MUNICIPAL FINANCE IN DEVELOPING COUNTRIES:
THE NEXT FRONTIER

The Experience of Santa Fe de Bogotá, Colombia

by

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In common with other Latin American countries, Colombia is experiencing an important process of political and fiscal decentralization. Direct election of territorial and subsoverign authorities at the department and municipal level and the growing participation of local governments in fiscal decision making are redefining the flows of participation, accountability and funds. This process helps advance structural reforms through which territorial governments and, most importantly, large and medium-sized cities are acquiring a growing importance in their relationship with the citizenry and in economic growth.

The case of Bogotá, capital of Colombia, during the period 1995 to 1997 offers a clear example of the effects of decentralization. Of particular relevance are fiscal achievements, indicating the possibilities for financing development which open up once a subsoverign government has a certain level of autonomy and independence.

The Reform in Bogotá

Although the direct election of mayors and partial fiscal decentralization have been in place since the 1980s, it was the constitutional reform of 1991 that created the conditions for economic and institutional transformation of the city. The reform helped redefine the legal status of the city, conferring on the Capital District powers equal to those assigned to the Departments. As part of the first reform phase, in 1993 the Decree-Law 1421 introduced the *Estatuto Orgánico* (organic statute or charter) which established the city as an autonomous district different from other territorial entities and helped reduce the size and outreach of the centralized state.

This law clearly defined the executive and normative responsibilities of the city and eliminated the so-called co-administration which in reality undermined the city’s legitimacy through political cronyism. It also introduced new instruments for administration, budgeting and planning by the city government. Following the establishment of the new statute, it became relatively easy to execute a number of reforms, such as the fusion of the district treasury with the finance department, and the dismantling of some public entities like the district’s urban transport authority.

The second phase of reforms focused on improving social conditions, raising international competitiveness and maintaining macroeconomic stability. Naim (1995) notes that in this phase, momentum has to be created by raising administrative capacities and reforming education, health, justice and security institutions, as well as transforming the civil service, improving tax collection institutions, developing more complex privatizations, and reforming labor legislation. This second part of the reform process is longer, more costly and technically more difficult than the first phase. Political costs can be high since formerly privileged groups, such as public administrators, tend to lose privileges and advantages they traditionally gained through their institutions. They will resist changes; yet, they are indispensable for the management of the state.

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1 In the following, both “city” and “district” will be used interchangeably for Bogotá, with the latter describing its particular political and administrative position among other cities in Colombia but reflecting the same geographical area.
Following the election of Antanas Mockus as mayor of Bogotá in October 1994, the district’s administration wanted to embark on this phase of reforms during the period 1995 to 1997. In style and origin, Mockus represented a new type of politician in the Colombian arena: A former dean of the Universidad Nacional, a philosopher and mathematician with long standing in academia, he was not linked to any traditional party. His unconventional style provoked sharp polemics. Yet, the large number of votes he received in a relatively short electoral campaign, which contrasted sharply to those of his competitors in being innovative and creative, gave him the strong backing required to implement institutional reforms.

A City Searching for a Long-term Financing Strategy

Bogotá has about 7 million inhabitants – 20% of the total population of Colombia - and produces about 25% of the country’s GNP. The city grows by 300,000 new inhabitants every year which was equivalent to an average growth rate of 2.5% from 1993 to 1997, compared to 1.8% for the whole country, putting a lot of pressure on municipal management. Bogotá is Colombia’s administrative and political center and combines municipal and departmental territorial entities, particularly in the areas of education and health. The administration is based on a central unit and 20 local subdivisions.

With the decentralization, particularly from 1994 onward, the city assumed a number of new functions while receiving only part of the necessary resources through transfers. The district government is responsible for all residential services (energy, water, sewage, local telephone, collection and treatment of garbage) as well as other urban services (public safety, recreation, fire, transit management, roads, as well as primary health care and primary education). In other words, the city is responsible for all essential services for economic growth and for improving the living conditions of its inhabitants, particularly those with low incomes.

The city has a number of economic advantages, such as the best education system in the country and economies of scale associated with the expansion of investment in infrastructure (market spillovers, wide range of inputs available and specialized labor supply). However, it also possesses a number of disadvantages resulting from rapid urbanization and fast growth: transport congestion; limited availability of natural resources; uncontrolled rural-to-urban migration which generates additional costs in the provision of public services; and overstaffing of companies providing public services, making municipal administration difficult and affecting the quality and efficiency of services rendered.

Consequently, one of the major tasks of the local authorities is to capture as many benefits as possible from the process of urbanization in order to improve services to the people. A growing population can be translated into a growing tax base. The possibility of mobilizing growing resources depends on the level of control over sources of income as well as on the taxing efforts of the local government. However, the district encounters limits in creating new taxes, and cannot go beyond certain tax limits established by the national government. In addition, level of indebtedness and tariffs for services are controlled by the Ministry of Finance and regulatory commissions, respectively.
These limits, while imposed on all municipalities in the country, are not appropriate for the capital. The city’s Secretaría de Hacienda (Treasurer) notes that “the control over the level of indebtedness is not consistent with the level of decentralization because governments and local companies have acquired the major responsibility for investment in expansion of public services, urban infrastructure, education and health, and have a growing capacity to leverage their revenues given the relatively stable income from tariffs and taxes, and because they receive growing statutory transfers, which improves their credit risk” (1998, p. 16).

Under these limitations and conditionalities, the district administration started to draft its Plan de Desarrollo Formar Ciudad, where for the first time priorities were stated by sector: civic culture, public space, environment, social progress, urban productivity and institutional legitimacy. The financial strategy of the plan not only sought to provide the resources to finance the works and actions defined by the government. It was also aimed at establishing a solid financial structure for the city with diversified funding sources, within legal limits, to support long term investments required by a growing population and increasing international competition imposed on the local economy.


The first important step in setting up a new financial strategy was to increase the city’s income immediately, especially from taxes, and to expand the funding base in the medium and long-term. The strategy was directed at increasing investment and improving its efficiency. Although not explicitly named in the strategy paper, a permanent and systematic evaluation of results was part of the plan to increase transparency for the city’s inhabitants.

Table 1: Formar Ciudad Investment Plan, 1995-1997

<table>
<thead>
<tr>
<th>Objective</th>
<th>US$ million</th>
<th>Completed as of May 1997 (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Safety/Civic Responsibility</td>
<td>182</td>
<td>55</td>
</tr>
<tr>
<td>Environment</td>
<td>429</td>
<td>56</td>
</tr>
<tr>
<td>Public Space</td>
<td>524</td>
<td>60</td>
</tr>
<tr>
<td>Social Welfare</td>
<td>1,363</td>
<td>99</td>
</tr>
<tr>
<td>Urban Infrastructure</td>
<td>1,434</td>
<td>64</td>
</tr>
<tr>
<td>Public Administration Services</td>
<td>1,013</td>
<td>72</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,945</strong></td>
<td><strong>74</strong></td>
</tr>
</tbody>
</table>

Source: Secretaría de Hacienda

The financial strategy was aimed at obtaining around 5.8 billion pesos colombianos (US$5 billion) for investment in 1995-1997 (table 1). This amount was significantly higher - eight times more in current terms, and five times more in constant terms - than under the previous government. Out of the total amount, the city committed itself to contribute about 70% through its own sources, both traditional and new ones, 20% through national funds other than transfers and 10% through the private sector. Including the latter was an absolute novelty in
financing local development. These resources were expected to be generated by privatization, capitalization of state-owned enterprises\(^2\) and similar measures.

The city’s financial strategy was based on four central policies: rationalization of expenditures, rationalization of taxation, building a tax culture and developing new sources of funding. In other words, the policies were directed not only at income and expenses but paid attention to funding and spending the budget, the management of the treasury, and the administrative and procedural aspects of financial management. It included actions to be taken by the public administration as well as by the people themselves, making them co-responsible for the outcome of the strategy, and by the private sector which was invited to improve its capacity to implement public investment projects.

Rationalization of Expenditures

To promote efficiency of investment, the plan adopted austerity criteria for spending on operations, based on the principle “public resources, sacred resources”. The administrative reform included reducing executive functions and strengthening control functions. The excessively high number of public servants had to be cut while at the same time improving the professionalism of functionaries. Efficiency criteria demanded a higher standard of project design and tighter tendering and procurement procedures; improvement in contract management, particularly with regard to maintenance as a fundamental part of the budget; and strengthening planning, programming and implementation as well as control and evaluation systems.

Rationalization of Taxation

It was necessary to adjust the city’s tax structure to make it simpler, more progressive, more universal as well as flexible and effective in its control and coverage. This implied presenting a large package of projects to the city council, including measures such as introducing a surcharge on gasoline and earmarking revenues to finance road work and particularly road maintenance, which were approved. Eliminating a large combination of tax exemptions broadened contributors’ bases. This clearly exposed the client structures of some traditional members of the council, which explains why this authority was not interested in advancing the discussion on this topic. At the same time, a number of measures were introduced to modernize tax administration, improve procedures, and professionalize and systematize the responsible authorities.

Tax Payment Culture

In accordance with the priorities of the Plan Formar Ciudad which emphasize citizen culture, and because of the share of tax income in the city’s financing, it was considered indispensable to build fiscal responsibility and a tax payment culture among Bogotá’s citizens who traditionally are tax evaders. The mood for doing so was favorable. The investment crisis which had excessively reduced basic infrastructure expansion and accelerated the deterioration

\(^2\) Capitalization of state-owned or private companies means that shareholders inject new capital with the objective of improving the financial and productive operation of their company, or assist a company in crisis by augmenting assets and/or reducing liabilities so that the company can continue to operate.
of existing infrastructure, especially transport and roads, primarily resulted from low tax revenues. Inefficiencies in tax administration gave way to widespread tax evasion. Administrative corruption and low investment implementation capacity discouraged contributors even more because no results were visible from paying or from not paying taxes. The administration used the low contributions as an excuse for a low level of investment and its incapacity to respond to citizens’ demands, creating a vicious circle of inaction.

In this context, mayor Mockus created the campaign slogan “everybody puts in, everybody takes out” which suggested that as a first step everybody had to contribute to recover from almost 20 years of stalled investment. Citizens were asked to show patience before they could “take out” and were promised that all new resources would be directed exclusively toward investments.

It was equally important to guarantee transparency in managing resources to counter the arguments of evaders who defended their non-compliance by pointing at corruption, and to strengthen the relationship between citizens and government. Building a tax culture among children and youth was of particular interest, to educate them about the necessity of taxation and to show them the direct connection between contributions and the improvement of living conditions in the city.

New Sources of Financing

Taking into account the structural restrictions limiting further tax increases, but also taking advantage of better tax collection, the administration sought to widen the range of finance for investment. Three sources were considered which previously had not been used or used only to a marginal extent: portfolio investment from the treasury, and funding from the private sector and the international financial system.

Returns on portfolio investment required liquidity in the treasury. This required new resources, given that the concept of this income had not existed previously, because of a permanent deficit in the municipal treasury. It was difficult to convince people of the advantages of such liquidity because both the media and traditional politicians permanently attacked the new administration, accusing them of holding back investable funds which remained in the central bank. This not only led to a profound confusion between the budget and cash income and expenditures but also stigmatized one of the most important indicators when it came to searching for funding. The surplus was a major strength in administrative terms because having liquidity helped avoid problems of corruption associated with the management of accounts receivable. It was also indispensable in building credibility in relationships with contractors and suppliers through timely and compliant payment. Participation of the private sector and the search for financing beyond the national level were both novelties for Colombia.

As a result of Bogotá’s efforts, the financial situation of the city improved substantially (table 2):
Table 2  Revenues and Expenditures, 1992-1996
(US$ millions and percentage of total revenues)

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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>+ Total Revenues</td>
<td>286</td>
<td>340</td>
<td>680</td>
<td>856</td>
<td>1,312</td>
</tr>
<tr>
<td>- Current Expenses</td>
<td>203</td>
<td>227</td>
<td>345</td>
<td>330</td>
<td>391</td>
</tr>
<tr>
<td>- Interest Expense</td>
<td>40</td>
<td>44</td>
<td>64</td>
<td>98</td>
<td>113</td>
</tr>
<tr>
<td>= Current Savings</td>
<td>43</td>
<td>68</td>
<td>271</td>
<td>428</td>
<td>808</td>
</tr>
<tr>
<td>- Investment</td>
<td>116</td>
<td>198</td>
<td>301</td>
<td>502</td>
<td>871</td>
</tr>
<tr>
<td>+ Financing</td>
<td>18</td>
<td>65</td>
<td>81</td>
<td>156</td>
<td>149</td>
</tr>
<tr>
<td>= Budget Balance</td>
<td>-54</td>
<td>-65</td>
<td>-51</td>
<td>-82</td>
<td>-85</td>
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</tbody>
</table>

Source: Secretaria de Hacienda. Note rounding errors.

In 1996, using a different breakdown from that given in table 2, Bogotá received 53% of its total revenues from municipal taxes, 25% from central government transfers, 19% from financial income, and 3% from non-tax revenues. It is important to note that financial income grew substantially over the last years. Municipal taxes mainly consist of an industry and commerce tax, property tax, beer consumption tax, vehicle tax and gasoline tax, making up 97% of locally generated tax revenues. Ninety-three percent of the current savings have been allocated to Formar Ciudad. Investment expenses (extraordinary operating and capital infrastructure spending) accounted for 64%, current expenses for 28% and interest for 8% of total expenses. Of all expenses, current expenses have shown the lowest growth, mainly due to extensive personnel restructuring.

New Sources of Financing Municipal Development

New ways of financing represented a consequence of administrative and fiscal decentralization. The increased capacity to leverage resources, and the necessity of doing so, was also quite significant for the growth of the Colombian capital market and has clearly helped turn around the city’s finances. The diversification of sources of financing helps overcome temporary restrictions due to limited own resources, and reduces the dependency on them while lowering the overall costs of financing.

Bearing in mind these benefits, the district’s government embarked on innovative operations in the national and international capital markets. These operations received favorable recognition by rating agencies. They were also widely perceived as models and analyzed, discussed, improved upon and applied by other territorial entities which began to search for private capital to finance development.

To attract private investment, governments have to be transparent and seriously interested in raising overall living conditions, stimulating economic growth and resolving problems through peaceful decision making. These governments have to be supported by an efficient administrative apparatus which can reliably produce timely and accurate information and solid financial structures.
Firmly believing that the new local government would regard such innovative financing initiatives favorably, in 1995 the district administration decided to expand the range of financial sources of the city, based on the city’s own revenue resources, without national or bank guarantees. Every time the city borrowed in national or international credit markets, a detailed analysis and knowledge of financing requirements and instruments of each market - bank, securities, and others - were necessary, as was information about the financial situation of the city. Bogotá contracted Corfivalle as its financial consultancy firm and relied on a number of banks and other entities as leaders of the various deals, which helped create related skills among the functionaries at the different authorities of the district.

**Local Credit Ratings**

International rating agencies began to operate in Colombia in 1994. Bogotá’s eighth local bond issue was the first to obtain a credit rating. Duff & Phelps de Colombia assigned it an A rating in 1994. Continuing improvement of the city’s financial situation has been reflected in an upgrading from the A obtained in 1994 to A+ in 1995 and AA in 1996. The revision in August 1997 maintained the same level, mainly because of the expected change in administration following the election. The current credit rating is the highest of any territorial entity in the country.

The rating agency has highlighted a number of strengths of the city:

- implementation of the *Estatuto Orgánico* and the plan to rationalize taxes which has augmented the city’s financial resources;
- reduction in operating costs as percentage of total income, from around 50% in 1993 to 27% in 1996;
- programming of investment plans, the level of implementation and the financing of investment through savings which rose from 34% in 1993 to 93% in 1996;
- tax compliance by the city inhabitants which increased taxation revenue by 20% in real terms from 1995 to 1996;
- the debt coverage ratio; and
- excellent administrative management.

**International Credit Ratings**

To enter foreign financial markets in 1996, it was necessary to prepare all the information required by internationally renowned credit rating agencies. Standard & Poor’s conducted an extensive analysis of the financial history of the city, its soundness and future perspectives. The agency analyzed the national and local economy, its behavior, size, tendencies of fiscal management and actual and future financing policies. Following the analysis, the rating agency assigned a BBB- rating to the city, equivalent to Colombia’s sovereign credit rating which is also the sovereign ceiling for any subnational or private entity in the country.³

³ Standard & Poor’s (1996).
The capital district was therefore the first municipality in Latin America, and probably in all developing countries, to receive an investment grade rating according to international standards. This risk qualification - which draws the line between speculative and non-speculative markets, and which on the sovereign level only Chile, Colombia and Uruguay have so far received in Latin America - allows the district access to a large base of institutional investors, to lower interest rates and to better conditions than those of issuers without an investment grade rating.

According to Standard & Poor’s report, the strengths of the district were:

- sound financial behavior, reflected in a healthy surplus from operations and in liquidity (particularly after 1994);
- a reformed tax system which increased the collection of taxes and raised income;
- a moderate level of indebtedness and realistic debt projections; and
- a strong administrative team which implemented control systems and prudent and effective administrative practices.

In 1997 the city sought a second international credit rating to support financing for a project to clean up the Río Bogotá and to prepare a possible operation in the credit market. Bogotá solicited a rating by Duff & Phelps de Colombia, which assigned BBB (investment grade), based on the following strengths:

- conservative fiscal policy and sound financial position;
- manageable levels of indebtedness;
- sound administration;
- significant improvement of finances since 1993;
- increasing revenues;
- control of operational costs;
- conservative debt management; and
- professional management and investment by the treasury.4

Although the city wanted to obtain a third rating by Moody’s, particularly important for bond markets, it was decided to postpone this process until after the new administration decided on its development and financing plan for the period 1998-2000.

The city had hoped to gain access to international bond markets, but on all occasions the government of Colombia perceived this as inconvenient and denied the necessary authorization. However, it did permit access to international loan markets. The reasons behind this are questionable because the city’s access to bond markets abroad would not have presented any competition to the national government’s access, and the advantages of entry into these markets are obvious, particularly with regard to maturities.

Operations in the National Bond Market

The bond market in Colombia is still very underdeveloped. One of the principal restrictions is the regulation of issuing fees on public securities which inhibits improving offerings through the market. The city had issued domestic bonds for several years, but it is only since 1990 that bonds were established as one of the primary sources of debt. After 1995 these issues maintained their relative importance but were subject to significant modifications.

In 1995, Bogotá issued bonds worth US$165 million, the highest amount ever placed by a territorial entity, the first without a bank guarantee, with the longest maturity ever achieved for local issues (a series of 10 years and another of 6 years) and with a credit rating. The issue was backed by a reserve fund created through fiduciary assignment, and by a pledge of the unified property tax (impuesto predial unificado) for 130% of the debt service to bond holders.

The placement was achieved through underwriting and was oversubscribed. As a novelty, the bonds carried coupons reflecting the capital amortization and interest which could be traded independently from the original bond, thereby enabling the bondholder to unbundle the rights derived from the bonds. These modifications were intended to improve their trading in the secondary market.

In 1997, Bogotá issued bonds for a total value of US$70 million and introduced additional changes. The bonds had a bullet maturity without periodic amortization. The maturities of the series – five, seven and ten years – were designed parallel to those of the Colombian treasuries TES (Títulos del Tesoro Nacional) to improve market references. The interest rates included the consumer price index as a parameter; the offer was carried out and administered by DECEVAL (Depósito Central de Valores); and pledges were eliminated so that the credit rating practically acted as the sole guarantee. In addition, the placement was directly made by the district treasury. Successful marketing resulted in large oversubscription and a rate which was only 25 basis points (0.25%) above that offered on national government securities with the same maturity. The total emission was taken up by four Colombian institutional investors.

Operations in the National Loan Market

The internal debt management strategy of the city required modifications in its debt profile, which was characterized by short terms and high interest rates. It was decided to use about US$15 million annually from FINDETER, the national financing institution for territorial development, for projects in social infrastructure, and to renegotiate the bank debt outstanding.

The city government decided that increasing the total amount of internal debt was not an option. First, the restricted size of the bank market does not permit flexible accommodation of the city’s cash flow patterns and requires the government to have contracts with virtually every
bank to cover its financing demands, resulting in administrative complications. Second, the high interest rates, under upward pressure because of growing borrowing, make it very expensive to finance investment. Third, Bogotá would have basically crowded out other regions and municipalities, and also the private sector, from the internal market. Nevertheless, a plan was set up and implemented to prepay and renegotiate the bank debt contracted before 1994, capitalizing on the improved financial situation of the city.

As a result, by mid 1997 around US$100 million of this debt was transformed from an average maturity of five years to eight years and from an average cost of depósitos a término fijo (DTF)\(^5\) +5.17% to DTF +2.38%. Of particular relevance was the negotiation with a partially foreign-owned bank which acquired 43% of the debt and restructured it to 14 years at a rate of DTF +2%. This operation helped improve Bogotá’s debt profile significantly (see table 2).

### Table 3: Bogotá’s Debt Profile, 1992-1997

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<tbody>
<tr>
<td>Debt/Total Revenues (percentage)</td>
<td>86</td>
<td>87</td>
<td>55</td>
<td>47</td>
<td>46</td>
<td>..</td>
</tr>
<tr>
<td>Interest/Operational Savings (percentage)</td>
<td>48</td>
<td>39</td>
<td>19</td>
<td>21</td>
<td>17</td>
<td>..</td>
</tr>
<tr>
<td>Internal Debt (US$ millions)</td>
<td>116</td>
<td>165</td>
<td>251</td>
<td>282</td>
<td>320</td>
<td>286</td>
</tr>
<tr>
<td>External Debt (US$ millions)</td>
<td>131</td>
<td>130</td>
<td>124</td>
<td>124</td>
<td>291</td>
<td>287</td>
</tr>
<tr>
<td><strong>Total Debt (US$ millions)</strong></td>
<td><strong>247</strong></td>
<td><strong>295</strong></td>
<td><strong>375</strong></td>
<td><strong>406</strong></td>
<td><strong>611</strong></td>
<td><strong>573</strong></td>
</tr>
</tbody>
</table>

..: not available at the time of writing  
Source: Secretaria de Hacienda

### Securitization

The Instituto de Desarrollo Urbano (IDU) is responsible for a road infrastructure project - the Avenida Longitudinal de Occidente – with costs of around US$400 million. The project will be carried out with participation from both the private sector and the national government. The latter will provide around US$200 million through future budget claims for the period 1998-2000. Because the project will help connect major arteries of the national road system, the national government has assigned the above amount to buy land for the right-of-way. This is a crucial aspect which has to be resolved before inviting tenders for construction and operation of the road. However, if the resources were delivered over a period of five years, the land acquisition costs would increase with property values generally and from speculation and other side effects.

The decision was taken to sell future budget claims, ceding the rights to collect the claims to an autonomous authority and determining the dates when the resources will be delivered by the government. This securitization process implied a revision of the agreement signed between the national government – via the Instituto Nacional de Vias (INVIAS) – and the capital district

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\(^5\) DTF is the benchmark for financial markets in Colombia, serving the same purpose as US Treasuries or other government bonds in developed financial markets.
via IDU to overcome the obstacles of undetermined dates of funding and in assigning the resources exclusively to buying land.

Once these aspects were resolved, the claims practically converted into IOUs. To cover the liquidity risk associated with delayed payments by the government, the district offered a liquidity guarantee for the 1a and 2a series which received an AAA rating by Duff & Phelps de Colombia. The series 3a and 4a, discounted at nominal value, received AA+ and AA, respectively. Thus, the medium-term flow of around US$200 million was converted into receipts of US$100 million effective very quickly, which certainly helps the implementation of this project.

It should be noted that all of Bogotá’s operations in the national capital market between 1995 and 1997 showed that the risk associated with the district was well accepted, as could be seen in oversubscription and the speed of placement. These operations had positive modernization effects on the national capital market, where only a handful of issuers were of similar financial quality.

**Operations in External Markets**

Between 1980 and 1994, the experience of the city in international markets basically consisted of two loans. A US$120 million loan by the Inter-American Development Bank (IDB) in 1984 was intended to develop major poverty areas in the city (among those Ciudad Bolívar which today has around one million inhabitants). The loan carried a guarantee by the national government. The other loan of US$25 million was received in 1994 from a French supplier to develop a telecommunications project for the metropolitan police.

**The World Bank Loan**

Since the late 1980s, the city had attempted to negotiate a US$65 million World Bank loan for crucial transport projects. Delays in negotiations caused large additional costs to the projects envisaged as well as transport congestion and the deterioration of existing roads. The main reason for the delays were:

- The Bank’s lack of knowledge about municipal clients, which took time to overcome and required legal structures for negotiation and contracting by municipalities;
- The lack of technical and negotiating capacity on the district’s side to counteract the Bank’s slowness, primarily due to inconsistencies in investment programs, projects, and fiscal information within the district, and to resolve differences with the national government, which had to provide a guarantee;
- The unwillingness of the national government to provide a guarantee, which was related to a conflict arising from a loan to the city in the 1970s for which the government had lost the documents.

In January 1995, under the new Mockus administration, the process was close to being resolved regarding the first two points and had entered arbitration to resolve the third one.
Finally, the loan was signed in June 1996, the first one ever between a municipality and the World Bank.

Although the learning from this experience was very productive for both the city and the World Bank, it also clearly demonstrated the limitations of multilateral sources of finance regarding the time required to close a deal and to determine the loan amount. Hence, such funding could not be regarded as a dependable source for annual budgets or even 3-4 year development plans. In addition, the necessity of a national guarantee limited the city’s autonomy and independence in negotiating these loans. Resolving the old dispute showed that the national government was ready to drown the district before giving a hand to resolve critical problems such as transport.

In any case, the benefits derived from obtaining World Bank resources are evident: it imposed a certain rigor on information management and coordination. In practice, this had positive effects on the city administration in that it became familiar with internationally accepted accounting practices, received a transfer of technology, and engaged in capacity building in related areas that spread to others.

**Syndicated Loans**

The first syndicated loan was realized in the second half of 1996 under the leadership of JP Morgan and ING Bank. These leaders were selected through international bidding by a large number of banks for a US$150 million syndicated loan. The winners expressed a lot of optimism, even though the city was an unknown issuer and an unknown type of issuer in this market, a municipality in Latin America. The *International Financing Review* cited the loan as the loan of the year in Latin America in 1996, recognizing its stunning success and the financing opportunities it opened up for cities and banks.

Issuing international bonds was considered critical as part of Bogotá’s financing strategy because it would open the way to tap international institutional investors and to lengthen debt maturities. However, the national government refused to authorize this, and the local government decided to return to the international loan market in 1997. This time, the operation was led by Société Général, Dresdner Bank and IBJ and rated by Standard & Poor’s as well as Duff & Phelps. Initially, the city requested a loan for US$80 million, but because of the excellent conditions offered by the leading banks, it became possible to prepay the previous loan of 1996. The final loan size was US$275 million, to be paid back in four years with a rate of LIBOR + .95, only 30 basis points (0.3%) above the sovereign rate.

The difficulties arising from the Asian financial crisis in the second half of the year virtually shut down the global financial markets for emerging market issuers and inhibited the city from further global operations. Although market conditions deteriorated, the leading banks maintained their offer. In the end, the three banks took equal portions of the loan, expressing their commitment to building business with municipal and other subsovereign clients.

**Other Instruments**
The concession to build the first water treatment plant on the Río Bogotá had been signed in October 1994 but the final financial structure was created under the Mockus administration. The concessionaire is a French company. First efforts to finance the project via local banks were not fruitful because the banks required a guarantee by the Colombian government. The local government resisted this because it feared losing the autonomy just gained. The French company finally invited a US bank to come in.

Chase Bank assumed leadership of the US$100 million bond issue which was privately placed in the US market, primarily with insurance companies, and received an oversubscription twice its original size. As a novelty, this 13-year bond issue carried a partial guarantee from the Inter-American Development Bank (IDB): Series A (US$30 million) with IDB’s guarantee was rated A, and series B (US$70 million), guaranteed by the city, received a BBB rating.

The district added four declarations or covenants that enhanced the contract and were vital to concluding the deal. It also prepared and participated in the road show for the issue (road shows are presentations to potential investors). As final guarantor of the operation, the district created a fund which over a 10 year period would accumulate sufficient resources to back up payments to the concessionaire for treated water. These payments are scheduled to start once the construction is completed at the end of 2000.

Construction by the French-Colombian consortium Bogotana de Aguas began in October 1997. The consortium carries the construction risks and also contributed US$20 million of the total project costs of US$120 million. This phase of the operation has no costs for the city, which starts to pay water tariffs once the plant is operating. The sinking fund created to redeem the bond issue was funded by revenue from a number of environmental projects and will hold an amount almost equal to the cost of construction when construction is completed.

The consortium asked the IDB to provide a partial guarantee for up to US$31.25 million and issued bonds for US$100 million which were bought by five US institutional investors. The IDB participation carried additional benefits. The private sector was able to offer long-term financing because the IDB guarantee covered the risks associated with early termination of the concession. This helped to lock in the financing and is considered a model for future projects in the region.

A similar concession was awarded by Bogotá’s water supply company after competitive bidding in 1997. The objective of the concession was to rehabilitate the Tibitoc water purification plant which was 40 years old and had deteriorated due to financial difficulties blocking new investment. A 20 year concession was granted in exchange for a US$65 million investment to improve the water supply.

Before granting the concession, Bogotá’s water supply company had studied and analyzed experiences in other countries and commissioned technical and financial studies. This process was open for public participation and citizens were invited to contribute suggestions. The bidding companies were required to possess an international quality certification. The winning consortium of Corfivalle, Compagnie Générale Des Eaux and Fanalca, the latter both French, received a BBB rating.

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complied with all legal, technical, operational and financial requirements, and offered a tariff per cubic meter below the ceiling fixed by the administration.

Lessons from the Experience

Bogotá’s access to national and international financial markets depended critically on the local government’s capacity to implement institutional, procedural, administrative, political and fiscal reforms. The legal preconditions, such as the Estatuto Orgánico of 1994, and the constitutional and legal norms regarding administrative and legal decentralization defined the framework for the exercise of this autonomy. Local independence was required to move toward an image of a participatory city for all.

The development plan Formar Ciudad was not just words but the road map for all actors in the period 1995-1997. Follow-up and control instruments systematized periodic reporting of the results of government action. Because the eye of the plan was the civic culture, many of the results can be assessed only over the medium and long-term and depend on continuation under future administrations.

The success in tapping new markets and the participation of the private sector in the funding of companies or concessions show that there is significant scope for subsovereign entities to find financing for their development. The benefits for Colombia apply to the capital district as well as to the country in general by improving the image of the city through international presence. At the domestic level, Bogotá’s operations in the bond market introduced new maturities and conditions.

Even if the limits of the domestic loan market became evident when the demands of a city like Bogotá were put into play, renegotiating old debt helped organize this market and created criteria for the evaluation of territorial quality and subsovereign issuers by the local banks.

Bogotá’s experience also clearly showed the limits of multilateral agencies. While they are potentially suitable for loans supporting long- or medium-term programs, they are not useful sources of finance for annual budgets.

Throughout the process of building and maintaining a presence in financial markets, it is necessary to provide active communication with everyone concerned. These include the banks, rating agencies and bond market makers at both the national and international level, multilateral entities, the media, and especially the citizens. Media campaigns about the city can be very useful. It is critically important to offer high quality information and consistent monitoring and follow-up. This is particularly true once an entity engages rating agencies. Complying or not complying with their standards will have enormous implications for credit quality and thus for the costs of financing through markets.
References


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