

EAP Task Force



CENTRE FOR
PRIVATE SECTOR DEVELOPMENT
ISTANBUL



**SEVENTH MEETING OF THE
EECCA ENVIRONMENTAL FINANCE NETWORK**
26 - 27 January 2004
Istanbul, Turkey

SUMMARY RECORD

**Seventh Meeting of the EECA Environmental Finance Network
26 - 27 2004, Istanbul, Turkey**

I. Session One: “Environment for Europe” Process after Kiyv – Implications for the Work on Environmental Finance

1. The Seventh Meeting of the EECCA Environmental Finance Network¹ was 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) and held at the OECD Istanbul Center for Private Sector Development. The meeting was attended by over 60 participants from EECCA, OECD and other non-OECD countries (Croatia) (for more information, please see the attached list of participants). The participants included officials from EECCA environmental agencies, Ministries of Economy and Finance, Committees on Statistics, experts in the area of environmental finance. Representatives of the NGO community, international organisations (Regional Environmental Centre (REC) for CEE, REC for the Russian Federation) and international financing institutions (EBRD/PPC²), bilateral donors (Austria, Czech Republic, Germany, Greece, Italy, Turkey), EECCA local governments as well as private sector consultants, active in the EECCA region, also attended the meeting.

2. The main objectives of the meeting were to:

- Report on the results of the 2001-2003 EAP Task Force Program on Environmental Finance;
- Launch the new 2004-2006 EAP Task Force Work Program on Environmental Finance, in light of the conclusions adopted by Environment Ministers at the 5th “Environment for Europe” Conference, held in Kiev, Ukraine, May 2003;
- Discuss the proposed work program of the Project Preparation Committee (PPC) as well as those activities that might be jointly implemented by the EAP Task Force and the PPC.

The emerging results from the work on environmental finance will be presented to Environmental Ministers at the Kiev+ 1 Ministerial Conference, scheduled to take place in October 2004, in Tbilisi, Georgia.

3. *Prof. Dr. Mustafa Ozturk, Deputy Undersecretary from the Turkish Ministry of Environment and Forestry* welcomed the participants and stressed that this meeting presented yet another opportunity for transferring of know-how across countries, including between EECCA and Turkey. *Mr. Brendan Gillespie, Head of the Non-member Countries Division at the OECD Environment Directorate*, presented the major outcomes of the Kiev Ministerial Conference and the implications for the new work program of the EAP Task Force in general and the work on environmental finance in particular. He placed a special emphasis on the challenge for the EAP Task Force to facilitate and support the achievement of objectives identified in the EECCA Environmental Strategy adopted by Environmental Ministers at Kiev.

4. *Mr. Grzegorz Peszko*, presented a general overview of the work on environmental finance carried out by the EAP Task Force as part of the previous work program. He introduced one of the main

¹ Meetings of the Network (previously known as the NIS Environmental Funds Network, NIS Environmental Finance 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, in Yerevan, Armenia in May, 2001 and in Warsaw, Poland, in July 2002.

² PPC stands for Project Preparation Committee, created as part of the “Environment for Europe” process to facilitate match-making between IFIs providing loans to transition economies and donors providing grants for technical assistance as part of the preparation of IFIs investments.

communication tools developed by the Secretariat – an off-line database containing all major products and tools developed by the EAP Task Force over the past four years. An identical on-line database is placed at EAP Task Force web-page and can be reached at <http://oecd.hybrid.pl> .

II. Session Two: Report on the Implementation of the 2001 – 2003 EAP Task Force Program on Environmental Finance

5. An overview of the major outputs and tools developed over the past years in the 5 areas of work on environmental finance was presented during this session. These areas are:

- Improving environmental expenditure information systems;
- Strengthening realism and affordability of environmental financing strategies;
- Strengthening investment capacity of local governments;
- Improving management of public environmental expenditure;
- Facilitating dialogue on opportunities and risks of debt for environment swaps.

6. The main findings from the work carried out in the area of environmental expenditure information systems as well as the main conclusions from the report on the Trends in Environmental Expenditure and International Commitments for the Environment were presented by *Ms. Carla Bertuzzi*. In addition, the outcomes of the demonstration project in Georgia on setting up a regular and consistent system of environmental data collection was reported. Some of the major conclusions emerging from the work in this area reveal that:

- Expenditure data collected by EECCA are too weak to support robust policy relevant conclusions;
- Due to major methodological problems in data collection, meaningful comparability among countries and over time is difficult.
- In most EECCA, capital investment expenditures compared to current expenditures are negligible;
- Water supply and sanitation accounts for the largest share of environmentally-related expenditures in EECCA (50-85%);

7. **General consensus on the need to improve EECCA expenditure information systems in line with international standards such as those of OECD and Eurostat was achieved.** A number of participants pointed out that the methodology developed by the EAP Task Force is very useful and should be more widely disseminated and implemented in the countries. Projects for fostering harmonisation of environmental expenditure systems with OECD/Eurostat standards are envisaged to be implemented in Kyrgyzstan and Ukraine as part of the new work program on environmental finance.

8. As part of the discussion on environmental financing strategies (EFS), *Mr. Alexander Martusevich*, presented an overview of the major findings and conclusions emerging from the work of the Secretariat in this area. A case-study from the Russian Federation - Yaroslavl Oblast (municipal solid waste sector) - was presented by *Ms. Tamara Machtina*.

9. The FEASIBLE model has been used in the development of financing strategies for water and environmental infrastructure in a number of countries and regions in both CEE and EECCA as well as in China, for that matter. Fifteen financing strategies have been prepared so far (in Georgia, Moldova, 8 regions in Russia, Kazakhstan, Ukraine, Armenia, Latvia). A new version of the model has been prepared – FEASIBLE 2. The new version calculates gaps in financing of the urban water supply, wastewater

collection and treatment sector, rural water as well as municipal solid waste sectors. A particular improvement in the model is related to the calculation of affordability levels based not on average income as done before but on the basis of different income groups. This allows to have a more realistic picture of these layers of the population that need subsidies in order to pay their water bills. A number of EECCA experts and officials have been trained in the use and application of the FEASIBLE model. Additional training on the model is envisaged as part of the new work program on environmental finance.

10. The major conclusions and challenges emerging from several years of work on the country/regional EFS show that:

- The continuation of current trends in financing water supply and wastewater treatment infrastructure is not sustainable and would likely result in further serious deterioration of services in this sector;
- Poor municipal solid waste management practices in most EECCA have led to serious threats to environment and public health as poorly operated dump sites and landfills do not meet national environmental and sanitary requirements. This situation needs urgent solutions;
- User charges are the only feasible long-term source of finance for operation and maintenance (O&M) expenditure in the water sector;
- In the municipal waste management sector, tariffs are also very low but in some cases (e.g. Yaroslavl) they are sufficient to cover operating costs, thus making the sector financially viable and attractive for private operators. As a result, more private sector involvement is observed in the management of municipal solid waste;
- Households in EECCA are often able and willing to pay more than they are currently paying providing services are improved. The affordability constraint is more of an issue for the water supply and sanitation sector than for the municipal solid waste management sector;
- In the short-to-medium term, national and local budgets have an essential role to play in financing rehabilitation and capital investments in these sectors, in providing social protection and /or operating subsidies to water utilities as well as 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 (operators, strategic investors) for public infrastructure will still play a more limited role in the coming years due to a number of obstacles, such as significant risks and uncertainty caused by improper regulation, institutional set-up and tariff policy that undermine the financial health of utilities and discourage private operators.

11. **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.** As part of the new work program, more financing strategies are envisaged to be developed. Some of the previous ones will be revisited with a particular focus on developing plans for their implementation. Some regions in Russia (e.g. Khanty-Mansiysk) have already allocated their own resources for the preparation of such strategies as they see this as an important tool for policy and decision-making.

12. As in most EECCA countries financing of environmental infrastructure is a responsibility of local governments, the limited management capacity of municipalities to design, finance and implement heavy-cost infrastructure investments is a significant constraint to raising debt financing for such projects. In this context, *Mr. Dariusz Smialkowski* presented an overview of the work carried out by the Secretariat on strengthening investment capacity of local governments in EECCA. The results of this work are mainly

based on experience from the demonstration projects in Ukraine (Lutsk, Donetsk) and Russia (Ekaterinburg) with developing multi-year investment plans (MYIP). *Mr. Vitalij Michajlov* presented practical experience from Ukraine, from the 3 cities in the Donetsk Oblast where such plans were prepared.

13. The experience from this work reveals that investment plans for municipal infrastructure require improvement of city's budget preparation and monitoring processes. It also shows that local governments in EECCA 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 EECCA cities is mostly driven by ambiguous and discretionary criteria.

14. MYIP could help overcome some of these problems. MYIP introduce medium term financial planning into the regular yearly budget process which results into better allocation of scarce public resources, improved transparency and enhanced financial viability and borrowing capacity of local governments. The computer model for preparing MYIP, developed under the guidance and supervision of the EAP Task Force, as well as the toolkit for EECCA municipalities, which consists of guidelines, instructions, software applications, templates of documents and administrative procedures, provide local governments with an instrument that helps facilitate transition from myopic, ad hoc municipal investment planning, to predictable, realistic 4-6 year rolling investment programs based on clear rules and procedures that are credible to investors.

15. **Agreement was reached that mid-term, rolling MYIP are important and practical tools for EECCA municipalities to enhance their investments in environmental infrastructure and to improve their access to finance.** An obvious obstacle to introducing MYIP in EECCA is the lack of provisions in Budgetary Codes of long or medium-term capital investment plans as well as the lack of approved procedures for developing such plans. In such cases, regulations need to be changed to promote MYIP. In order to support further dissemination of this approach and tools, as part of the new work program, additional MYIP for municipal water and environmental infrastructure are envisaged to be implemented for which EECCA candidates are sought. Training of municipal officials as well as technical experts in financial management will be carried out as well. Additional demonstration projects, linked to prospective IFI loans, are possible subject to additional funding.

16. As most of infrastructure projects developed by EECCA municipalities are too small to be of interest to IFIs, the EBRD representative *Mr. Eugene Ofrikhter* recommended that municipalities should make use of economies of scale, by getting together and proposing a package of projects which would create critical mass of resources that would make the package more attractive to IFIs. In addition, while credit lines for small cities are in principle possible, these require interest from good commercial banks which are not always easy to find in EECCA. For this reason, the opportunities for issuing credit lines for smaller cities in EECCA are still underutilised.

17. An overview of the work conducted by the EAP Task Force in the area of public environmental expenditure management (PEEM) was presented by *Ms. Nelly Petkova*. *Ms. Tatiana Pleshco* presented the major findings and recommendations from the Performance Review of the National Environmental Fund in Moldova conducted by the EAP Task Force and the follow-up work on implementing some of the review recommendations in terms of legal, institutional and operational changes of the Fund and the Funds system in the country.

18. Some of the major conclusions emerging from the analytical work on the performance of environmental funds in EECCA show that:

- In general, the performance of environmental funds in EECCA is very poor - they usually comply with their national legislation but do not meet internationally-recognised standards for public financing institutions;
- They are insignificant players vis-a-vis other sources of finance in these countries and are often driven by political considerations rather than efficiency and cost-effectiveness concerns;
- Expenditure programs are vague and ad-hoc while project appraisal and selection criteria are non-transparent;
- Very few EECCA environmental funds manage expenditures (e.g. apply routine project cycle management procedures) - they primarily focus on revenue collection, with very poor results. Where tax authorities have been involved in the revenue collection (e.g. Ukraine, Russia), the collection rate has significantly increased;
- There have been few improvements on the revenue side - new revenue-raising instruments have been introduced to feed the funds (e.g. in Moldova - product charge on imported fuels, tires, batteries, tobacco products). In principle, such charges have relatively lower administrative costs than pollution charges;
- A significant problem for most Funds is the lack of a clear institutional set-up and qualified and professional staff for managing expenditure programs;
- However, experience from Central and Eastern Europe shows that if properly designed and managed, funds could become effective and efficient instruments for implementing national/regional environmental policies.

19. With the aim of helping improve public environmental expenditure management, the EAP Task Force Secretariat has developed two major tools in this area: Good Practices of Public Environmental Expenditure Management in Transition Economies (PEEM) and Handbook for Appraising Environmental Projects Financed by Public Funds.

20. The Good Practices of PEEM, endorsed by Environmental Ministers at Kiev, aim to provide guidance to environmental agencies on how to design and implement public environmental expenditure programs. They also provide a structure for evaluation of the performance of such programs in terms of environmental effectiveness, fiscal prudence and management efficiency. Two Funds have been evaluated so far using the Good Practices methodology, namely the National Environmental Fund of Moldova and the Volgograd Oblast Environmental Fund in Russia. In addition, a representative from Donetsk reported that they had used the Good Practices methodology to conduct a self assessment of the Donetsk Oblast Fund which is one of the important applications of the Good Practices. As part of the new work program, the Secretariat is planning to conduct more systematic performance measurement and international benchmarking of public environmental expenditure programs. Harmonising performance evaluation with credit rating by private agencies was identified as an interesting area for future work.

21. If the Good Practices show what needs to be done to improve PEEM, the Handbook aims to show how to implement these Good Practices in programming and project cycle management with focus on wastewater infrastructure projects. The Handbook is based on the best practices of the most advanced CEE Environmental Funds and OECD subsidy programmes. The Handbook is close to final and is expected to be published in April 2004. Training on the Handbook is envisaged in the new work program for 2004 – 2006. **Both the Handbook and the Good Practices were approved as tools for evaluating and improving performance of public environmental expenditure programs.** It was acknowledged that they could help improve access of EECCA environmental agencies to additional finance.

22. The potential for financing public environmental expenditure through debt-for-nature/environment swaps³ was widely discussed during this session. *Mr. Grzegorz Peszko* presented the work done by the Secretariat in close collaboration with the Georgian Government in preparation of a Pre-Feasibility Study for developing a framework for negotiations and design of mutually acceptable debt-for-nature swaps with selected Paris Club⁴ creditors. This paper reviews 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.

23. As part of the new work program, additional analysis has already been carried out in developing specific project pipelines on the basis of country's priorities that could potentially be financed from the funds made available through a swap deal. This second part of the project on the institutional support to the Georgian debt for environment swap further strengthens the analysis and ensures that Georgia is well prepared for the negotiations with the Paris Club creditors.

24. **Participants expressed their interest in the results of the analysis conducted by the EAP Task Force in cooperation with the Georgian Government in preparing a pre-feasibility study and identifying project pipelines for potential debt-for-environment swaps in Georgia.** A similar demonstration project, as part of the new work program, is planned for Kyrgyzstan. The Kyrgyz Republic is the only other EECCA country to have included a debt-for-nature swap clause in the debt restructuring agreement with the Paris Club.

III. Session Three: Consultations on the New 2004 – 2006 EAP Task Force Work Program on Environmental Finance

25. This session was dedicated to the new 2004-2006 work program, presented by *Mr. Grzegorz Peszko*. He pointed out that while there is a continuation of most of the activities from the previous work program, dissemination activities as well as implementation and practical application of the tools developed until 2003 will be the major focus of the new program. In addition, the work on environmental finance will be more closely linked to the PPC-type of activities due to converging objectives of the two bodies.

26. The main components of the new work program are:

- Aligning environmental expenditure information systems with OECD/Eurostat standards;
- Implementing financing strategies for water and environmental infrastructure;
- Improving management of public environmental expenditure;
- Facilitating access of environmental projects to local capital and financial markets;
- Strengthening local governments' capacity to invest in environmentally-related infrastructure;
- Debt for environment swaps.

³ 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.

⁴ 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: <http://www.clubdeparis.org/en/index.php>

27. Of all these components, facilitating access of environmental projects to local capital and financial markets is a completely new element. The decision to include this work element is related to the need to better understand emerging opportunities for using local currency debt to finance local infrastructure investments in EECCA. Although until recently, local financial sector and local capital markets, knocked down by the Russian financial crisis in 1998, have been unable to provide adequate debt financing to municipalities and utility operators, several signals seem to indicate that the investment climate for infrastructure investments has been improving and the capital and financial markets have started showing signs of maturity. Having this in mind, the project has been launched with the aim of collecting more information as well as facilitating the acceleration of these positive developments and harnessing opportunities for financing water and environmental infrastructure from capital and financial markets.

28. Work has been already done in launching some of the individual projects included in the 6 components of the work program. These projects are at different stages of development ranging from launched and on-going, to fully prepared, partially prepared, to such for which both EECCA partners and donor support are sought.

29. The new work program on environmental finance was endorsed by the members of the Network. **In this context, Network members are encouraged to send letters to the EAP Task Force Secretariat with expression of interest to participate in demonstration projects included in the new work program on environmental finance.**

IV. Session Four: Joint Co-operation between the EAP Task Force and the PPC

30. The EAP Task Force and the PPC were mandated by Environmental Ministers at Kiev to work more closely together. In this context, *Ms. Sara Browning*, PPC Executive Secretary, presented the new 2004 – 2007 PPC Strategy and outlined possible ideas for joint projects between EAP Task Force and the PPC. *Mr. Grzegorz Peszko*, further reinforced the opportunities for such co-operation.

31. The major areas of cooperation proposed were:

Contribution by the EAP Task Force:

- Design of demonstration projects so as to provide technical assistance to IFI operations;
- Building capacity of present and future IFI clients through demonstration projects and training;
- Reducing risks to IFI projects by providing solid empirical analysis of enabling conditions and investment environment;
- Improving institutional and policy environment for IFI projects.

Contribution by the PPC/IFIs:

- Participation in the design and implementation of demonstration projects (ToR, steering committees, quality assurance);
- Access to relevant reports, documents, information and contacts;
- Joint trainings, workshops and capacity building;
- Joint publications (tools, good practices), peer review and dissemination of documents.

32. **It was agreed that enhanced cooperation between the two bodies could mutually benefit members of the EAP Task Force and the PPC.** Joint meetings and training workshops are already being planned as part of the new work program.

33. In conclusion, the major outcomes of the meeting are:

- The major tools and products from the previous work program were approved and endorsed, including the methodologies for collecting environmental expenditure data in line with OECD/Eurostat standards, for developing financing strategies supported by a computer-aided tool (FEASIBLE), a toolkit for developing MYIP for EECCA municipalities, the Good Practices for PEEM and the Handbook for Appraisal of Environmental Projects Financed from Public Funds, as well as the framework for facilitating dialogue on opportunities and risks for debt-for-environment swaps;
- The new work program was endorsed and countries are encouraged to express their interest in participating in individual demonstration projects as identified in the work program;
- Areas of cooperation between the EAP Task Force and the PPC were principally approved but the joint work program needs to be further developed and translated into specific projects where such cooperation could be most useful;
- The need to get the NGO community more closely involved in project implementation was recognised but more efforts both on the part of the EAP Task Force Secretariat as well as EECCA governments are needed in order to make such cooperation practical and operational.

V. Evaluation of the Meeting

34. We would like to thank all for the positive evaluation and feedback on the meeting's substantive contents and organisational issues we received. The participants noted that the meeting was conducted in a very professional manner, with well-prepared documents and clear messages and presentations. A particular request by some participants was to have the preliminary List of Participants before the meeting so that they could plan meetings, negotiations with participating Network members. We shall make sure that we do so in the future.

35. In view of the next annual meeting of the Network, the Secretariat is looking for a host country to help organise the meeting. In this connection, we would encourage countries to express their interest in co-hosting the meeting and contact us over the next several months.

36. The OECD/EAP Task Force Secretariat would like to take this opportunity to once again thank our Turkish colleagues from the Ministry of Environment and Forestry and the Turkish International Cooperation Agency for their support for the meeting.

VI. Experts' Meeting on Environmental Financing Strategies

37. In addition, on 28 January 2004 a small experts' workshop was organised to present selected countries' experience with developing financing strategies for the water and environmental infrastructure sectors to Turkish government officials, involved in financial planning for urban infrastructure. The meeting was also linked to the implementation of an EU-supported project on Environmental Heavy Cost Investment Planning in Turkey.

38. This subject was of particular interest to our Turkish colleagues vis-a-vis the country's ambition to join the European Union. The work and policy recommendations presented by EECCA participants could be specifically useful when it comes to financial planning for the implementation of the EU heavy-cost environmental directives in Turkey.

39. In addition, the concept of the FEASIBLE model, that supports the preparation of financing strategies, and its application in calculating the financial gap between the required and the available finance was presented by *Mr. Grzegorz Peszko*. This was followed by a discussion on the practical use of the financing strategy in the negotiation process with the EU as a tool for setting realistic targets for the implementation of EU environmental directives and reaching agreement on respective transition periods. The Turkish representatives expressed interest in further cooperation in this area within the EAP Task Force framework.

40. *Ms. Birgitte Martens* from COWI presented the FEASIBLE-2 tool as well a case-study from Riga (Latvia) where the tool was used to assess the costs of meeting the requirements of the EU Directives on municipal solid waste management.

41. Special thanks go to our colleagues - *Mr. Rubik Davtyan* from Armenia, *Mr. Andrei Isac* from Moldova and *Mr. Alexander Boitsov*, Vice-Governor of the Novgorod Oblast of the Russian Federation. They presented their countries' experience with the development of financing strategies, respectively: a strategy for the wastewater collection and treatment sector in Armenia, for the urban water supply and sanitation sector in Moldova and for the municipal solid waste sector in the Novgorod Oblast. The Turkish counterparts were invited to attend the final workshop in Yerevan where the final report on the financing strategy for urban wastewater collection and treatment in Armenia would be presented.