

# EAP Task Force

## FIFTH MEETING OF THE NIS ENVIRONMENTAL FINANCE NETWORK

*21-23 May, 2001  
Yerevan, Armenia*

### SUMMARY RECORD

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## **Fifth Meeting of the NIS Environmental Finance Network**

*May 21 - 23, 2001, Yerevan, Armenia*

### **Summary of the Discussion**

1. The Fifth Meeting of the NIS Environmental Finance Network<sup>1</sup> was hosted by the Ministry of Nature Protection of Armenia and organised under the auspices of the Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe (EAP Task Force). The meeting was attended by over 60 participants from NIS and OECD countries (a list of participants is attached). 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 and international financing institutions, bilateral donors, the Regional Environmental Centre for CEE and private sector consultants, active in the NIS region.
2. The main objectives of the meeting were:
  - To present, discuss and disseminate results of completed projects and discuss and comment on on-going work in the area of environmental finance, such as reforming environmental funds, guidelines on integration of environmental finance with public finance, studies on environmental expenditure and environmental financing strategies;
  - To launch the new 2001-2003 work programme on environmental finance in the NIS and to discuss the roles of different participants' in its implementation;
  - To present and seek participants' guidance on the scope and implementation of the new EAP Task Force activities, such as support for the development of multi-year investment plans for municipal environmental infrastructure in NIS cities;
  - To launch a consensus-building process on the best practices of integrating environmental finance into public finance and exploring opportunities for building a high level political support which would lead to subsequent endorsement of these practices in the near future and possibly by Environment Ministers at the Kyiv Ministerial Conference "Environment for Europe".
3. The meeting was opened by Mr. Murad Muradyan, Minister of Nature Protection of Armenia and Mr. Brendan Gillespie, Head of the OECD Non-member Countries Division. Mr. Muradyan stressed the importance of the discussion on the effectiveness of environmental financing in the context of overall economic development and reform in the NIS. Mr. Gillespie underlined the need for a dialogue between environment and economic agencies in addressing urgent environmental problems in the NIS and securing financing for priority environmental investments in these countries. He presented the work methods of the EAP Task Force, emphasising the multi-stakeholder co-operation within the EAP Task Force framework based on NIS ownership of the work products achieved through demonstration projects and in-country specific activities. He suggested that the discussion focus on the most effective ways for financing environmental improvements, including the role of public budgets, public extra-budgetary environmental funds and financing at a municipal level.
4. The EAP Task Force Work Programme on Environmental Finance for 2001-2003 was further presented by the Secretariat. The participants were invited to discuss and comment the objectives and the tools of the programme, their applicability in the NIS conditions. The participants were also requested to express their interest to participate in implementing selected projects of the programme in their countries.

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<sup>1</sup> 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, in Moscow, Russian Federation, in April 1999 and in Tashkent, Uzbekistan in March, 2000.

5. The main discussion topic during the first day of the meeting was Integration of Environmental Finance into Public Finance. This discussion was already launched at the Network meeting in Tashkent, Uzbekistan (March 2000) where the EAP Task Force Secretariat presented an analytical paper on “Integrating Public Environmental Expenditure Management and Public Finance in Transition Economies” with a special focus on the role of the public sector and public environmental funds, in particular. The analytical paper is based on the work carried out within the EAP Task Force, OECD and international financing institutions. *In Tashkent participants expressed their concern that the reforms suggested could not be implemented without a high level political support as well as adequate legislative adjustments to support these changes.*
6. As a follow-up to Tashkent, the Secretariat prepared a short policy paper on developing “good practices” for managing public environmental expenditure (“The Good Practices of Public Environmental Expenditure Management”), aimed at policy decision-makers in the NIS. This policy paper outlines the essential elements of a toolkit for improving environmental expenditure management by public financing institutions in transition economies (with a focus at targeted, technical assistance tailored to the needs of specific institutions which aim to introduce expenditure management practices in line with internationally recognised good practices). These good practices are applicable but not limited to earmarked environmental funds as various institutional arrangements are possible to manage public environmental expenditure. The Good Practices are also meant to facilitate the discussion between environmental authorities in the NIS and other parts of the government as to the optimal institutional arrangements for managing public resources for environmental protection. Governments could also use these Good Practices and sound principles of public expenditure management in assessing the performance of any existing or newly established institutions managing environmental expenditure. The policy paper was also prepared with the aim of launching a consensus-building process on reforms needed for improving public environmental expenditure management in the NIS as well as for reaching an agreement on the further steps towards achieving political endorsement by Environment Ministers at the Kiyv “Environment for Europe” Conference.
7. In the context of the discussion on integrating environmental and public finance, the Secretariat presented the preliminary findings and conclusions of the Survey on Non-Monetary Transactions Conducted by NIS Environmental Funds, launched at Tashkent, back in March 2000. This Survey was based on a detailed questionnaire which was filled out by seven NIS national environmental funds (Azerbaijan, Belarus, Kyrgyzstan, Moldova, Russia, Turkmenistan, Ukraine and Uzbekistan). It also looked at seven selected Russian oblast environmental funds (Arkhangelsk, Kirov, Kursk, Nizhny Novgorod, Tomsk, Vladimir) and two Ukrainian oblast Funds (Donetsk and Lviv). The Survey shows that there is little progress in Funds’ performance towards compliance with the best international good practices for public environmental expenditure management, such as those contained in the St. Petersburg Guidelines. It also shows that Funds are not essential instruments of environmental policy in the NIS and the NIS environmental agencies place more emphasis and attention on these Funds than they actually deserve. Another major finding emerging from the Survey is that, in general the non-cash component of the Funds’ transactions is growing and the non-monetary transactions (NMTs) are further spreading throughout the NIS with all forms of non-cash operations made use of (barter being the most common, followed by pollution charge offsets and veksels). However, the participants from Russia and Ukraine reported that their governments are working on creating an appropriate policy framework for phasing out non-cash revenues. The final draft of the paper on NMTs will be presented at the next Network meeting. The results of the Survey will also be used as a reference in various analytical papers to be prepared by the EAP Task Force for the Kiyv Ministerial Conference in 2003.

8. During the Working Groups discussion on the Good Practices the participants recognised that the proposed steps to implement the good practices were relevant and could realistically be implemented over a period of two years providing there was a political will and commitment. The participants agreed that such institutions should have clear spending programmes with SMART objectives and should be primarily involved in selecting and financing projects through competitive procedures. Such institutions need to have management bodies and staff with clearly defined responsibilities and a sufficient degree of managerial freedom and autonomy from political interference. All procedures need to be transparent and decision-makers held accountable for their choices. The participants also recognised that environmental authorities should periodically review the effectiveness of such institutions as policy instruments and adjust them to the evolving needs of the transition process. In this regard, it was also pointed out that for such reforms to be effective they needed to be legally backed up by a law or other bye-laws. Some participants pointed out the need for clearly defining the entities entitled to government subsidies. To this end, it was suggested *that a meeting at the level of Deputy Ministers of Environment, Finance and Economy should be convened in order to achieve consensus on the proposed reforms and build political support for implementing the good practices.* The participants also supported a gradual removal of non-monetary transactions from the operations of such institutions. In this regard, Kyrgyzstan, Kazakhstan and Uzbekistan requested help from the EAP Task Force.
9. *At the Network meeting in Tashkent, 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. The EAP Task Force responded to this need and launched a demonstration project in Kazakhstan on reviewing the performance of the State Environmental Protection Fund (a republican and 16 local funds) and other Sources of Environmental Finance. The main conclusion of the review is that the Funds in Kazakhstan fulfil the mandate given by national legislation but they are not financial institutions managing public environmental expenditure, as internationally understood. However, if strengthened and upgraded to internationally-recognised standards, the Kazakh Funds could potentially become co-financiers of environmental investments and even act as intermediaries or service-providers for external sources of finance. To this end, the EAP Task Force Secretariat jointly with the Ministry of Natural Resources and Environmental Protection of Kazakhstan has designed a follow-up project for reforming environmental finance mechanisms. Donors' support is being sought for implementing the project. The project aims at demonstrating the ability to bring existing institutions for managing public environmental expenditure in line with international practices. However, the implementation of the reforms requires strong political will and commitment by the Kazakh authorities.
10. Mr. Oleg Kulik of the Ministry of Ecology and Natural Resources of Ukraine was invited to present the activities related to strengthening environmental funds in the country. He pointed out the low level of disposable resources at the Funds. These are often not used for the purposes envisaged in the legislation. Funds encounter difficulties in selecting and financing projects. In this context, the Secretariat presented a new mechanism designed to facilitate transfer of practical knowledge and expertise between the most successful CEE environmental funds and NIS funds on how to effectively finance environmental investments. The CEE – NIS twinning mechanism for institutional strengthening of Environmental Funds at national and regional levels in the NIS is envisaged as a supplement to donors' programmes and is aimed at addressing specific training needs of individual Funds.
11. *The participants recognised that the Funds system, as it currently exists in the NIS, needs reforming. Major reform measures need to be implemented in order to bring these Funds in line with*

*internationally-recognised standards – ranging from changes in the legal basis to introducing proper project cycle management procedures. Hence, the need for extensive training.* The EAP Task Force was requested to organise training seminars on these issues for NIS funds experts. Kyrgyzstan offered to host such a seminar. Several countries expressed their willingness to participate in the twinning mechanism (Kazakhstan, Kyrgyzstan, Uzbekistan). The participants also called for establishing partnerships among NIS environmental funds to arrange co-financing of cross-country environmental programmes. Kyrgyzstan and Uzbekistan expressed their willingness to be used as “case-study” countries in launching such a co-operation. The EAP Task Force Secretariat would be happy to facilitate such a process but donors’ support will be needed as well as strong commitment on the part of the countries involved. Donors may want to consider this idea.

12. The representatives of Russia and Georgia shared that they were working with the Paris Club on restructuring their external debts. Both countries are hoping that donors will agree to swap part of the countries’ external debt to be converted into financing of environmental investments. The EAP Task Force Secretariat are willing to work with the countries on this issue once framework agreements with the Paris Club are reached. The participants requested more information on this mechanism. In this regard, the participants may choose to look at the EAP Task Force web-site <http://www.oecd.org/env/eap/finance/efnet/polishfundreview.htm> and check the report from the performance review of the Polish EcoFund in English and Russian (“Swapping Debt for the Environment: the Polish EcoFund”). For additional and more recent information, the participants may want to check the web-site of the Polish EcoFund (the information exists in English and Polish only) - <http://www.ekofundusz.org.pl/us/index.htm>
13. The major conclusions and policy options emerging from the Environmental Financing Strategies in the Water Sector (EFS) were the topic of discussion during the fourth session of the meeting. The work on the EFS in Georgia, Moldova and the Nizhny Novgorod Oblast in the Russian Federation has already been completed, and the EFS for Kazakhstan and the Pskov Oblast in Russia are close to being finalised. In Ukraine, the EFS is under preparation. The 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. Currently, Slovakia, Kaliningrad and the Novgorod Oblast in the Russian federation are being considered as countries/regions where EFS for the water and solid waste sector can be developed.
14. The Secretariat presented the modelling methodology, including data requirements for calculating expenditure needs and for developing the forecast for the supply of finance. Representatives of the case study countries (Mr. Viktor Zubarev from Moldova, Mr. Marat Balgereev from Kazakhstan, Mr. Vladimir Savin and Ms. Nina Korobova from Russia and Mr. Malkhaz Aseishvili from Georgia) were invited to present the major results and policy implications of the possible scenarios for closing the financing and affordability gaps. The work on the strategies in these countries has confirmed, in quantitative terms, the serious situation of the municipal water and waste water infrastructure. A fundamental challenge to any effort to overcome the water sector crisis is to find practical solutions under conditions of very scarce funds in public budgets and extremely limited capacity for additional borrowing. The Strategies have proposed short-to-medium term actions to achieve realistic and affordable targets. In all countries studied, there is a scope to raise water user charges within the generally accepted "norms" of what households can afford (the standard benchmark is 4% of households’ income). There is no other alternative way to cover operation and maintenance (O&M) expenditure and avoid further deterioration of service level and quality in the urban water sector but by increasing user charges. On the other hand, increases in user charges should be part of an overall strategy for improved service provision developed through a participatory process, making appropriate provisions for poor and vulnerable households. In terms of sources of major capital investments and rehabilitation in this sector, it is clear that in the short-to-medium term public budgets/funds will continue to play a key role.

15. Thus, the EFS 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 also 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.
16. It was recognised that these strategies are a practical tool for realistic assessment of costs and available financing for optional targets. Mr. Viktor Zubarev of the Ministry of Economy and Reforms from Moldova demonstrated the capacity of the interactive computer model used in simulating, 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 Users Manual, which will accompany the computer-aided toolkit, will be released soon in both English and Russian and will be made available to all interested countries. *To this end, several countries have expressed their interest to further continue the work on the EFS: Armenia, Kyrgyzstan and Uzbekistan requested EFS for the water supply and sanitation sector; Kazakhstan requested an extension of the Financing Strategy to the waste and air sector as well as assistance in developing a short-to-medium term investment programme for the urban water and sanitation sector (on the basis of the EFS). Several countries also requested training for multi-stakeholder teams in using the EFS model.*
17. As part of the session on the EFS, the conclusions emerging from the first cycle of the environmental expenditure studies in Georgia and the Novgorod Oblast of the Russian Federation were presented. The expenditure study in the Pskov Oblast in Russia is close to finalisation. These studies are conducted on the basis of OECD methodology. However, the methodology has been improved and adapted to the specific conditions in these countries 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. The results from the studies show a lot of inconsistencies in the data collection system. While there is no regular data collection from enterprises, information on government budgetary data is extremely limited. Data on environmental investment expenditure are collected more regularly than data on current expenditure and O&M costs. To this end, 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. 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.
18. *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 could 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. In this context, Georgia 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. In this regard, Armenia and Kazakhstan requested that that such studies be conducted in their countries as well.
19. The Survey on Financial Trends in the NIS was launched at the end of the second day of the meeting. The major objectives of the Survey are to: (i) collect consistent data on financial flows to the NIS in

terms of domestic expenditure (both public and private), FDI and ODA and identify regional patterns; (ii) to get a sense of the scale and magnitude of these flows; and (iii) to set-up a comprehensive database on this issue. The Survey is intended to serve as a baseline in preparing a report for the Kiyv Ministerial Conference “Environment for Europe” (in response to the call by Environmental Ministers in Aarhus) in order to conduct an analysis of the extent to which “refocusing” on the NIS has actually occurred and identify policy responses for addressing the obstacles to increasing environmental financing in the NIS.

20. The Survey, to be carried out through a detailed questionnaire, was discussed by the participants and a general agreement was reached as to its contents and the practicalities relating to its implementation. All NIS countries are invited to participate in the project. A key concern is the access to and availability of information. For this purpose, the Secretariat seeks case study countries where the methodology can be tested. Armenia, Kyrgyzstan and Uzbekistan already expressed their interest to play such a role. The Survey Questionnaire will be sent out to NIS experts by mid September 2001. The first phase of the Survey and the analytical part based on it are expected to be completed by the end of the year 2002. The first draft of the Survey report will be presented and discussed at the next meeting of the Network.
21. The last session of the meeting was dedicated to Financial Planning for Urban Environmental Infrastructure - a new area of work in the EAP Task Force Environmental Finance Work Programme. The Secretariat had the opportunity to present the new project, its objectives and the toolkit to be developed. The project aims to introduce long-term financial/investment planning as a basis for annual municipal budget preparation thus enhancing cities’ financial viability and creditworthiness and facilitating access to external sources of finance. Long-term investment plans for municipal environmental infrastructure will be applicable to overall capital needs of municipal services. Particular attention will be paid to water, sanitation, district heating, solid waste and public transportation infrastructure. The project will benefit all twelve NIS countries. However, pilot implementation of demonstration projects will only occur in selected countries and cities. Transparent process within the framework of the EAP Task Force, involving NIS, donor countries and IFIs will be initiated to select cities for the pilot projects.
22. As part of the session on Municipal Finance, the participants had the opportunity to learn more about the experience of other countries in this area. Ms. Angelina Gurkina, a representative of the USAID-Russia presented their programme on Municipal Economic Development. Within the local budgets and finance part, USAID-Russia reported efforts on, among others, strengthening of municipal associations, policy dialogue on financial responsibilities, introduction of performance-based budgeting, debt-analysis, constant budget monitoring, prediction and assessment, debt analysis, multi-year budgeting. In their 2001 Programme, USAID is going to be involved in the development of a policy and legislation framework at national and regional levels to promote reforms and allow municipalities to implement changes in co-operation with local businesses and NGO communities. USAID-Russia is also supporting a project for exploring the possibility for setting up a Loan-Guarantee Fund for Municipal Infrastructure with the aim of facilitating and creating conditions for attracting private capital into the municipal housing and communal sector.
23. The participants also had the chance to learn about the CEE experience in the area of municipal finance. The experience of the Polish City of Poznan on Capital Improvement Programme (CIP) was presented as a case study at the meeting by Mr. Tomasz Kayser, Deputy Mayor of Poznan. The CIP is used as a strategic management tool by the Poznan City authorities in the process of investment planning at a municipal level. This tool has been used for several years now and has proved to be extremely useful and practical in the routine investment planning process. Mr. Kayser, on behalf of Poland’s Local Government Association, confirmed the interest and commitment of the Association to

co-operate with the NIS within the EAP Task Force framework in the transfer of know-how and expertise in this area.

24. NGO representatives, participating at the meeting, requested a slot on the agenda to make an official statement. NGOs requested closer co-operation with NIS governments and the international community within the EAP Task Force framework. NGOs are willing to participate in different EAP Task Force projects in monitoring the implementation of the decisions from the Almaty Ministerial Consultation between Economic / Finance and Environment Ministers on Water Management and Investments in the NIS (October 2000). NGOs would like to organise a number of seminars on the areas of work of the EAP Task Force in order to be able to further disseminate the results of this work among NIS community. They believe they could effectively facilitate the dialogue between governments and the population and could help in creating popular support for the implementation of the EAP Task Force projects.

#### Evaluation of the Meeting

25. As usually done at the EAP Task Force events, the participants were asked to evaluate the process and the contents of the meeting. Most of the participants are satisfied with the overall organisation of the meeting. The role and the support of the Ministry of Natural Protection of Armenia, and more specifically Ms. Nune Darbynian and her colleagues from the International Cooperation Department, were particularly appreciated in this regard.
26. The participants noted that the meeting was conducted in a highly professional manner, with well-prepared documents and presentations. One common concern, expressed by most people, was that the allocation of time for in-depth discussions after the presentations was greatly insufficient. Working Groups discussions have to be more focused and should give equal opportunities to all participants to participate in the discussion. The assessment also stressed the need for more meetings on these and related topics.
27. The representative of the Novgorod Oblast, Russia, kindly suggested to host the next meeting of the Network in Novgorod. The Secretariat would like to thank Novgorod for the offer which will be further considered.