



**OECD-CHINA WORKSHOP ON ENVIRONMENTAL FINANCING  
Beijing, 21-23 November 2000-11-30**

**Summary of the Discussion**

**Background**

This was the third OECD-China workshop on environment and economic/finance issues; the others were on economic instruments (1996) and environmental taxation (1998). In addition, a workshop on environmental information was held in Beijing in 1999.

The workshop was well-prepared by staff of the Chinese Research Academy of Environmental Sciences (CRAES), an Institute under the State Environmental Protection Agency (SEPA). The CRAES staff prepared several well-researched papers and managed the logistical arrangements very well.

Participation on the Chinese side was broad with representatives from MOFTEC, the Ministry of Construction, State Developing and Planning Commission and Development Research Centre of the State Council and several local authorities (representatives of Finance Departments and Environmental Protection Bureaus from the municipalities of Beijing and Shanghai, as well as Guangdong, Shaanxi, Sichuan, Zhejiang Provinces). Representatives from 16 OECD countries participated (Australia, Canada, Czech Republic, Finland, France, Germany, Hungary, Italy, Japan, Korea, the Netherlands, Norway, Poland, Sweden, Switzerland and the US from the capitals and country embassies in Beijing. Representatives of the banking and private sectors from China and OECD countries also participated in the workshop.

**Main Conclusions**

The workshop was considered particularly timely by the Chinese: reflecting an increasing political priority for environment, environmental finance is slated to rise to about 1.3% of GDP, about \$90 billion, in the 10<sup>th</sup> five-year plan (2001-5). This is up from 0.9% in the 9<sup>th</sup> five-year plan (1996-2000). Meeting these targets will be a significant challenge: the finance targets in the 9<sup>th</sup> five-year plan were far from being achieved; in the context of market reforms, new, more market-based environmental finance mechanisms need to be developed; and there is a continual challenge to ensure that resources are used cost-effectively. Thus, the Chinese authorities were particularly interested to learn from OECD country experience in these areas.

China will need to pay more attention to the policy framework for environmental finance. The Polluter-Pays and User-Pays principles need to be more firmly established as the basis for an environmental finance strategy. This implies stricter enforcement of environmental measures, greater reliance on user fees as well as a more limited and strategic role for public budgets at national and local levels.

The concepts and methods used in analysing environmental finance requirements need to be reformulated. For example, operation and maintenance costs are not integrated into expenditure estimates leading to a significant underestimate of overall finance requirements. This is particularly problematic in sectors like urban water supply and sanitation which was the main focus of attention in the workshop.

Evidence emerged during the workshop that the supply of finance for environmental purposes was not always or necessarily the main bottleneck. For example, a Swedish study indicated that concessioned finance had supported some projects which were not really necessary. An environmental fund supported by the World Bank had experienced difficulty in disbursing its resources. Mechanisms to link supply and demand, and the costs and conditions associated with finance are at least as important as supply mechanisms *per se*.

Currently China relies significantly on external sources of finance; one expert suggested that they might account for almost one-quarter of environmental finance. This is clearly not sustainable and there will need to be greater reliance on domestic sources.

A rudimentary environmental finance strategy was developed by Chinese experts for the workshop. It estimated that the finance gap is about \$2.5 billion. This is probably a significant underestimate in relation to the objectives. But these objectives and associated targets would benefit from a careful review from the perspective of financial feasibility. Thus the Chinese environmental finance strategy would clearly benefit from a more systematic elaboration using concepts and methods developed within OECD.

One of the central issues will be the role of user charges in the water sector. Chinese representatives expressed concern about the affordability and political acceptability of user charges. However, it is difficult to see how a realistic environmental finance strategy could be developed without raising user charges. Currently, charges for water are less than 0.5% of household income, lower than widely-used 4% benchmark of affordability. Further analysis of household-willingness and ability to pay could provide important support for the gradual introduction of user charges, taking account of the needs of poor and vulnerable households.

Financing issues are closely related to institutional arrangements. There seemed to be recognition that the model employed in most OECD countries of corporatised utilities, with clear responsibilities, powers and autonomy to deliver water services with mechanisms to ensure accountability, provide the best model. Such utilities generally integrate responsibilities for water supply and sanitation, which is currently not the case in China. Normally they are financed on the basis of user charges. The establishment of more autonomous water utilities suggests a shift in the government's role from provider of services to regulator of utilities' performance.

The elaboration of a more systematic environmental finance strategy could help access the possible value-added of a national environmental fund in China. Several of the Chinese papers recommended the establishment of such a fund but its rationale and potential value-added was not clear.

There is considerable interest in China in private sector participation in the water sector. Experience with the demonstration project in Chengdu which involved Vivendi in a BOT (Build-Operate-Transfer) project was presented. There is some doubt about whether this project provides a good model, despite the fact that it is moving to the implementation stage. Further analysis of alternative models, and the pre-requisites for their successful implementation, should be carried out.