels in the north. Next, the chapter considers the financial performance of Kampala itself, particularly in the handful of years since the creation of the Kampala Capital City Authority (KCCA) but with a sidebar on the City's default on its indirect loan from the World Bank (via the national government), which stands in stark contrast to Dakar's financial performance and diligence in honoring its debts. The chapter concludes with a close examination of the municipal bond considered by the KCCA and how the concept of such a transaction has impacted the unique power-sharing arrangement established within Uganda's capital City.

Contextualizing the Ugandan nation-state and its uneasy attempts at decentralization

During the pre-colonial era, the concept of “Uganda” did not exist; like much of sub-Saharan Africa, the borders of present-day Uganda were imposed by colonizers for better territorial management and maximization of resource extraction. The territory that is now Uganda encompassed pieces of three different kingdoms: the Hima (a highly hierarchical society with power concentrated in the western parts of the country, extending into the neighboring lands of present-day Burundi and Rwanda), the Bito (a more egalitarian society dominated by nepotism in the granting of power over “sub-sovereign” districts) and the Buganda. The inhabitants of Buganda, who controlled the area where Kampala is now located, and were the direct antecedents of the society in place at the time of European colonization, organized their society under a centralized kingship and, from their capital on the northern shores of Lake Victoria, were able to participate in the burgeoning cultural development fostered by their relative isolation (Bandyopadhyay & Green 2016; Stephens 2009).

The presence of a highly centralized state with a strong monarch made the transition to colonial status far less traumatic for most of the population located in what is now Uganda than in other parts of sub-Saharan Africa, and there were only limited instances of resistance to the growing European presence (Reid 2002). In 1888, for example, when a new ruler (Mwanga) attempted to halt the foreign ideologies that he perceived as a threat, he was quickly deposed by internal factions more sympathetic to the British and the French (Byrnes 1990). Instead, threats to the kingdom were internal in nature, and driven by religious civil war between Protestants, Catholics and Muslims.

When British colonizers eventually assumed control of the so-called “Uganda Protectorate” in 1900, they did so with the expressed intention of reliance on local, native leaders: a perfect example of the policy of indirect rule. Again, and in contrast with the French example of assimilation explored in the case study of Dakar in the previous chapter, the continued prevalence of local leaders who maintained control over smaller sub-Protectorate areas laid the foundation for decentralization of power to sub-national levels of government. By the time power was handed over to an African successor government in 1962, Uganda had become a patchwork of district administrations, sub-divided into counties and consolidated into provinces. The entity as a whole was administered, as it had been from the inception of the British Protectorate, from a capital situated at Entebbe on the northern shore of Lake Victoria, or by departments with headquarters situated 20 miles further inland at Kampala (Hansen & Twaddle 1998).

The ongoing presence of lower levels of government during the colonial era, and the Protectorate’s

attendant self-governance to a significant extent, created the impetus for the post-colonial struggle for decentralization that affected Uganda during the second half of the 20th century. From independence through the early 1980s, the country was dominated by a military dictatorship that allowed for no dissent and only limited, non-democratic sub-national powers; the military regime of Idi Amin (1971–1979) dissolved district and urban administrations and, in their place, established provincial administrations led by governors, most of whom were high-ranking military officials (Dauda 2006). As a result of these experiences with totalitarian regimes, the Ugandan government introduced a new Constitution in the mid-1990s which incorporated a clear delineation of power to sub-national governments. Curiously, in comparison with the previously discussed examples of decentralization during the same era in Senegal and South Africa, power shifts in Uganda occurred more comfortably between the national government and the secondary cities of Jinja and Entebbe than with the primary City of Kampala. This was primarily due to the fact that there were longstanding rivalries among the political stakeholders: the Buganda kingdom (which continues to play a pivotal role in the urban politics and policies of Kampala to this day), the president, and other elites. This would later manifest itself in the development of the guiding principles for the KCCA, and, in particular, the debt limits accorded to Kampala relative to its peer sub-national entities as described below (Gore & Muwanga 2014). Two particularly important pieces of legislation stemming from that era which enshrine decentralization and ensure a formalization of the use of land within an urban area are:

1. The 1997 Local Government Act, which defined the structure of local governments, as well as the powers and functions devolved to them. Later amendments have increased the extent of devolution and aimed to provide for implementation of decentralization.
2. The 1998 Land Act, which established legal provision over ownership and management of land. Regarding urban development, the Land Act established that once urban land has been zoned and a plan becomes law, registered landowners have to conform to approved plans (UN-Habitat 2016).

Both of the above pieces of legislation paved the way for the creation of the KCCA and the concept of additional decentralization of power to actors at the sub-national level. In fact, Uganda's decentralization policy, as laid out in the 1995 Constitution and the 1997 Local Government Act, placed it among Africa's most decentralized countries (Dickovick 2005; Ndegwa 2002). However, while a number of legal and policy powers have been devolved, revenue raising remains dominated by central government. As a result, local governments rely upon the center for 80% of their funding – this comes largely in the form of multiple conditional transfers channeled by the center to specific policy areas. In contrast, own-source revenue accounts for less than 10% of local government funds. As municipal borrowing is capped at 25% of own-source revenues by Ugandan law, low local revenue generation restricts the ability of local governments to

raise finance through borrowing (World Bank 2016).

The large number of conditional transfers created a substantial administrative burden for local governments – the conditions of each funding stream adding to the complexity of reporting processes and funding formulae (World Bank 2016). In 2002, the Fiscal Decentralization Strategy (FDS) was adopted with the aim of giving local government greater autonomy and accountability by simplifying the transfer system. Implementation of the FDS was initially limited; however, since 2015 there has been a renewed focus on it. This has included reducing the number of transfers to 20, and giving local policy-makers greater flexibility in how grants are spent. Plans are in place to build on this success by further improving the efficiency of the transfer system (World Bank 2016). However, there are still significant challenges to be dealt with in resolving the ongoing debate over how much autonomy local governments across Uganda should enjoy, both politically and financially (Green 2015; Kiwanuka 2013). The World Bank describes what the next stage might include, explaining in its conceptualization of its support to local governments that the next stage of the reform launched in 2016, which focuses on reducing horizontal inequalities and enhancing the efficiency of the transfer systems, includes some innovations intended to streamline processes. This includes the introduction of the Straight Through Process, which aims to speed up the allocation of grants that finance development spending; these grants can currently take up to six weeks to process. However, there remain some issues with the government's capacity to implement the FDS. Currently, one of the key issues with fiscal transfers is that, under this new regime, the focus on spending shifts dramatically from infrastructure to social services, leaving either one or the other of the policy areas with a deficiency in budget. This highlights the fact that the central government is not adequately consulting local governments as to where best money can be spent. In addition, local governments have little control over where they spend their revenue (World Bank 2017). In Jinja, the conditionality on grants and transfers leaves the municipality with only UGX 10 billion (USD 2.8 million) of own source revenue to spend in areas of its choosing, with stipulations as to how the vast majority of the transfer must be spent.

The improved efficiency and flexibility of intergovernmental transfers in Uganda over the last two decades has given local government greater autonomy to finance urban infrastructure. Nevertheless, due to their size and conditional nature, transfers alone cannot meet Uganda's urban infrastructure needs.

In order to meet backlogs and achieve the official and popular aspirations for Kampala, it is clear that local governments must increase their own-source revenue generation, which has led to the argumentation behind the attempt on the part of Uganda's capital City to issue a municipal bond. The debate about the municipal bond must, however, be seen in the context of the wider national fiscal policies and performance. Before considering the municipal bond in relation to Kampala, one must look at the macro-economic environment

and Uganda's financial performance, with the understanding that economic activity in Kampala makes up the majority of Uganda's GDP.

Uganda's financial performance

Uganda typifies an East African country as regards its financial performance on many fronts: it benefits from rapid economic growth, driven in part by its young population, and has predictable inflation patterns. It differs from its neighbors, however, in two key areas: its recent discovery of fossil fuels in the northern part of the country and its highly conservative approach to sovereign debt, which has manifested itself in the country's decision to avoid commercial borrowing in any currency other than the local Ugandan shilling (CNBC Africa 2014). More specifically, Uganda is the only African country that has spoken of the acquisition of Eurobonds⁶⁰ as too risky for countries on the continent. Governor of the Bank of Uganda Emmanuel Mutebile has said:

We should not be complacent about the dangers of big projects built on sovereign debt because it would be unwise for African countries, which will never again get debt relief. From what we are seeing in Ghana, we are not yet ready to issue sovereign bonds.⁶¹

Although the Eurobond market offers a higher diversity of investors and typically larger amounts of money on a particular issuance, the risk inherent in borrowing internationally with revenue generated in local currency creates a worrisome mismatch that the Ugandans have rejected in favor of a more cautious route.

Economic growth in Uganda has been steady and comparable to its peers in the region, but far ahead of global averages.⁶² This can primarily be attributed to the country's effective management of its natural resources, and is an important indicator for investors seeking reliable returns on government fixed-income products. This is a critical consideration when looking at Uganda's national borrowing because, as in the case of Senegal, this can form part of the basis for investment decisions on the part of institutions considering debt issued by sub-national governments in well-performing countries.

Both of these factors are important not only in considerations of national financial matters but also in a review of the likelihood of success in sub-sovereign debt, as they are important indicators of the potential

⁶⁰ Eurobonds are bonds issued in a currency other than the one in which the bond issuer traditionally conducts its work. For example, in this case, a bond issued by the Ugandan government in USD, EUR or GBP would be considered a Eurobond – only a bond issued in UGX would not be considered to be a Eurobond.

⁶¹ Hambayi, T. 2016. "Africa's Ticking Time Bomb: \$35-billion worth of Eurobond debt." *Financial Times*. <https://www.ft.com/content/a5adfb84-cd23-35b8-8e18-df62a38fdf68>, accessed October 2018.

⁶² See <https://tradingeconomics.com/uganda/gdp-growth-annual>, accessed June 2018.

confidence of investors who may purchase municipal bonds.

Uganda has three primary sources of revenue: (1) taxation (central and local), (2) debt financing, and (3) donor funding. While Uganda's current debt levels are manageable (the International Monetary Fund rates the risk of external debt distress as low, and judges that this is not augmented by significant risk from domestic debt), government borrowing is crowding out the private sector – meaning that further reliance on debt finance is not an attractive option (International Monetary Fund 2015). As a result, it is clear that the bulk of the required investment for sustainable urban development must be funded by domestic taxation, including sub-nationally generated revenue sources.

There are a number of different factors which contribute to low tax revenue rates within Uganda. The most important factor is the government's limited ability to identify and register the tax base liable for payments and to then collect taxes from the population. Uganda has significantly increased its total tax revenue in the period from 2011/12 to 2015/16. However, compared to other East African Community countries⁶³, Uganda's tax to GDP ratio is one of the lowest (World Bank 2015). This is largely as a result of Uganda's informal economy, which contributes up to 43% of GDP and employs 91% of the population (World Bank 2012), ultimately constraining the government's ability to collect taxes (Uganda National Planning Authority 2015). To add to this, Uganda has undeveloped tax registries, which increases the risk of tax evasion. As a result, at the start of the 2016/17 financial year, the government enacted the Tax Procedures Code Act which guides and harmonizes the administrative procedures of the current tax laws, hence easing the compliance process for taxpayers (Seatini Uganda 2017). Furthermore, there is often a lack of coordination between central and local governments as to how tax collection is split between levels of government. This is coupled with low staffing, limited funding, low motivation at local government levels and a lack of autonomy of the Uganda Revenue Authority, which results in inefficiencies and a reduction of tax revenue at all levels of government (Seatini Uganda 2017).

Domestic revenue collection in Uganda represents an average of 11.4% of the country's GDP over the last decade.⁶⁴ This figure is slightly lower than those of neighbors Tanzania and Rwanda (12.4% and 13.5% respectively), and below the 12.5% average for middle income countries – a group that Uganda aspires to join.⁶⁵ However, as this revenue is largely raised at the central level through income and corporate taxes, it

⁶³ The East African Community is an intergovernmental organization composed of Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda.

⁶⁴ According to data available at http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?year_high_desc=false, accessed July 2018.

⁶⁵ According to data available at http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?year_high_desc=false, accessed July 2018.

is likely to rise as Uganda's economy develops and more enterprises move into the formal sector.

Revenue collection at a local government level is minimal – meaning that local governments are reliant on central government transfers for around 90% of revenues (World Bank 2015b). However, the methods used to gather revenue at the local level mean that a similar increase in revenue collection at this level requires significant structural changes. Rather than levying a few lucrative taxes, local government revenues in Uganda are raised through an assortment of fees, levies, and taxes that vary across the country; these include local service taxes, trading licenses, property rates, occupation permits, administrative fees (e.g., parking, livestock, and abattoir fees), and the rental of government facilities (World Bank 2015c). On top of this complex picture of a large number of low-value revenue generation measures, local governments are characterized by limited capacity to design and administer taxes and levies. The combination of these two factors results in small local government own-source revenues and in small outgoings per resident of the City.

Local governments seeking to reduce their reliance on central government transfers by increasing their own revenue generation streams face two systemic barriers. First, Uganda's legal framework does not facilitate revenue generation at the local level. A key barrier in this regard is that control over many of the most substantial means of taxation (e.g., general sales tax, income tax) is held by central government, while local governments are left to administer more burdensome revenue sources that require substantial administration costs and deliver lower yields.

Even where local governments are not constrained by the legal framework from implementing revenue-generating measures, a lack of capacity substantially hinders effective administration of taxes. The governance structures surrounding local revenue often lack both coordination and clearly defined functions. As a result, local governance in Uganda's cities is often characterized by weak institutions that are incapable of enforcing existing laws and regulations, let alone implementing and administering new ones.

In addition to facing the challenge of coordinating with external bodies, local governments face substantial internal capacity barriers. For example, it has been estimated that up to one-third of posts within Ugandan local government administrations are vacant (World Bank 2016). This figure illustrates the fact that local governments lack both the personnel to operate effectively and the financial resources to adequately address this capacity gap.

The intergovernmental fiscal transfers that local governments depend on for the vast majority of their income are delivered in a fashion that prevents them from being spent to greatest effect. For example, the large number of separate transfers results in a substantial administrative cost for capacity-constrained local

governments, which have to demonstrate that they are spending transfers in line with central government conditions. This burden is exacerbated by the complex historical processes and formulae on which the distribution of such transfers is based (World Bank 2016). The complexity of the processes of obtaining and demonstrating the use of transfers, as well as the conditional nature of many of them, can inhibit local governments from channeling funding towards locally recognized infrastructure needs.

As part of an analysis of the underlying challenges facing Kampala, politicians recognized that the system needs to be overhauled to ensure proper financial flows that can shore up municipal financing. In an interview in June 2017, District Mayor of Kampala's Nakawa District Ronald Balimwezo shared that "stronger control over financial issues at the local government level is essential for two reasons: (1) to better manage available cash resources to deliver better services to constituents; and (2) to demonstrate to potential lenders and investors that the City is a responsible entity that can be trusted as a custodian of funds received from financial institutions expecting a full return of their funds".⁶⁶ These concerns echo those of politicians in Dakar, and demonstrate a forward-thinking attitude which would be welcomed by sources of finance interested in sub-national governments.

In seeking to borrow, Uganda's cities are hindered by low revenue bases, legal constraints on borrowing, and poor or non-existent credit ratings (Government of Uganda & New Climate Economy Partnership 2016). Significantly, Ugandan law currently restricts Ugandan municipality-level borrowing to 25% of own-source revenues, and this percentage is even lower for the KCCA (Munawwar 2010). Nonetheless, Kampala's leadership is prepared to work within the existing constitutional system in an effort to source the finances required to deliver on the City's long-term development plans and needs.

Understanding Kampala and the development of KCCA

Kampala is Uganda's dominant city: it contains one-third of Uganda's population (Lall et al. 2011), it is the seat of government, and 80% of Ugandan industrial and commercial activity occurs in Kampala (Global Rating Co. 2015). Despite Kampala's size, smaller cities and towns make up a significant proportion of Uganda's growing urban population – 69% of Ugandan urban dwellers live in cities with populations smaller than 500,000 (World Bank 2015c). While Kampala and the broader Entebbe – Kampala – Jinja (E-K-J) corridor are developing rapidly, development is not distributed evenly across the country; 70% of the country's 1,200 manufacturing plants with 5 or more employees are located in the E-K-J corridor. This uneven development is reflected in the infrastructure provision in urban areas of varying sizes: in 2013,

⁶⁶ Interview with Ronald Balimwezo, District Mayor of the Nakawa District in Kampala, June 2017, Kampala, Uganda.

45.8% of Kampalans had access to piped water, compared to 24.2% in other big cities and 10.2% in small towns. This pattern is repeated for access to electricity for lighting (79%, 41.3%, and 24.7% respectively) (Musoke 2016).

Much of Kampala's infrastructure backlog has resulted from years of neglect and under-investment, combined with the rapid growth and urbanization of the population. In addition, prior to the introduction of the Kampala Capital City Authority (KCCA) discussed below, the City was plagued by corruption and maladministration, which severely impacted its ability to deliver services to residents. To stem the erosion, a study was commissioned by the World Bank-sponsored Kampala Institutional and Infrastructural Development Programme in 2009, to investigate ways of corporatizing the management of the City (World Bank n.d.). The recommendations of this study informed development of the legislation known as the Kampala Capital City Authority Act ("the Act"), which Parliament passed in 2010 (Gore & Muwanga 2014). Under Section 4 of the Act, Kampala ceased to be a local government entity, and under Section 3(2) it became a central government entity administered by the central government. In practice, this meant that the central government would have direct authority over Kampala, with the minister in charge of the presidency also being made responsible for the City. Thus, the old Kampala City Council ("KCC") was transformed into the Kampala Capital City Authority ("KCCA or the municipality"). The Act came into effect on 1 March 2011. The key feature of the Act (and the one which provided the impetus to reform the City's operations) was the separation of the political arm of the City from the managerial functions. The political arm of Kampala City, i.e., the KCCA, comprises 34 elected councilors, representing specific electoral districts, special interest groups (such as youth and persons with disabilities) and various professional bodies (architects, medical practitioners, and the legal community). At the helm of the KCCA is the lord mayor, who presides over all KCCA meetings, performs various ceremonial functions and helps formulate strategies and programs for the development of the City. Divisional mayors are also elected to represent the five divisions in Kampala City. Primarily the role of the divisional mayors and elected councilors is to maintain contact with the residents of the electoral area, and thereby gain an understanding of the needs and challenges facing the population, as well as overseeing the impact of programs that have been implemented. Based on these interactions, the councilors can make recommendations and proposals to the KCCA, which can be included in its development plans.

Challenges relating to the reform of Kampala are longstanding, and are driven by a history of poor service delivery, as well as deep-seated tensions and historic frustrations between multiple interests involved in the governance of the City: central government, Kampala politicians and administrators, the Kingdom of Buganda, civil society organizations, and government and business elites based in the City. For example, in 2011 President Yoweri Museveni converted the governance of Kampala from one based on the

conventional structure of a local council and a mayor to the status of a national ministry, headed by a technocrat whose first act was to re-staff the administration (Collier & Venables 2016).

The KCCA's executive director and the deputy executive director are appointed by the president on the recommendation of the Public Service Commission. This ensures independence from the political authority as their positions are not dependent on the councilors or the lord mayor. The administration of the KCCA is split into ten directorates, covering such areas as engineering and technical services, public health and environment, physical planning, legal affairs, treasury, revenue collection and internal audit. For each directorate, a director and deputy director are appointed, under whom a team of managers oversees the various aspects of the City's operations. Through these bodies, the KCCA increased revenue collection in Kampala by 89% between 2010/11 and 2014/15, created a strategic plan outlining a vision of the future of Kampala, and set out the projects required over the next five years to achieve this vision (Global Rating Co. 2015).

As per the Act, the KCCA is responsible for the day-to-day management of the City, as well as its financial wellbeing and strategic direction. Thus, its responsibilities broadly include:

- initiating and formulating policy, setting service delivery standards and monitoring the administration and provision of services;
- enacting legislation for the management of the City;
- constructing and maintaining roads, storm drainage, street lights and other transport infrastructure;
- supporting public institutions such as schools, hospitals, libraries, museums, public parks and the like;
- promoting economic activity within its jurisdiction, including the establishment of slaughterhouses and markets, as well as supervising and licensing street vendors and transport operators;
- regulating and licensing various types of establishments, including bars, clubs, and lodgings.

Although the KCCA has the power to enact legislation, any ordinances passed have to first gain the approval of the attorney general and then be signed off by the lord mayor. The municipality can also institute and collect on certain taxes, fees and charges, but in many cases the tariffs that can be charged are determined by the national government. Nevertheless, the KCCA does have the power to raise and determine certain

fees (including those for utilities and other services), and is actively engaging the national government on tariff rates where increases are deemed appropriate, particularly for businesses. Along with the directorates, the legislation that created the KCCA also created a political system in which there are checks and balances between the will of the people (through popularly elected local politicians) and the desires of the national government (through appointments made directly by the office of the president) (Gore & Muwanga 2014). More specifically, the Act calls for the positions of:

- a lord mayor (Sections 9 – 11), who shall “be elected by universal adult suffrage” to “be the political head of the Capital City”, and “head the Authority in developing strategies and programmes for the development of the Capital City” but also be “answerable to the Minister” from national government responsible for overseeing the City; and
- an executive director (Sections 17 – 19), who shall “be appointed by the President” and serve as the “chief executive”, providing leadership as the “head of the public service in the Authority and to head the administration of the Authority” and to “be responsible for coordination and implementation of national and council policies, laws, regulations, bylaws, programmes and projects”.

This system, initially established to ensure sufficient checks and balances, has instead stymied the City in achieving some of its long-term goals, including fiscal power, as the municipal bond efforts outlined later in this chapter reveal (Lambright 2014). In an interview in June 2017, Kampala-based political advisor Bernard Luyiga shared that “the KCCA was designed more as an effort to curtail Kampala’s autonomy” while “giving a semblance of increased power through the lip service of constitutional change”.⁶⁷

The KCCA and its borrowing capacity

According to Luyiga, one of the “clearest ways to see that the KCCA was created without full power” was through “significant limitations on its power”.⁶⁸ Section 54 of the Act provides the KCCA with specific borrowing powers, stating that “the Authority may, from time to time, with the approval of the Minister, raise loans from financial institutions, by way of debenture, issue of bonds or any other method, in amounts not exceeding ten percent of the locally-generated revenue of the Authority; provided that the Authority demonstrates ability to meet its statutory obligations”. Curiously, and frustratingly for the KCCA, less financially restrictive legislation exists for all local governments in Uganda, which are allowed to borrow and to issue bonds in Ugandan shillings subject to the rules under Section 20 of the Local Government Act

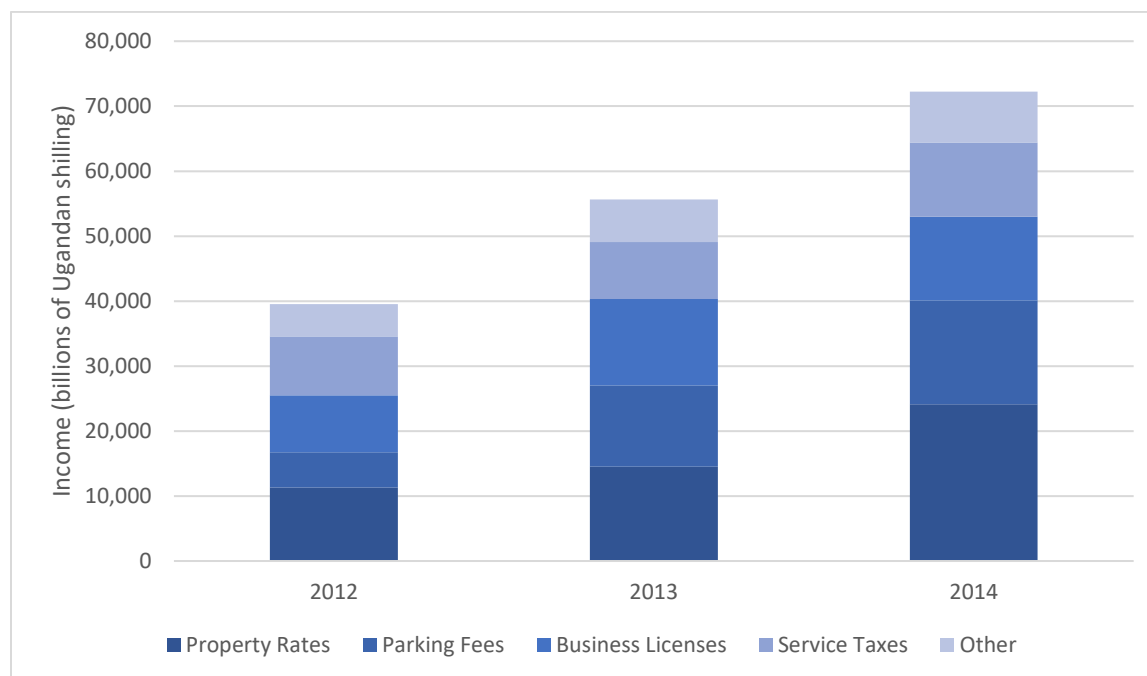
⁶⁷ Interview with Bernard Luyiga, political advisor, June 2017, Kampala, Uganda.

⁶⁸ Interview with Bernard Luyiga, political advisor, June 2017, Kampala, Uganda.

of 1997, and with the approval of both the Ministry of Local Government and the Capital Market Authority. According to KCCA’s Deputy Director for Strategy, Patrick Musoke, this decision is driven by a “fear of losing control, of allowing KCCA to eclipse the national government in its decision-making ability about the future growth and financial needs of the city.”⁶⁹ In terms of this Act, borrowing is allowed by law, but confined to a maximum of 25% of own-source revenues. The 1995 Constitution further commits, in section 197, that “urban authorities shall have autonomy over their financial and planning matters.”⁷⁰

In Kampala, the local own-source revenue situation is markedly different to that in the rest of Uganda. The KCCA raises around 50% of its budget from own-source revenues (World Bank 2015c). This proportionally high scale of revenue has been achieved by substantial investment in the capacity of the Directorate of Revenue Collection, which now operates at a level comparable with that of many developed countries (Kopanyi 2015). Unlike local governments outside Kampala, the KCCA focuses revenue collection on a limited number of sources (namely property taxes and user fees), as shown in Figure 6.1.

Figure 6.1: Sources of income for Kampala Capital City Authority, 2012–2014



Source: Compiled by the author from City Archives, KCCA.

Recognizing the centrality of predictable revenues and collection efficiency, within months of its formation

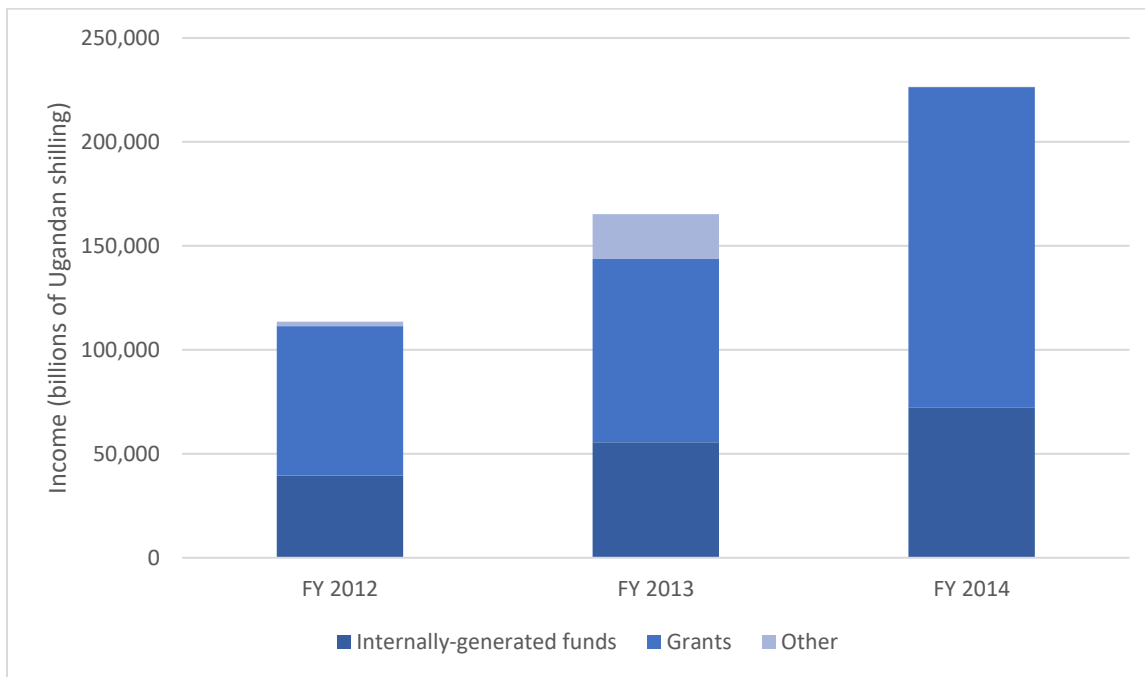
⁶⁹ Interview with Patrick Musoke, KCCA, 3 June 2019 (Kampala, Uganda), and 28 July 2019 (London, England).

⁷⁰ *Constitution of the Republic of Uganda*.

http://www.parliament.go.ug/images/stories/constitution/Constitution_of_Uganda_1995.pdf, accessed in August 2018.

the KCCA designed, validated, and implemented a plan to overhaul the existing system of tax collection. Although there was initial resistance from some of the delinquent taxpayers, revenues have steadily increased from UGX 30 billion (USD 9 million) during the 2010/11 financial year to UGX 81 billion (USD 24 million) in 2015/16; this growth of 89% after inflation in just five years is largely attributable to the current financial stability of the KCCA.⁷¹ Internally generated revenues over the period from 2012 to 2014 have grown dramatically, from UGX 39,523 million in 2012 to UGX 72,222 million in 2014 (Figure 6.2).

Figure 6.2: Total income for Kampala Capital City Authority, 2012–2014



Source: Compiled by the author from City Archives, KCCA.

Figure 6.2 shows the City’s total income, demonstrating an unsustainable percentage of the total coming from grants (averaging around 62% per annum from 2012 through 2014), and the KCCA’s administrative leadership committed to exploring new sources of funding to meet long-term capital investment needs. Table 6.1 shows the results of a corresponding increase in focus on financial sustainability based on own-source revenues, which created an impetus for the City to “look at what the impact might be of a significant capital investment into infrastructure anticipated to generate revenue”, the sort of investment that would be

⁷¹ Taylor, L. “How One African City is Flipping the Script on Urban Development”. *Next City*, 26 July 2016. <https://nextCity.org/features/view/kampala-africa-urban-development>, accessed in July 2018.

“achieved through a financial instrument like a municipal bond”.⁷² As a result of its financial size and governance maturity, Kampala succeeded in obtaining a local credit rating of A– from an external agency, Global Credit Ratings (Global Rating Co. 2015), making borrowing through a municipal bond a potentially viable financing option.

⁷² Interview with Bernard Luyiga, political advisor, June 2017, Kampala, Uganda.

Table 6.1: Financial information, City of Kampala, 2011–2015*

	2010/11	2011/12	2012/13	2013/14	2014/15
Operating revenues	98,836.59	113,589.24	165,187.74	226,494.34	304,192.01
Operating expenses	-86,632.08	-107,889.55	-146,772.36	-224,558.77	-249,442.30
Gross savings	12,204.51	5,699.69	18,415.38	1,935.57	54,749.71
Loan repayments	0	0	0	0	0
Net savings	12,204.51	5,699.69	18,415.38	1,935.57	54,749.71
Appropriations/taxes for the year	0	-11,956.43	16.17	0	-24.42
Year-end surplus/ deficit	12,204.51	-6,256.74	18,431.55	1,935.57	54,725.29

Source: Compiled by the author from Financial Statements, City of Kampala, 2010–2015

Note: * All amounts shown are in Ush thousands.

Simultaneously with the measures designed and implemented to increase own-source revenue, the KCCA leadership carefully reviewed options for financing long-term debt, and ultimately settled on a municipal bond because of the relative length of the repayment period of bonds compared to loans; with a longer period, the City would be able to better manage its financial needs and potentially build in a grace period (similar to that incorporated into the City of Dakar’s proposed issuance).⁷³ The idea of municipal bond issuances in Uganda has been circulated for over ten years, longer even than the existence of the KCCA. In 2007, the Economic Policy Research Centre published a report, “Municipal Bonds for Financing Development of Infrastructure: A Way Forward for KCC and Local Governments in Uganda” (Mayanja & Mayengo 2007), which argued that a municipal bond was the most appropriate instrument for Kampala; ironically, this was published before the KCCA was even established and may have influenced the thinking of all decision-makers on the amount of power and financial autonomy ultimately granted to it.

Unlike the other municipalities or municipal corporations considered in this thesis, the KCCA is the only one that has no self-initiated debt. Since its establishment, the KCCA has not borrowed from any entity, although its accounts show a loan inherited from its predecessor, the City of Kampala. This loan, originated in 1991 for an infrastructure project completed in 2000, represented a portion of a larger transaction between the Republic of Uganda and the World Bank. Although the national government has repaid the World Bank in full for the transaction, the loan between the national and sub-national government has not been satisfied. For some investors, this non-existent credit history for the KCCA (and weak credit history for Kampala) is a concern, as it fails to demonstrate the likelihood or predictability of on-time payments by the KCCA as an issuer in the capital markets. “Investors are usually skittish around virgin municipal bond issuers, and this concern is only heightened when an independent assessment shows that the City only has experience with borrowing on one other instance,” according to Marc Joffe, chief executive officer of Global Credit Ratings. The fact that “the City ultimately defaulted on this loan obligation” only “worsens investor perception of municipal creditworthiness”.⁷⁴

Although the City is optimistic about its ability to raise funds from investors through a bond payment, the constitutional questions on debt limits raised earlier significantly constrain the potential for a successful issuance. To reiterate, current legislation restricts the amount of debt that the KCCA can assume to 10% of internally generated revenue on an annual basis. Therefore, despite the strong growth in internally generated revenue from the inception of the KCCA in 2012, a municipal bond of USD 2.4 million (or 10% of the USD 24 million raised in 2015) is unlikely to be viewed as attractive to the municipality due to the high

⁷³ Interview with Leonard Mathu, Head of Nairobi Office for Lion’s Head Global Partners, June 2016, Nairobi, Kenya.

⁷⁴ Interview with Marc Joffe, chief executive officer for Global Credit Ratings, March 2018, Johannesburg, South Africa.

fixed transaction costs to issue a bond relative to the fees associated with the origination of a bank loan.

The City has not formally progressed with initiating the transaction because of anticipated challenges relating to the constitutional debt limits, and there is thus limited information available on the way in which the proceeds of such a transaction would be used. In an October 2014 interview with the *Daily Monitor*, the Ugandan Capital Markets Authority's spokesperson indicated that he understood that the City planned to "issue a municipal bond to finance infrastructure in the City".⁷⁵ The African Securities Exchange Association similarly reported that the KCCA planned "to issue the country's first municipal bond by June 2015 to finance the infrastructure development needed to change Kampala into a modern commercial hub".⁷⁶ The City's inability to launch its bond has proven particularly frustrating to City leaders, who point to the unfair disadvantage to Kampala of being restricted to an amount of debt that does not exceed 10% of internally generated revenue (compared to the significantly higher debt provisions for all other Ugandan cities, which can borrow up to 25% of their annual revenues), as well as to the strong investor appetite coming from institutional investors like pension funds and insurance companies for this more competitively priced long-dated instrument. Stephen Kaboyo, a financial sector analyst in Kampala, warned in 2014 that there might be a "challenge for KCCA in making a good case that they are in good financial condition and that they have a reliable surplus of revenues over expenditures that can be used to make interest and principal payments".⁷⁷ More troubling is the political power play currently occurring in the City; although not as dire in consequence as the jailing of the Senegalese mayor for a five-year prison term, the City manager is rumored to be at risk of losing her position, due partly to her strong advocacy of the bond issuance. In 2014, Collier and Haas explained that

KCCA is an artificial construct. It was a way for the national government to recentralize power after decades of being impotent relative to other stakeholders (i.e., the decentralized districts, the Kingdom of Buganda, etc.). There have been some positive short-term gains in City efficiency, but at the cost of the popular voice. (Collier & Haas 2014)

⁷⁵ Kulabako, F., "KCCA Finalising Plans for Municipal Bond". *Daily Monitor*, 17 October 2014. <http://www.monitor.co.ug/Business/Markets/KCCA-finalising-plans-for-municipal-bond---official/688606-2489180-m92oc5z/index.html>, accessed July 2018.

⁷⁶ Mwaniki, C., "Kampala Plans \$6 bn bonds issue". *The East African*, 16 October 2014. <http://www.theeastafrican.co.ke/business/Kampala-plans--6-bn-bonds-issue/2560-2488166-8nl6bx/index.html>, accessed July 2018.

⁷⁷ Musoke, R., AllAfrica.com, "KCCA's Bond – Mileage or Mirage?" 8 December 2014. <https://allafrica.com/stories/201412082524.html>, accessed July 2018.

Conclusion

Although the case of Kampala presented in this chapter is different from the case of municipal bond issuance in Dakar discussed in Chapter 5, in terms of the ultimate repercussions for key sub-national government stakeholders in the process the results for the urban population are the same: central government interventions and distrust of the actualization of decentralization have led the City of Kampala to be in a position where it is unable to issue a municipal bond that would unlock additional capital for infrastructure investment. This chapter has demonstrated that there is an overwhelming need for urban infrastructure provision, particularly in an environment where such a large concentration of the population lives in and around the capital city, and that the sole obstacle to municipal bond issuance stems from an inability on the part of the national government to create an appropriate enabling environment.

Taking the case of Dakar together with that of Kampala, it is clear that the challenges to bond issuance in both instances are not a function of municipal capacity or investor appetite, but rather of the political interplay between national and sub-national counterparts, related to decentralization and the devolution of power.

Conclusion

Municipalities in sub-Saharan Africa are currently challenged in their efforts to expand the tools available to raise funds for long-term, capital-intensive investments. Money is needed at the city scale to meet the local expectations of residents, and these challenges place significant limitations on the ability of municipalities to respond effectively to rapid population growth, before even trying to meet the international community's expectations for the global achievement of the United Nations' Sustainable Development Goals. Further, the introduction and subsequent chapters demonstrated that the inability to raise finance through tools like municipal bonds, which are well-suited for long-term, capital-intensive investments, stems not from internal capacity deficits or poor financial management in municipalities, but instead from a critical external factor not under the control of sub-national governments: the discomfort of the national governments with allowing a comprehensive decentralization of power to sub-national governments.

Considering the barriers to sub-national governments' abilities to raise funds for city development and urban infrastructure in greater detail, Section 1 of the thesis began with a review of the early history of cities and the reasons for the development of urban concentrations, manifested through human settlements. Chapter 1 examined the growth of the City within a larger context, acknowledging that there is a constant friction between city-level government and that found at the national scale, often driven by the desire for decision-making accountability at a level where the citizens feel that they can have meaningful impact. For the purposes of this thesis, the most apparent of these frictions were identified as factors in the realm of financial and fiscal decentralization; however, the basis of this ongoing debate centers on questions of power, and on an explicit underlying question of political decentralization. It is for this reason that the opening chapters considered both the monetary and the institutional, politically sensitive sides of the decentralization argument.

As a complement to the discussion of decentralization, and again core to the case studies presented in Section 2, Chapter 2 explored financial instruments available for cities to meet their capital investment needs. Taking a long view of history, the chapter both defined the instruments most commonly available to cities and highlighted the fact that, although initially satisfactory to meet sub-national government needs, traditional tools and mechanisms – including transfers from government, own-source revenue collection, concessionary loans from municipal development funds or development finance institutions, and commercial banks – cannot meet the needs of rapidly growing cities or cities where there is a mismatch between the useful life of capital-intensive assets and the investment horizons for the aforementioned instruments. The chapter argued that, although first piloted in Europe hundreds of years ago, municipal

bonds have had a checkered past, failing to take hold as a well-accepted tool until the early 19th century experiments with municipal finance in the relatively more decentralized United States. Nonetheless, municipal bonds themselves are well-suited to the task of long-term, capital-intensive investments as required by sub-national governments.

To provide a fully comprehensive view of sub-national finance in Africa, with a pronounced emphasis on municipal bonds in the sub-Saharan context, Chapter 3 reviewed the political dimensions of the development of the African nation-state, considering examples from the pre-colonial period, the colonial era, and the modern, post-colonial period. In all instances, it was argued, the experiences of states in Africa are not necessarily unique; rather, they are simply progressing at a different pace from peers in the global north or elsewhere in the global south. The often-cited example of the comparative performance of South Korea and Ghana in regard to GDP levels in 1957 and 1987 is a perfect case in point: Ghana's per capita GDP in 1957 was USD 490 and, 30 years later had fallen to USD 481, while South Korea's per capita GDP rose from USD 491 in 1957 to USD 4,832 in 1987 (Werlin 1991). While many insist that this difference can be attributed in part to external challenges, the differing approaches to development and decentralization adopted by the two countries further support the argument that the finance required for necessary urban infrastructure development in sub-Saharan Africa will not be obtained without the creation of additional opportunities for capital-raising, through instruments that depend on a greater degree of autonomy at the sub-national level.

Section 2 of the thesis explored the interplay of the thematic concerns set out in Section 1 in greater detail, using the case studies of the cities of Dakar, Senegal, and Kampala, Uganda, as exemplars of the challenges that incomplete decentralization can introduce into visionary cities which have exhausted the finances available to them from other, more traditional sources. While the experiences in the two cities differ, the end result in both has been the same: failure to allow for full decentralization, driven by a wariness of the loss of power, has led to situations in which the municipalities have invested considerable time and resources to attract financial capital, only to have transactions halted by the national government. Responding to the concept of citizen engagement, City leadership in both Dakar and Kampala has committed to consensus-building with the entire population, which, coupled with internal capacity-building, demonstrates an ability to effectively manage debt. Curiously, and in line with the second thematic area of municipal finance considered in the thesis, the expression of interest coming from potential purchasers of bonds remains consistent; this is driven by the understanding that, in both cases, the cities have well-considered master development plans from which the projects to be undertaken, which themselves are financially sustainable, have been selected. The experiences in these two case study cities that have not yet issued municipal bonds – Dakar and Kampala – as well as the counter-examples discussed

in Chapter 4 of cities that have done so – Douala and Johannesburg – strengthen the argument made in Chapter 3 in regard to the third thematic area: namely, that the uniqueness of the African context is relevant only for the level of development and decentralization across a longer spectrum of time, not for anything inherently exceptional about sub-Saharan Africa.

The central argument of the thesis itself – that sub-Saharan African cities are being unnecessarily constrained from raising funds for long-term, capital-intensive investment projects due to national government limits on decentralization – has merit for at least three types of scholars: those interested in (1) the incomplete devolution of power and its impacts, (2) the ability of municipal bonds to finance urban infrastructure, and (3) the relevance of decentralization and finance within the context of African exceptionalism.

For scholars interested in devolution, a review of the examples of both Senegal and Uganda will demonstrate that incomplete decentralization leads to the development of a non-sustainable handicap through which cities feel that they are constitutionally and institutionally prevented from undertaking some of the most valid forms of financial capital-raising. Contrasted with the two countries at opposite ends of the spectrum – South Africa, where full decentralization and a commitment to non-interference have occurred, and Cameroon, where extremely limited decentralization has triumphed and cities are fully controlled by the central government – this analysis underpins the need for governments to take decisive action on decentralization and adhere to their approaches.

Scholars interested in municipal bonds who consider the cases of Senegal and Uganda are likely to be more satisfied with the findings because (1) these cities have recognized the need to expand their tools for raising finance for urban infrastructure to encompass municipal bonds; and (2) institutional investors are eager to invest in long-term City debt. For most academics interested in finance, this is not a surprise: there is a distinct lack of local currency-denominated fixed-income instruments available for investors who are mandated to allocate a certain percentage of their portfolio to that sector. This directive, coupled with the fact that cities pay a higher risk premium than national governments due to calculations of inherent additional risk, makes municipal bonds even more attractive.

For Africanists, the argument made by this thesis is likely to be unsettling: it undermines the argument of African exceptionalism and instead simply highlights the fact that sub-Saharan Africa is at a different point on the decentralization and sub-national finance trajectory than other parts of the world. This realization does not come with an insistence to increase the pace of decentralization or to be more accepting of municipal bonds; it does, however, show that the failure to incorporate municipal bonds into their range of available financial instruments or to achieve complete decentralization will limit the ability of cities to raise

additional finance for their own urban infrastructure projects, which in turn will weaken these hubs of finance and employment opportunities for governments that are struggling to meet the needs of their populations.

This thesis has been crafted to fill a lacuna in the academic literature around municipal bond issuance in sub-Saharan Africa. Building from, and occasionally rebutting, the generally-held perception that the reason why cities have been unable to access financing for their urban infrastructure projects based on capacity issues and poor financial management, this thesis demonstrates that a select number of Cities are fully prepared and ready to issue municipal bonds. Reflecting on the questions introduced in the introductory chapter, this thesis has reviewed and answered each item:

- 1) What are the reasons why bonds are appropriate tools for municipal leaders to use in financing their urban infrastructure needs? How do bonds differ from other tools and instruments that Cities have used, and continue to use, today?
- 2) Why have there been so few successful (i.e., closed) municipal bond issuances in sub-Saharan Africa? Is it due to internal factors, such as a lack of capacity at the municipal level to demonstrate financial responsibility and/or to launch a complex instrument, or is it driven by external factors, such as incomplete decentralization?
- 3) How, and what, does the experience of municipal bond finance add to our understanding of intergovernmental politics in sub-Saharan Africa?

By framing the answers to these questions from a theoretical perspective grounded in the realities of municipal bond issuance on the ground, this thesis introduces a fresh approach to academic consideration of the issue. Equally important, as stated above, it bridges the gap between the interests of economists and financiers with those of political economists and policy advisors.

A Final Word of Caution

There is no guarantee that municipal bonds will work in every instance and, in the cases of some of sub-Saharan Africa's least developed countries, may never be attempted due to financial instability, political immaturity, and the presence of concessionary-rate lending from DFIs. However, for Cities in countries that are no longer eligible for the most concessional financing available and have begun to borrow at market rates, municipal bonds represent one of the ways for Cities to access finance for infrastructure projects at more competitive rates and over longer terms than those offered by other sources of funds.

The entire discussion on the need for municipal bonds needs to be placed into a broader context, though – one that addresses questions of political economy as well as financial need and readiness. This thesis has argued that municipal bonds are appropriate for funding long-term, capital-intensive investments in urban infrastructure where Cities have demonstrated their financial preparedness. However, the stumbling block of intergovernmental politics, between national and-subnational levels, has limited the use of municipal bonds. Therefore, the thesis could have additional value beyond the academic world for decision-makers themselves, whether at the national or sub-national level. Learning from the experiences and efforts of sub-national governments, and drawing from the arguments set forth in this thesis, policy-makers and politicians may find that there are ways in which collective efforts to collaborate can lead to a more reliable flow of funds for critical urban infrastructure projects, which can all positively impact the achievement and maintenance of political and financial sustainability.

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