

**THEMATIC WORKING GROUP ON SUBNATIONAL FINANCE–
OPEN MEETING SUMMARY
6th September 2023**

LPSA's Thematic Working Group (TWG) on Fiscal Decentralization and Subnational Finance met on September 6, 2023. [Jamie Boex](#), the Executive Director of LPSA commenced the first working group meeting by presenting the background of LPSA. He outlined that the aim of the working group is to keep the community informed about the latest developments on the fiscal aspects of decentralization, covering the four pillars of fiscal decentralization. Boex presented the co-chairs of the [LPSA Subnational Finance Working Group](#), [Titilola Akindeinde](#) (Executive Director, LOGRI), [Gundula Löffler](#) (Research Fellow, ODI) and [Elton Stafa](#) (Senior Expert, NALAS).

Boex then handed over the time to [Astrid Haas](#), who provided an overview of the meeting agenda and presented the main topic and guest speakers of the meeting. Haas highlighted legislation, creditworthiness and the pipeline of projects as the major constraints to municipal borrowing. Sustainable and productive cities and local governments need finance for long term investment. Haas suggested that municipalities should be extremely prudent in terms of the borrowing infrastructure, as well as in terms of how they pay it back.

Gundula Löffler and Astrid Haas presented their research on [Financial Intermediaries for Facilitating Cities' Access to Debt Finance in Africa](#). This study evaluates the diversity and possible influence of financial intermediaries in improving cities' access to debt financing in Africa. Löffler's presentation during the meeting centered around this topic. In addition to facing increasing infrastructure gaps due to urbanization, climate change, and other challenges, many African cities and local governments also lack direct access to financial markets for infrastructure investments. Instead, they rely on intergovernmental transfers or development grants from development partners. Löffler delved into the role financial intermediaries can play in removing the obstacles by facilitating access to loan financing. Financial intermediaries can come in various legal and institutional forms and structures, drawing on various financial sources and offering various financial and non-financial instruments to facilitate borrowing. Löffler emphasized that a broad definition of a financial intermediary is someone who makes it easier for people to access capital investment and finance by providing better data conditions than the market. The research proposes a typology along two main constituting elements: the *institutional setup* of the financial intermediary, including its ownership and legal and organizational structure, and the *sources of financing* it draws on.

[Paul Smoke](#) discussed the issue of commercial borrowing in developing economies, highlighting that many countries use more than necessary transfers and concessional lending, often through sovereign financial arrangements with ministries of finance and special intermediaries. Smoke noted that local governments are not borrowing much but investing a fair amount of the total government investment portfolio, and intergovernmental transfers are a fairly common share of total revenue. Smoke's study of 14 middle income countries found some anomalies, such as those in the green category, where there is very little borrowing compared to others. These countries have fewer functions and smaller fiscal roles in the public sector, and most of the borrowing that goes on is concessional. Smoke suggested that they may have limited access to

development finance due to weak domestic financial sector development, weak sovereign credit ratings, or constraints due to a lack of a national borrowing framework.

Time was then given to [David Painter](#), who emphasized the need to increase the volume of financing available to local governments, particularly through market-based financing. He believes that there are not enough funds in donor communities or national governments for use by cities. He suggested de-emphasizing the phrase "create better than market conditions for debtors" unless it means access or special treatment with lower interest rates or other concessions. Painter also suggested addressing the concession of other credits to attract market-based funders. He focused on creditworthy subnational governments and noted that the financing transaction should be credible. In conclusion, Painter emphasized the importance of expanding financing options for local governments and segments.

The discussion and Q&A session focused on the importance of financial intermediaries in helping local governments access finance and improve their capacity to become effective borrowers. Smoke discussed the idea of building credit worthiness by forcing weaker local governments to take small loans. He suggested linking grants and loans with parts of infrastructure projects financed by a partial loan tied to revenues, as this could help establish creditworthiness. Some subnational financial intermediaries mix grants and loans, but the mix depends on the fiscal state of the local government and the nature of the development project. Smoke noted that the need to separate special financial intermediaries from the government and make them more independent can improve their effectiveness. He also mentioned that borrowing in many countries is mostly domestic, with little evidence of loans in foreign currency.

Löffler discussed the importance of financial intermediaries in helping local governments and cities access finance from financial markets. These intermediaries provide better than market conditions, such as providing guarantees for loans, credit enhancement mechanisms, and technical assistance at a reduced price. These conditions help structure deals financially and prepare projects from a technical standpoint, reducing the cost of investment and debt. However, there is a risk that cities may turn away from going to the private sector entirely due to the crowding out effect. To address this, Loeffler suggested limiting access to these better than market conditions for local governments capable of accessing financial markets directly and creating incentives for them to improve their capacity and become professional borrowers.

In conclusion, financial intermediaries play a crucial role in helping local governments access finance and improve their capacity to become effective borrowers.

Löffler concluded the meeting by expressing gratitude to the speakers. She encouraged participants to visit the LPSA website to learn more about Subnational Finance Working Group's initiatives and join the thematic working groups. Löffler emphasized the importance of sharing experiences, both successes and failures, and invited suggestions for future topics. She announced the next quarterly meeting for the Subnational Finance Working Group on **December 6, 2023 (9:00 EDT/ 14:00 GMT/ 15:00 CET)**.