

EAP Task Force

**SECOND WORKSHOP ON ECONOMIC INSTRUMENTS IN THE NIS
FOURTH MEETING OF NIS ENVIRONMENTAL FINANCING
NETWORK
22nd-24th March, 2000
Tashkent, Uzbekistan**

SUMMARY OF THE DISCUSSION

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HIGHLIGHTS OF THE MEETINGS

Economic Instruments in the NIS require reform

The application of economic instruments in the NIS encounters profound problems. These include: poor economic incentive, administrative complexity, high discretion in implementation and enforcement. The system of pollution charges needs to be simplified and clear distinction should be made between instruments for revenue raising and those with the incentive effect. The instrument should be designed in close relation with the policy targets and potential for compliance and enforcement. The application of the instruments may be enhanced by stronger incentives linked to the improvement of the economy and further market reform.

Environmental financing strategies reveal that dramatic messages will have to be delivered to high level decision makers in the NIS

There is a need to prepare Ministers of Environment and Economy/Finance to acknowledge the crisis in the urban water sector and to make commitments to a long and painful reform process that will include many politically difficult choices. Preliminary results from the development of environmental financing strategies in some NIS show that the financial gaps for environmental improvement in the water supply and sanitation sector are significant but the affordability gap is even bigger. Environmental financing strategies can be a powerful tool that informs decision makers on how to use limited financial resources of public sector to mobilise financing from private and foreign sources.

Environmental Funds should be part of the reform of the public finance in the NIS

The Environmental Funds operating in some NIS need to develop clear spending programmes. This process can be supported by the development of new guidelines for public environmental expenditure management which will adjust the recommendations presented in the 1995 St. Petersburg Guidelines on Environmental Funds in CEE and NIS. The new guidelines would provide a benchmark for technical assistance within the work of the EAP Task Force.

KEY DECISIONS OF THE MEETINGS

Workshop on Economic Instruments

It was agreed that the participants would provide additional information to the Survey on EIs taking into account the discussion at the meeting and individual requests from the Secretariat. The draft final version will be sent for comments by the end of May. Expert comments are expected by the end of June. This will enable the Secretariat to present the final draft of the survey at the next EAP Task Force meeting in October 2000 for approval.

The next steps in evaluating the effectiveness of Economic Instruments in the NIS should focus on the assessment of the optimal mixes of policy instruments, including administrative, economic and others, for addressing particular types of environmental problems. Such an assessment should be carried out through country-specific studies. Several countries expressed their willingness to participate in such projects, such as Azerbaijan and Kazakhstan.

Fourth Meeting of the NIS Environmental Finance Network

It was recognised that environmental expenditure studies could be a very useful tool in providing environmental authorities with essential information on expenditures on environmental protection and improvement and serve as a means to monitor their effectiveness. Georgia, where such a project is already underway, requested further work to assist the country to institutionalise and implement a systematic and consistent environmental data collection system.

Several countries have expressed their interest to further continue the work on the Environmental Finance Strategies (EFS) recognising their role as a practical and powerful tool for realistic assessment of costs and available financing for optional targets. Georgia and Moldova requested that the EFS be extended to cover municipal solid waste and urban air quality, while Azerbaijan requested a complete EFS. Russia requested that EFS be developed for more regions in the country. Moldova also requested assistance in developing multi-year investment programmes for selected municipalities in the country, which will draw from the financing strategy and move its implementation to a municipal level.

The participants called for more demonstration projects on institutional reform and strengthening of environmental financing mechanisms in the NIS using the good practices of public environmental expenditure management. Acquiring knowledge on the assessment of cost-effectiveness of proposed environmental projects and programmes is one issue that needs special attention by the EAP Task Force, bilateral donors and IFIs working in the region.

An agreement was reached as to the contents of the questionnaire for the Survey on Non-Monetary Transactions conducted by NIS Environmental Funds and the practicalities of its implementation. Both national and regional environmental funds were invited to participate in this project. The final version of the questionnaire would be sent out to experts in April 2000 and the responses were expected to be received by the Secretariat two months later. The Survey was expected to be completed by the end of the year 2000. The final draft of the survey would be presented and discussed at the next meeting of the Network in 2001.

Second Workshop on the Use of Economic Instruments in NIS and Fourth Meeting of the NIS Environmental Financing Network

March 28 - 24, 2000, Tashkent, Uzbekistan

Summary of the Discussion

Introduction

1. The Second Workshop on the Use of Economic Instruments in NIS and the Fourth Meeting of the NIS Environmental Financing Network were hosted by the State Committee for Environmental Protection of the Republic of Uzbekistan and organised under the auspices of the Environmental Action Programme (EAP) Task Force. The meetings were attended by over 60 participants from NIS and OECD countries (a list of participants is attached). The participants included officials from environmental agencies and funds, Ministries of Economy and Finance, as well as experts involved in the area of economic instruments and environmental financing representing the 12 New Independent States (NIS)¹ as well as the representatives of the European Commission, Denmark, Germany, the Regional Environmental Centre for CEE and the private sector consultants, active in the NIS region.
2. The objectives of the two meetings were:
 - to discuss the draft survey on the use of economic instruments (EIs) for pollution control and natural resource management in the NIS, launched at the first workshop in Moscow in April, 1999, as well as share the experience from implementing economic instruments in the NIS, CEE and OECD countries;
 - to present and discuss the results of on-going work in the area of environmental finance, including studies of environmental expenditures, development of Environmental Financing Strategies and the ways for sound integration of environmental finance into public finance;
 - to launch a survey on non-monetary transactions conducted by NIS environmental funds; and
 - to seek participants' guidance on shaping the future EAP Task Force Programme on policy instruments and environment finance as well as discuss inputs on the subject of environmental finance to the high level meeting of NIS Environment and Economy/Finance Ministers which will be organised within the EAP Task Force framework, in October 2000, in Almaty, Kazakhstan.
3. The meetings were opened by Mr. Askhad Khabibullaev, Chairman of the State Committee of Environmental Protection of the Republic of Uzbekistan and Mr. Jean-Francois Verstyngne, Deputy Director General of the European Commission's Directorate for the Environment and the Co-Chairman of the EAP Task Force. Mr. Khabibullaev stressed the importance of the discussion on the effectiveness of environmental policy instruments and financing in the context of overall economic development and reform in the NIS. Mr. Verstyngne underlined the need for a dialogue between environment and economic agencies and the opportunity which would be provided by the consultations between Ministers of Environment and Economy/Finance in October 2000 in Almaty, Kazakhstan. He suggested that the discussion should focus on demonstrating the benefits of environmental policies, budgetary impacts of unsustainable economic policies and the most effective ways for financing environmental improvements, including the role of public budgets and the private sector.

¹ The 12 NIS members of the EAP Task Force are: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The Second Workshop on the Use of Economic Instruments in NIS

4. The main objective of the workshop was to present the preliminary findings and key observations that stem from the draft survey on the use of economic instruments (EIs) in the field of pollution control and natural resources use in the NIS. The introduction of the preliminary results emerging from the draft survey was followed by an in-depth discussion in working groups on:
 - ◆ the policy and institutional context for the design and implementation of EIs;
 - ◆ characteristics and qualities of the individual instruments; and
 - ◆ necessary framework conditions that need to be in place in order to ensure their better implementation.
5. Although the NIS countries have acquired some positive experience with the application of economic instruments, the preliminary results of the survey on the Use of Economic Instruments for Pollution Control and Natural Resource Management in the NIS and the discussion at the workshop showed that the whole system of EIs, as currently implemented in the NIS countries, needs fundamental reform, if it is to provide incentives to economic agents to carry out environmental improvements. There are several problems in the current design and use of EIs. They include poor economic incentives, complexity and fragmentation, high administrative costs, poor integration with environmental policy goals and targets, too much discretion in their implementation and enforcement. More in-depth analysis of these issues will be presented in the final draft of the NIS survey of EIs.
6. Participants agreed that most of EIs are currently geared towards generation of revenue for environmental purposes rather than towards changing polluters' behaviour and stressed that the incentive role of economic instruments should be strengthened. The reform has to take into account the extent to which the actions of enterprise managers would be based on the weighing of costs and benefits of such actions. The redesign of EIs also needs to take into account which instruments are best suited to serve as incentives as well as the nature and extent of environmental problems, the number and type of polluters, technological and managerial options for reducing the levels and the costs of administering and controlling the policy instruments in the given situation.
7. On the other hand, certain instruments may have a bigger revenue raising than incentive potential. In those cases that purpose should be clearly stated and presented to the stakeholders. Participants agreed that more emphasis should be placed on the collection and disbursement aspects in applying these instruments. Several examples have been presented on the current situation in most NIS where the revenue from EIs is earmarked for environmental purposes and is managed by Environmental Funds. There seems to be a general trend, however, towards consolidation of revenue raised by environmental charges and taxes into general budgets. In this case revenue raising effects of economic instruments would become less important for environmental agencies. On the other hand, resources in general budget could still be available to support environmental measures. Though in many NIS experience suggests that resources earmarked for environment to general budgets are used for non-environmental purposes.
8. During the discussions, the issue of the assessment of effectiveness and efficiency of EIs received particular attention. It was stressed that economic instruments should not be regarded as an end in themselves but they should be designed, applied and also assessed in the context of an overall environmental policy development and implementation. In this framework economic, and other policy instruments, should help to achieve specific and realistic policy targets. Thus, it was proposed

that the assessment of optimal ways to deal with certain type of environmental problems by applying mixes of policy instruments need to be carried out.

9. In the discussion on the practical steps to carry out such an assessment it was also pointed out that in order to better tailor individual instruments to country specific economic conditions there is a need for more country-specific studies. Several countries expressed their willingness to participate in such projects, such as Azerbaijan and Kazakhstan.
10. The participants stressed the fact that the effectiveness of EIs would also be enhanced through the improvement of environmental monitoring and compliance. General economic policies and further market reforms would also enhance the effectiveness of EIs. Several speakers underlined that these messages would need to be communicated to high-level decision makers to stimulate a better political support as well as commitment by other government agencies involved in their implementation (e.g. the Ministry of State Revenues to make relevant changes in the Tax Code).
11. In response to the request by the participants at the first workshop on EIs held in 1999 in Moscow, a discussion was held on the principles and practical application of user charges in the water sector. Experience of the OECD (the situation in Denmark was presented as a case study) and CEE countries were presented at the meeting. Some of the main issues discussed related to: the degree of cost coverage and price level of the communal water services, possibilities for full cost recovery (operating and maintenance, capital cost, environmental costs) and affordability, the tariff structure (connection fee, flat fees, volumetric fees), metering of water supply and cross-subsidisation between groups. It was pointed out that while user charges are payments for the cost of collective services and are mainly used as a financing device by local authorities, they have a huge incentive effect and need to be considered and implemented just as other EIs.
12. Finally, it was agreed that the participants would provide additional information to the survey, as needed, and the draft final version will be completed by the end of May. The draft will be sent out to experts for their final comments, which have to be then sent back to the Secretariat by the end of June. The final draft of the Survey is expected to be completed by the end of July 2000 and will be presented, together with conclusions and recommendations, for approval at the next EAP Task Force meeting in October 2000.

Fourth Meeting of the NIS Environmental Financing Network

13. The NIS Environmental Financing Network² had its fourth meeting on 23 and 24 March 2000. Previous meetings sought to provide a forum for NIS representatives to discuss the role and operations of Environmental Funds in the region. At the third meeting in Moscow, however, the focus of the network was expanded to include a broader range of environmental finance issues. The tradition was continued in Tashkent where the current results of several key on-going projects in this area were presented to the participants along with the policy options emerging out of this work. The network was also expanded in terms of representation. NIS officials from the Ministries of Economy and Finance were invited to participate and contribute to the work of the environment experts.
14. During the first day of the Network meeting, the methodology of conducting environmental expenditure studies was presented. This paper lays down the major issues to be considered in assessing the level and magnitude of environmental expenditures in these countries. The project, jointly implemented by the Secretariat and the consultancy firm COWI and supported by the Danish

² Meetings of the Network (previously known as NIS Environmental Funds Network) were held in Almaty, Kazakhstan in November 1996, in Kiev, Ukraine in December 1997 and in Moscow, Russian Federation, in April 1999.

government, is currently conducted in Georgia and two regions (oblasts) of the Russian Federation, namely Novgorod and Pskov. This work builds on a project carried out a couple of years ago in Georgia and Russia but now the methodology has been improved and tailored to the specific conditions in these countries. This new methodology has been 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. The participants were invited to discuss relevant methodological issues, definitions of environmental expenditure, data problems, statistical needs and standards used and their compatibility with the OECD methodology. The significance of high quality information and data in the formulation and assessment of environmental policy measures and in informing the public at large as well as the necessity for improving the data collection system in a consistent way were hugely recognised. However, the lack of adequate legal framework, regular reporting forms and limited institutional capacity are among the major constraints in designing and implementing a reliable data collection system. It was also pointed out that while in market economies enterprises are allowed a certain level of confidentiality of information (but they still need to report certain environmental data in accordance with legal requirements) it is crucial that information on government budgetary data be improved and made more transparent.

15. It was recognised that environmental expenditure studies could be a very useful tool in providing environmental authorities with essential information on expenditures on environmental protection and improvement and serve as a means to monitor their effectiveness. It was also recognised that the transition from the old data collection system to a new one takes time, hence, this process should be carried out in phases and improved continuously. To this end, Georgia, where such a project is already underway, requested further work to be done in this direction, in terms of assisting the country to institutionalise and implement a systematic and consistent environmental data collection system.
16. The methodology for the development of environmental financing strategies (EFS) and some preliminary results and policy options emerging from the projects under implementation were presented during the afternoon session of the first day of the Network. These projects are also carried out in co-operation with COWI and financially supported by the Danish government. It was recognised that while almost all NIS countries have developed NEAPs and have identified environmental problems and actions, targets have not been made SMART (specific, measurable, agreed, realistic, time-bound) or prioritised and costs of the actions have not been estimated. All the more so, demand for environmental expenditure is not linked to available finance and affordability issues are not addressed. Given these drawbacks of the existing NEAPs, environmental financing strategies go a step further in identifying demand for and sources of environmental expenditure as well as possible scenarios for closing the financing and affordability gaps. Such strategies are being developed in close cooperation with local experts and policy makers in Georgia, Moldova and the Novgorod oblast in Russia and preliminary results are already available. EFS are under development for Kazakhstan and Ukraine as well. The methodology includes an interactive computer model to simulate, in quantitative terms, the consequences of different policy choices. So far, water and waste water treatment have been in the focus of these strategies but waste and air quality costing models are being developed and are to be applied at a later stage. The preliminary results from the model, applied in both Georgia and Moldova, prove, in quantitative terms, the crisis situation of the municipal water and waste water infrastructure in these countries. These results provide policy makers with options to make informed decisions on how to use limited funds of the public sector to mobilise financing from private and foreign sources and close existing gaps. The generated results helped identify realistic short-to-medium term 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.

17. It was recognised that these strategies are a practical and powerful tool for realistic assessment of costs and available financing for optional targets. To this end, several countries have expressed their interest to further continue the work on the EFS: Georgia and Moldova requested that the EFS be extended to cover municipal solid waste and urban air quality, while Azerbaijan requested a complete EFS. Russia requested that EFS be developed for more regions in the country. Moldova also requested assistance in developing multi-year investment programmes for selected municipalities in the country which will draw from the financing strategy and move its implementation to a municipal level.
18. During the first half of the second day of the Network meeting the Secretariat presented a paper on integrating environmental finance and public finance with a special focus on the role of public sector and public environmental funds, in particular. Five years after the adoption of the St. Petersburg Guidelines, which set forth the conditions under which subsidised finance can be justified in the transition period, it is clear that very few environmental funds have made progress in implementing these Guidelines. Very few have become effective tools of environmental policy or sound instruments of public finance. Those that have been successful (mainly in the most advanced market reform countries where transition is coming to an end) are now under pressure to consider various post-transition scenarios. The paper aims at introducing the sound principles and good practices in public environmental expenditure management. It lays down the main goals of public expenditure management (fiscal discipline, allocative efficiency, cost-effectiveness) as well as the necessary conditions for achieving public expenditure goals (transparency, accountability, comprehensiveness of budget). The report discusses advantages and disadvantages and hazards of earmarking and provides a basis for a fundamental policy discussion as to what the alternative options to environmental funds might be in managing public environmental expenditure.
19. The discussion in the working groups sought to clarify and reach consensus on certain key principles of the reform package and possible institutional arrangements for managing special public expenditure (ranging from direct purchase of goods and services by administration through (extra-) budgetary funds to public or private intermediaries contacted by the governments to manage (grant or debt) expenditure programmes, etc.). The participants were also invited to provide specific comments in writing as well guidance on how these good practices can be implemented and used as a benchmark for technical assistance within the framework of the EAP Task Force work programme.
20. The paper and its main messages, particularly those concerning the future of the funds, stimulated heated discussions. It was agreed that funds should be part of the public finance reform in the NIS and should actively support the development of more market-based mechanisms. However, environmental authorities should periodically review the effectiveness of the Funds as policy instruments and adjust them to the evolving needs of the transition process. The participants pointed out that the paper is very timely, topical and useful for the work in their countries but there is a need for a high level political commitment to the proposed changes (which will need to be further discussed) as well as adequate legislative adjustments to support these changes. To this end, the participants called for more demonstration projects on institutional reform and strengthening of environmental financing mechanisms in the NIS using the good practices of public environmental expenditure management. It also became obvious that acquiring knowledge on the assessment of cost-effectiveness of proposed environmental projects and programmes is one issue that needs special attention by the EAP Task Force, bilateral donors and IFIs working in the region.
21. The Survey on non-monetary transactions conducted by NIS environmental funds was launched at the end of the meeting. The major objectives of the Survey are to: (i) update some of the major data sets collected in the 1997 Survey on Environmental Funds in Economies in Transition; (ii) to compile consistent empirical data across NIS environmental funds on the use of non-monetary transactions

and identify regional patterns; (iii) to get a sense of the scale and magnitude of the non-monetary transactions conducted by the NIS environmental funds and (iv) to identify Funds who may need support in phasing out non-monetary transactions from their operations with the view of developing technical assistance programmes for such funds within the framework of the EAP Task Force. The Survey is intended to serve as a baseline in future studies and analyses on this issue as well as help identify best policy responses in addressing this phenomenon. While it is clear that Funds cannot deal with this problem unilaterally, outside of the general macroeconomic context, given the stated objective of remonetisation by the NIS countries facing such problems, NIS environmental Funds should become part of the solution rather than part of the problem.

22. The Survey, to be carried out through a questionnaire, was discussed by participants and a general agreement was reached as to its contents and the practicalities relating to its implementation. A key concern, raised by the NIS experts, was that demonetisation is not a problem in all countries and that some of the information requested is difficult to obtain as it might be available only outside of the funds. The comments made by the participants will be taken into account in finalising the Questionnaire and the final version will be sent out to experts in April 2000. The questionnaire will be prepared by Funds' or Ministry of Environment officials. Both national and regional environmental funds are invited to participate in this project.
23. It was agreed that the experts, who would be assigned to work on the Survey, would provide responses to the questionnaire two months after receiving it. The Survey and the analytical part based on it are expected to be completed by the end of the year 2000. The final draft of the survey will be presented and discussed at the next meeting of the Network in 2001.

Evaluation of the Meeting

24. As usually done at the EAP Task Force events, the participants were asked to evaluate the process and the contents of the meetings. The participants were highly satisfied with its organisational aspects. The role and the support of the Uzbek State Committee for the Environment, and more specifically Mr. Luptullaev and his colleagues from the International Cooperation Department, were particularly appreciated in this regard.
25. The participants indicated that the objectives of the meetings were met. Judging by the ten assessment forms, handed back to the Secretariat, the overall assessment of the participants is that the information and issues, presented and discussed at the two meetings, were topical, significant and of great practical value for their work in their countries. One common concern, expressed by most people, was that the allocation of time for in-depth discussions during the two meetings on the issues/problems/projects of interest to the participants, was greatly insufficient. The assessment stressed the need for more meetings on these and related topics.
26. The meetings were concluded by a press conference with the attendance of the participants. Several journalists from Uzbekistan and other countries participated in the presentations, made by the Chairs, of the main conclusions of the meeting and had an opportunity to ask questions related to environmental issues in Uzbekistan, the follow-up of the meetings and other activities of the EAP Task Force.