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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

EAP Task Force

**SIXTH MEETING OF THE
NIS ENVIRONMENTAL FINANCE NETWORK**
8 - 10 July 2002
Warsaw, Poland

SUMMARY RECORD

Secretariat of the EAP Task Force:

Environment Directorate, OECD; 2, rue André-Pascal, 75775 Paris CEDEX 16, France
tel: (33 1) 45 24 81 85; fax: (33 1) 45 24 96 71; e-mail: env.contact@oecd.org; <http://www.oecd.org/env/eap/>

in co-operation with

Regional Environmental Centre for CEE; Ady-Endre út 9-11, 2000 Szentendre, Hungary
tel: (36 26) 311 199; fax: (36 26) 311 294; e-mail: rec-info@rec.org; <http://www.rec.org/>

Sixth Meeting of the NIS Environmental Finance Network

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Summary of the Discussion

I. Session One: Introduction

1. The Sixth Meeting of the NIS Environmental Finance Network¹ was hosted by the Ministry of Environment of Poland and the Polish National Fund for Environmental Protection and Water Management (NFEPWM) and organised under the auspices of the OECD Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe (OECD/EAP Task Force). The meeting was attended by over 60 participants from NIS, OECD and other non-OECD countries (Thailand) (for more information, please see the attached list of participants). The participants included officials from NIS environmental agencies and funds, Ministries of Economy and Finance, experts in the area of environmental finance, NGOs as well as representatives of international organisations (European Commission, the Regional Environmental Centre for CEE, UNDP) and international financing institutions (EBRD), bilateral donors (Austria, Denmark, France, Germany) as well as private sector consultants, active in the NIS region.

2. *Dr. Jerzy Pietrewicz, President of the NFEPWM Board and Mr. Czeslaw Wieckowski, Acting General Director of the Ministry of Environment of Poland and Director of the International Co-operation Department of the Ministry* welcomed the participants and stressed that this meeting presented yet another opportunity for transferring of know-how between Poland and the NIS. *Mr. Grzegorz Peszko, Environmental Finance Team Leader from the OECD/EAP Task Force Secretariat*, presented the structure and the work methods of the OECD/EAP Task Force, emphasising the multi-stakeholder co-operation within the OECD/EAP Task Force framework, based on an NIS ownership of the work products achieved through demonstration projects and in-country specific activities. He introduced the package of tools developed within the Environmental Finance Work Programme, offered for discussion during the two days of the meeting.

II. Session Two: Integrating Environmental Finance into Public Finance - Good Practices of Public Environmental Expenditure Management

3. The main focus of this session was the performance of public environmental expenditure management (PEEM) in the NIS and the experience of other non-NIS countries with PEEM. The potential for financing of environmental investments in the NIS through debt-for-environment/nature swaps was also discussed during this session.

4. Some of the major conclusions emerging from the analytical work on the performance of environmental funds in the NIS, supported by presentations made by *Moldova (Mr. Andrei Isac), Ukraine (Mr. Oleg Litvin and Mr. Maciej Kostrzewa (Polish NFEPWM) and the OECD/EAP Task Force Secretariat (Ms. Nelly Petkova)*, carried out within the OECD/EAP Task Force framework, are the following:

¹ Meetings of the Network (previously known as the NIS Environmental Funds Network) were previously held in Almaty, Kazakhstan in November 1996, in Kiev, Ukraine in December 1997, in Moscow, Russian Federation, in April 1999, in Tashkent, Uzbekistan in March, 2000 and in Yerevan, Armenia in May, 2001.

- In general, the performance of environmental funds in the NIS is very poor - they usually comply with their national legislation but do not meet internationally-recognised standards for public financing institutions;
- There have been attempts to improve the control and transparency of the funds - a trend towards incorporating extra-budgetary environmental funds into state budgets (e.g. Ukraine, Kazakhstan);
- Very few NIS environmental funds manage expenditures (e.g. apply routine project cycle management procedures) - they primarily focus on revenue collection, with very poor results;
- There have been few improvements on the revenue side - new revenue-raising instruments have been introduced to feed the funds (e.g. product charge on imported fuels in Moldova);
- Tax authorities have been involved in the collection of revenue from pollution charges and fines (e.g. Ukraine). Where this has been done, the collection rate has significantly increased;
- The expenditure management side is still highly problematic - although certain elements of the project cycle management have been introduced (e.g. Moldovan National Fund), most funds do not have clear spending strategies and programmes, neither do they have clearly-specified criteria for appraisal of projects and allocation of resources;
- A significant problem for most Funds is the lack of a clear institutional set-up and qualified and professional staff for managing expenditure programmes.

5. **The participants recognised that the Funds system, as it currently exists in the NIS, needs to be reformed** in order to bring these Funds in line with internationally-recognised standards. In this context, the *OECD/EAP Task Force Secretariat* presented the new project on developing a Handbook for Appraising Environmental Projects Financed by Public Funds². The Handbook aims at providing institutions managing public environmental expenditure in the CEE/NIS regions with practical guidance and tools for identification, appraisal, and financing of priority environmental investment projects in the water sector. The Handbook will cover the essential stages of project cycle management - from programming and project appraisal to post-implementation and evaluation procedures. It will be based on the best practices of the most advanced CEE Environmental Funds and OECD subsidy programmes. **The development of the Handbook and the further implementation of the project were endorsed by the Network participants as a necessary and timely tool for improving the management practices of NIS Funds.**

6. Representatives of *Poland (Mr. Piotr Rucinski)*, *Austria (Mr. Gottfried Lamers)* and *Thailand (Mr. Soodsakorn Putho)* presented their countries' experience with PEEM. Discussants from these countries presented different models of public financing, ranging from earmarked pollution charges and fines managed by specialised institutions (environmental funds in Poland) to outsourcing the management of public environmental expenditure to a commercial body (Kommunalkredit³ in Austria). Thailand's experience in establishing an Industrial Environmental Management Fund, under the supervision of the Ministry of Industry, to provide subsidies to industry mainly, proves that integration of environmental concerns into sectoral policies is possible. Thailand's other environmental fund (financing mostly municipal infrastructure projects) is managed by the Ministry of Science, Technology and Environment. These experiences show that although different countries apply different solutions, depending on the specific needs and governance traditions in the country, they should all comply with a set of minimum standards in order to ensure transparency, accountability and efficiency of resource allocation.

7. In this context, the *OECD/EAP Task Force Secretariat (Mr. Grzegorz Peszko)* presented the Good Practices of Public Environmental Expenditure Management in Transition Economies (PEEM).

² At the time of writing this Summary Record the Handbook project has been already launched. For more information, please check the project web-page - <http://www.oecd.org/EN/home/0,,EN-home-499-14-no-no-no-no,00.html>

³ Kommunalkredit of Austria is a bank specialised in communal financing.

These Good Practices outline the framework for integrating environmental financing into sound public finance. They also provide checklists for measuring the performance of public institutions financing environmental projects in terms of environmental effectiveness, fiscal prudence and management efficiency.

8. The Good Practices in PEEM emerge from the empirical and analytical work carried out within the EAP Task Force, OECD and international financing institutions. They are aimed at environmental policy makers in transition economies. They are also meant to facilitate the discussion between environmental authorities and other parts of the government as to the optimal institutional arrangements for managing public resources for environmental protection.

9. During the Working Groups discussion on this topic, participants pointed out that the Good Practices of PEEM should be linked to the broader process of economic and social reforms. **The poorly-functioning governance and market mechanisms, in general, and in the environmental sector, in particular, were identified as one of the major constraints to the implementation of these Good Practices of PEEM in the NIS.**

10. The participants also pointed out that for these Good Practices of PEEM to be successfully implemented in their countries, **high-level political support is crucial**. To this end, the up-coming Kyiv Ministerial Conference is the right forum to present this policy document and achieve its political endorsement. **Hence, the participants confirmed the usefulness and timeliness of the Good Practices of PEEM and requested their wide dissemination.**

11. The potential for financing public environmental expenditure through debt-for-nature/environment swaps⁴ was widely discussed during this session. Participants from *Poland (Mr. Stanislaw Sitnicki)* and from *the Russian Federation (Mr. Renat Perelet)* presented their countries' experiences in arranging such swaps with the Paris Club⁵ creditors. So far, Russia has succeeded in arranging a one-time swap of 10% of Russia's Soviet time debt with Finland. While Poland has chosen to establish a specialised institution (the Polish EcoFund⁶) to manage the resources made available through such swaps with several creditors, Russia seems to go for a project-based institutional arrangement allowing the creditor direct choice of projects.

12. Different institutional options for managing resources made available through debt-for-nature/environment swaps were further presented by the *OECD/EAP Task Force Secretariat (Mr. Grzegorz Peszko)* and *Georgia (Mr. Malkhaz Adeishvili)*, based on the analytical work carried out by Georgia with support from the OECD/EAP Task Force Secretariat. Georgia has signed an agreement with the Paris Club creditors to restructure Georgia's official external debt and a debt swap clause has been included in the agreement, thus enabling creditors to undertake swaps for environment on a voluntary and bilateral basis. Following this agreement, and upon request by Georgia, the OECD/EAP Task Force Secretariat has worked with the Georgian Ministry of Environment to prepare an Institutional Options Paper for government consultations with the aim of developing a framework for negotiations and design of mutually acceptable debt-for-nature swaps with selected Paris Club creditors. This paper reviews

⁴ Debt-for-nature/environment swaps are transactions that reduce or convert a country's external debt in exchange for the debtor country's commitment to spend an agreed portion or the whole amount of the reduced foreign debt, on agreed conditions, on domestic environmental improvements in local currency.

⁵ The Paris Club is an ad-hoc body of bilateral creditors (mostly OECD, although it includes Russia as well) that negotiates debt restructuring agreements with debtor countries on a case-by-case basis. It was formed in 1956 and it meets on a monthly basis in Paris. For more information, please check the Paris Club web-site at: <http://www.clubdeparis.org/en/index.php>

⁶ For more information, please check the Polish EcoFund web-site <http://www.ekofundusz.org.pl/us/index.htm>

several institutional options for designing the swap transactions and expenditure management mechanisms and identifies factors that can help the Georgian Government take optimum decisions in this regard.

13. **The participants recognised the importance of the work in Georgia for other countries.** They stressed several benefits of the debt-for-environment swaps for the NIS, such as providing environmental public goods of international significance and poverty alleviation. **Kyrgyzstan**, which is the only other NIS to have included a debt-for-nature swap clause in the debt restructuring agreement with the Paris Club, **was particularly interested in this work and requested further co-operation on this issue within the OECD/EAP Task Force framework.** Participants also discussed the possibility for a **regional debt-for-environment swap initiative** that could be launched at the Kyiv Conference. Such an initiative could either involve direct partnerships between a group of the NIS and a group of Western creditors or a series of trilateral transactions, where Western countries would swap a portion of the old Soviet debt of the Russian Federation, and Russia - in turn - would swap for environment a portion of its debt credited to smaller NIS.

III. Session Three: Financing and Investment Strategies for Environmental Infrastructure

14. The conclusions and policy options emerging from the work on Environmental Financing Strategies (mainly) in the Urban Water Supply and Sanitation Sector (EFS), conducted in several NIS, were the major focus of this session. **Five such strategies have been completed so far** - in Georgia, Moldova, Kazakhstan and the Novgorod and Pskov Oblasts of Russia. The work on the EFS for the urban water supply and sanitation sector in Ukraine and Kaliningrad is in progress. These projects have been financially supported by the Danish Government and implemented by the Consultancy Company COWI in close co-operation with local experts and policy makers. Methodological support was provided by the OECD/EAP Task Force Secretariat. Additional EFS are being developed with support by the European Union (TACIS) for three Russian oblasts - Novgorod (municipal solid waste), Rostov and Yaroslavl (urban water supply, sanitation and municipal solid waste) and for the East-Kazakhstan oblast (Ust-Kamenogorsk) for urban water supply and sanitation. EFS for the urban water supply and sanitation sector in Armenia has started, with support by the German Government.

15. **It was recognised that EFS provide governments with a practical strategic planning tool for checking financial realism and affordability of medium-to-long-term environmental programmes.** EFS aggregate specific implementation programmes and countless projects into a systematic framework of strategic investment planning in market conditions. The results help identify realistic actions for cost-effective and affordable improvements while at the same time making consequences of different, often painful, policy choices and trade-offs explicit and transparent. These Strategies can also be used as instruments to support claims of Ministries responsible for environmental infrastructure on public budgets and public investment programmes as well as to support requests for donor and IFI financing.

16. The major conclusions and challenges emerging from several years of work on the country/regional Strategies, supported by presentations from *Russia* (Mr. Alexander Martusevich, Mr. Albert Davidov) and a Strategies Overview by the *OECD/EAP Task Force Secretariat* (Mr. Grzegorz Peszko), show that:

- The continuation of current trends in financing water supply and wastewater treatment infrastructure is not sustainable and would result in further serious deterioration of services in this sector;
- User charges are the only feasible long-term source of finance for operation and maintenance (O&M) expenditure;

- Households in the NIS are often able and willing to pay more than they are currently paying providing services are improved;
- In the short-to-medium term, national and local budgets have an essential role to play in financing rehabilitation and capital investments in the sector, in providing social protection and in facilitating access to credit. Scarce public funds and donor grants need to be concentrated on fewer projects of priority importance;
- IFI projects will continue to play an important role in providing resources for capital investments. They will have a significant demonstration and catalytic function in mobilising additional in-country co-financing;
- Private sector finance for public infrastructure will still play a more limited role in the coming years.

17. One of the main issues discussed during this session was the practical use of EFS in the decision-making process in the NIS. While EFS triggered some regulatory reforms in some countries (e.g. making wastewater effluent standards more realistic in Moldova, adopted as local laws in Novgorod), there are still a number of problems that remain in the preparation and implementation of these Strategies. For instance, due to the multi-stakeholder nature of the water sector, it is not always clear who in the government should use this tool for strategic investment planning and how it should be used. Some NIS governments perceive EFS as actual investment implementation plans where Governments see themselves in the old style - as owners of pipelines of investment projects. Such a perception confuses the role of the government in a market economy. While governments can co-finance investments through the public budget, their major role is to create enabling conditions for project owners (firms, municipalities) to raise effective financing for their environmental investment projects.

18. It was also discussed how to link these strategies to the process of budget preparation and implementation and to the rolling investment plans in municipalities. The presentation of the *OECD/EAP Task Force Secretariat (Mr. Dariusz Smialkowski)* on linking national environmental infrastructure priorities to municipal long-term investment planning showed that municipal governments in the NIS lack a long-term vision of investment needs or even a forecast of the municipality's future financial situation. All revenues and expenditures are allocated annually through year-long financial plans. The choice of infrastructure investment project pipelines in the NIS cities is mostly driven by ambiguous and discretionary criteria. *Mr. Smialkowski* presented demonstration projects in Russian and Ukrainian cities, the goal of which is to develop skills in preparing an efficient multi-year investment planning framework for municipal infrastructure.

19. On the modelling side of the EFS - the computer-aided tool has been further improved and expanded. The **FEASIBLE** model (**F**inancing **E**nvironmental **A**ffordable **S**trategic **I**nvestment that **B**ring on **L**arge-scale **E**xpenditure) for the urban water supply and sanitation sector has been made more user-friendly and extended to include not only urban but rural water and municipal solid waste as well. These new features are being tested in several countries (see above). Experts from different NIS countries and government agencies have been trained in using the model⁷.

IV. Session Four: Environmental Expenditure Trends in the NIS

20. The main objective of this session was to present and discuss the preliminary results and major conclusions emerging from the work on environmental expenditure studies, in general, and the Survey on Financial Flows to the Environment in the NIS, in particular. The 2002 cycle of environmental

⁷ For more information, please check the project web-site - <http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-document-499-14-no-no-20962-0,00.html>

expenditure studies include Armenia, Moldova and Kyrgyzstan⁸. As part of the Survey, data on Kazakhstan, Turkmenistan and Ukraine were collected as well. These studies are conducted on the basis of the OECD/EUROSTAT methodology. However, the methodology has been adapted to the specific conditions in the NIS and expanded to include not only the traditional pollution abatement and control activities but also the spending on nature conservation and natural resource management and mobilisation, such as water supply. Data was collected (1) on a sectoral basis - air, water, waste, noise, (2) by economic sectors - private sector and public sector, and (3) by type of expenditure - current expenditure versus environmental investments.

21. The preliminary results from the in-depth studies on domestic environmental expenditure, also re-stated by the country presentations of *Armenia* (Mr. Ashot Haroutunyan and Mr. Yuri Pogosyan), *Kyrgyzstan* (Ms. Djipara Bekkulova) and *Moldova* (Ms. Maria Nagorny) and the *OECD EAP Task Force Secretariat* (Ms. Carla Bertuzzi and Mr. Ulrik Weuder), show the following:

- The level of domestic environmentally-related expenditure in the studied NIS is very low, both in absolute terms and as a per capita expenditure compared to other countries in transition;
- In general, domestic environmentally-related expenditure has not increased in the NIS in real terms and in some countries they have even decreased (e.g. Kyrgyzstan, Ukraine);
- The level of environmental investments is very low. In most countries, current expenditure makes up for most of all environmentally-related expenditure in the countries. However, there are significant methodological problems in distinguishing data between these categories;
- Environmental investments have been decreasing. Only in some countries, in selected years, have they increased in order to match IFI or official development assistance (ODA) financing (e.g. Armenia - 1999, 2000, Moldova - 2001, Turkmenistan - 2000, Ukraine - 2000);
- In most of the NIS, the highest share of environmentally-related expenditure goes to the water sector;
- In terms of expenditure made by economic sectors - private versus public - due to the lack of reliable and comparable data - no definitive conclusions on country or regional patterns can be drawn at this stage;
- Only few countries have a reliable data collection system, some countries have even ceased to collect data due to the lack of resources (e.g. Tajikistan).

22. As part of the Survey on Financial Flows to the Environment in the NIS, the EAP Task Force Secretariat has also collected data on ODA flows going to the NIS with the main aim of analysing the extent to which “refocusing” on the NIS has actually occurred. As this is work in progress, no firm conclusions can be drawn at this stage. However, the data on international financing sources, collected so far, suggest that:

- The environmental component of ODA has been increasing since 1996 (mainly due to bilateral environmental assistance from individual donor countries) to the level of about 6% of total ODA in 2000);
- IFI financing for the environment in the NIS has been slightly increasing since 1999 but is significantly lower than the flows recorded in the pre-Aarhus period - 1996 - 1998 and still remains at very low levels;
- In general, foreign direct investment (FDI)⁹ financing in the NIS has been decreasing over the period 1998-2000 to pick up again in 2001 reaching the highest level over the studied period (1996-2001), however, these levels, compared to other regions of the world, are still very low;

⁸ The first cycle of environmental expenditure studies (1999 - 2001) included Georgia and the Novgorod and the Pskov Oblast of the Russian Federation.

⁹ Based on UNCTAD data.

- Environmentally-related ODA is unevenly distributed across the NIS with Armenia and Azerbaijan receiving the highest shares (on per capita basis);
- It is still difficult to assess the actual extent to which "re-focusing" has occurred since Aarhus as data from the CEE¹⁰ countries are needed for comparison. However, the existing data suggest that for the real refocusing to happen, donors need to increase the levels of their support and diversify the countries and regions it is provided to.

23. The final report from the Survey will be presented at the next meeting of the Network. The report with the conclusions and recommendations from the Survey will be officially presented to the Ministers at Kyiv for their discussion and endorsement.

24. In addition, the work on expenditure studies shows again that there are a lot of inconsistencies and irregularities in the data collection systems of the NIS. There is no regular data collection from enterprises, information on government budgetary data is extremely limited. The lack of an adequate legal framework, regular reporting forms, confidentiality of information and limited institutional capacity are among the major constraints in designing and implementing a reliable data collection system in the NIS. **The need for improving the data collection system in a consistent way was recognised.**

25. In this context, *Georgia (Mr. Malkhaz Adeishvili)* reported on the follow-up project, implemented within the EAP Task Force framework, on setting up a systematic and consistent environmental data collection system in the country. The project is carried out at three stages: first, establishing a separate environmental expenditure reporting system for both the business and public sector; second, establishing regular reporting for enterprises (both publicly-owned and private enterprises) providing environmental services (e.g. waste water treatment, waste management) and third, initiating periodical surveys on environmental industry. Officials of the Georgian State Department of Statistics have been trained in the new methodology and a new 2001 data collection has been launched (including through surveys of the business sector) according to this new methodology. The new methodology and reporting forms have been approved by the Georgian State Department of Statistics and introduced in the national accounts statistics. The work so far has shown that the transition from the old data collection system to the new one takes time, hence, this process should be carried out in phases and improved continuously. **Kyrgyzstan and Ukraine expressed initial interest in participating in similar demonstration projects within the framework of the OECD/EAP Task Force.**

26. At the end of the meeting, the *OECD/EAP Task Force Secretariat (Mr. Ulrik Weuder)* presented the major issues and conclusions emerging from the analytical work on environmental finance in the NIS as part of the NIS Environmental Strategy which will be presented at the Kyiv Ministerial Conference in May 2003. The participants had the opportunity to discuss the draft outline of the Background Paper on Environmental Finance, developed by the Secretariat. Two major objectives have been identified to be included in the future Strategy, namely: Mobilising Additional Financial Resources, including Debt-for-Environment Swaps and Allocating Public Financial Resources more Efficiently. During the open discussion, the participants provided a number of useful and insightful comments and suggestions which will be taken into account by the Secretariat in preparing the Background Paper. The final version of the paper will be presented at the next Network meeting. Prior to that, **the draft paper will be sent out to the NIS Network participants for their comments**¹¹.

¹⁰ A similar survey process is conducted for the CEE countries and the South-Eastern European countries by the REC Szentendre, Hungary.

¹¹ The paper can also be viewed on the web-page of the Organising Committee of the Kyiv "Environment for Europe" Ministerial Conference at http://www.kyiv-2003.info/discussion/east-west-environmental-partnership-strategy/list_of_documents.html

V. Field Trip

27. A field trip to a municipal waste processing facility integrated with a wastewater treatment plant (WWTP) and a biogas recovery installation in the town of **Pu•awy** was organised on the third day of the meeting. These facilities have received support from the Polish NFEPWM. The participants discussed with local officials and facility managers the details of institutional arrangements of these municipal services and the details of financing arrangements for investments and operations of the facilities.

VI. Evaluation of the Meeting

28. The evaluation forms returned to the Secretariat (participants were asked to evaluate the process and the contents of the meeting) show that most of the participants are satisfied with the overall organisation of the meeting. The participants noted that the meeting was conducted in a highly professional manner, with well-prepared documents and clear messages and presentations. One common concern, expressed by most people, was the late distribution of the documents which does not allow all participants to prepare themselves for all substantial discussions during the meeting. Another concern is that the allocation of time for in-depth discussions after the presentations was greatly insufficient. All countries should be given a fair chance to present their position on the issues during the plenary discussions. More break-out sessions are needed so that participants can continue their discussions in a more informal way. Working Groups discussions have to be more focused and structured. There was a request for presenting more experiences from the OECD countries. The assessment also stressed the need for more meetings on these and related topics.

29. The OECD/EAP Task Force Secretariat would like to take this opportunity to once again thank our Polish hosts - the Ministry of Environment and the National Fund for Environmental Protection and Water Management - for helping us organise the meeting. Without the generous support of the Polish National Fund, both financially and logistically, this meeting would not have been possible. Special thanks go to our Thai colleagues for their participation in the meeting and their willingness to share their experience with us.