EAP Task Force Secretariat/OECD
and EU Phare Programme

Review of the Estonian Environmental Fund

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1 INTRODUCTION

1.1 BACKGROUND

The EAP Task Force is engaged on a series of voluntary reviews of environmental funds in Central and Eastern Europe (CEE) under the aegis of the Funds Network, which is supported in CEE by the European Union’s (EU) Phare Programme. Each review examines the operations of a given Fund and identifies institutional strengthening measures that would enhance fund effectiveness and efficiency. Reviews generally cover the major areas addressed by the St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy (OECD, 1995). Following the second meeting of the CEE Funds Network, the Task Force Secretariat based at the OECD received a request from the Estonian Environmental Fund to conduct such a review.

1.2 THE ESTONIAN ENVIRONMENTAL FUND

The Environmental Fund in Estonia (the “Fund”), dates back to 1983. Its revenues were, however, quite limited until the mid-1990’s. The Fund was reorganised in 1990, and in 1994 new legislation established the main features of the present structure and re-established the Fund as an extra-budgetary body. The Fund is a legal entity which operates under the authority of the Minister of Environment. The Fund formally consists of two parts: a Central Fund and 17 county or municipal funds. In 1996 the Fund established an Executive Unit of three persons. The official purpose of the Fund is to “collect additional resources for the protection of the natural environment and natural resources, and to provide additional funding for measures protecting the natural environment and natural resources.” More detailed information about the Fund (i.e. its objectives, organisational and management structure, revenues, expenditures) is contained in Annex 1.

In early 1998, Estonia was one of five CEE countries invited by the EU to begin negotiations on accession. Environmental requirements are certain to play an important role in the accession process and the Fund could potentially play a substantial role in contributing to the financing of the necessary investments.

1.3 OBJECTIVES OF THE REVIEW

Though focusing on the operations of the Central Fund (located in Tallinn), the review aimed to draw conclusions and offer recommendations which are relevant to the overall environmental fund system in Estonia. Also, while identifying institutional strengthening measures that would enhance Fund effectiveness and efficiency, the review aimed to provide suggestions for changes that can enable the Fund to help Estonia meet specific environmental challenges related to EU accession.

More specifically, the objectives of the review were to:

- assess the Fund’s present legal foundations, organisational and management structure, annual and longer-term planning processes, revenues, expenditures, project cycle procedures, and co-ordination and co-operation with other funding sources;
- assess the Fund’s potential for helping Estonia to meet EU accession related requirements in the environment sector, and;
- elaborate options for improvements in these areas, with particular emphasis on organisational structure and management, revenues, and programme/project cycle procedures.
1.4 Methodology

The review involved three stages: preparatory activities, appraisal and drafting mission, and preparation of the final report. A comprehensive set of background documents concerning, and relevant to, the Fund were examined by the review team (the “Team”) prior to the appraisal mission (see Annex 2). The appraisal and drafting mission was undertaken over the period 10 - 17 May 1998. During this time the team engaged in extensive discussions with Fund staff and Board members, officials of the Ministries of Environment and Finance, Fund clients and other organisations (see Annex 3). The full co-operation of these parties is gratefully acknowledged.

This report reflects the state of the Fund as it was at the time of the review and the months immediately thereafter. The review team acknowledges that some changes have since occurred at the Fund which may affect the accuracy and/or relevance of the report’s conclusions and recommendations.

The review team consisted of the following members: Ms. Zsuzsa Lehoczki, Mr. Grzegorz Peszko, Mr. Daniel Siddy, Mr. Patrick Francis (Head of Mission) and Ms. Nelly Petkova (observer). The team was assisted by a local expert - Ms. Ljuba Gornaja.

The views expressed in this report are those of the Review Team members and do not necessarily reflect those of the European Union, the OECD, the EAP Task Force or their Member countries.
2 EXECUTIVE SUMMARY

2.1 BACKGROUND

In 1983, the “Estonian Fund for Nature Protection and Rational Use of Natural Resources” was established as one of the first such funds in Central and Eastern Europe. The Fund was reorganised in 1990, resulting in the existing “Estonian Environmental Fund”. In 1994 new legislation established the main features of the present Fund and re-established the Fund as an extra-budgetary body. The Fund is a legal entity which operates under the authority of the Minister of Environment. The Fund formally consists of two parts: a Central Fund and 17 county or municipal funds. In 1996 the Fund established an Executive Unit of three persons; the Unit currently has five staff members. In 1997 the Fund received revenues of approximately EEK 146 million (~10.7 mln USD) and made expenditures of about 156 million EEK (~11.2 mln USD).

2.2 KEY CONCLUSIONS AND RECOMMENDATIONS

A number of Estonian officials - at the Fund, on the Fund Board, at the Ministry of Environment (MoE) and elsewhere - have recognised the need for, and opportunities associated with, strengthening the operations of the Fund. The Fund enjoys several positive attributes upon which further developments can be based:

- a long track record of ensuring that public revenues earmarked for environmental protection purposes are collected and put at the disposal of the state and regional environmental authorities;
- an important contribution to the development of project appraisal and preparation skills among MoE staff through the resources it provides in support of MoE goals;
- the recent adoption of more formal, comprehensive accounting and data-keeping procedures, and;
- a substantially increased revenue flow over the past few years.

Such attributes should facilitate the further improvements needed by the Fund for it to come into line with best-practice at other similar institutions in the region. These areas for improvement, as well as more significant reforms which would likely be necessary for the Fund to comply with the St. Petersburg Guidelines and become eligible to administer foreign sources of finance (e.g. the EU and IFIs), are outlined below.

Legal Basis, Organization and Operating Rules

- The draft Act on the Fund should be revised so as to clearly specify the Fund’s legal status, the structure and principal functions of its governing, executive and control bodies, and accounting and auditing standards by reference to legal entities defined precisely in other existing acts (such as the Act on Foundations, the Commercial Code or other entities in public law). The current legal status of the Fund is unclear and weaknesses have been identified in the draft new Act.

- The legal and functional relationship between the Central and County Funds is highly ambiguous and should be clarified in the Fund’s Act. The existence of the 17 County/Municipal Environmental Funds does not appear to be foreseen or mentioned anywhere in the Fund’s Act. Indeed, the Act refers only to a single “Fund” with a single “Fund Board”. The County Funds are not legal entities, but have some revenues of their own, their own bank accounts, their own Boards
and at least some level of autonomy in allocating those resources. While the structure of the County Funds is discussed in the Fund Statute, the legal and functional relations between the County and Central Funds are only scarcely addressed in the Fund’s Statute.

- The Executive Unit of the Fund should be given a statutory obligation to prepare an annual balance sheet and financial report, which should be verified by an independent, chartered external auditor prior to approval by the Board. While acknowledging recent improvements in the Fund’s accounting procedures, the new system should be assessed to ensure that it conforms with standards established by the Estonian Accounting Act for similar institutions. The Fund should also consider harmonising its accounting procedures with international standards.

- The Fund’s Act should specify which external public auditing institutions (e.g. State Auditing Office) are authorised to conduct audits to evaluate the Fund’s performance. The Act and/or Statute of the Fund should include performance criteria against which the Board and the Executive Unit can be evaluated. The Fund Board should not function as both auditor and “auditee”, as currently is the case, and should be relieved of its official auditing responsibilities. Audit reports should be made publicly available.

- The Fund’s institutional identity should be distinguished from that of the Ministry, in particular with respect to project cycle management. There is currently a lack of actual and perceived separation of the Fund from the MoE which raises the question of why the Fund, as a legally independent entity, is needed. The Act should more clearly define and distinguish the separate responsibilities and liabilities of the MoE, Board and Executive Unit vis-a-vis the Fund, in accordance with standards established for other existing, internationally recognized public organizations.

- Any revised Act on the Fund should define the procedures for appointing members of the Fund’s supervisory, executive and control bodies. The authority to appoint members of such bodies should not lie entirely with a single institution.

- The number of Board members should be decreased, perhaps to 9-13. Judged by the size of boards at similar, well functioning institutions in other CEE countries, and according to basic organisational theory, the Fund’s Board of 21 members is large. Such a size is not conducive to efficient deliberation or decision-making and does not seem justified by the Fund’s level of resources and project portfolio.

- The composition of the Supervisory Board should be more representative of the Fund’s clients and public at large, and less dominated by the environmental administration. The representation of County Environmental Departments should be decreased. (Representation of all the counties could be maintained over time by rotating county membership.) The Board should include a more balanced representation of the Fund’s clients and public at large, such as municipalities, environmental NGOs, business organizations and Parliament.

**Financing Policy**

- When the Fund considers whether an applicant has enough other money to fully finance a project, grants obtained by the applicant from external sources should not be counted as “own resources”. Currently, it appears that with the Fund’s contribution some projects may be financed 100% by
grants or other forms of heavily subsidised public funds. In such cases, project sponsors may not be motivated to ensure cost-effective, timely and efficient project implementation. The principle of co-financing should, to the extent possible, also be extended to non-investment projects as this is usually a much better warranty of cost-effectiveness than any administrative control or even competitive public tenders.

- **The legal basis for all financing instruments that may be used by the Fund (in particular loan guarantees and loan cancellation) should be specified in the Fund’s Parliamentary Act.** The Fund’s regulations should not introduce financial instruments which are not explicitly allowed by the Act on the Fund. The Fund’s Statute allows loan guarantees, however, the use of this instrument is not authorised by the Fund’s Act.

- **The Fund’s rationale for providing loans vs grants, and vice-versa, should be more clearly elaborated as should the eligibility criteria for each type of subsidy.** The general principles appearing in the Fund’s documents (which are sometimes followed by numerous exceptions) should be replaced by more rigorously applied rules and clearly defined criteria. The Fund’s data-keeping system should also allow commitments and actual expenditures of the Fund to be broken down according to type of disbursement mechanism and these figures should be included in the reporting requirements.

- **The Fund’s policy on loans should be more clearly formulated and strictly applied.** Specific conditions for debt cancellation should be introduced into the Act (or at least into the Statute enacted by the Government). Debt cancellation should not be left to the discretion of the Fund. Loans, in particular to applicants lacking a proven credit history, should be issued through private banks contracted for loan appraisal and loan management on the basis of competitive risk-sharing agreements. The Fund should develop and implement a policy on collateral. Interest subsidies should be used to leverage bank loans for environmental investments. Great caution should be exercised in issuing loan guarantees, as these may entail unreasonable risks for public entities, particularly in countries in transition.

**Revenues**

- **The large increase in the Fund’s revenues raises the environmental, institutional and political significance of the Fund, bringing greater financing opportunities, higher expectations and more political/public attention.** All of these can, however, subject the Fund to additional stress which can, in turn, aggravate institutional weaknesses.

- **A direct communication link should be established between the County Environmental Departments (CED) and the Fund Executive Unit so that the latter can track the inflow of charge and fee payments from each CED and verify whether the amounts are correct.** Currently the Executive Unit of the Fund does not systematically receive information from the CEDs on the payments that are due at each quarter and there do not appear to be procedures in place through which the Executive Unit checks whether the County Funds have transferred the proper amount of money at the right time.

- **The environmental effectiveness of the packaging tax exemption should be carefully monitored and evaluated.** Generally, such exemptions should be extended only under clear and strict conditions and the required level of recycling/reuse should be verified. The MoE should also compile a list of
the exemptions that were given and this list should be sent to the local tax and customs authorities each quarter.

- **The MoE and Fund Board may wish to consider new revenue sources to ensure continued growth of the Fund’s financial potential.** The Fund has experienced very strong revenue growth in recent years. Some of the Fund’s revenue sources are expected to continue growing (e.g. waste disposal and air pollution charges), however, the growth of certain sources (e.g. water extraction and water pollution charges) is likely to level off. A possible CO2 tax (mentioned by some MoE officials) or new product charges could offer other stable and substantial sources of revenue and would be in line with regional trends.

**Programming**

- **The MoE and Fund Board may wish to consider whether the Fund’s spending strategy, which in effect mirrors the full range of activities undertaken by the Ministry, represents the most effective and efficient use of the Fund’s limited resources.** A more clearly defined and targeted role for the Fund could result in more effective and efficient use of its resources. While the Fund’s spending priorities should remain consistent with the MoE’s environmental priorities, the Fund Board’s role in setting the long-term spending priorities of the Fund should be clear and distinct from the Ministry’s role in setting its own priorities. This role for the Board, and the means of fulfilling it, should be more clearly specified in the Fund’s Statute.

- **The extent, and processes through which, the MoE (or other institutions) may influence the Fund’s spending priorities and project appraisal criteria/procedures, should be clearly specified in the Fund’s Act or Statute.** The current programming process, wherein the various environmental programmes to be financed by the Fund are largely prepared by MoE staff, effectively ensures that the MoE’s environmental priorities are fully reflected in Fund spending. However, the key role being played by MoE staff, and the mechanisms through which that role is played, are not specified in the current Fund Act or Statute. (Indeed, the Act and Statute specify that the Fund Board is legally responsible for the allocation and use of the Fund’s money.) Such deep and extensive involvement of parties external to the Fund in both the Fund’s programming and project cycle management may amount to “micro-management” of the Fund.

- **Wording of the Fund’s Act and Statute should be re-examined so as to ensure that the Fund’s resources are used only for environmental protection purposes.** The wording of Article II, item 6 of the Fund’s Statute, which allows the Fund to finance measures concerning “other problems of national and regional importance”, creates the possibility of financing projects beyond the sphere of environmental protection. Similarly, it can be argued that some of the activities financed by the Fund under the budget line “Planning, Building and Investment”, are only indirectly related to environmental protection.

- **The Fund’s operating rules should not assign powers which extend beyond those provided for in the Fund’s Act and Statute.** The Fund’s internal rules appear to give greater powers to the MoE in affecting the annual Fund budget than otherwise provided for in the Fund Act and Statute, and the Ministry appears to have great power in modifying the Fund’s spending programme after it has been approved by the Fund Board.
• **Transparent procedures and criteria for the competitive selection of banks should be clearly specified in the Fund Statute or operational rules.** Currently, the procedures and criteria for selecting banks where the Fund maintains its accounts do not appear to be specified in either the Fund’s Act, Statute or other operational rules.

• **The Statute of the Fund should clearly define requirements for reporting to the MoE, Government, Parliament and public; guidelines and procedures for fulfilling these requirements should be elaborated in operational rules.** The Fund’s policies toward public disclosure and access to information should be documented and made available to the public and other interested parties. The Fund’s Statute currently requires the Board to “inform the public about the Fund’s activities”, however, this is not supported by detailed guidance or procedures. The Fund does not prepare its own annual report for external distribution nor does it appear to have a formal or informal public information policy. In practice, the Fund’s contributions are mentioned in various MoE reports.

**Project Cycle Management**

• **The Fund’s Statute should outline criteria for project eligibility and indicate key criteria for project appraisal (e.g. cost-effectiveness).**

• **The Fund Board should play a supervisory role, and take lead responsibility for selected, key parameters of the project cycle.** Notwithstanding the Board’s legal liability for ensuring appropriate use of the Fund’s financial resources and its nominal decision-making authority, the project cycle is currently managed primarily within the structures of state environmental authorities at both Central (Ministry) and County levels. An appropriate role for the Board in the project cycle would focus on: the establishment of the Fund’s investment priorities, based on the environmental priorities identified in the National Environmental Strategy and NEAP; the approval of eligibility and appraisal criteria to guide project evaluation and ranking carried out by the Executive Unit; and final decision-making authority on the approval of individual projects for financing. (Though provisions could be made for final decision-making authority to be delegated to the Executive Unit for some types of projects, for example small projects.)

• **Much greater responsibilities should be delegated to the Fund Executive Unit, which would require greater capacity and resources.** For the Fund to properly undertake the responsibilities assigned to it by its Act and Statute (as described above), the management and technical capacities of the Fund’s Executive Unit would have to be strengthened considerably. Fund Executive Units are typically responsible for project cycle management (i.e. project identification, appraisal, ranking, contracting and monitoring of implementation). Such units are also commonly liable for financial management and reporting. Many of the functions currently being fulfilled by the MoE’s Programme Managers should, in fact, be conducted by the Fund. A less optimal alternative would require the Fund Act and Statute to be revised to explicitly recognise the key role being played by the Programme Managers at the MoE in project selection, and clearly assign responsibilities and liabilities between them, the Fund Board and the Fund Executive Unit.

• **The Fund’s approach to project appraisal and ranking could build upon the procedures currently used in the Water Protection Programme as a model (with a number of improvements as discussed in the full report).** The procedures and criteria used by the Water Protection Programme are highly professional compared to most environmental funds in CEE. In developing such project appraisal tools, there should be a clear distinction between simple ‘pass/fail’ criteria for initial screening, and
those which are weighted criteria used for prioritisation. Appraisal criteria and results of ranking should be made known to applicants in order to add credibility to the process.

Implications of Accession to the EU

- The MoE, Fund Board and Executive Unit should jointly develop a clear vision of the Fund’s role in targeting domestic and foreign sources of finance toward the environmental requirements of EU accession. Discussions with Fund management, Board members, MoE and other government officials indicate that they are at an early stage of considering the Fund’s possible role in supporting EU accession. No clear vision supported by a consensus of the key players has been elaborated. There is clearly a need in Estonia for an organisation capable of acting as a financial intermediary (or implementing agency) for EU and other foreign financial support aimed at the environmental requirements of accession.

- The Estonian Environmental Fund would likely require substantial reforms before being able to provide the type of assurances commonly required by foreign institutions that it has the capacities necessary to manage and disburse external finance effectively and efficiently. The reasons for this conclusion, (outlined above and explained in the full report), relate primarily to weaknesses in the Fund’s legal basis, institutional set-up and limitations on the Fund’s in-house capacity and authority in critical areas of programming and project cycle management. The recommended changes would require the Fund to at least partially relinquish its current role as a de facto budgetary adjunct to the MoE and may be difficult to accomplish in time for the Fund to take advantage of pre-accession financial support from the EU and other institutions.

- It should be acknowledged, however, that different foreign sources of finance have different operational requirements for collaboration. It is probable that less significant reforms would be required of the Fund to function as an implementing agency for EU financial assistance than would be required for the Fund to function as an intermediary for IFIs. A certain degree of political imperative is associated with EU accession assistance, which is being programmed in close cooperation with Ministries of Environment of the region. The Fund, being closely linked with the MoE, may be a natural choice as a mechanism for managing such assistance. IFIs, however, would likely require much greater reforms before considering the Fund as an intermediary, including operational independence from the MoE and more in-house capacity.

- If the MoE, Fund Board and other relevant authorities determine that the significant reforms suggested above are not achievable within the near-term, an alternative might be to establish a new “Estonian Environmental Investment Fund”. Such a fund could complement the activities of the existing Fund and have the explicit purpose of administering foreign and domestic sources of finance for the implementation of investments important for EU accession. The possible characteristics of such a fund are outlined at the end of the full report.
3 ROLE AND ORGANISATION OF THE FUND

3.1 LEGAL BASIS OF THE ESTONIAN ENVIRONMENTAL FUND

The legal status of the Estonian Environmental Fund is determined by the parliamentary Act on the Environmental Fund. The Act stipulates that the Fund is a 'national/state institution' operating under the terms of the Act and its Statutes.

The concept of a 'national/state institution' does not appear to be defined in other, "core" legal acts or codes of the Republic of Estonia, although other acts do refer to the notion of a “legal person in public law”. The lack of a clear legal definition of 'national/state institution' creates two main potential problems:

- The scope of activities, structure and responsibilities of governing bodies, and accounting and auditing procedures are not anchored in clear, pre-existing and proven standards.

- The Fund is not covered by legally established, internationally understood standards for contracting and conflict resolution, and its institutional liabilities are not precisely specified in core acts of the Republic of Estonia. As a result, the Fund's partners and clients could reasonably have concerns about the credibility and institutional strength of the Fund.

Standards and procedures for accounting and auditing of the Environmental Fund are determined by the Fund Board rather than by an independent institution that sets country-wide standards. It may be difficult to defend an institution which has a vaguely defined legal status against potential allegations of impropriety because no reference can be made to legally acknowledged and publicly understood standards and principles of organisational structure and performance. The team notes, however, that there are other Estonian institutions for earmarked financing that have a similar legal status (e.g. Cultural Endowment of Estonia), though these institutions appear to be based on much more precise and exhaustive legal acts.

Specific provisions for the activities of the Fund are laid down in the Statute of the Environmental Fund enacted by the Government of Estonia upon the proposal of the Minister of Environment.

A new Act on the Environmental Fund has been prepared, based on the work of consultants commissioned by the Fund Board and a sub-committee of the Board itself, with the purpose of meeting an October 1998 deadline for re-registering the Fund in Estonia’s official Business Register. The first sentence of the proposed draft Act states that ”the Environmental Fund is a public legal foundation”. This suggests that the intention of the Fund Board members is to register the Environmental Fund as a foundation pursuant to the Foundations Act of 22 April 1997. If this is the case, the draft new Act on the Environmental Fund will have to be substantially revised, because many of its provisions directly contradict the Foundations Act.


(2) Regulation No. 100, 17 March 1994
If, however, the intention was to re-establish the Fund as a "public state institution" (such as Tartu University, the National Library or other legal entity in public law) then the Fund will continue to have an ambiguous legal basis for its operations and will face problems similar to those outlined above.

In either case, the new draft Act will require substantial revisions to its legal language (which is inconsistent) and its content (which is sometimes unclear).

Notwithstanding its officially independent legal status and explicit disclaimer of mutual liabilities between the state budget and the Fund in the Act on the Environmental Fund, the aggregated budget of the Fund is subject to annual approval by the Parliament in the budgetary laws. The state budget includes three figures that characterize the Fund budget: planned aggregate revenues, planned aggregate expenditures and planned carry-over (residual) at the end of the year.

The Environmental Fund is administratively subordinated directly to the Minister of Environment, although formally it operates outside of the structure of Ministry. The Forestry Fund and the Fishery Fund are other examples of such institutions.

**Box 1: Recommendations**

- **The draft Act on the Fund should be revised so as to clearly specify the Fund's legal status, the structure and principal functions of its governing, executive and control bodies, and accounting and auditing standards by reference to legal entities defined precisely in other existing acts (such as the Act on Foundations, the Commercial Code or other entities in public law). The current legal status of the Fund is unclear and weaknesses have been identified in the draft new Act.**

- **An alternative and more minimalist option could be to maintain the general status of the Fund as a "legal entity in public law", but to base key provisions (e.g. for the structure of governing bodies, accounting and auditing procedures, standards for contracting and conflict resolution, institutional liabilities) on standards and language used in existing acts and codes, such as the Act on Foundations or the Commercial Code.**

### 3.2 Accounting and Financial Auditing

According to the Ministry of Finance representative on the Fund Board, the accounting standards required by the Accounting Law on state budgetary institutions should apply to the Fund. One consequence of the Fund’s ambiguous legal basis for accounting and auditing is the fact that the Fund did not develop a true accounting system until as recently as 1997, the first year for which a balance sheet was produced. The Fund has not been subject to an external audit of financial reports by independent, chartered accountants. An internal financial auditing scheme exists through the Auditing Commission of the Fund Board, which is composed of Fund Board members all of whom, it should be noted, provide their services on a voluntary basis outside of their regular jobs. The effectiveness of this scheme is highly questionable because neither the Commission nor the Fund Board have the human resources needed to check receipts, invoices and financial transactions. The
representative of the Ministry of Finance, who serves as the Chairperson of the Auditing Commission, appears to be the only member of the Fund Board with appropriate expertise in financial auditing.

**Box 2: Recommendations**

- The accounting system should be changed so as to conform with the standards established by the Accounting Act for existing institutions of a similar profile of activity. The Fund’s Executive Unit should be given a statutory obligation to prepare an annual balance sheet and financial report, which should be verified by a chartered external auditor prior to approval by the Board of the Fund.

### 3.3 Performance Audits

The Team received conflicting information as to whether, prior to this review, any external audits of the Fund have been conducted to ensure that its activities and allocation of public money have been in compliance with the laws, statute and objectives of the Fund, and that these activities have been conducted with high professional standards. (The Team did not receive or see copies of any audit reports.) Neither the Act of the Fund nor its Statute contain performance criteria against which the Fund’s activity could be checked. Nor do the Act or the Statute explicitly require the Fund to be audited by the State Audit Office, which is the auditing body for the state administration.

Under the auditing approach currently employed by the Fund, there is an internal Auditing Commission appointed by the Fund Board. It consists of three people who are also members of the Board. All of them are volunteers, having their regular jobs in various government departments. The chairperson of the Auditing Commission is the Ministry of Finance’s representative on the Fund Board. The Fund does not appear to have any formal mechanism or procedures to address actual or alleged negligence or mis-use of funds. Under the present arrangement, the Board is responsible both for conducting audits and for the appropriate use of money, thus contravening the fundamental principle of separation of responsibilities between auditor and “auditee”.

**Box 3: Recommendations**

- The Act on the Fund and/or the Statute of the Fund should include performance criteria against which the Board and the Executive Unit can be evaluated. The Fund Act should specify which external public auditing institution (e.g. State Auditing Office) is authorised to conduct audits to evaluate how the Fund fulfils its objectives.

### 3.4 Governing and Decision Making Bodies of the Environmental Fund

Formally, the Fund consists of a Board and an Executive Unit. The Board of the Fund is the only entity defined in the Fund Act. The Act requires the Board to fulfill several different functions
simultaneously. It serves as a management, supervisory and even auditing body. In particular, pursuant to the Act on the Fund, the Board has the following competencies:

- approval of the Fund’s internal regulations;
- establishment of procedures for financial management and for accounting;
- approval of the annual budget of the Fund;
- making decisions on the financing of individual projects;
- making decisions on forms of disbursement and on terms of loans;
- appointment of members of Auditing Commission and scrutiny of its reports.

The Board currently consists of 21 members:

- A chairman appointed from among the senior officials of the Ministry of Environment;
- 17 representatives of county governments (usually heads of county environmental administrations);
- one representative of the Ministry of Environment;
- one representative of the Ministry of Finance; and
- one representative of the Estonian Scientists Association.

All Board members (including the chairman) are appointed by the Government of the Republic of Estonia, upon the proposal of the Minister of Environment.

All members of the Board (with exception of the representative of the Scientists Association) are regular civil servants or appointees of the central or county governments. They do not receive leave from their government posts to undertake their Fund work, and combine their duties as Board members with their full time jobs. Notwithstanding its officially independent legal status and own office space, in practice the functions of the Environmental Fund can hardly be distinguished from those of the Ministry of Environment and the County Environmental Departments.

Under the provisions of the Statute of the Fund, the Board is legally responsible for the appropriate use of the Fund’s financial resources. Board members receive monthly honoraria for their activities on behalf of the Fund Board. As is shown later in Chapter 6’s analysis of the Fund’s “Project Cycle”, however, this formal liability of the Board does not appear to be coupled with sufficient access to information on all individual projects or with the opportunity to have a real impact on project appraisal and selection. (In brief, Section 6 shows that the Fund’s Board does not review appraisal documentation on, nor does it actually select, each individual project which is to receive financial support from the Fund. These functions are actually fulfilled by the Ministry.)

Under the Statute (not the Act) of the Fund, the Board appoints the Managing Director and the staff of the Fund. The roles of the Managing Director and the staff are limited to administrative and logistical functions as well as book-keeping. According to the Statute, the Managing Director administers loan management, and related responsibilities, but appears to lack the decision-making authority that such responsibilities would normally entail.

Currently the Executive Unit of the Fund consists of five positions:

- Managing Director (vacant at the time of the review; since filled)
- Deputy Director
• Chief accountant
• Assistant accountant
• Secretary

The official structure of the Fund also includes 17 County and Municipal Environmental Funds. The County Funds are not legal entities. Officially they operate within the structure of the (singular) Environmental Fund, although they have some revenues of their own, their own bank accounts, their own Boards and at least some level of autonomy in allocating their own resources. All members of the Boards of the County Funds are appointed by the Minister of Environment in agreement with County Governor. Directors of County Environmental Departments usually hold the posts of Chairpersons of County Fund Boards and are also the County Governments’ representatives on the Board of the Central Fund.

The existence of the County Funds does not appear to be foreseen or mentioned anywhere in the Fund’s Act. Indeed, the Act refers only to a single “Fund” with a single “Fund Board”. Thus, while the Fund Act envisions one single Fund with a single Board, in practice it seems that there are up to 18 semi-autonomous Funds. While the structure of the County Funds is discussed in the Fund Statute, the legal relations between the County and Central Funds are not specified.

There are three major weaknesses with the existing structure of the Environmental Fund:

• There is a lack of actual and perceived separation of the Fund from the MoE. This factor does not seem to have adversely influenced the environmental effectiveness and efficiency of the project cycle, and perhaps has even enhanced the quality of the annual programme cycle. However, the current situation, in which the Board of the Fund is dominated by state and county environment officials and resource allocation decisions are made largely through the Ministry, raises the question of why the Environmental Fund, as a legally independent entity, is needed at all. With little external identity of its own, and no obvious investment strategy of its own, it would appear that the main justification for the Fund’s legal independence is the guarantee its provides for the continued earmarking of certain public revenue flows for environmental protection purposes. Furthermore, the Fund’s weak institutional identity can hinder its ability to “market” the benefits of its activities (e.g. the Fund does not have its own external annual report), thereby limiting its potential to build public and political support for it and its earmarked revenue sources.

• The functions and responsibilities of the Fund’s supervisory and executive bodies are insufficiently distinguished. From the Fund’s governing documents it is not always clear who is responsible for what. The all-purpose role of the Board also appears to violate the principle that those who supervise should be separated from those who are supervised. This principle of European organizational structures is also explicitly required in Estonian Laws such as Foundations Act and Commercial Code.

• The size and composition of the Fund’s Board could be made more efficient and representative. Judged by the size of boards at similar, well functioning institutions in other CEE countries, and according to basic organizational theory, the Fund’s Board of 21 members is large. Such a size is not conducive to efficient deliberation or decision-making and does not seem to be justified by the level of financial resources under the care of the Fund. Additionally, the current composition of the Board, which is dominated almost entirely by government (state and county) administration officials, is hardly representative of the Fund’s clients or public at large.
**Box 4: Recommendations**

- **The Fund’s institutional identity should be distinguished from that of the Ministry, in particular with respect to project cycle management.** There is currently a lack of actual and perceived separation of the Fund from the MoE which raises the question of why the Fund, as a legally independent entity, is needed. *The Act should more clearly define and distinguish the separate responsibilities and liabilities of the MoE, Board and Executive Unit vis-a-vis the Fund, in accordance with standards established for other existing, internationally recognized public organizations.*

- **Any revised Act on the Fund should define the procedures for appointing members of the Fund’s supervisory, executive and control bodies.** The authority to appoint members of such bodies should not lie entirely with a single institution.

- **Decrease the number of Supervisory Board members, perhaps to 9-13.**

- **Change the composition of the Board so as to be more representative of the Fund’s clients and public at large and less dominated by the environmental administration.** To avoid the fund being “captured” by any single constituency, decrease the representation of County Environmental Departments to less than half of the total. (Fair and equitable representation of all the regions can be ensured by rotating county membership on the Board at regular, specified intervals.) **Incorporate additional representatives of the Fund’s clients and public at large, such as Parliament, municipalities, environmental NGOs and business organizations.**

- **Clarify the legal and functional relationships between the Central and County Funds in the Fund’s Act.**

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**3.5 Co-financing**

According to the provisions of the Fund’s Act, the Fund Statute and internal written regulations issued by the Board, the Fund is an institution providing “additional” financing. As a rule, the share of the Fund's grant or loan extended to support an investment project cannot exceed 75% of the total capital cost of the project. The project sponsor is required to provide at least 25% of her/his own resources, although it is unclear whether owner’s equity includes or excludes resources from the state budget, foreign aid and loans from other financing institutions. Non-investment projects may receive grant aid for up to 100% of total project costs.

Some projects supported by the Fund in recent years have been large infrastructure projects for which the Fund was a minority co-financier. The bulk of financing was provided either from the state budget (e.g. through Public Investment Programme – PIP), or from foreign and international financing institutions (e.g. EBRD, NEFCO). In such cases, the Environmental Fund’s role in project development and appraisal has been minimal. These projects are brought to the attention of the Fund after having passed through the regular, comprehensive project cycle procedures utilized by those other institutions’ senior financiers.
Secured financing from other sources (fully-closed financing) is one of the Fund’s preconditions for it to sign financing agreements on projects. As part of the documentation attached to a project application form, the Fund requires a full financing plan, warranty letters from all financiers, exact sums and forms of their participation as well as the time schedule for disbursement of their financing.

It can be concluded, therefore, that if state budget support or foreign grants are allowed to be classified as part of the “own resources” required by the Fund, then some projects may be financed 100% by grants or other forms of heavily subsidized public funds. It is well documented that in such cases, project sponsors may not be motivated to ensure cost-effective, timely and efficient project implementation. Commitment of one's own resources and/or willingness to take market-priced loans are the best indicators of a project sponsor's commitment to implement the project effectively and efficiently.

**Box 5: Recommendations**

- Grants from external sources (e.g. State budget or foreign aid) should not be counted as owner’s equity.

- To the extent possible, the principle of co-financing should be extended to non-investment projects. This is usually a much better warranty of cost-effectiveness than any administrative control or even competitive public tenders.

- The Fund should require copies of all relevant invoices including invoices for those project components which are financed from other sources, including owners equity. This will enable the Fund to ensure that items are not financed twice and that there is no cross-subsidization between different project components.

### 3.6 Disbursement Mechanisms

According to the Act on the Fund, the Fund is empowered to make the following types of disbursement:

- grants;
- subsidies;
- soft loans;
- interest subsidies.

In addition, the Statute of the Fund (enacted by the regulation of the Government of the Republic of Estonia) provides the Environmental Fund with the right to issue loan guarantees. The Fund’s legal authority for extending loan guarantees is, however, questionable because this financing instrument is not explicitly allowed by the Act of Parliament (unless the vague term “subsidies” includes any favorable financing instrument, such as a loan guarantee).

(3) The term ‘subsidy’ is not defined in the Act on the Fund and its precise meaning is unclear.
The decision on whether any given project is financed by grant or loan or any other financing instrument is made by the Fund Board, which also decides interest rates and other terms for loans. An internal regulation adopted by the Board of the Fund provides some general guidelines for the choice of financing instrument. These internal regulations include four documents adopted by the Fund Board:

- General Rules of Financing from the Estonian Environmental Fund (approved April 1996);
- Rules for Financing Investments from the Estonian Environmental Fund (July 1996);
- Rules for applications for loans and grants from the Estonian Environmental Fund (May 1996);
- Documents required to apply for financing from the Estonian Environmental Fund (undated).

By the provisions of these documents:

- loans with nominal interest rates of up to 10% and maturity 5 years may be extended to enterprises;
- loans with nominal interest rates of up to 7% and maturity 7 years may be extended to local governments;
- grants may be provided to finance projects related to nature protection, monitoring, enforcement, education and training;
- partial grants (for less than 100% of project costs) may be provided to finance publications;
- research projects are eligible for either grant or loan support;
- only municipalities and public interest institutions can receive grants.

The above information suggests that, in principle, enterprises are not eligible for grant financing.

Most of the Fund’s resources to date have been disbursed in the form of grant. Few loans have been given and no loan guarantees have been offered. For example, loan commitments in 1997 amounted to 13.75 million EEK (roughly about $1 million) and accounted for 8.6% of the Fund’s total expenditure, although actual loan disbursement seems to have been only 7.5 million EEK (more than $0.5 million), or about 4.7% of total expenditures. The Fund's annual reports on its budget fulfilment do not classify expenditures by type of disbursement mechanism. (These 1997 figures were calculated ad hoc by the Fund Executive Unit during interviews.)

**Box 6: Recommendations**

- The legal basis for all financing instruments that may be used by the Fund (in particular loan guarantees and loan cancellation) should be introduced via the level of a Parliamentary Act. Care needs to be taken to ensure that the Fund’s regulations do not introduce financial instruments which are not explicitly allowed by the Act on the Fund.

- Clearer eligibility criteria should be established for loans and grants. The general principles appearing in the Fund’s documents (which are sometimes followed by numerous exceptions) should be replaced by strict rules.

- The Fund’s data-keeping system should allow commitments and actual expenditures of the Fund to be broken down according to type of disbursement mechanism and these figures should be
3.7 **LOAN MANAGEMENT**

The Fund has issued only a few loans to date. Nonetheless, the Team was informed that the Fund Board has received requests from Fund borrowers to cancel their debt.

According to the provisions of the “General Rules of Financing ...” the Fund can contract commercial banks to provide loan management services. “Rules for applications for loans and grants ...” go so far as to state that this is a mandatory requirement. However, according to interviewees, so far most loans were appraised, issued and managed by the staff of the MoE or the Fund itself. (Apparently commercial banks were used for the appraisal of two loans.) While some of the loans have yet to enter their payback periods, the requests for debt cancellation mentioned above forewarn of possible defaults. Based on the information and evidence presented to the Team, there appears to be very limited capacity either within the MoE (with the exception of the Water Programme) or Fund to conduct the project financial analysis, and no capacity to evaluate creditworthiness of potential borrowers, necessary for effective loan management.

The Fund does not appear to have any policy on acceptable collateral or collateral evaluation. The only collateral required according to the internal regulations is a 'Resolution of the Council of the Local Government' confirming that the loan principal and interest liabilities will be incorporated into the current and future local budgets, according to the agreed loan repayment schedule. Again, requests made by some of the Fund’s borrowers for loan forgiveness suggest that this instrument has not been sufficiently robust. The Fund does not require borrowers to provide cashflow forecasts.

According to the persons interviewed, no loans have so far been extended to enterprises, and there is therefore no experience in managing private sector loans.

The Statute of the Fund authorises the Board to “determine justified forgiveness of loans”. However, the Fund's regulations do not contain any definition of, or guidance on, the term “justified”. The legal basis for loan forgiveness is not provided for in the Act on the Fund and the legality of loan forgiveness is therefore unclear in the current situation. To date, no loans have been forgiven, but not all have been repaid in accordance with loan agreements.

**Box 7: Recommendations**

- Again, the legal basis for all financing instruments that may be used by the Fund (e.g. loan forgiveness) should be introduced at the level of a Parliamentary Act.

- Specific conditions for debt forgiveness should be introduced into the Act on the Fund (or at least into the Statute enacted by the Government). Debt forgiveness should not be left to the discretion of the Fund, as this raises expectations that the Fund will be a “soft negotiator” and may undermine the financial prudence of borrowers.

- Loans should be issued only through commercial banks, contracting them for loan appraisal and loan management. Risk-sharing agreements should added to loan management contracts with the banks. The Fund should develop and implement a policy on collateral.
• Interest subsidies (i.e. grants which effectively reduce the interest rates on commercial loans) should be used to leverage bank loans for environmental investments.

• Great caution should be exercised in issuing loan guarantees. These require specific expertise in project financial analysis and assessing the creditworthiness of applicants, and are considered to be a risky instrument if used by public entities, particularly in countries in transition.
4 REVENUES

4.1 OVERVIEW

The potential revenue sources of the Fund are specified in its Act and detailed in Annex 1. Table 1 below shows that the actual revenues of the Fund have increased substantially (over seven-fold in current prices) since 1994, with the 1998 total expected to be about 175 000 000 Kroons. The structure of the Fund’s revenue sources has also changed considerably in recent years. While pollution charges previously provided the large majority of revenues (90% in 1994), new revenues sources such as natural resource use fees and proceeds from privatisation have diversified the Fund’s revenue base and diminished the relative importance of the pollution charges.

Table 1. Revenues of the Estonian Environmental Fund in thousands of EEK

<table>
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</thead>
<tbody>
<tr>
<td>Pollution charges</td>
<td>20 614</td>
<td>35 339</td>
<td>40 939</td>
<td>58 957</td>
<td>80 000</td>
</tr>
<tr>
<td>Game resource use fees</td>
<td>1 580</td>
<td>1 976</td>
<td>1 786</td>
<td>2 403</td>
<td>2 000</td>
</tr>
<tr>
<td>Natural resource use fees</td>
<td>22 502</td>
<td>37 861</td>
<td>39 000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues from privatisation</td>
<td></td>
<td>11 000</td>
<td>29 113</td>
<td>25 000</td>
<td></td>
</tr>
<tr>
<td>Revenues from packaging excise tax</td>
<td></td>
<td></td>
<td>3 603</td>
<td>6 600</td>
<td></td>
</tr>
<tr>
<td>Special allocation from State Budget</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>13 500</td>
</tr>
<tr>
<td>Other revenues</td>
<td>1 899</td>
<td>1 982</td>
<td>30 400</td>
<td>14 500</td>
<td>8 900</td>
</tr>
<tr>
<td>TOTAL</td>
<td>24 093</td>
<td>39 297</td>
<td>106 626</td>
<td>146 436</td>
<td>175 000</td>
</tr>
</tbody>
</table>

Note: Totals might not add up due to rounding.

Besides the sources shown in Table 1, the Fund’s Act also enables the Fund to obtain loans and to deposit its financial resources in securities or stocks up to a value of 25% of the Fund’s revenues for the given year(s). A detailed breakdown of the value of “other revenue” sources for 1996 show that revenues from financial operations and interest on bank deposits accounted for over 23% of revenues that year, while the corresponding figure for 1997 is much smaller - just over 5%. Loan repayments to the Fund are also a source of revenue, with their total value amounting to about 3% of total revenues in 1997.

Key features of the changes in revenue flow over recent years are as follows:

- The large increase in the Fund’s revenues raise the environmental, institutional and political significance of the Fund, bringing greater financing opportunities, higher expectations and more political/public attention.

- The diminishing (though still important) role played by pollution charges means that an increasing amount of the Fund’s revenues do not flow through the County Environmental Departments. (Pollution charges are first collected by the CEDs and held on the accounts of the County Funds, then a pre-determined share is transferred to the Central Fund, with the rest remaining at the County Fund.)

- In 1994-95, when pollution charges were by far the dominant source of revenue for the entire Fund system (Central and County Funds), the Central Fund’s share of total revenues was approximately...
50%. As new sources of revenue emerged in recent years, the Central Fund’s share of overall revenues has increased to about 60-65%.

- Some revenue sources (such as part of privatisation proceeds and the packaging excise tax) are “earmarked”, meaning that the Fund is required to use these resources for specific purposes as laid down in the relevant legislation.

These changes have important implications (discussed below) for the Fund in terms of checking revenue collection mechanisms and designing the programme cycle, particularly the budgeting process. Planned new revenue sources, such as a CO₂ tax, would be in line with regional trends.

4.2 PROCEDURES FOR REVENUE COLLECTION AND TRANSFER TO THE FUND

4.2.1 Pollution charges

Pollution charges were the main revenue source of the Fund until 1996. The charges were introduced by the Act on Pollution Charges of 1993 and are closely linked to the environmental permitting system. Charges have to be paid by those who are required to hold environmental permits. Polluters must present a report to the appropriate CED stating the quantity of pollutants emitted and providing a written calculation of the pollution charge to be paid. The report must be submitted by the 10th of the month following the relevant quarter. If the polluter fails to submit the report, the CED makes the calculations on its own.

The charge must be paid by the 25th of the month following the relevant quarter. Charges are paid to the CED on the account of the corresponding County Fund. The CED checks calculations and remittances and keeps the related records. A fine of 0.2% per day is levied on late payments. If payment is delayed by more than three months, the CED takes the polluters to court under the provisions of the Civil Code. According to the Statute of the Fund, the Central Fund receives 50% of the pollution charges. The County Funds are to transfer this money quarterly.

The charge calculation is a rather complicated process. However, the additional administrative burden on the permitting process does not appear to be excessive. The collection rate is generally assessed as high and may be attributed to the fact that the County Funds receive half of the revenues, creating an incentive for the CEDs as the collection body.

The Executive Unit of the Environmental Fund does not systematically receive information from the CEDs on the charge payments that are due at each quarter. There apparently is no procedure in place through which the Executive Unit checks whether the County Funds have transferred the proper amount of money at the right time.

4.2.2 Water extraction fee

The water extraction fee is levied on water utility companies as well as on the energy sector (for use of cooling water) and on the oil-shale mining industry in return for the right to extract water, as granted by a special permit. CEDs undertake both the permitting and fee payment collection. CEDs divide the payment between the local municipalities and the Environmental Fund. The Fund receives 50% of the payment. In case of transboundary water bodies, the entire payment is transferred to the Fund.
Fees must be paid by the 25th of the month following the relevant quarter to the CED. A fine of 0.15% per day is levied on late payment. If payment is delayed by more than three months, the CED takes the water users to court under the provisions of the Civil Code.

The additional administration for the fee system does not appear to place an excessive burden on the permitting process. The collection rate is generally assessed as being high.

As with pollution charges, the Fund’s Executive Unit does not systematically receive information from the CEDs on the fee payments that are due at each quarter, and is not able to verify that the right amount of money has been transferred at the right time.

4.2.3 Mineral resources extraction fee

An extraction fee must be paid for the right to exploit state-owned mineral deposits and is connected to the relevant permitting process. The MoE is the permitting authority for mineral resources of national importance and CEDs are the permitting authorities for resources of local importance. The majority of revenue (more than 90%) is from extraction of oil shale.

The extraction fee is collected by the CEDs. Fees from resources of national importance are divided between the local budgets (70%) and the Environmental Fund (30%). Fees from resources of local importance are paid into the local budgets. Payments in respect of mineral resources located in transboundary water bodies, territorial and coastal waters and the exclusive economic zone are transferred solely into the Fund. Fees must be paid by the 25th of the month following the relevant quarter to the CED.

As with the previous fees, the Fund’s Executive Unit does not systematically receive information from the CEDs on the fee payments that are due at each quarter, and is not able to verify that the right amount of money has been transferred at the right time.

**Box 8: Recommendation**

- A direct communication link should be established between the CEDs and the Fund Executive Unit. Each CED should provide the list of charge and fee payments due from the previous quarter, by the 25th of the month following the respective quarter. The Executive Unit could then track the inflow of charge and fee payments from each CED and verify whether the amounts are correct.

4.2.4 Packaging Excise Tax

The excise tax on packaging is a relatively new revenue source. The relevant Act of Parliament came into effect on March 1, 1997 for alcohol packaging and shall come into effect on December 1, 1998 for soft drinks. Excise is levied on packaging manufactured in Estonia and imported to Estonia.

Excise on imported packaging is paid according to a procedure established by the Act on Customs. Excise on packaging manufactured in Estonia is paid to the account of the local authority of the Tax Board. Collected revenue is split between the Environmental Fund (50%) and the general budget.
(50%). The tax must be paid quarterly. An excise declaration must be presented to the local authority of the Tax Board by the 15th day of the month following the taxation period.

Total revenue to the Environmental Fund in 1997 from the packaging excise was planned to be 5 million EEK. Due to exemptions allowed under the law for packaging re-use/recycling, the actual amount received by the Fund was 3.6 million EEK.

The possibility of exemption is intended to provide an incentive for packaging re-use and recycling. The exemption provisions state that: until 31 December 1998, excise tax shall not be levied on packaging of which at least 40 per cent will be reused, and; as of 1 January 1999, the tax shall not be levied on packaging of which at least 60 per cent will be reused. The exemption is granted through a certificate issued by the MoE. The certificate is issued, and the exemption it provides for is valid, on the condition that the tax payer arranges reuse/recycling of the packaging at least to the extent stipulated by the Act.

The history of the packaging excise tax is too short to assess collection efficiency. However, it is possible to make observations related to the exemptions, which are granted by the MoE. Exempted taxpayers receive a certificate from the MoE, which they present to local tax or customs authority. The Ministry does not notify the tax and customs authorities about the exemptions that were granted.

**Box 9: Recommendation**

- The environmental effectiveness of the packaging tax exemption should be carefully monitored and evaluated, especially since it is relatively new. Generally, such exemptions should be extended only under clear and strict conditions and the required level of recycling/reuse should be verified. The MoE should send the list of exemptions that it awarded to the local tax and customs authorities in each quarter.

### 4.2.5 Part of privatisation proceeds

In accordance with the *Act on Use of Privatisation Revenue*, the Environmental Fund receives 5% of revenues from:

- privatisation of state property effected pursuant to the Privatisation Act;
- privatisation of state land effected pursuant to the Land Reform Act.

The appropriate amount is transferred to the Fund as revenues are collected in the privatisation process. According to the Act, these revenues are to be used for “environmental impact assessment and the elimination of environmental damage:

- on sites to be privatised;
- on privatised sites to the extent required of the State in the purchase-sale agreement;
- on privatised sites where the purchase-sale agreement did not stipulate prevention or elimination of the damage but where it has been ascertained that the damage occurred prior to the privatisation.”
4.2.6 Part of motor fuel excise tax

An excise tax on motor fuel was introduced in 1993. As a result of the initiative of the MoE, and with the support of the Government, Parliament agreed to allocate a portion (~1%) of these revenues to the Environmental Fund, as a one-time transfer as part of the 1998 Budget Act. (To be precise, the Budget Act does not specify that the transfer is to come from the fuel tax revenues, though this is understood between the Government and Parliament and specified in the draft Budget Act.) The Amendment on the Act on Motor Fuel Excise provides for the gradual increase of the excise rate on engine fuel and oils until they reach the obligatory rates specified in EU Directive 92/82/EEC in 2002. This tax is expected to provide substantial revenue in 1998 and has the potential to become a stable source of revenue, with low administrative costs, into the future. It is unclear, however, whether the Government and Parliament will again decide to allocate a portion of these revenues to the Environmental Fund.

4.3 Predictability of Revenue Flow

Predictability of the different revenue sources depends on the how the rates and the base quantities change over time. Rates for pollution charges, now established by the Government through a process of negotiation which takes into account the consumer price index, have been fairly predictable. (From 1994-1996 the Government delegated the responsibility for adjusting the base rates of pollution charges to the Minister of Environment and the Minister of Finance.) Changes in base quantities such as emissions of each pollutant or quantity of water extracted can also be predicted with reasonable confidence. In case of pollution charges, CEDs maintain records of past emissions and, due to their primary role as the permitting authority, are familiar with individual polluters and any environmental investments aiming at reducing pollution. Natural resource use fees also provide a relatively stable revenue flow. Prediction of future values for those revenues requires analysis of water consumption patterns and changes in production technologies. If not for the possibility of exemption, the stability and predictability of the packaging excise tax would probably be high. However, the exemption introduces uncertainty into revenue forecasting. Revenue flow from privatisation proceeds is largely uncertain due to its dependence on the speed and style of the privatisation process.

In conclusion, the Fund’s revenues are dominated by sources which have a predictable future revenue path. These revenues establish a stable revenue base for the Fund that is expected to increase in the medium-term, though not as rapidly as in recent years.

**Box 10: Recommendation**

- The MoE/Fund should encourage the Government to amend the Act on Motor Fuel Excise Tax so as to ensure that a fixed portion of these tax revenues are channeled to the Fund each year. The production and use of motor fuel results in a number of adverse environmental effects which may justify the earmarking of motor fuel tax revenues for environmental protection purposes. Similar taxes serve as important revenue sources at other environmental funds in the CEE region (e.g. Hungary) and generally provide long-term, stable sources of revenue with low administrative costs.

- The MoE and Fund Board may wish to consider new revenue sources to ensure continued growth of the Fund’s financial potential. The Fund has experienced very strong revenue growth in recent years. Some of the Fund’s revenue sources are expected to continue growing (e.g.
waste disposal and air pollution charges), however, the growth of certain sources (e.g. water abstraction and water pollution charges) is likely to level off. A possible CO$_2$ tax (mentioned by some MoE officials) or new product charges could offer other stable and substantial sources of revenue and would be in line with regional trends.
5 PROGRAMMING

The term “programming”, as used here, refers to the process by which the Fund establishes its environmental investment priorities from year-to-year and for the longer-term, as well as how the Fund decides to allocate its financial resources across the various environmental/project sectors in a given year. Generally, a fund’s spending programme is derived from an environmental strategy which identifies environmental priorities and considers the role and purpose of the fund in addressing those priorities. Programming also involves the definition of eligibility criteria which set a framework for projects aimed at solving the priority problems. These criteria also take into account the characteristics of the target groups who can receive funding. Eligibility criteria may, for example, take the form of a priority list of expenditure areas with ranks (weights) reflecting a prior assessment of relative benefits of solving particular problems. On the basis of the spending programme, the fund establishes its annual budget, which estimates revenue and an expected allocation of revenues across major spending categories.

5.1 SPENDING STRATEGY

The Fund’s current Act states that the purpose of the Fund is “to collect additional financial resources for the protection of the natural environment and natural resources, and to provide additional funding for measures protecting the natural environment and natural resources”. The Fund’s Statute goes on to delineate the following tasks of the Fund:

- protection of the environment;
- protection of nature;
- monitoring;
- development of environmentally sound technologies
- training, public education and post-graduate education on environmental protection and nature protection;
- other problems of national and regional importance.

Thus, a very wide field of potential activities can be supported financially by the Fund. Projects addressing virtually any sort of environmental issue, and quite possibly even non-environmental issues (note the last bullet point), are legally eligible for financial support from the Fund.

With regards to the process for determining how the Fund’s financial resources will be allocated, the Fund's general rules on financing state that:

- “Financing from the Environmental Fund will be implemented through programmes, which have been developed based on the submitted projects and applications and which have taken into account both the national and local environmental priorities.

- The programmes in turn are divided into short-term programmes, continuing not more than one year, and long-term programmes, lasting more than one year.

- The Fund Board shall define the priorities to be financed from the fund in the next 3 years at its annual session in April at the latest and shall present them to the Minister of Environment for
approval. Proposals for priorities are presented by the members of the Fund Board and programme managers.”

It is important to note that the “programmes” mentioned above are developed by the Ministry of Environment and that the “programme managers” are Ministry of Environment staff. It is no surprise, therefore, that the Fund’s spending priorities closely reflect the overall priorities of the Ministry of Environment. Indeed, annual and longer-term programming of the Fund is fully integrated into the overall programming of the Ministry. The Fund clearly functions as an instrument of the Ministry and does not appear to have a distinct spending strategy of its own.

The Fund’s programme and project cycle process is described in the 1994 Report on the Estonian Environment. This states that the Fund’s spending priorities are:

• hazardous waste treatment;
• co-financing municipal wastewater treatment plants supported by state or foreign aid;
• co-financing small wastewater treatment plants built with local government finances;
• support to environmental administration at both national and local level.

Subsequent to the three year spending priorities identified in the 1994 Report on the Estonian Environment, it does not appear that a new set of three year priorities has yet been established for the Fund. (The team could not find such priorities explicitly stated in the Fund’s documentation.)

The Fund’s expenditure data (see Annex 1) show that much more money is spent in the water sector than any other single sector. Other major sectors of expenditure are (in descending order): “planning, building and investment”; “environment supervision”; “waste management”, and; “mineral resources”. An analysis of actual disbursements indicates that the Fund’s priorities are to co-finance projects supported by foreign assistance or foreign loan programmes (often in the water sector) and to complete unfinished small water treatment facilities.

According to the general rules on financing from the Fund, at least 60% of the Fund’s financing must support projects of national importance in the environmental programmes.

The Fund’s Statute allows for the creation of special subfunds (internal earmarking). A special “Reserve” subfund (called for in the Act) has been established to provide compensation for damage caused by nationally protected species. No special subfunds have been created for earmarked revenue sources such as privatisation revenue and packaging excise tax.

The Fund's programming does not explicitly consider exemptions from the packaging excise tax as a spending area, even though non-payment of the tax probably constitutes a substantial subsidy. Revenue from the packaging excise tax is earmarked for supporting solid waste reduction measures. However, the Team could not evaluate the fulfilment of that requirement because the present expenditure records maintained by the Fund do not readily allow tracking of those revenues or expenditures on that specific type of project.

**Box 11: Recommendations**

- The MoE and Fund Board should re-consider whether the Fund’s spending strategy, which in effect simply mirrors the full range of activities undertaken by the Ministry, represents the most
effective and efficient use of the Fund’s limited resources. As a legally independent instrument for implementing State environmental policy, the Fund need not pursue a mandate as broad and inclusive as that of the Ministry itself. A more narrowly defined and targeted role for the Fund (e.g. investments important for EU accession) could result in more effective and efficient use of its resources. A more distinct role for the Fund would also contribute to establishing a stronger institutional identity for it and possibly greater political and public support for its activities.

- Given the Fund Board’s legal responsibility for the allocation and use of the Fund’s financial resources (as set out in the Statute), its role in setting the long-term spending priorities of the Fund should be very clear and distinct from the MoE’s role in setting its own priorities. This role of the Board, and the means of fulfilling it, should be more clearly specified in the Fund’s Statute. In addressing this issue, the wording of the “General Rules of Financing from the Estonian Environmental Fund” is ambiguous. On the one hand, the Board is to “define the priorities”, but on the other hand, the priorities are to be presented “to the Minister of Environment for approval”. Such language also seems to be inconsistent with the supposed legal independence of the Fund.

- Article II of the Fund’s Statute should be revised so as to ensure that the Fund’s resources are used only for environmental protection purposes, as required in the Fund’s Act. The wording of item 6 under article II - “other problems of national and regional importance”- appears to allow the Fund to finance measures aimed at any sort of “problem”, whether environmental or otherwise.

- To date, programming has not been an important part of the Fund’s operation, since major spending lines have largely been predetermined by the MoE. This is changing and some of the new revenue sources require spending in areas that have not previously been specified in other programmes. For example, since the packaging tax revenues are earmarked for waste reduction measures, this requirement should be explicitly reflected in programming and the Fund’s data keeping system should allow tracking of the use of packaging tax revenues.

- If not already done, the Fund Board should re-examine the three-year priority spending areas identified in 1994 and update the Fund’s spending priorities as appropriate.

5.2 **ANNUAL BUDGETING**

According to its founding legislation, the Fund operates according to an annual budget. The Fund budget consists of the budgets of the Central Fund and the County Funds. The draft budget must be approved by the Fund Board. It is then submitted by the Minister of the Environment to the Government of the Republic of Estonia for approval. The budget of the Fund is approved at the same time as the State Budget.

The Fund’s rules require that book-keeping and accounting must be carried out according to an established procedure. The Fund’s administrative expenses are indicated separately in the budget.

At least 50% of the pollution charges which remain in the County Funds must be spent on local projects within the framework of county environmental programmes. Half of the pollution charges
accumulated in the Central Environmental Fund must be spent on projects with national importance within the framework of the national environmental protection programmes. No further details are given on how these programmes should relate to the annual budget.

Unspent funds remaining on the Fund’s account at the end of the year are retained by the Fund and rolled-over to the next fiscal year.

The Managing Director of the Fund is legally responsible for:

- keeping records on financial resources; receiving funding and loan applications and contracting external expertise;
- organising the drawing up of the draft budgets for the County Funds and Special Funds and ensuring that reports are submitted on time to the Fund Board.

Special legal requirements from revenue source legislation with consequences for budget preparation are described in Chapter 3.

In practice, the budgeting procedure is largely determined by the MoE and its Programme Managers have an active role in budgeting discussions. They select and prepare projects for funding and negotiate for a share in the Fund's budget on that basis. The Fund Board establishes a Budgeting Committee from its members. However, the Committee's role seems to be confined to registering the results of Programme Work Groups and ensuring that the amount of finance requested from the Fund by the Programme Manager does not exceed the amount earlier allocated for the respective programme by the Fund Board.

Moreover, the “General Rules of Financing from the Estonian Environment Fund” appear to give greater powers to the Minister and Ministry in affecting the annual budget than are otherwise provided for in the Fund Act and Statute. These rules state: “The Minister of Environment and the Manager of the State Programme are entitled to make changes in the general volume of financing, time and order (as well as replacements), with prior agreement of the changes with the Chairman of the Environmental Fund Board.” As the Programme managers and the Chairman of the Fund Board are employees of the Ministry, this in effect gives the Ministry great power in modifying the Fund’s spending programme after it has been approved by the entire Fund Board. The Fund Board’s approval does not appear to be required before such changes can be made and the Board Chairman is merely required to “inform the members of the County Fund Board of the corresponding regions of the planned changes” and to “notify other members of the Fund Board of the changes made at the following session . . .”

There is little reference in the budget preparation process as to how special revenue source-related requirements are taken into account. Book-keeping rules and a related information system is being developed and implemented by the Fund.

**BOX 12: RECOMMENDATION**

- The same weaknesses noted earlier in the procedures for developing the Fund’s longer-term spending strategy also exist in the procedures for developing the Fund’s annual budget, namely: lack of distinction between the roles of the Ministry, Fund Board and Fund Executive Unit; lack
of clearly defined, consistent legal/statutory responsibilities among these bodies; both of which contribute to a lack of institutional identity for the Fund. The Fund’s Act, Statute and important operational rules should be revised to eliminate such weaknesses.

- The extent, and processes through which, the MoE (or other institutions) may influence the Fund’s spending priorities and project appraisal criteria/procedures, should be clearly specified in the Fund’s Act or Statute. The current programming process, wherein the various environmental programmes to be financed by the Fund are largely prepared by MoE staff, effectively ensures that the MoE’s environmental priorities are fully reflected in Fund spending. However, the key role being played by MoE staff, and the mechanisms through which that role is played, are not specified in the current Fund Act or Statute. Such deep and extensive involvement of parties external to the Fund in both the Fund’s programming and project cycle management may amount to “micro-management” of the Fund.

- The Fund’s operating rules, in this case the “General Rules of Financing from the Estonian Environment Fund”, should not assign powers which extend beyond those provided for in the Fund’s Act and Statute. Given the official legal responsibility of the Fund Board for the allocation and use of the Fund’s financial resources, it does not seem appropriate that the Ministry should have such wide powers in modifying the spending programmes after already being approved by the Board, and without the prior consent of the entire Board. If the Ministry is to have such powers, they should be clearly defined in the Fund’s Statute.

- The statutory responsibilities of the Fund’s Managing Director should be more clearly defined, and clear procedures established, so as to provide an effective setting for fulfilment of those responsibilities. For example, all applications or proposals for support from the Fund should be registered and maintained at the Fund’s Executive Unit. (Currently, many applications are sent directly to the Programme Managers in the Ministry.)

5.3 **CASH MANAGEMENT**

The Fund’s accounts are kept in banks selected by the Board. County Fund boards also have the right to open bank accounts. However, the procedures and criteria for selecting these banks do not appear to be specified in either the Fund’s Act, Statute or other operational rules.

The fairly regular inflow of revenues offers opportunities for rational cash-flow management. However, these opportunities are limited by the fact that the Fund Executive Unit has too little oversight of the payment disbursement schedule for projects and little expertise in the area of cash-flow management. For pollution abatement investment projects, the Ministry Programme Managers are most well-informed about implementation schedules and not all the information is passed to the Fund Executive Unit. Even if such information were readily available to the Fund Executive Unit, however, it does not appear to currently have the capacity to process the information or to design and implement real cash management practices.

**Box 13: Recommendation**
• Procedures and criteria for selection of the bank(s) to keep the Fund’s accounts should be clearly specified in either the Fund’s Statute or operational rules. A transparent and competitive selection process should be used to help the Fund retain quality, reasonably priced banking services.

• While it may not be realistic to introduce cash-flow management in the immediate future due to present lack of capacity, it is nevertheless important to start organising an information system that would allow the Fund to keep track of the time pattern of financial commitments. Additionally, the Fund Executive Unit should be trained or augmented so as to enable sound cash-flow management practices.

5.4 REPORTING

The Fund’s Statute requires the Board to “inform the public about the Fund’s activities”. However, this is not supported by detailed guidance or procedures. Apart from this and certain obligations related to the Fund’s budget, requirements for the Fund to report on its activities are not specified in the Act, Statute or operational rules. The Fund does not prepare and distribute its own external annual report nor does it appear to have a formal or informal public information policy. In practice, the financial contribution of the Fund is mentioned in reports on various MoE programmes, prepared by Ministry staff. There is also a section on the Environmental Fund in the Ministry’s annual reports on the Estonian Environment.

**BOX 14: RECOMMENDATION**

• The Fund’s Statute should clearly define requirements for reporting to the MoE, Government, Parliament and public. Guidelines and procedures for fulfilling these requirements should be elaborated in operational rules. The Fund’s policies toward public disclosure and access to information should be documented and made available to the public and other interested parties. A pro-active external information policy based on transparency and awareness raising would benefit the Fund by building political and public support domestically and strengthening international credibility.
6 PROJECT CYCLE MANAGEMENT

6.1 PROJECT IDENTIFICATION AND SCREENING

The Fund does not identify projects itself. Project concepts are generated by the CEDs or the MoE and serve as input to 12 environmental programmes managed by the MoE. The key role in project screening and appraisal is played by the Ministry’s Programme Managers, in particular those of the water management programme, solid waste management programme, air protection programme and nature conservation programme. These environmental programmes are developed on a rolling basis as packages of priority actions and 'shopping lists' of projects together with implementation schedules, preliminary cost estimates, implementing agents and envisioned financing sources.

Each year (usually in September), managers of all 12 environmental programmes receive information from the Board of the Environmental Fund about the sums of money available to each programme in the following year. On the basis of this information, Programme Managers send letters to the CEDs requesting proposals for specific projects to be co-financed by the Environmental Fund in the next year. Therefore, the first pre-selection of project proposals is done at county and local level.

Having received lists of priority projects from all CEDs, Programme Managers develop preliminary project portfolios with initial financing packages by matching co-financing envisioned from the Fund with other sources of financing available for individual projects. Thus, a secondary selection of project proposals is carried out by the Programme Managers.

In principle, individual applicants can submit their applications directly to the Fund. However, the Fund does not screen such applications and has no experts capable of conducting project appraisal. Instead, applications are usually sent to the respective Programme Manager at the MoE, sometimes via the CEDs. Pursuant to the provisions of the General Principles of Financing from the Fund, “...only the ... projects ... which are included in the programmes ... shall be financed from the Environmental Fund”. Therefore, one of the preconditions for financing from the Fund is that a Programme Manager must decide to incorporate any given project into her/his programme.

6.2 PROJECT APPRAISAL AND SELECTION

Towards the end of each year, Programme Managers organise discussions within the Working Groups established for each programme. The purpose of these discussions is to appraise and pre-select a portfolio of projects prepared by Programme Managers. Working Groups consist of specialists in particular environmental issues. These specialists are recruited from the environmental administration and are approved by the Fund Board. Working Groups operate on a voluntary basis and often include some members of the Board of Environmental Fund.

For example, the Air Protection Working Group includes five members of the Board of the Fund, while in the Water Protection Working Group there are none. Each Working Group is chaired by a nominated individual who cannot also be a MoE Programme Manager. Working Groups conduct appraisals of individual projects and revise financing packages. Smaller projects, which are financed solely by the County Funds, are appraised by the CEDs.

Appraisal by the Working Group is prepared and led by the Programme Managers. Some Programme Managers have developed sophisticated appraisal tools. Perhaps the most advanced system is used by
the Water Protection Programme (see Box 15). Much less sophisticated and therefore much more discretionary appraisal techniques are used in other programmes.

**Box 15: Appraisal procedure for investment projects in the Water Protection Programme**

Different appraisal windows exist for the large and small investments. For investment projects of total capital cost of over 10 million EEK (c.a. $715,000), a pre-feasibility and a detailed feasibility study must be submitted by the applicant. In addition to a description of the background and the scope of the project, the study must also include analysis of alternative project options and cost-effectiveness analysis. In principle, the pre-feasibility and feasibility studies must be paid for by the applicant, although the Fund sometimes subsidizes pre-investment analyses including detailed engineering designs. The feasibility study must be reviewed by an independent, licensed consultant and the review report must be attached. In addition to a feasibility study, the applicant must also prepare an environmental impact assessment (EIA) as well as technical and economic analyses. The scope of the required financial analysis covers, inter alia, calculation of tariffs and analysis of affordability of user fees. A specific application form has not been developed by the Fund (or rather by Programme Managers), although applicants receive simple application guidelines and a list of required attachments. For smaller projects (especially if capital cost is less then 1 million EEK), the level of detail of pre-feasibility studies is much lower and no additional review is required. Very large infrastructure projects, co-financed under the umbrella of Public Investment Programme (PIP), have detailed financial analysis conducted within the scope of PIP.

The Manager of the Water Protection Programme has developed a comprehensive system of project selection criteria. In the first step, general screening criteria are used for the initial ‘pass/fail test’. These criteria include protection of human health, preservation of biodiversity and ecosystems, construction of environmental infrastructure in remote, poor areas, co-financing from foreign sources and clean up of past pollution. Projects that pass these initial screening criteria are appraised further using a set of environmental, economic and technical criteria. At the end of the appraisal process, projects are prioritized according to the criterion of cost-effectiveness. For projects over 1 million EEK the cost-effectiveness criterion is the PV (present value) of project capital and O&M (operation and maintenance) costs divided by the expected reduction of pollution load measured in tones of BOD. A twenty year lifetime is used both for calculation of PV of costs and for load reduction. For smaller projects, only project capital costs are used (instead of discounted PV) in the indicator of unit cost of pollution removal. The calculation period is also shortened to 1–2 years. As a result of the appraisal process, a ranked list of priority projects is presented to the Fund Board and the Minister of Environment for approval.

**Box 16: Recommendations**

**Project Appraisal Procedures**

- The Fund’s Statute should outline criteria for project eligibility and indicate key criteria for project appraisal (e.g. cost-effectiveness).

- All Programme Managers should develop project appraisal tools similar to the system used in the Water Management Programme, with the improvements listed below. The appraisal procedures and criteria used by the Water Protection Programme represent an attempt to make the appraisal process transparent and objective, and are highly professional compared to most environmental funds in CEE. Some areas for improvement may, however, be suggested:
The list of appraisal criteria should be made more consistent. At the moment there are overlaps between criteria. For example, ‘pollution load’ is listed as a different criterion than ‘cost of achieving environmental effect’ although it is included in the formula for cost-effectiveness.

All criteria should be explicitly and numerically weighted. At the moment all criteria appear to be important, but not in any ordered manner. Unless the relative importance of the criteria are clearly indicated this means that project selection is only slightly less discretionary than it would be without any criteria at all.

It should be more clearly stated which criteria are simple ‘pass/fail’ criteria for initial screening, and which are weighted criteria used for prioritisation. For instance, is it a strict requirement that a project is co-financed from foreign sources or does it simply increase the chances (or decrease the cost) of financing from the Fund?

More use should be made of aggregate measures of environmental benefits in denomination of the cost-effectiveness criterion. Using only ‘BOD reduction’ discriminates against the wastewater treatment projects which include a high level of biogens removal, in particular of Nitrogen.

Rationing the PV (present value) of costs to the lifetime pollution reduction value is not an incorrect measure of cost-effectiveness. However, a more useful and commonly used measure is unit cost expressed as annualised cost (annualised capital cost plus annual O&M costs) over annual reduction of pollution. The applicability of both measures, however, is limited to projects that are not financially viable or to infrastructure projects where cost-recovering user fees need to be determined. In order to develop cost-effectiveness indicators which would allow comparability between a wider range of non-viable and viable projects, more sophisticated measures must be used or, alternatively, financially viable projects should not be supported at all.

Appraisal criteria and results of ranking should be made known to applicants. It would add credibility to the process of disbursing subsidised public resources.

At the end of the year, Programme Managers prepare a final draft of the list of projects proposed to be implemented and co-financed from the Environmental Fund in the following year (annual programme). Two reports are attached to this list. One is written by the relevant MoE Programme Manager, and another by the leader of the respective Working Group. Usually consensus is reached among all members of the Working Groups and recommendations of these two reports do not differ. This list is submitted to the Fund Board. The Budgetary Committee of the Fund Board screens the lists of projects in order to ensure that financing sought from the Fund matches the resources available (or rather expected) in the Fund. After the screening by the Budgetary Committee, the list of projects is sent to the Minister for Environment for his approval.

Once signed by the Minister (usually at the end of January), the list of proposed projects is sent again to the Fund. Meanwhile, Parliament approves the budgetary law which includes the annual budget of the Fund. The Fund Board, at its session in February or March, approves all the programmes to be financed in the current year. Members of the Fund vote “en bloc”, on the entire list of projects. No
decisions on financing individual projects are made by the Board of the Fund unless problems appear at later stages.

Thus, notwithstanding the legal liability for appropriate use of financial resources and notwithstanding its supposed sovereign decision making authority on project selection, the Fund Board plays only a minor role in project identification, appraisal and selection. The project cycle is managed primarily within the structures of state environmental authorities at both Central (Ministry) and County (CED) levels. The key role in project identification, appraisal and selection is played by managers of the environmental programmes in the MoE. The responsibilities and liabilities of Programme Managers with respect to the Fund are not specified anywhere in the legislation nor in the Fund Statute.

The MoE in general, and Programme Managers in particular, have developed impressive skills in developing and appraising environmental projects including investments. Departments of the Ministry have become effective project implementation units. Without doubt, this has been an important factor in Estonia’s success in attracting considerable foreign financing to the environment sector. In the longer run, however, this virtue may easily turn into a problem. Project development and implementation are not typical tasks of governments in democratic, market societies. Rather, state government institutions usually set the legislative and policy framework within which actions are developed and implemented by local governments, households and private sector. The preoccupation of the MoE with these tasks may result in backlogs in the development of environmental policies and in strengthening of enforcement and institutions. It may also hinder the development of the private sector in the area of environmental consulting services by unfair competition. The Ministry could easily force private consulting companies out of the market if its staff offer the same project preparation services, but subsidised by taxpayers and with immediate impact on financing decisions. Some forewarning signs can already be observed in Estonia.

**Box 17: Recommendations**

**Roles of Ministry and Fund in Project Appraisal and Selection**

- **To properly reflect the level of responsibility assigned to it by the Fund’s Act and Statute, the Board should play a strong supervisory role, and take lead responsibility for selected, key parameters of the project cycle. An appropriate role for the Board in the project cycle would focus on: the establishment of the Fund’s investment priorities, based on the environmental priorities identified in the National Environmental Strategy and NEAP; the approval of eligibility and appraisal criteria to guide project evaluation and ranking carried out by the Executive Unit; and final decision-making authority on the approval of individual projects for financing. (Though provisions could be made for final decision-making authority to be delegated to the Executive Unit for some types of projects, for example small projects.)**

- **Such a new role for the Board would involve a delegation of much greater responsibilities to the Fund Executive Unit. For the Fund to properly undertake the responsibilities assigned to it by its Act and Statute (as described above), the management and technical capacities of the Fund’s Executive Unit would have to be strengthened considerably. Fund Executive Units are typically responsible for project cycle management (i.e. project identification, appraisal, ranking, contracting and monitoring of implementation). Such units are also commonly liable for financial management and reporting.**
• In a less optimal alternative, the Fund Act and Statute should be revised to explicitly recognise the key role being played by the Programme Managers at the Ministry in project selection and should clearly assign responsibilities and liabilities between them, the Fund Board and the Fund Executive Unit. It is a widely recognised principle that individuals who have the main impact on decisions should be made explicitly liable for the consequences of these decisions. Clear definition and division of accountability are a preconditions for a correct incentive structure.

• The MoE should consider how its substantial efforts to develop and implement individual projects affects its broader mandate and ability to establish and strengthen an appropriate policy and institutional framework for the achievement of national environmental goals. Activities currently undertaken by MoE Programme Managers in the area of project development and implementation could hinder the emergence of similar services in the private sector.

6.3 CONTRACTING, INVOICING AND PAYMENTS

The Board’s decision on the entire programme authorizes the representative of the Fund by proxy or Managing Director of the Fund to sign agreements on project financing, providing that all formal and legal requirements are met by project proponents. In particular, before an agreement can be signed, the applicant must submit a construction permit which can be obtained only after a detailed engineering design is prepared and other permits are issued. In addition, the applicant must conduct a tender to select contractors and suppliers of equipment according to the Estonian Public Procurement Act. For projects with capital costs of over 1 million EEK, a representative of the MoE should participate in the tender committee. A report on the tendering procedure must be attached to application.

If – after the programme is approved by the Board - any significant changes in project scopes and finances occur, or if the required documentation is not submitted by applicants, individual projects may be brought to the attention of the Board. In particularly difficult cases, applicants, independent experts and Programme Managers can be invited to the Board meeting to discuss problems and seek solutions. In a typical session of the Board, (which meets about 10 times a year), several individual projects are discussed. As a rule (pursuant to the Board regulation) presentation of a project and related discussion should not exceed 15 minutes per project (but in practice it often lasts longer). At this stage, the Board can reject individual projects from previously approved programmes. In 1997, the Board rejected 40 projects.

Financing is disbursed on the basis of agreements signed between the Managing Director of the Fund and the project proponent. The financial agreements are counter-signed by the Accountant. For smaller projects financed by the County Funds, agreements are signed by the Chairman or Deputy Chairman of the Board of the County Fund and Accountant of County Fund. Financing agreements (both grants and loans) are governed by the Civil Code.

When an agreement is signed, it is normal practice for the Central Fund to transfer money to the respective County Fund for disbursement. It is typical for up to 30% of the total sum to be paid in...
advance. The rest is disbursed in tranches upon presentation of original invoices from contractors and suppliers, or according to other procedures as specified in the agreement. One condition for issuing of invoices is an official approval of the completed works by the Commission consisting of representatives of project proponent, permitting authorities, environmental administration and the Fund.
7 IMPLICATIONS OF ACCESSION TO THE EU

7.1 BACKGROUND

7.1.1 Accession Preparation and the Environment

Since signing its Association Agreement with the EU in 1995, Estonia has focused its approximation activities on transposing White Paper legislation into Estonian law. This work has now evolved to embrace the whole of the environmental acquis with the support of the Phare-funded DISAE programme. At the same time, and closely linked to the development of the environmental approximation strategy, Estonia has been reforming and implementing its national environmental policy, in particular through the preparation of a National Environmental Strategy (NES) and National Environmental Action Plan (NEAP). The NES was approved by Parliament in March 1997, and the NEAP was approved by the Government on May 26, 1998.

The first stage of DISAE’s assistance has been project EST-101, *Estonian Approximation Strategy and Institutional Support*, undertaken by Agriconsulting Europe. The Draft Final Report on EST 101, issued on 6 April 1998, included an investment and cost analysis in addition to legislative and institutional gap analyses and recommendations on next steps.

A National Programme for adoption of the *acquis communautaire* (NPAA) was adopted by the Estonian Parliament in March 1998 and the official English translation was submitted to the European Commission in April 1998. The NPAA includes a report on environmental approximation, drawing on the preliminary findings of the DISAE study and the NEAP preparation process. The NPAA states that Estonia expects to complete the process of legal approximation in three years (i.e. by the middle of 2001) and that an action plan for institutional and capacity building for sufficient implementation and enforcement of the environmental acquis will be developed shortly.

7.1.2 Environmental Financing Requirements

Citing the above-mentioned DISAE study, the NEAP states that, if Estonia decides to reach full compliance with the main EU Directives by 2010, there is a need to invest a total of mECU 2 217.5 (EEK 35 billion) between 1998 and 2010. The NEAP states that at least 38% of this expenditure should be made by 2005. In addition to these investment costs, additional operating costs will also be incurred.

7.2 ROLE AND CONTRIBUTION OF THE FUND

7.2.1 To Date

Financing projects for approximation with the environmental acquis is not an explicit function of the Fund as defined by either the current Act and Statutes or the draft new Act on the Fund. As noted elsewhere in this report, the main role of the Environmental Fund to date appears to be to safeguard earmarked non-budgetary funds derived from pollution charges and other domestic revenue sources, and to make these available for co-financing state and municipal environmental protection programmes.
Notwithstanding the absence of an explicit mandate in relation to financing projects for EU accession, the Fund’s EU approximation role in practice appears to have been limited to date due to the ‘passive’ nature of its programming and project identification functions.

The team did not come across data, either from the Fund or elsewhere, as to which projects supported by the Fund are targeted directly at EU accession, or on the Fund’s relative financial contribution to these projects.

The Fund’s role to date in relation to EU accession can therefore be defined only in general terms, based upon the extent to which the programmes and projects prepared outside of the Fund (notably in the Ministry of the Environment) are geared to implementation of the environmental acquis. As noted in Chapter 5.1, a significant proportion of the Fund’s spending is on projects in the water sector. Compliance with the relevant EU standards is likely to be a major factor in such projects. Other key areas of expenditure in 1997 were “environmental supervision” and “planning, building and investment”. The precise nature of such projects was not uncovered by the team and therefore their relevance to EU accession is unknown.

7.2.2 Planned and Potential

Discussions with the Fund Executive Unit, Board members and Ministry officials indicate that they are at an early stage in considering the Fund's possible EU accession role. No clear vision, supported by a consensus of the key players, has yet been elaborated. Development of the NES and NEAP and elaboration of Estonia’s environmental approximation strategy, however, have begun to outline a possible role for the Fund.

The NES states that the Environmental Fund, the state budget, Forestry and Fisheries Funds will:

- support local authorities in developing the technical infrastructure for environmental protection (at least 6% from the Public Investment Programme);
- cover part of the management costs of the existing wastewater facilities in economically underdeveloped regions;
- support treatment of hazardous and radioactive waste;
- cover the costs related to elimination of past pollution (military pollution caused by the former Soviet army, past pollution on abandoned sites, past pollution transferred to state responsibility during the privatisation process);
- partially compensate for damage caused by protected species as well as for owners’ lost revenues due to legal environmental restrictions;
- promote activities aimed at the prevention of waste generation and the introduction of cleaner production technologies.

The Team understands that the Fund Executive Unit did not play an active role in the development of the NEAP. In particular, the Fund was not represented on the NEAP Economic Team which undertook a review of financing requirements. Nevertheless, the NEAP identifies the Environment Fund as source of finance or co-finance for a large number of actions.

Of the ten policy goals in the NEAP, the following are particularly relevant for EU accession:

- PG3 - Energy;
The Fund is identified as a source of co-financing for about one-third of the short and medium-long term actions under each of these four policy goals. Examples of such actions include:

- pilot energy audits in large energy production and consumption companies (PG3, action 3.2.2) (estimated cost EEK 1 million, funding sources: Environmental Fund, companies, grants);
- technical and economic feasibility study for construction of a final radioactive waste storage facility (PG4, action 4.1.5) (estimated cost EEK 5 million, funding sources: Environment Fund, foreign aid).

The Fund is also named as a financing source for actions under other, less accession-related policy goals. For example, one of the major new roles for the Fund envisaged within the NEAP is to administer an environmental education budget (preparation costs of EEK 20,000) which will aim at 10% of the Fund’s resources. (Environmental awareness raising is listed as both the NES and NEAP’s first priority.) Other actions where the Fund would be a major source of finance include the creation of an environmental videotheque (EEK 330,000).

Although cost-estimates of accession-related environmental finance requirements are still somewhat preliminary, the order of magnitude of such requirements is significant. There is clearly a need for additional capacity in terms of implementing agencies capable of managing EU financial assistance in this sector.

7.3 **ABILITY OF THE FUND TO MANAGE FUTURE EU FINANCIAL ASSISTANCE**

The EU will require domestic implementing agencies to conform with strict criteria. These have not yet been finalised or published, but are likely to require, *inter alia*, that such organisations should:

- be properly constituted and registered as a recognisable type of legal entity in accordance with sound public/corporate laws, with clear separation of supervisory, management and auditing functions;

- operate independently of government ministries and other agencies, and be free from real *and perceived* political interference;

- have a management structure, internal procedures and appropriately qualified staff (including financing and environmental experts) so as to enable it to undertake most key functions in-house, including strategy and programme development, project appraisal and preparation, and financial management;

- operate transparent project selection criteria and processes, and be subject to external scrutiny through regular external financial and performance audits and self-disclosure of relevant information e.g. via external reports;

- operate sound financial management systems including robust procedures for project financial appraisal (including credit appraisal), project monitoring and disbursement.
The team has identified significant shortcomings at the Fund in relation to the above. These are discussed in previous chapters of this report and include the following observations:

- The current legal status of the Fund, as set out in the existing Act on the Fund, is unclear. The draft new Act on the Fund is also ambiguous on the proposed new legal status of the institution and, in many respects, inconsistent.

- Under both the current and draft new Acts on the Fund, there is inadequate definition and separation of the supervisory, management and auditing functions.

- Standards and procedures for accounting and auditing are determined by the Fund itself and do not conform to any externally recognised standards. The Fund did not develop an accounting system until 1997. Financial audits are now conducted on a regular basis but these are internal audits and are also likely to be of limited effectiveness due to the time constraints on the voluntary auditing personnel.

- No external performance audits are carried out.

- A number of recommendations have been made regarding improvements to be made to the Fund’s governing and decision-making bodies. In particular, there is a lack of clearly defined responsibilities and separation from the MoE.

- The Fund’s programming and spending strategies are fully integrated into those of the MoE. The Fund itself does not play a significant role in the project cycle. With the probable exception of the Water Protection Programme, project appraisal criteria are not entirely clear and appraisal procedures involve a high level of discretion by Programme Managers.

- There is a lack of external transparency and feedback with regards to how individual projects pass initial screenings and find their way into approved spending programmes.

- The Fund Executive Unit is small and comprised mainly of administrators and accountants. The Fund does not employ its own environmental, technical or finance specialists.

**Box 18: Conclusions and Recommendations**

- The MoE, Fund Board and Executive Unit should jointly develop a clear vision of the Fund’s role in targeting domestic and foreign sources of finance toward the environmental requirements of EU accession. Discussions with the Fund Executive Unit, Board members, MoE and other government officials indicate that they are at an early stage of considering the Fund’s possible role in supporting EU accession. No clear vision supported by a consensus of the key players has been elaborated. There is clearly a need in Estonia for an organisation capable of acting as a financial intermediary (or implementing agency) for EU and other foreign financial support aimed at the environmental requirements of accession.

- The Estonian Environmental Fund would likely require substantial reforms before being able to provide the type of assurances commonly required by foreign institutions that it has the capacities necessary to manage and disburse external finance effectively and efficiently. The
reasons for this conclusion relate primarily to weaknesses in the Fund’s legal basis, institutional set-up and limitations on the Fund’s in-house capacity and authority in critical areas of programming and project cycle management. The recommended changes would require the Fund to at least partially relinquish its current role as a de facto budgetary adjunct to the MoE and may be difficult to accomplish in time for the Fund to take advantage of pre-accession financial support from the EU and other institutions.

• It should be acknowledged, however, that different foreign sources of finance have different operational requirements for collaboration. It is probable that less significant reforms would be required of the Fund to function as an implementing agency for EU financial assistance than would be required for the Fund to function as an intermediary for IFIs. A certain degree of political imperative is associated with EU accession assistance, which is being programmed in close cooperation with Ministries of Environment of the region. The Fund, being closely linked with the MoE, may be a natural choice as a mechanism for managing such assistance. IFIs, however, would likely require much greater reforms before considering the Fund as an intermediary, including operational independence from the MoE and more in-house capacity.

• If the MoE, Fund Board and other relevant authorities determine that the significant reforms suggested above are not achievable within the near-term, an alternative might be to establish a new “Estonian Environmental Investment Fund”. Such a fund could complement the activities of the existing Fund and have the explicit purpose of administering foreign and domestic sources of finance for the implementation of investments important for EU accession. The possible characteristics of such a fund are outlined in the following chapter.

• Irrespective of EU accession related reforms, the Fund should consider closer involvement in the NEAP process than has been the case to date. This would enable the Fund to take part in key decisions on its role as a source of domestic finance for NEAP actions. The MoE and Fund Board should consider the relative importance of the Fund’s financing of "softer" actions (such as environmental awareness) versus EU accession actions, within the context of the Fund’s medium-longer term strategic development aims.
Another Option: An “Estonian Environmental Investment Fund”

As noted in previous chapters, it appears that the MoE, Fund Board and other relevant bodies do not share a clear, common vision for the long-term strategic development and role of the existing Environmental Fund. While most officials acknowledged a need to strengthen the Fund, the views they expressed on how this should be done varied and were sometimes incompatible. Moreover, the Team has concluded that the Fund is not well suited to function as an implementing agency for EU or other major foreign sources of finance at this time. The substantial reforms that would likely be required of the Fund might not be achievable in a sufficiently short timeframe (six months - two years) to allow the Fund and MoE to take full advantage of pre-accession financial support which may be made available by the EU and other foreign sources.

In view of this, Estonian authorities may wish to consider another option - the establishment of a new “Estonian Environmental Investment Fund” (EEIF). While the Team realises that the establishment of a new fund is a serious undertaking and would not be quickly achieved, it might be more feasible than wholesale reform of the existing Fund and would offer some advantages. A carefully designed EEIF could complement the activities of the existing Fund and have the explicit purpose of administering foreign and domestic sources of finance for the implementation of investments important for EU accession. Some of the key steps for creating an EEIF, and characteristics which such a fund might exhibit are outlined below.

Role of EEIF

- An EEIF could have a more clearly defined and distinct focus than the existing Fund by providing financial assistance (perhaps restricted to soft-loans) for capital investments playing a crucial role in helping Estonia meet selected EU environmental standards. The EU standards and types of projects would be clearly defined in the Fund’s documentation, as would the respective roles of the MoE and EEIF authorities in identifying the key standards and setting eligibility criteria for projects.

- During its first 1-2 years of operation, an EEIF would concentrate its efforts on: building institutional capacity in project cycle management, in particular in economic and financial appraisal of environmental investment projects, loan management and in cash management; developing its accounting and reporting system, internal procedures, document forms, appraisal and management tools and contract templates; establishing partnerships with commercial banks and foreign financing sources (EU pre-accession funds, IFIs, bilateral donors); identifying project opportunities leading to closure of non-compliance gaps with EU standards, and; developing a portfolio of appraised environmental projects in industrial and municipal sector.

Legal Basis

- An EEIF could be established either as an independent, non-profit foundation pursuant to the Act on Foundations, or as a State Commercial Enterprise pursuant to the Commercial Code and to the Act on Foundation of and Participation in Legal Persons in Private Law by the State. In the second option, the possible legal status could be as a public limited company, all the stocks of which (or at least a majority) would be held by the State and administered on its behalf by the MoE.
Accounting

- An EEIF’s accounting system would be developed according to the standards established in the Estonian Accounting Act and according to EU standards. The EEIF’s Executive Unit should be given a statutory obligation to prepare an annual balance sheet and financial report, which should be verified by a chartered external auditor prior to approval by the EEIF’s Supervisory Board. After 2-3 years of operation, an independent financial audit should be carried out according to international standards.

Governing Structure

- If established as an independent, non-profit foundation, the governing structure should conform to the standards established under the Act on Foundations. If established as state commercial enterprise, the governing structure should conform to the Commercial Code and to the law on ‘Foundation of and Participation in Legal Persons in Private Law by the State Act’.

- Clear procedures and effective liaison mechanisms would have to be put in place to ensure that the authorities of the existing Fund and EEIF co-ordinate priorities and activities.

Revenues and Cash-Flow Management

- An EEIF would be designed to attract substantial revenues from the EU and other foreign sources of finance. However, it should be expected that a minimum level of domestic revenues would have to be allocated to the EEIF to demonstrate domestic commitment. One possibility would be to transfer a portion (10-25% annually) of the resources of the existing Environmental Fund as a grant to the EEIF to establish and gradually increase its stock capital. Once the EEIF started to extend loans, loan repayment and interest would become an important revenue source. Cash-flow management practices should also generate income for the EEIF.

- As noted, cash-flow management should be foreseen and provided for in the EEIF’s enabling statute. The necessary information resources, technology and human capacity should also be planned for in EEIF’s establishment and developed in its early stages of operation.

Reporting Requirements

- The statute of an EEIF should clearly define requirements for reporting to the Ministry of Environment, Government, Parliament and public. Guidelines and procedures for fulfilling these requirements should be elaborated in operational rules. The EEIF’s policies toward public disclosure and access to information should be documented and made available to the public and other interested parties. Pro-active external information policies would benefit the fund.
ANNEX 1: SUMMARY OF THE ESTONIAN ENVIRONMENTAL FUND

(The following information is taken from a survey of the Estonian Environmental Fund conducted by the EAP Task Force Secretariat at OECD. The survey was completed with the help of a number of Estonian officials and experts, particularly Ms. Ljuba Gornaja, Environmental Consultant and Mr. Jossif Eidelkind, Managing Director of the Fund.)

1. Background and Objective

The predecessor of the Estonian Environmental Fund (hereinafter the “Fund”) was established at the end of 1983 by the regulation of the Council of Ministers of the USSR as Estonian Fund for Nature Protection and Rational Use of Nature Resources. In its present form, the Fund operates since 1990 when the Fund has been legalized by the regulation of Government of Estonia as Estonian Environmental Fund. The Fund is a national institution operating in conformity with the Act on the Environmental Fund, its Statute, and other legal acts of the Republic of Estonia. The “Act on the Environmental Fund” was passed on January 12, 1994 (Riigi Teataja Part I 1994, No. 8, Art. 105).

According to Act on the Environmental Fund, the objective of the Fund is to collect additional financial resources for the protection of the natural environment and natural resources, and to provide to additional financing - with the help of grants and loans - international, national, county and local programmes and measures in the field of:

- Environmental protection;
- Nature conservation;
- Monitoring in environmental protection and nature conservation;
- Development and provision of environmentally sound technologies, equipment and technical means;
- Training, public and post-graduate education and public relations in environmental and nature protection;
- Solving other, environment-related problems of national and regional importance.

2. Management and Administration

General Provisions

The Fund collects and allocates financial resources for additional financing of environmental protection activities. The Fund’s support is additional to other sources of funding (State Budget, local budgets, enterprises own resources, foreign aid and commercial loans). The Fund is a legal entity (legally independent institution) which has its own stamp and bank accounts. The Fund operates within the area of government of the Minister of the Environment but is subject to the Fund Board. According to the Act on the Environmental Fund, the Minister of Environment approves the breakdown of expenditures of the Environmental Fund according to various programmes, based on the proposal of the Fund Board. The Minister of the Environment is also responsible for submitting the Fund draft annual budget and budget implementation report to the Government in a timely and appropriate manner. The Fund staff (Managing Director and other employees) is appointed and dismissed by the Fund Board. The payroll of the Fund staff is approved by the Fund Board too.

In order to enhance the Fund’s performance, and under its Statute, the Fund is internally divided into the Central Fund and County Funds which exist in all counties and the cities of Narva and Tallinn. Counties are regional units of the State government administration. There are currently 15
administrative units below national level. Within the Fund, special sub-funds can be established. Currently no special sub-funds exist.

Administration of the Fund

The Fund is supervised by the Fund Board. The Board disposes of, and is responsible for the appropriate use of, the Fund’s financial resources. The Chairman and the members of the Board are appointed by the Government of Estonia (by the Governmental Decree) on the proposal of the Minister of the Environment. The Board currently has 21 members, including representatives of the Ministry of the Environment (2 members), the Ministry of Finance (1 member), all county governments (15 members), two major cities (Tallinn and Narva) and scientific institutions (1 member). The Deputy Chairman of the Board is elected by the members of the Board. The Board’s current Chairman is Mr. Peeter Sooväli, Deputy Secretary General of the Ministry of Environment. The current Deputy Chairman is Mr. Kalev Aun, Head of the Järva County Environmental Department. None of the Board members are employed by the Fund but the Board members receive remuneration for the work and the sums are covered from administration expenses.

The Fund Board is competent to pass resolutions if at least half of its members are present, among them the Chairman or the Deputy Chairman. Decisions of the Board are adopted by simple majority vote of the Board members present at the meeting. In the case of tied votes, the vote of the chairperson (the Chairman or the Deputy Chairman) is decisive. Sessions of the Fund Board are held as needed, and at least once a quarter of a year. In exceptional cases the Board can make decisions without convening a session. Such exceptional occasions have actually happened: In that case, voting will take place by means of telephone or fax and 75 percent of the Board members must agree with the decision. For example, in April 1998, the Board approved the programme for diminishing transport air pollution with 21 votes gathered by means of fax/phone and granted 4 million EEK for carrying out the programme. The Board’s decisions must be in writing and signed by the Chairman of the Board. The Board approves also the composition of the Auditing Commission.

The Fund Board has the following responsibilities:

- Establishing the work regulation of the Fund;
- Approving the draft annual budget of the Fund and the budget implementation reports. The Minister of the Environment is responsible for submitting these reports to the Government in a timely and appropriate manner. The Fund’s budget is adopted by the Parliament and appears as an annex to the State Budget;
- Approving the draft budgets and the budget implementation reports of County Funds and Special Funds. The budgets of the County and Special Funds appear in the State Budget as part of the Fund’s overall budget;
- Establishing the procedures for applying for, and awarding, financial resources of the Fund;
- Making the decisions to award financial resources and establishing the terms of contracts;
- Making the decisions to forgive loans;
- Decides on profit making activities of the Fund (interest from loans; bank deposits; bonds);
- Establishing the procedures for accounting system for County Funds and Special Funds;
- Appointing and dismissing the Managing Director and other employees of the Fund;
- Approving the administrative expenses and payroll of the employees of the Fund;
- Overseeing the activities of the Managing Director of the Fund;
- Informing the public about Fund’s activities.

Due to a dramatic increase in the annual budget of the Fund, an executive unit of three persons, lead
by a Managing Director, was established by the Fund in 1996. Since the end of 1997 the Executive unit has five members: Managing Director, Deputy Director, Assistant Managing Director (responsible for administrative and personnel management and keeping of records) and two bookkeepers. This unit is broadly responsible for implementing Board decisions, coordinating programmes and managing the financial and economic activities of the Fund. The project appraisal and evaluation is conducted by outside experts - programme managers.

The Fund’s Managing Director of the Fund has the following responsibilities:

- Implementing the decisions of the Fund Board;
- Organizing Fund activities, calling in experts as necessary, and arranging their compensation;
- Keeping accounts on revenues, receiving applications for financing and organizing expertise;
- Convening Fund Board sessions on the order of the Chairman of the Board and ensures logistical services of the session;
- Monitoring and ensuring appropriate use of loans and grants;
- Organizing the drafting of the budget of County Funds and timely submission of reports to the Fund Board. The Director oversees the budget preparation by County Fund officials.

County Funds have been established at the Environmental Departments of all county governments and at the Environmental Departments of Tallinn and Narva. The County Funds, which focus on solving county-level environmental problems, are not legal entities and are officially part of the structure of a single Environmental Fund. Their annual budgets range from 0.5 to 13 million kroons. Total revenues and expenditures of the County Funds in 1994 and 1995 are shown in Table A.3; the revenue structure of the overall environmental fund system in Estonia is shown in Table A.2.

Each County Fund is administered by its County Fund Board which consists of 5-9 members. The members and the Chairman of the County Fund Boards are appointed by the Minister of the Environment in agreement with the County Governor. The Fund Board members are representatives of municipality or town councils and governments, county governments, NGOs, scientific community, water and wastewater enterprises, architects and foresters. The County Fund Board can pass resolutions if at least two thirds of its members are present. The decisions of the County Fund Board are made by simple majority vote. In case of tied votes, the vote of the Chairman of the County Fund Board is decisive. The County Funds have their own stamp and bank accounts.

The County Funds are independent in taking decisions on expenditures according to their budgets. The activities of the County Funds are organized by the corresponding County Environmental Departments and by the Environmental Departments of Tallinn and Narva. The Funds operate in close cooperation with the Ministry of the Environment, the County Environmental Departments and the Environmental Departments of Tallinn and Narva. The spending priorities of County Funds are set under corresponding county or town development programmes. The priorities are set by county governments with cooperation with municipalities. Most important expenditure areas in practice are water protection and nature conservation.

3. Sources of Revenue

The Fund’s sources of revenue are set by legislation. The bulk of the revenues to the Fund is generated by pollution charges, and water / mineral extraction fees.

A physical or legal person whose activities causes the emission/disposal of polluting substances and solid wastes into the environment has no right to avoid pollution charges. If, however, they are willing to invest into environmental protection, they have a right to apply for a pollution charge waiver. In accordance with Act on Pollution Charges (Riigi Teataja Part I 1994, No. 1, Art. 2; 1996, No. 49, Art.
the Minister of Environment has the right to grant waivers from pollution charge payments to polluters who invest in environmental protection measures which guarantee a reduction pollution by at least 25% from the previous year’s pollution level or participates in the financing of national or regional environmental programmes or projects approved by the Minister of Environment. If the pollution charge waiver in the first year is not sufficient to cover investment costs, pollution charges can be reduced for up to three years up to the point where the nominal investment value equals the nominal value of the pollution charge waiver. A polluter applying to the Minister of Environment for exemption from pollution charges submits an application together with a project for environmental measures including ecological and economic considerations. The basis for granting a pollution charge waiver is an agreement between the polluter and the Minister of Environment. The agreement includes the commitments of a polluter to reduce pollution, i.e. the information how the pollution will be reduced and up to which level. On the day of agreement termination, the polluter should present the data on actual amounts of pollution reduction. The implementation of the agreement is monitored by the Environmental Department of the respective district where the polluter is located, and, the Environmental Inspectorate. If the information about the pollution charge waiver is available at the time of budgeting, the Fund does not account this money as revenue.

The revenue sources of the Fund include the following:

- Pollution charges;
- Revenues from privatization of land and buildings (in force since May 3, 1996). In accordance with the Act on Use of Privatization Revenue (Riigi Teataja Part I 1996, No. 26, Art. 529) the Environmental Fund receives: 5% of the revenues from privatization of the state property effected pursuant to the Privatization Act, and, 5% of the revenues from privatization of the state land effected pursuant to the Land Reform Act;
- Excise taxes on packaging. In accordance with the Packaging Excise Act (Riigi Teataja Part I 1997, No. 5/6, Art. 159), the Environmental Fund receives 50% of the excise taxes on packaging for alcoholic products (in force since March 1, 1997) and packaging for soft drink products (to come into force on December 1, 1998);
- Water and mineral extraction fees (charges);
- Special allocations made from the State and local budgets. For example, in 1998, 13.5 million kroons was allocated from the State budget (from the fuel excise revenues) to the Central Fund;
- Special allocations made by the governments of foreign countries, legal and natural persons and international organizations; (in practice, revenues from such sources has been received by the County Funds);
- Donations;
- Interest and repayments of loans provided by the Fund;
- Revenues from profitable activities of the Fund (loan interest payments; loan repayments; interest from deposits);
- Other revenues.

The revenues from pollution charges are not earmarked for expenditures according to the respective environmental sector. According to the Act on the Environmental Fund, at least 25% of the pollution charges received by the Fund from a county will be spent on financing local environmental projects and compensation of pollution damage.

The revenue distribution is different for each revenue source. The County Funds collect pollution charges, game resource fees, natural resource use fees (water and mineral extraction fees) from corresponding county or town polluters or users and transfer to the Central Fund the following shares: 50% of pollution charges, 100% of Fund’s part of the natural resource use fees, 50% of the hunting rent, 20% of the game shooting fees. Violation of the forest regulations, compensation for nature damage, fines for delayed payment and other revenues stay fully at the County Funds. If revenues
from pollution charges which remain with a County Fund (50% of total pollution charges from corresponding county) is less than 0.5 millions EEK, the Central Fund compensates it to the County Fund so that the County Fund’s revenue from pollution charges will be 0.5 millions EEK. Revenues from excise taxes on packaging materials and privatization of land/buildings are revenues to the Central Fund only.

The majority of revenues is collected by the County Environmental Departments, and, partially also by the Environmental Inspectorate on the account of the corresponding County Fund. Excise taxes on packaging materials are collected by the National Tax Board and the Customs Board. The collection efficiency of revenues is affected by the outside factors, i.e. unforeseeable bankruptcies of companies. Revenues from privatization are hardly predicable. The efficiency of revenue collection has an impact on the implementation of the annual budget of the Fund: if the budget revenue plan can not be fulfilled, the planned projects will not take place either.

The revenues and expenditures of the Central Environmental Fund of Estonia are shown in Table 1 below (and Table A.4). The revenue structures of the overall Environmental Fund System, and, the Central Environmental Fund of Estonia are shown in Tables A.2 and A.5, respectively.

| Table 1: Total Revenues and Expenditures of the Central Environmental Fund of Estonia (all data in mln USD; actual values for the given year). |
|---------------------------------|----------------|-----------|-----------|-----------|-----------|
| Annual revenues (see table A.5) | n.a.          | 0.928     | 1.775     | 6.780     | 7.691     |
| Environmental expenditures (see tables A6-10) | n.a.          | 1.078     | 1.833     | 5.411     | 8.776     |
| Overhead / administrative costs  | n.a.          | 0.009     | 0.012     | 0.029     | 0.052     |
| Total expenditures 1             | n.a.          | 1.087     | 1.845     | 5.440     | 8.828     |

Notes: The Fund carries over (in some years substantial amounts of) unspent money from one year to another, and, total disposable resources for environmental expenditure are consequently higher than the amounts indicated under “annual revenues”. For detailed start/end year balances and total disposable yearly resources see table A.4. Totals might not sum up due to rounding. “n.a.” = data are not available. 1) “Total expenditures” = “Environmental expenditures” + “Overhead / administrative costs”.


4. Spending Strategies

Financing from the Environmental Fund is implemented through programmes, which are developed by the program managers based on submitted project proposals and applications. In addition, programmes take into account both national and local environmental priorities. The programmes are initiated as a result of state environmental policy, the prime responsibility for which is with the Ministry of Environment. The policy is based on the Economic Development Act and the Estonian National Environmental Strategy passed by the Parliament in 1995 and 1997 respectively. These programmes are elaborated in cooperation with municipalities, counties and specialists from the Ministry of Environment and are approved by the Fund Board. Part of the programmes are short term programmes, effective for not more than one year, and, part are long term programmes lasting from one up to seven years depending on the importance of the programme.

The implementation of national programmes financed from the Central Fund is carried out under the leadership and responsibility of respective programme managers appointed by the Ministry of
Environment and approved by the Fund Board. In 1997, 18-20% of Fund expenditures were allocated for programmes being implemented by the Ministry of Environment. The implementation of county and local programmes financed from County Funds is carried out under the leadership of programme managers appointed by County Environmental Departments and approved by the County Fund Board.

As a rule, the programmes to be financed are approved by the Fund Board together with the approval of the current Fund Budget. These programmes appear as an annex to the Budget. For example, in 1998, 12 programmes will be financed, including the water and air protection programme, the waste treatment/recycling programme, the environment inspection programme, the training and education programme, the nature conservation programme, etc. In 1997, the Environmental Fund made a remarkable contribution to the fulfilment of the obligations stemming from the Estonian National Environmental Strategy.

The Fund operates according to its annual budget. The budget consists of the budgets of the Central Fund and the County Funds. The draft budget must be approved by the Fund Board. It is then submitted for approval to the Government by the Minister of the Environment. The budget of the Fund is approved together with the State Budget. The Fund Board shall define the priorities financed from the Fund for the next 3 years at its annual session in April at the latest and shall present them to the Minister of Environment for approval. Proposals for the priorities are presented by the members of the Fund Board and programme managers. The public is informed about the Fund’s financing priorities through media channels. The annual budget is compiled according to these spending priorities. The programmes are divided into projects.

The most important priority for 1998 is gathering, transportation and treatment of dangerous waste. The work is continuing in the following years. After the departure of the Soviet Army, the Fund’s top priority was the liquidation of past environmental pollution and dangerous waste, including radioactive objects (Paldiski Nuclear Station). The Fund acted as a co-financier. Most of these dangerous objects have been liquidated by now and thus the priorities have changed as well. Water protection has also been a high priority. (The biggest share in expenditures of the Fund by environmental sector in 1997 was the water protection programme - 33.3% of the total environmental expenditures of the Central Fund.)

A special “reserve fund” has been established to cope with environmental accidents and compensation of damages caused by protected birds or animals species according to the procedure established by the Minister of the Environment. For example, the migrating Barnacle geese cause damage to fields with grain crops of both the summer and winter species (in spring and autumn), as well as cultivated and natural grasslands (in spring). Barnacle geese feed on grain and young shoots in grain fields, and on grass in grasslands. The scope of damage (loss of crops) caused by barnacle geese depends on the feeding intensity of the birds, i.e. with amount of birds feeds within which size of territory during which period. Considerable losses of crops are caused only in the case of intensive use of the fields (1000 or more barnacle-geese-days per hectare during migration season). The maximum losses of crops proven through experiments has reached 80% of the total crops in the case of grasslands and up to 60% of the total crops in the case of grain fields. A necessary precondition for compensation for damage (loss) caused by protected wild animal species is that possible and necessary measures for prevention of damage by the owner have been taken. In the case of Barnacle goose the options for prevention of damage include frightening and chasing away, e.g. with acoustic effects or setting up of scarecrows.
5. Expenditures

Expenditures on environmental investments in Estonia (excluding operation and maintenance costs) and R&D increased substantially from 1993 to 1997, eventually stabilizing at around 1.5% of GDP (see Table 2). In 1993, the Central and County Environmental Funds provided about 7% of total environmental investment and R&D financing in the country. In 1994, the share of the Central Fund was 7.3%, and, the share of County Funds was 6.8%; in 1995, 8.0% and 7.4% respectively; in 1996, 8.7% and 2.0% respectively; and, in 1997, the Central Funds share was 12.6% while the County Funds accounted for 3.5%. The key sources of the environmental investment and R&D financing for 1997 are indicated in Table 3.

The granting of financial resources from the Fund is made on the basis of a contract between the Fund and the applicant in accordance with the procedures established by the Fund Board and the provisions of the Fund’s Statute. The basis for concluding a contract is the decision of the Fund Board. Contracts are signed by persons entitled by the Fund Board. As a rule, contracts for financial transactions are signed by the Managing Director of the Fund. Leadership decisions are signed by the Chairman of the Board. The Fund monitors the appropriate use of the financial resources it provides.


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</thead>
<tbody>
<tr>
<td>Total expenditures</td>
<td>249.9</td>
<td>192.2</td>
<td>309.4</td>
<td>752.2</td>
<td>966.6</td>
</tr>
<tr>
<td>(mln EEK, current prices)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenditures as a % of GDP (current prices)</td>
<td>1.1</td>
<td>0.6</td>
<td>0.8</td>
<td>1.4</td>
<td>1.5</td>
</tr>
</tbody>
</table>


Table 3: Revenue Sources for Environmental Investment and R&D in Estonia in 1997 (%).

<table>
<thead>
<tr>
<th>Investment Sources</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Budget</td>
<td>7.0</td>
</tr>
<tr>
<td>Funds of State Budget and non-budgetary Funds</td>
<td>1.1</td>
</tr>
<tr>
<td>Local Budgets</td>
<td>10.8</td>
</tr>
<tr>
<td>Enterprises</td>
<td>41.7</td>
</tr>
<tr>
<td>Municipalities</td>
<td>1.7</td>
</tr>
<tr>
<td>Central Environmental Fund</td>
<td>12.6</td>
</tr>
<tr>
<td>County Environmental Funds</td>
<td>3.5</td>
</tr>
<tr>
<td>Foreign Assistance</td>
<td>13.0</td>
</tr>
<tr>
<td>Foreign Loans</td>
<td>5.6</td>
</tr>
<tr>
<td>Other Sources</td>
<td>3.0</td>
</tr>
</tbody>
</table>


A profile of expenditures made by the Central Environmental Fund is shown in Tables A.6 - A.10.

So far, the financial resources are not regularly maintained in reserves, but held in a bank account or as shares/stocks. Free cashflow is invested in short-term bank deposits. The new draft Fund Law foresees the formation of fixed capital reserves.

The Fund can provide soft or interest free loans for environmental investment projects. The maturity date of a loan is up to 7 years. The Fund can finance a maximum of 75% of total project costs. The portion of loans in financing projects is not strictly determined, however it will become more dominating in coming years.
Enterprises may be awarded low interest loans (0-10% nominal interest rate) for the implementation of high priority projects. A 25% share of the applicants’ own resources (self-finance) in the total cost of the project is necessary as well as a loan security and business plan.

Municipalities may be awarded loans having 0-10% nominal interest rates, while in the case of timely and successful realization of the project, partial or total forgiveness of the loan is possible based on the decision of the Fund Board. At least a 25% share of the municipalities’ own resources is necessary. (The Fund Board has a right to make exceptions on grounded necessity).

In practice, the nominal interest rates extended for municipalities are 3-5% and those offered for enterprises are 5-9%. (As of July 1998, average annual interest rates on loans in national currency, from credit institutions, ranged from 14-16%). Municipalities rarely receive loans with total forgiveness. The loans may be defaulted, if there is evidence that the municipality is unable to pay off the loan.

For financing projects, a public tender procedure is necessary for both private enterprises and municipalities. It has to be carried out before money from the Fund is transferred. The requirements for public tender procedures is established by the Law on Public Procurement (Riigi Teataja Part I 1995, No. 54, Art. 883). Pursuant to this Law, public procurement shall be the procurement of goods, public works and services, if this occurs from account of monetary resources of the state and local authorities, and state funds.

Grants may be given for training, awareness raising and nature conservation. The form of support provided for publications is decided on a case-by-case basis; either a loan or a grant may be offered. Environment supervision (inspection) is mainly granted. Supervision means state environmental supervision and supervision over the fulfillment of respective environmental measures. The Fund supports the development/upgrade of the material-technical basis of supervising institutions, for example the reconstruction of their offices, the equipment of laboratories, the acquisition of special means of transportation and special equipment (like communication means, night monitoring binoculars).

Applied research may be supported as part of a relevant national programme. Research is not financed on an application basis, but is commissioned as needed within relevant programmes. The implementing agents of the research projects are selected following a public tender procedure announced in a nation wide newspaper.

In order to support environmental activities, the Fund may collaborate with other financial institutions for the co-financing of projects. The Fund commonly co-finances projects with national, municipal, enterprise resources and foreign aid. Table 4 illustrates co-financing of environmental projects included in Public Investment Programme for 1995-2000. Table 5 illustrates the Environmental Fund’s role as a co-financier of some on-going long term (1995-2000) environmental projects.
Table 4: Environmental Fund’s Co-financing of the Public Investment Programme for 1995-2000.

<table>
<thead>
<tr>
<th>Source of finance</th>
<th>Total cost</th>
<th>Financed until 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>mln EEK</td>
<td>%</td>
</tr>
<tr>
<td>State Budget</td>
<td>492.051</td>
<td>24.4</td>
</tr>
<tr>
<td>Local Budgets</td>
<td>248.399</td>
<td>12.3</td>
</tr>
<tr>
<td>Pollution charge waivers</td>
<td>50.500</td>
<td>2.5</td>
</tr>
<tr>
<td>Environmental Fund (Central Fund and County Funds)</td>
<td>167.573</td>
<td>8.3</td>
</tr>
<tr>
<td>Foreign assistance</td>
<td>670.221</td>
<td>33.2</td>
</tr>
<tr>
<td>Foreign loans</td>
<td>230.445</td>
<td>11.4</td>
</tr>
<tr>
<td>Enterprises own resources</td>
<td>127.720</td>
<td>6.4</td>
</tr>
<tr>
<td>Sought</td>
<td>30.558</td>
<td>1.5</td>
</tr>
<tr>
<td>TOTAL (a total of 27 projects is included)</td>
<td>2017.467</td>
<td>100.0</td>
</tr>
</tbody>
</table>


Table 5: Environmental Fund’s Role as a Co-financer of Environmental Projects (some examples).

<table>
<thead>
<tr>
<th>Project Description</th>
<th>Total cost of the project (mln EEK)</th>
<th>Cost of the project that have been and/or will be financed by the Environmental Fund (mln EEK)</th>
<th>Cost of the project that have been and/or will be financed by the Fund (% of total project cost)</th>
<th>Other financiers involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kohtla-Jarve water supply, sewerage and wastewater treatment</td>
<td>219.445</td>
<td>18.150</td>
<td>8.3 %</td>
<td>state/local budget, enterprise’s own resources, bank credits, foreign aid</td>
</tr>
<tr>
<td>Narva intake, sewerage and water supply</td>
<td>226.660</td>
<td>22.410</td>
<td>9.9 %</td>
<td>state budget, local budget, loans (EBRD, NEFCO), foreign aid</td>
</tr>
<tr>
<td>Small municipalities wastewater treatment plants and water supply</td>
<td>70.000</td>
<td>13.000</td>
<td>18.6 %</td>
<td>state budget, local budget, foreign aid</td>
</tr>
<tr>
<td>Wastewater treatment facilities &amp; water protection measures of the Matsalu Bay drainage basin</td>
<td>17.790</td>
<td>3.960</td>
<td>22.2 %</td>
<td>state budget, foreign aid</td>
</tr>
<tr>
<td>Development of the hazardous waste treatment system</td>
<td>154.000</td>
<td>28.600</td>
<td>18.6 %</td>
<td>state budget, foreign aid</td>
</tr>
</tbody>
</table>

Sources: Authors calculations based on data presented in Draft Public Investment Programme for 1998-2000.

6. Evaluation, Reporting and Public Information

The Fund’s performance is evaluated by the Fund Board, and also by the Government and the Parliament of the Republic of Estonia. The Fund reports by presenting an annual report on its activities and budget implementation to the Government. The Fund will also report quarterly to the
Ministry of Environment and monthly to the Ministry of Finance on the budget implementation. Monthly reports are also submitted to the Statistical Office and National Tax Board.

The public is informed regularly through television (in a special environmental news TV programme), newspapers and radio.

Once a year, the State Audit Office controls the economic activities and the results of the work of the Funds. In addition, the Fund has formed an auditing commission consisting of three members, that controls the implementation of Board decisions at the Central Fund as well as in the structural units (County Funds).
ANNEX 1.1: DATA TABLES

Note: Tables A.1 - A.3 refer to the overall Environmental Funds System (Central & County Funds).

Table A.1.: Total Revenues and Expenditures of the Overall Estonian Environmental Fund System (million EEK; actual values for the given year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Start of year balance</td>
<td>3.040</td>
<td>8.575</td>
<td>5.389</td>
<td>3.836</td>
<td>29.928</td>
</tr>
<tr>
<td>Annual revenues (see table A.2)</td>
<td>22.876</td>
<td>24.093</td>
<td>39.297</td>
<td>106.626</td>
<td>146.436</td>
</tr>
<tr>
<td>Total disposable resources</td>
<td>25.916</td>
<td>32.668</td>
<td>44.686</td>
<td>110.461</td>
<td>176.364</td>
</tr>
<tr>
<td>Environmental expenditures</td>
<td>n.a.</td>
<td>26.949</td>
<td>40.172</td>
<td>79.585</td>
<td>153.851</td>
</tr>
<tr>
<td>Overhead / administrative costs</td>
<td>n.a.</td>
<td>0.330</td>
<td>0.679</td>
<td>0.948</td>
<td>1.888</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>17.341</td>
<td>27.279</td>
<td>40.851</td>
<td>80.533</td>
<td>155.739</td>
</tr>
<tr>
<td>End of year balance</td>
<td>8.575</td>
<td>5.389</td>
<td>3.836</td>
<td>29.928</td>
<td>20.626</td>
</tr>
</tbody>
</table>

Notes: Totals might not sum up due to rounding. “n.a.” = data are not available. 1) “Total disposable resources” = “Start of year balance” + “Annual revenues”. “Total expenditures” = “Environmental expenditures” + “Overhead / administrative costs”. 2) “End of year balance” = “Total disposable resources” - “total expenditures”.


Table A.2.: Annual Revenues to the Overall Estonian Environmental Fund System (million EEK; actual values for the given year)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Air pollution charges and fines</td>
<td>4.025</td>
<td>6.448</td>
<td>6.718</td>
<td>9.070</td>
<td>11.519</td>
</tr>
<tr>
<td>Water abstraction fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>17.034</td>
<td>18.967</td>
</tr>
<tr>
<td>Mineral extraction charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5.468</td>
<td>18.894</td>
</tr>
<tr>
<td>Game 1 resource use charge</td>
<td>1.580</td>
<td>1.976</td>
<td>1.786</td>
<td>2.403</td>
<td></td>
</tr>
<tr>
<td>Packaging excise tax</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.603</td>
</tr>
<tr>
<td>Loan repayment (including interest)</td>
<td>-</td>
<td>-</td>
<td>1.463</td>
<td>2.579</td>
<td>4.932</td>
</tr>
<tr>
<td>International grants 2</td>
<td>-</td>
<td>-</td>
<td>0.116</td>
<td>1.891</td>
<td>-</td>
</tr>
<tr>
<td>Revenue from privatisation</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11.000</td>
<td>29.113</td>
</tr>
<tr>
<td>Revenue from financial operations and interest on bank deposits</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>25.163</td>
<td>8.162</td>
</tr>
<tr>
<td>Other (violation of the forest regulations, compensation for damage to nature, fine for delayed charge payment, etc.)</td>
<td>3.432</td>
<td>1.899</td>
<td>0.403</td>
<td>0.767</td>
<td>1.406</td>
</tr>
<tr>
<td>TOTAL</td>
<td>22.876</td>
<td>24.093</td>
<td>39.297</td>
<td>106.626</td>
<td>146.436</td>
</tr>
</tbody>
</table>

Notes:  Totals might not sum up due to rounding. 1) Charge on game resources such as elk, dear, wild pig, red dear, lynx. 2) Foreign grants have been received by the County Funds.

Table A.3: Total Revenues and Expenditures of County, City and Central Fund(s) in Estonia, 1994 and 1995 (EEK; actual values for the given year).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total revenues</td>
<td>Total expenditures</td>
<td>Total revenues</td>
<td>Total expenditures</td>
</tr>
<tr>
<td>Tallinn</td>
<td>2'028'400</td>
<td>1'248'100</td>
<td>2'307'800</td>
<td>2'180'500</td>
</tr>
<tr>
<td>Narva</td>
<td>2'120'100</td>
<td>2'079'900</td>
<td>3'370'800</td>
<td>3'135'100</td>
</tr>
<tr>
<td>Harju</td>
<td>300'400</td>
<td>86'400</td>
<td>754'000</td>
<td>530'500</td>
</tr>
<tr>
<td>Hiiu</td>
<td>236'000</td>
<td>75'300</td>
<td>278'200</td>
<td>168'100</td>
</tr>
<tr>
<td>East Viru</td>
<td>5'654'300</td>
<td>5'571'900</td>
<td>7'459'400</td>
<td>7'196'500</td>
</tr>
<tr>
<td>West Viru</td>
<td>1'142'200</td>
<td>955'700</td>
<td>1'585'000</td>
<td>1'008'500</td>
</tr>
<tr>
<td>Jogevo</td>
<td>284'000</td>
<td>184'600</td>
<td>518'300</td>
<td>333'100</td>
</tr>
<tr>
<td>Jarve</td>
<td>256'000</td>
<td>199'300</td>
<td>525'500</td>
<td>467'200</td>
</tr>
<tr>
<td>Laane</td>
<td>353'200</td>
<td>67'600</td>
<td>523'400</td>
<td>519'600</td>
</tr>
<tr>
<td>Polva</td>
<td>253'300</td>
<td>130'000</td>
<td>307'000</td>
<td>285'800</td>
</tr>
<tr>
<td>Parnu</td>
<td>905'000</td>
<td>289'500</td>
<td>1'109'400</td>
<td>755'400</td>
</tr>
<tr>
<td>Rapla</td>
<td>237'800</td>
<td>184'400</td>
<td>327'700</td>
<td>220'500</td>
</tr>
<tr>
<td>Saare</td>
<td>445'200</td>
<td>219'800</td>
<td>656'300</td>
<td>590'800</td>
</tr>
<tr>
<td>Tartu</td>
<td>1'506'400</td>
<td>1'334'200</td>
<td>1'686'700</td>
<td>1'825'000</td>
</tr>
<tr>
<td>Valga</td>
<td>222'500</td>
<td>133'300</td>
<td>217'200</td>
<td>175'900</td>
</tr>
<tr>
<td>Viljandi</td>
<td>251'200</td>
<td>224'800</td>
<td>307'900</td>
<td>292'600</td>
</tr>
<tr>
<td>Voru</td>
<td>177'600</td>
<td>177'600</td>
<td>227'700</td>
<td>207'200</td>
</tr>
<tr>
<td>Central Fund</td>
<td>16'294'500</td>
<td>14'116'500</td>
<td>22'524'000</td>
<td>21'158'500</td>
</tr>
<tr>
<td>TOTAL</td>
<td>32'668'100</td>
<td>27'278'900</td>
<td>44'686'300</td>
<td>40'850'800</td>
</tr>
</tbody>
</table>

Note: Data on County Funds are not available for 1993, and, 1996-1997. Revenue data include start of year balances, and, expenditure data include overhead and administration costs.
Note: Tables A.4 - A.10 refer to the Central Estonian Environmental Fund only.

Table A.4: Total Revenues and Expenditures of the Central Environmental Fund of Estonia (all data in mln EEK; actual values for the given year).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Start of year balance</td>
<td>n.a.</td>
<td>4.249</td>
<td>2.178</td>
<td>1.366</td>
<td>17.486</td>
</tr>
<tr>
<td>Annual revenues (see table A.5)</td>
<td>n.a.</td>
<td>12.046</td>
<td>20.346</td>
<td>81.594</td>
<td>106.446</td>
</tr>
<tr>
<td>Total disposable resources</td>
<td>n.a.</td>
<td>16.295</td>
<td>22.524</td>
<td>82.960</td>
<td>123.932</td>
</tr>
<tr>
<td>Environmental expenditures (see tables A6-10)</td>
<td>n.a.</td>
<td>13.998</td>
<td>21.017</td>
<td>65.123</td>
<td>121.456</td>
</tr>
<tr>
<td>Overhead / administrative costs</td>
<td>n.a.</td>
<td>0.118</td>
<td>0.141</td>
<td>0.351</td>
<td>0.717</td>
</tr>
<tr>
<td>Total expenditures 1</td>
<td>n.a.</td>
<td>14.117</td>
<td>21.159</td>
<td>65.474</td>
<td>122.173</td>
</tr>
<tr>
<td>End of year balance 2</td>
<td>4.249</td>
<td>2.178</td>
<td>1.366</td>
<td>17.486</td>
<td>1.759</td>
</tr>
</tbody>
</table>

Notes: Totals might not sum up due to rounding. “n.a.” = data are not available. 1) “Total disposable resources” = “Start of year balance” + “Annual revenues”. “Total expenditures” = “Environmental expenditures” + “Overhead / administrative costs”. 2) “End of year balance” = “Total disposable resources” - “total expenditures”.


Table A.5: Annual Revenues to the Central Environmental Fund (mln EEK; actual values for the given year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Air pollution charges and fines</td>
<td>2.012</td>
<td>3.224</td>
<td>3.359</td>
<td>4.535</td>
<td>5.760</td>
</tr>
<tr>
<td>Water abstraction fees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>17.034</td>
<td>18.967</td>
</tr>
<tr>
<td>Wastewater charges and fines</td>
<td>3.743</td>
<td>3.603</td>
<td>7.093</td>
<td>8.092</td>
<td>9.796</td>
</tr>
<tr>
<td>Waste disposal charges and fines</td>
<td>3.967</td>
<td>3.480</td>
<td>7.217</td>
<td>7.842</td>
<td>13.923</td>
</tr>
<tr>
<td>Mineral extraction charges</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5.468</td>
<td>18.894</td>
</tr>
<tr>
<td>Game resource use charge</td>
<td>-</td>
<td>0.790</td>
<td>0.988</td>
<td>0.779</td>
<td>0.895</td>
</tr>
<tr>
<td>Packaging excise tax</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.603</td>
</tr>
<tr>
<td>Loan repayment (including interest)</td>
<td>-</td>
<td>-</td>
<td>1.463</td>
<td>1.419</td>
<td>2.398</td>
</tr>
<tr>
<td>Revenue from privatisation</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11.000</td>
<td>29.113</td>
</tr>
<tr>
<td>Revenue from financial operations and interest on bank deposits</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>25.163</td>
<td>2.927</td>
</tr>
<tr>
<td>Other (violation of the forest regulations, compensation for damage to nature, fine for delayed charge payment, etc.)</td>
<td>n.a.</td>
<td>0.949</td>
<td>0.226</td>
<td>0.262</td>
<td>0.170</td>
</tr>
<tr>
<td>TOTAL</td>
<td>n.a.</td>
<td>12.046</td>
<td>20.346</td>
<td>81.594</td>
<td>106.446</td>
</tr>
</tbody>
</table>


Note: Totals might not sum up due to rounding. “n.a.” = data are not available. 1) Charge on game resources such as elk, dear, wild pig, red dear, lynx.
Table A.6: Central Fund Environmental Expenditures by Type of Disbursement Mechanism (mln EEK; actual values for the given year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants</td>
<td>n.a.</td>
<td>13.788</td>
<td>19.972</td>
<td>62.349</td>
<td>108.806</td>
</tr>
<tr>
<td>Interest free loans</td>
<td>0.400</td>
<td>0.075</td>
<td>0.170</td>
<td>0.527</td>
<td>9.270</td>
</tr>
<tr>
<td>Soft loans</td>
<td>0.010</td>
<td>0.135</td>
<td>0.875</td>
<td>2.247</td>
<td>3.380</td>
</tr>
<tr>
<td>TOTAL environmental</td>
<td></td>
<td>13.998</td>
<td>21.017</td>
<td>65.123</td>
<td>121.456</td>
</tr>
<tr>
<td>expenditures</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Totals might not sum up due to rounding. “n.a.” = data are not available.

Table A.7.: Number of Projects Supported by the Central Fund According to Type of Disbursement Mechanism.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>679</td>
</tr>
<tr>
<td>Interest free loans</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>“Soft” loans</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>TOTAL number of projects</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>688</td>
</tr>
</tbody>
</table>

Note: “n.a.” = data are not available.

Table A.8.: Central Fund Environmental Expenditures by Sector (mln EEK; actual values for the given year).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental protection programme</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Air protection programme (total)</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>1.800</td>
<td>2.272</td>
</tr>
<tr>
<td>incl. - energy production/heating sector</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>0.798</td>
<td>0.280</td>
</tr>
<tr>
<td>- industry sector (excl. energy/heating)</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- transport</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- other expenditures related to air pollution</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>1.002</td>
<td>1.992</td>
</tr>
<tr>
<td>Water protection programme (total)</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>28.324</td>
<td>40.419</td>
</tr>
<tr>
<td>incl. - water supply</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>3.300</td>
<td>9.509</td>
</tr>
<tr>
<td>- wastewater treatment / sewage</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>20.288</td>
<td>26.466</td>
</tr>
<tr>
<td>- other exp. related to water protection/supply</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>4.736</td>
<td>4.444</td>
</tr>
<tr>
<td>Waste management programme (total)</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>9.280</td>
<td>12.213</td>
</tr>
<tr>
<td>incl. - reuse / recycling</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>0.609</td>
<td>0.060</td>
</tr>
<tr>
<td>- incineration and other treatment</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>5.146</td>
<td>6.315</td>
</tr>
<tr>
<td>- disposal</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>0.850</td>
<td>2.800</td>
</tr>
<tr>
<td>- other exp. related to waste management</td>
<td>n.a.</td>
<td></td>
<td></td>
<td>2.675</td>
<td>3.037</td>
</tr>
<tr>
<td>Nature conservation programme</td>
<td>n.a.</td>
<td>0.834</td>
<td>1.365</td>
<td>2.000</td>
<td>4.029</td>
</tr>
<tr>
<td>Nature use taxation programme</td>
<td>n.a.</td>
<td></td>
<td>0.380</td>
<td>2.200</td>
<td>1.295</td>
</tr>
<tr>
<td>Education and information programme</td>
<td>n.a.</td>
<td>0.809</td>
<td>1.063</td>
<td>1.955</td>
<td>4.689</td>
</tr>
<tr>
<td>Monitoring programme</td>
<td>n.a.</td>
<td>0.918</td>
<td>0.125</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
<td>-------</td>
</tr>
<tr>
<td>Environment supervision programme</td>
<td>n.a.</td>
<td>1.750</td>
<td>1.524</td>
<td>4.853</td>
<td>14.432</td>
</tr>
<tr>
<td>Hunting programme</td>
<td>n.a.</td>
<td>0.076</td>
<td>0.362</td>
<td>0.687</td>
<td>0.882</td>
</tr>
<tr>
<td>Mineral resource programme</td>
<td>-</td>
<td>-</td>
<td>0.170</td>
<td>4.636</td>
<td>10.818</td>
</tr>
<tr>
<td>Planning, building and investment programme</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>9.095</td>
<td>23.421</td>
</tr>
<tr>
<td>Information technology programme</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2.168</td>
</tr>
<tr>
<td>Environmental technologies</td>
<td>-</td>
<td>-</td>
<td>1.282</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Reserves</td>
<td>n.a.</td>
<td>-</td>
<td>1.757</td>
<td>0.294</td>
<td>3.011</td>
</tr>
<tr>
<td>Other (“Earmarked”)</td>
<td>n.a.</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1.808</td>
</tr>
<tr>
<td>TOTAL environmental expenditures</td>
<td>n.a.</td>
<td>13.998</td>
<td>21.017</td>
<td>65.123</td>
<td>121.456</td>
</tr>
</tbody>
</table>

Notes: Totals might not sum up due to rounding. “n.a.” = data are not available.

Table A.9: Central Fund Environmental Expenditures by Type of Recipient (mln EEK; actual values for the given year).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprises (total)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>75.739</td>
</tr>
<tr>
<td>State administration</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>4.908</td>
</tr>
<tr>
<td>County administration</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.680</td>
</tr>
<tr>
<td>Municipal / local administration</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.126</td>
</tr>
<tr>
<td>Public institutions (schools, universities, hospitals, etc.)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>28.474</td>
</tr>
<tr>
<td>NGOs</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>10.474</td>
</tr>
<tr>
<td>Private persons</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.574</td>
</tr>
<tr>
<td>Other</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.480</td>
</tr>
<tr>
<td>TOTAL environmental expenditures</td>
<td>n.a.</td>
<td>13.998</td>
<td>21.017</td>
<td>65.123</td>
<td>121.456</td>
</tr>
</tbody>
</table>

Notes: Totals might not sum up due to rounding. “n.a.” = data are not available.

Table A.10: Central Fund Environmental Expenditures by Purpose of Money Used (mln EEK; actual values for the given year).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment projects (total)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>30.990</td>
<td>68.571</td>
</tr>
<tr>
<td>Incl.: - technology/equipment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>30.990</td>
<td>68.571</td>
</tr>
<tr>
<td>- operation/maintenance</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>30.990</td>
<td>68.571</td>
</tr>
<tr>
<td>Non-investment projects</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>34.133</td>
<td>52.885</td>
</tr>
<tr>
<td>TOTAL environmental expenditures</td>
<td>n.a.</td>
<td>13.998</td>
<td>21.017</td>
<td>65.123</td>
<td>121.456</td>
</tr>
</tbody>
</table>

Notes: “n.a.” = data are not available. 1) The term “investment projects” here means capital expenditures associated with environmental technology/equipment and the construction of facilities (including operation and maintenance of such installations). The term “non-investment” projects here includes activities such as training/education and public awareness raising, environmental monitoring and research, nature protection through non-technological means, etc. (including computers and other office equipment for the support of such activities).
ANNEX 2: BACKGROUND DOCUMENTS EXAMINED

1. Final Draft of Estonian NEAP.
9. Documents Required to Apply for Financing from the Estonian Environmental Fund (not dated).
12. Survey of Economic Instruments for Environmental Policy in Estonia (being prepared by the Regional Environmental Centre; 1998).
15. Act on Pollution Charges - Resolution of the President of the Republic of Estonia (December 1993).
17. Establishment of Rates for Pollution Charges for 1998.
18. Selected Economic Indicators of Estonia.
19. Act on Use of Privatisation Revenue.
27. Procedure for Providing Compensation for Damage Caused by Protected Wild Animal Species.
ANNEX 3: LIST OF PEOPLE INTERVIEWED FOR THE REVIEW OF THE ESTONIAN ENVIRONMENTAL FUND

Estonian Ministry of Environment:

− Mr. Villu Reiljan, Minister;
− Mr. Rein Ratas, Secretary General;
− Mr. Peeter Sooväli, Deputy Secretary General; Chairman of the Fund Board;
− Ms. Eva Kraav, Deputy Secretary General;
− Mr. Harry Liiv, Director General of Environmental Department;
− Mr. Allan Gromov, Director General of Environmental Policy Department;
− Mr. Kalju Kukk, Director General of General Department;
− Mr. Viktor Grigorjev, Deputy Director General of Environmental Department (Air Protection Programme);
− Mr. Marko Tuurmann, Water Protection Programme Manager;
− Mr. Matti Viisimaa, Head of Waste Division, Waste Management Programme Manager;
− Mr. Tiit Randla, Head of Nature Conservation Division; Nature Conservation Programme Manager;
− Ms. Mai Zernask, Education and Training Counsellor; Education, Training and Promotion Programme Manager;
− Ms. Riinu Rannap, Nature Conservation Bureau, Environmental Information Centre;
− Mr. Joel Valge, Counsellor of Air Division;

Estonian Environmental Fund (Board and Executive Unit):

− Mr. Kalev Aun, Member of the Fund Board, Head of Järva County Environmental Department, Chairman of Järva Environmental Fund Board;
− Mr. Toomas Padjus, Member of the Fund Board, Head of Pärnu County Environmental Department, Chairman of Pärnu Environmental Fund Board;
− Mr. Madis Kaasik, Deputy Managing Director of the Fund Executive Unit;
− Ms. Lea Kulla, Chief Accountant of the Fund Executive Unit;

Estonian Ministry of Finance:

− Ms. Evi Ladva, Member of the Fund Board;
− Mr. Hannes Aarma, Deputy Head of Department, Director of the Assistance Coordination Unit

European Union Delegation in Estonia:

− Mr. Niall Leonard, First Secretary

Others:

− Ms. Anneli Küllaots, Office of European Integration, Estonian State Chancellery;
− Mr. Patrick Doherty, Project Manager of EU Approximation Strategy (DISAE) project;
− Mr. Kalle Türk, Manager of the Environmental Board, Tallinn City Government;
− Mr. Valdur Lahtvee, Deputy Project Manager of Estonian NEAP, Vice Chairman of Friends of the Earth of Estonia;
–Mr. Heino Luik, Managing Director of Green Cross Estonia; member of the Governmental Committee on Sustainable Development;
–Mr. Enn Otsa, Environmental Research Centre (representative of Fund’s clients);
–Mr. Neeme Reinap and Mr. Tõnis Meriste, EcoPro (representative of Fund’s clients).