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ROLE OF NATIONAL ENVIRONMENTAL FUNDS IN PROMOTING GREEN INVESTMENTS

Discussion Note

This Note was prepared for discussion at the OECD GREEN Action Task Force Annual Meeting on 30 September – 1 October 2019, in Boulogne-Billancourt, France and will support Item 7 of the agenda.

Contacts: Nelly PETKOVA, Economist/Policy Analyst, nelly.petkova@oecd.org
Kumi KITAMORI, Head of the Green Growth and Global Relations Division, kumi.kitamori@oecd.org

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Introduction

1. The establishment of public funds for environmental investments is now re-gaining interest of environmental policy makers in many countries of Eastern Europe, Caucasus and Central Asia (EECCA). Once common in the EECCA region, such funds were typically governmental institutions, capitalised by a variety of earmarked public revenue sources, including pollution charges and fines. Notwithstanding their generally modest role and challenges with the efficiency and effectiveness of the use of resources, these comprehensive funds were an important instrument of public environmental finance and provided financing, usually in the form of grants or soft loans, to a wide range of environmental protection activities for both the public and private sectors.

2. Given the natural link between Environmental Funds and national budgets, the debate on these Funds can also be framed in the broader context of "green public budgeting". Environmentally responsive or green budgeting means using the tools of budgetary policy-making to help achieve environmental goals.

3. There is growing international interest in green budgeting. At the One Planet Summit in December 2017, OECD Secretary-General launched the Paris Collaborative on Green Budgeting, working with governments, institutions and experts to embed climate and other environmental goals within national budgeting frameworks. This initiative aims to design new, innovative tools to assess and drive improvements in the alignment of national expenditure and revenue processes with climate and other environmental goals.

4. This Discussion Note provides a general overview of the main features of existing Environmental Funds and outlines some of the issues concerning Funds' performance. The Note also discusses the challenges in existing Funds' operations as well as those that may be faced by governments when new (e.g. energy efficiency) funds are established.

5. The term "Environmental Fund" is employed to denote a variety of institutional arrangements primarily financed by domestic sources that have been put in place by governments in the EECCA countries to manage their public environmental expenditure programmes.

6. The information in this Note is based on a review of publicly available information on Environmental Funds in all EECCA countries. Sources include both national and international reports, relevant websites, government documents, previous OECD work on public environmental expenditure management.

Questions for discussion

7. This Note aims to support the discussion during the session on "The Role of National Environmental Funds in Promoting Green Investments". The discussion will be held within the framework of the GREEN Action Task Force and will focus on promoting green investments and the achievement of national environmental/green and climate-related policy objectives. The session will also seek countries' interest to work jointly with the OECD and other partner organisations to improve public environmental expenditure management in the EECCA region and bring it in line with international good practices.

8. The main questions proposed for this discussion are:

- What is the role of public environmental finance in promoting environmental / green investments?
- Are Environmental Funds an indispensable tool of environmental policy-making and achieving national priority environmental objectives?
- What are the main challenges facing the governments in managing public environmental expenditure programmes and institutions such as Environmental Funds?
- How can the OECD, development partners and Development Finance Institutions (DFIs) further support EECCA governments in their efforts to improve their environmental support programmes?

Past OECD work on public environmental expenditure management and Environmental Funds

9. In the 1990s, Environmental Funds in the EECCA region were one of the main sources of domestic public environmental finance providing subsidies to priority environmental actions. These Funds were extra-budgetary, outside of public scrutiny, and often inefficiently managed.

10. Over the last 15 years or so, however, Environmental Funds have undergone fundamental transformations. Due to pressures to improve the public finance system, some countries closed down their extra-budgetary (including environmental) funds starting in the early 2000s. The revenues of these funds were consolidated into countries' state budgets. At the same time, new financing sources started to emerge and replace the Funds, including external finance via development partners (often blended with domestic financial resources), or DFI-supported lending products extended through domestic commercial banks. Where the Environmental Funds have remained, their operations have been somewhat reduced and they have largely lost their primacy on the market of environmental finance.

11. While the Polluter Pays Principle (PPP), which guides OECD environmental policy, implies that polluters should bear the full cost – without subsidies - of compliance with the goals established by the relevant administration, the PPP also provides for certain exceptions to this "no subsidy" philosophy. Specifically, a subsidy may be justified if it is well targeted (i.e. the environmental objectives to be achieved by the subsidy are clearly specified), limited in size and duration and does not introduce significant distortions in markets and trade. It can also be used where considerable external benefits or provision of public goods are involved (e.g. publicly provided infrastructure). Thus, if subsidies are to be used, their justification should be clearly demonstrated.

12. Over the years, the OECD has developed a number of policy tools that aim to support the efforts of governments to manage their environmental subsidy programmes in a cost-effective way and in line with good international practices. These include, among others, the Recommendation of the OECD Council on Good Practices for Public Environmental Expenditure Management (PEEM) (http://www.oecd.org/env/outreach/38787377.pdf) and the Handbook for Appraisal of Environmental Projects Financed from Public Funds (http://www.oecd.org/env/outreach/38786197.pdf).

13. The Good Practices for PEEM provide guidance on how to design and implement public environmental expenditure (or subsidy) programmes. These Good Practices can also be used to evaluate the performance of Environmental Funds in terms of environmental effectiveness, management efficiency, fiscal prudence, transparency and accountability. The Appraisal Handbook complements the Good Practices and provides a step-by-step approach to implementing the Good Practices in real life.

14. These guiding documents, prepared jointly with the governments in the region, served as a basis for the development of a methodology for an in-depth review and assessment of public institutions that manage subsidy programmes to support green investments. Between 1997 and 2007, a number of Environmental Funds in both Central Europe, EECCA and Asia were reviewed using this methodology, including Funds in the Czech Republic, Estonia, Poland, Slovenia, Kazakhstan, Moldova, the Russian Federation, Ukraine, China, Vietnam.

15. These performance reviews identified a number of common challenges, such as unfocused expenditure programmes, inadequate efficiency, lack of transparency, over-politicisation and excessive dispersion of resources. However, the few successful Funds in Central Europe, which continue to exist, have demonstrated that government-controlled Funds can be made cost-effective, market friendly, fiscally sound and environmentally effective institutions. Such Funds have attracted sizeable external funding from development partners as well.

16. Most recently, the OECD has moved a step further in its public finance work. With the aim of demonstrating how the Good Practices can be implemented on the ground, the OECD has assisted the governments of Kazakhstan, the Kyrgyz Republic and Moldova to design green public transport investment programmes in line with the Good Practices. As part of this work, the OECD designed a model which supports the analysis of the programme and its development. This Excel-based tool was called Optimising Public Transport Investment Costs (OPTIC) model. The model allows to calculate and optimise total programme costs, for both the public financier and private sector investors, the optimal level of the subsidy and the air pollution and greenhouse gas emission reductions that can be achieved as a result of programme implementation. The model is an analytical tool that can help the decision-making process become more objective and more transparent.

17. In addition, within the framework of the GREEN Action Task Force, the OECD also worked on green budgeting and more specifically on the integration of public environmental investment programmes in medium-term budgeting processes. This work was largely prompted by the new approaches to budgeting adopted by the EECCA countries, including the introduction of medium term expenditure frameworks and the new approaches to aid delivery adopted by international partners via national country systems and sectoral and general budget support.

18. Progress notwithstanding, shifting to a low-carbon economy, that countries in the region are committed to, still requires massive resources. While the private sector is expected to contribute significantly to financing the transition, the state has a key role to play in providing the right incentive framework to stimulate increased demand for green and clean-energy investments. Public support is one of the main policy instruments that governments have in their policy toolbox. If used in a smart and cost-effective manner, limited public resources, including those managed through Environmental Funds, can leverage significant external and private funds and contribute to the achievement of priority climate and energy-related national objectives.

19. It is in this context that interest in public Environmental Funds has re-emerged. A number of countries in the region are considering re-establishing an Environmental Fund or improving the performance of existing ones.

Brief overview of existing Environmental Funds

20. "Traditional" extra-budgetary Environmental Funds were first established in the late 1980s in most of the then-Soviet Union Republics except in Armenia, Georgia and Tajikistan.[1] "Traditional" Funds here mean: (i) managing earmarked public resources for environmental improvements; (ii) capitalised mostly by the revenue generated by pollution charges and fines; and (iii) being comprehensive, that is, financing a broad range of environmental/green activities (water, waste, air, biodiversity).

21. As already discussed, starting in the early 2000s, a number of countries closed down their traditional extra-budgetary Funds and their revenues were integrated into state budgets. This budget consolidation happened in Kazakhstan in the year 2000, in Belarus in 2011 and in Ukraine in 2014. [2]

22. At the same time, several EECCA countries continue to maintain their traditional Environmental Funds. These include Azerbaijan, the Kyrgyz Republic, Moldova and Uzbekistan. These Funds have all been converted from extra-budgetary into budgetary and their revenues are internally (within the budget) earmarked for environmental activities managed by the Funds. The Kyrgyz Republic and Uzbekistan have established Environmental Funds at both a national and sub-national level while in 2017 Moldova closed down its sub-national level Environmental Funds.[3]

23. Alongside these traditional Funds, a new type of Environmental Funds have emerged. For the sake of this Note, we call them "Specialised Clean Energy Funds". These include, for example, the Renewable Resources and Energy Efficiency Fund in Armenia (established in 2005), the Georgian Energy Development Fund (2010) and the Energy Efficiency Fund in Ukraine (2018).

24. All these Funds are state-owned and were established through an initial equity injection from the state. The main source of revenue of the Funds is also the state budget but their sources are not linked to the pollution charge system. Instead, the Funds receive budget allocations on the basis of their spending plans. In addition, these Funds have been supported by the international development partners and have received significant international transfers and technical support over the years.

[1] Similar Environmental Funds were also established in several Central European countries, many of which are now members of the European Union. These include, among others, the Czech State Environmental Protection Fund, Estonian Environmental Fund, Polish National Fund for Environmental Protection and Water Management, Slovenian Environmental Development Fund.

[2] It is interesting to note that until 2014, Ukraine had a national (special budget) Environmental Protection Fund and numerous regional/local Environmental Protection Funds managed by local authorities. In 2014, the National Fund was closed down while the local Funds continue to exist. The resources that were previously allocated to the National Fund are now split between the local Funds and the general state budget.

[3] Azerbaijan seems to have a national-level Fund only. However, the public information is not sufficient to state this with certainty.

25. Another important feature that distinguishes these Funds from the "Traditional" ones is their focused mandate and spending strategy. Unlike traditional comprehensive Funds which finance projects across all environmental media, these recent Funds support investments in one or two main sectors, usually renewable energy and energy efficiency. The general typology of Environmental Funds as discussed in this Note is presented in Table 1.

Table 1. Typology and evolution of Environmental Funds

Traditional Environmental Funds fully consolidated into state budgets and year of their closure	Traditional budgetary Environmental Funds in operation	Specialised Clean Energy Funds
Belarus: National and regional Nature Protection Funds (closed in 2011)	**Azerbaijan**: State Fund for Environmental Protection	**Armenia**: Renewable Resources and Energy Efficiency Fund (est. 2005)
Kazakhstan: State Environmental Protection and regional Funds (closed in 2000)	**Kyrgyz Republic**: Republican and 4 local Environmental Protection and Forestry Development Funds	**Georgia**: Georgian Energy Development Fund (est. 2010)
Turkmenistan: State Environmental Fund (closed in 2008)	**Moldova**: National Ecological Fund	**Ukraine**: Energy Efficiency Fund (est. 2018)
Ukraine: National (special budget) Environmental Fund (closed in 2014) (but local Environmental Funds continue to exist)	**Uzbekistan**: National Ecology, Environmental Protection and Waste Management Fund and 14 local Funds	

26. There are other specialised Funds in the EECCA countries, such as the Energy Efficiency Fund of Moldova or Georgia's Renewable Energy Fund. However, they are not included in this analysis as: (i) they are exclusively financed by external development partner organisations only without the use of domestic finance, and/or ii) their main investment focus is not clean energy, climate or environment (although occasionally they may finance some green investments).

27. For example, the Energy Efficiency Fund of Moldova, that was established in 2011-12, received more than EUR 20 million from the European Union (EU) between 2012 and 2015 to support energy efficiency investments in both the public and private sector. Another example is Georgia's Renewable Energy Fund set up by KfW. As this Note focuses on the role of domestic public funds in green investments these two Funds are not discussed in detail here.

Traditional budgetary Environmental Funds

28. The analysis in this section is based on the experience of the four national Funds in Azerbaijan, the Kyrgyz Republic, Moldova and Uzbekistan. This section discusses the main aspects of traditional budgetary Funds. These include: the legal status and management of the Funds, their revenue sources and expenditure focus, mechanisms used by the Funds to disburse resources, programming and project appraisal practices employed by the Funds. These are some of the key elements that need to be considered in setting up Environmental Funds and assessing Funds' performance.

Legal status and management of the Funds

29. The Environmental Funds in Azerbaijan, the Kyrgyz Republic, Moldova and Uzbekistan are not independent legal entities. They were created by a Government or Ministerial Decree. These funds are institutionally subordinated to the administrative structure of environmental authorities and do not have independent management, staff and balance sheet.

30. Generally, Funds' assets represent annual appropriations on a special budget line earmarked for environmental purposes. Disbursement is made by the Treasury upon the authorisation of the environmental administration.

31. The available information on the Funds in the Kyrgyz Republic, Moldova and Uzbekistan show that they have a two-tier management structure: a supervisory body and an executive office (there is no such information on the Fund in Azerbaijan). The supervisory body (Board of Directors in the Kyrgyz Republic, Administrative Council in Moldova, Management Council in Uzbekistan) usually consists of 7-11 people who are members of different parts of the government, including representatives of the academia and NGO community. The main responsibilities of the supervisory body include, among others, establishing spending priorities for the Fund, setting internal policies, approving the annual budget, approving projects for financing. The available information does not make it clear if the Funds have well established executive offices with qualified professional staff and clearly defined responsibilities for project appraisal and selection. It seems rather that people working at the Funds are regular staff of the government administration overseeing the Funds' operations. Funds' staff may often have to perform other additional tasks not related to project cycle management.

Revenue of the Funds

32. Environmental Funds are usually capitalised by revenues from charges and fines on pollution (e.g. air emissions, wastewater discharges, waste disposal at landfills) as well as from charges on natural resource use (e.g. water consumption, mining) and particular products (e.g. fuel, packaging). The revenue from these charges is usually collected at the local level and shared with the Fund at the national level.

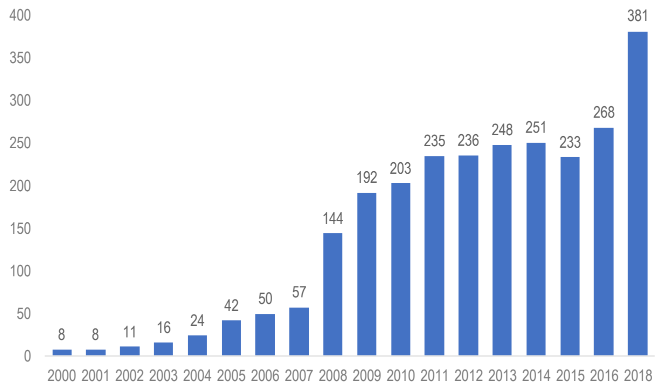
33. There is little information on current revenue and expenditure of these Funds. Such data are either highly aggregated or completely lacking. Available data are often not up-to-date. Generally, there are no reports on Funds' operations and spending, which undermines transparency.

34. Anecdotal evidence suggests that resources made available to these Funds are not significant. For example, in 2016, the total revenues of the Kyrgyz Republican Fund were about USD 1.5 million and, in 2017, its revenue amounted to a little bit more than USD 4 million.

35. Of the four countries, only Moldova seems to produce annual reports on its National Ecological Fund. Recent data show that the revenue of the Fund increased significantly between 2008 and 2018 (by over two-fold) from MDL 150 million (USD 10 million) in 2008 to about MDL 400 million (about USD 22 million) in 2018. The strong growth in the Fund's revenue is almost entirely related to the introduction of a levy on imported plastic and packaging in 2008. This is one of the levies on imported environmentally-harmful goods that generates revenue only for the National Ecological Fund. During the period 2011–2012, this levy accounted, on average, for about 86.5% of the total revenue of the National Ecological Fund. The Fund's second largest source, the fuel tax on mobile

emission sources[4], accounted for another 12%; the remaining 1.5% derived from the revenue generated from charges for air pollution from stationary sources, water pollution, waste storage and fines. It is no surprise that as a result of this successful revenue growth there has been a lot of interest by different parts of the government to oversee the management of the Fund.

Figure 1. Revenue of the National Ecological Fund of Moldova, mln MDL



Source: OECD (2017), Measuring the Performance of Green Economic Development in the Republic of Moldova and Ministry of Agriculture, Regional Development and Environment of Moldova (2019), Report on the Activities of the National Ecological Fund for the Period 01.01.2018 – 31.12.2018.

36. These countries, and the EECCA countries more generally, have inherited from the former Soviet Union a complicated and rather burdensome system of pollution charges, levied on a large number of pollutants. These numerous charges, even if not very high in absolute terms, make their administration rather ineffective and costly relative to the revenue they generate. Previous OECD analysis has shown that poor design and enforcement of pollution charges have often created ample opportunities for polluters to evade payments, leading to a very low revenue collection despite low charge rates.

37. Moldova's experience with introducing a levy on environmentally-harmful goods and products is a good example of using a source which is more stable and can generate significant resources relative to the efforts needed for its revenue collection. This Moldovan experience is worth noting for other countries.

Expenditure of the Funds

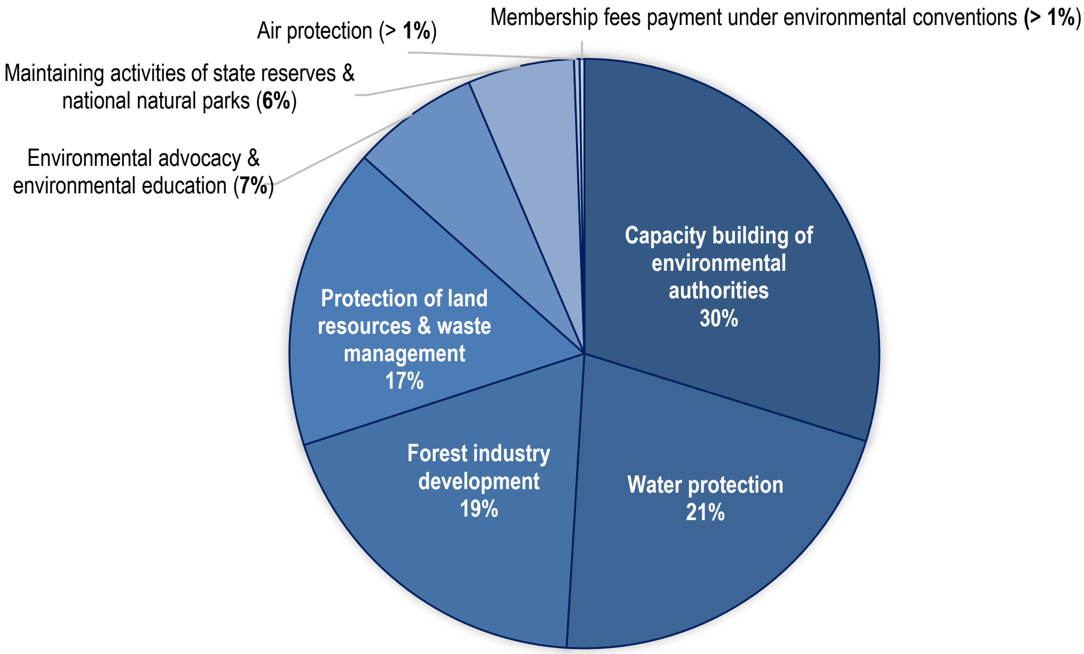
38. All Funds support investments in municipal environmental infrastructure. For example, in 2018, more than 90% of the spending of the National Ecological Fund of Moldova went to water supply and sanitation projects with local governments as the main beneficiary of this support. However, very little support went to air, waste or biodiversity. There are concerns in Moldova that the Fund does not respect the principle of earmarking, that is if most of its revenue comes from levies on environmentally-harmful products, the Fund needs to allocate proportionally part of its resources to solving problems in the waste management sector and the waste disposal of harmful products. In general, all Funds seem to provide very little financial support to the enterprise sector.

[4] In 2017, in relation to the reform of the system of Environmental Funds and the closure of local Funds, this tax was excluded as source of revenue for the National Ecological Fund of Moldova.

39. A significant part of the Funds' resources seem to be allocated to non-investment activities (e.g. running costs and equipment for environmental authorities, monitoring equipment, international co-operation, environmental education, training, development of laws and regulations). As expenditure data of the Republican Fund of the Kyrgyz Republic for 2016 show (see Figure 2), the lion's share of its spending went to water protection (about 21%), followed by the forestry sector (19%) and land protection and waste management (17%). All these three sectors constituted about 60% of the Fund's expenditure.

40. On the other hand, spending on environmental advocacy and education, capacity building of environmental authorities and the payment of membership fees under environmental conventions constituted about 40% of the Fund's expenditure. The Funds in Uzbekistan are also mandated to provide benefits and bonuses to their employees.

Figure 2. Types and share of environmental expenditure in the Republican Environmental Protection and Forestry Development Fund of the Kyrgyz Republic, 2016, %



Source: http://www.ecology.gov.kg/page/view/id/205.

41. One reason for this non-investment focus of the Funds may be that their revenues are too low to allow significant spending on investment projects. In addition, these small resources seem to be scattered thinly across too many local funds and small projects to satisfy several stakeholders. Another reason is that salaries of environmental administrations in EECCA are still very low even compared to other government sectors. Therefore, Funds may be under pressure of their controlling (and often managing) bodies to finance running costs including salaries of regular government staff. Funds are meant to be financing vehicles and should not be used as a substitute for paying for regular government functions as they may lose their relevance and become redundant.

Disbursement mechanisms used by the Funds

42. When actual investment projects are funded, grant financing is the main disbursement mechanism used by the Funds in the four countries. Only Moldovan legislation allows the National Ecological Fund to use other instruments such as interest rate subsidies, soft and interest free loans and guarantees for loans taken from banks. It seems, however, that even the Moldovan Funds have provided only grants so far.

43. Anecdotal evidence suggests that even when the Funds finance investment projects, these grants often resemble direct purchases on behalf of the government. It is the Funds that purchase goods and services according to public procurement procedures and transfer them to beneficiaries (state or local administration).

44. Given the Funds' low revenue levels and limited experience with financing significant investment projects, it makes sense that Funds use grants only. Direct grants as instruments for disbursing subsidies are simpler and more transparent. It is important that more sophisticated instruments such as loans or loan guarantees should only be used when Funds reach higher institutional and managerial capacity.

Programming and project appraisal

45. The absence of strategic spending programmes and transparent, rigorous project selection criteria is often the Achilles' heel of traditional Environmental Funds in the region. The Funds typically have (far too long) lists of vaguely specified tasks, which cover almost all possible environmental sectors and issues. The absence of realistic and measurable objectives makes it impossible to assign accountability for results and resource use and to evaluate Funds' performance. This allows those who control and manage the Funds to avoid responsibility for achieving more specific pre-defined environmental policy objectives.

46. It is difficult to say much on the investment project appraisal process used by the Funds as there is no information on this in the public domain. It seems, however, that the Funds use eligibility "pass/fail" criteria only, and then apply more discretionary approaches to select projects for financing. The role of the political body, such as the Minister, can often be overly important in making final decisions about project selection. Usually objective criteria, such as cost-effectiveness, do not seem to be used in the project selection process.

47. Post-implementation monitoring and evaluation seems to be very weak for projects financed by these Funds. Reporting is mostly restricted to financial reports and listing of those projects that have been financed by the Funds. Environmental benefits of projects implemented with Funds' support are often not recorded. Under these circumstances, it is difficult to properly evaluate the environmental effectiveness of the Funds and justify them as a necessary tool of environmental policy.

Specialised Clean Energy Funds

48. The three Clean Energy Funds in Armenia, Georgia and Ukraine that are discussed in this section are very different from the traditional Environmental Funds analysed above. Apart from being sector specific with targeted mandates, these Funds have different revenue sources and their disposable revenue is much higher. They also have a clear governance structure and professional staff that work on the day-to-day project cycle management. The Armenian and Ukrainian Funds have also greatly benefited from external support by development partners, both financially and in terms of capacity building and technical advice. At the same time, there exist a number of differences across the Funds.

49. Of the three, the Armenian Renewable Resources and Energy Efficiency Fund (R2E2) is the oldest and has been in operation since 2005. The Georgian Energy Development Fund was established in 2010 and promotes investments in renewable energy. The Energy Efficiency Fund of Ukraine has started operations only recently, in 2018, and lunched its very first Call for Projects in mid-2019.

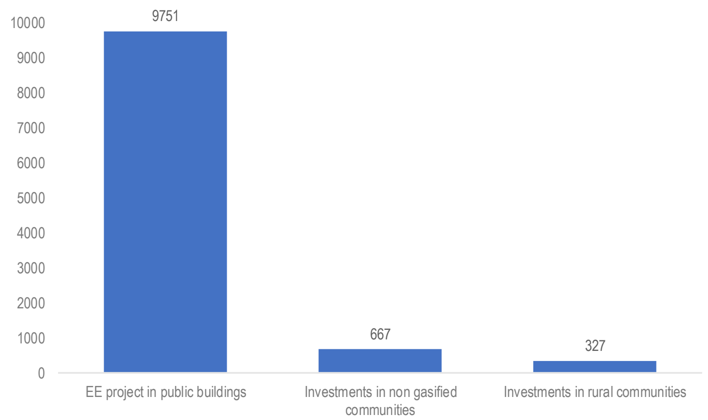
Armenia's Renewable Resources and Energy Efficiency Fund

50. Armenia's Renewable Resources and Energy Efficiency (R2E2) Fund was established in 2005 by a Government Decision. Fund's activities are regulated by relevant legislation (e.g. Law on Funds) and the Charter of the Fund. The Fund is an independent legal entity with its own governance structure, professional staff and own balance sheet. The Fund is governed by a Board of Trustees which consists of 11 members appointed for a period of two years. Board members are representatives of different government bodies and civil society organisations. The Fund's Director is responsible for the daily management of the Fund and its five departments. According to the Fund, its legal and institutional basis is very solid and does not allow political interference by the state. The Fund maintains a good level of transparency and publishes annual reports on its operations.

51. The founder, the State, provided initial equity to the Fund to the tune of AMD 22 362 874 (USD 46 000). Currently, the main revenue sources of the Fund are budget allocations, grants provided by different institutions, including DFIs, financial income, income from different services (energy audit, consulting, ESCO (energy service company) services), and project implementation fees. On average over the period 2017-19, the Fund's budget has varied between USD 400-500 thousand per year. In addition, the Fund has benefited from a number of international grants from the World Bank, Climate Investment Funds, and Germany.

52. The Fund supports renewable energy (RE) and EE projects in vulnerable rural communities, social entities, public buildings, innovation fields. Over the past five years, the lion's share of the Fund's support, about USD 10 million, has gone to energy efficiency projects in public buildings (kindergartens, schools, hospitals). The Fund's administrative costs amount to about 20% of the Fund's total expenditure.

Figure 3. Armenia R2E2 Fund total spending, 2015-19, thousand USD



Source: R2E2.

53. The Fund uses a wide variety of financial products to disburse its resources including grants, interest rate subsidies on bank loans that families with three or more children have borrowed on the financial market, soft loans to domestic commercial banks and communities, factoring. This is an interesting combination of disbursement mechanisms that requires strong in-house capacity. The Fund works closely with four domestic partner banks.

54. Apart from identifying and financing EE and RE investments, the Fund seems to be involved in many other activities. Among others, the Funds conducts studies and scientific research in the RE and EE market, designs projects which it implements, organises public tenders, provides advisory services to clients of the Fund, organises trainings. The Law allows the Fund to undertake commercial activities and provide financial and legal consulting, financial intermediation, trading of energy equipment. Managing a portfolio of so many and diverse activities is not a trivial task.

55. At the same time, the Fund seems to manage its resources prudentially. It maintains intensive cooperation with many international organisations which testifies that the Fund is considered a credible partner by the international community. The Fund also cooperates closely with a number of DFIs: the Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, KfW. In addition, the Fund has applied to the Green Climate Fund (GCF) to become Armenia's Accreditation Agency. The Fund has successfully submitted its accreditation package, which is currently under consideration by the GCF Secretariat. Once accredited, the Fund will be able to implement much bigger projects of up to USD 50 million each and enlarge its investment portfolio.

Georgian Energy Development Fund

56. Georgian Energy Development Fund (GEDF) is a joint stock company set up in 2010 by the Government of Georgia through a Government Decree and an Order of the Minister of Economy and Sustainable Development. The main objective of GEDF is to support the development of the renewable energy market in Georgia including investments in hydro, wind and solar energy.

57. As a joint-stock company, the Fund is managed by a Chief Executive Officer and a Board of Directors where all main decisions are made. It is not clear to what extent the Government participates in strategically guiding the operations of the Fund. The Fund seems to employ an experienced investment team with an extensive knowledge of the region, energy markets and sector expertise. The Fund has three substantive departments: Portfolio Management, Project Management and Development and Public Procurement Department.

58. The Fund functions as a project developer, project promoter, service provider (e.g. engineering consultancy for project scoping, obtaining necessary permits and licences) and project manager. The Fund's staff members carry out extensive research and analysis, identify project opportunities, conduct project pre-feasibility assessment and environmental impact assessment, design projects, look for investors to co-finance projects and raise funding for project implementation, organise public tenders, manage projects for which funding has been ensured.

59. The Fund often enters into partnership with investors (international financial institutions and/or private financial entities) with whom the Fund establishes Joint Ventures (Special Purpose Vehicles). The Fund also functions as a Public Equity Fund. The Fund can provide up to 30% equity on an investment project. However, the Fund always has an exit strategy and can leave the project at various stages of its development. This scheme allows the Fund to maintain its resource base and function as a revolving Fund as well.

Ukraine's Energy Efficiency (EE) Fund

60. The EE Fund has emerged from the concept of "Turning Subsidies into Investments" (S2I) developed by the Ministry of Regional Development, Construction, Housing and Communal Services with support by Germany and the European Union. The idea was to provide significant support to investments in energy efficiency in residential buildings as a way of reducing households' electricity and heat consumption bills. These bills have increased significantly over the past years and more and more households have turned to the state for support. Improved energy efficiency will lead to lower bills which will help reduce the amount of inefficient energy-related social subsidies provided by the state budget. Saved budgetary resources will instead be allocated to a Fund that will manage this revenue stream. This is how the EE Fund was designed and came into existence.

61. The work on the preparation of all legal, regulatory and procedural documents on the Fund took several years. The Fund was established through a Law on the EE Fund adopted by the Parliament. The Fund is an independent legal entity under public law and a non-profit state institution. It was founded by the State represented by the Council of Ministers of Ukraine and is governed by the Fund's Charter. The Fund's governing body is the Supervisory Board that consists of two representatives of the Cabinet of Ministers, two independent members and one representative of donors. The Board of Directors is the executive body of the Fund which is responsible for the day-to-day management of its operations.

62. The State provided an initial equity to the Fund and its Charter capital amounts to about EUR 58 million. The Fund will be capitalised by annual contributions from the State budget. During this initial phase, two international partners are providing support to the Fund: Germany (EUR 20 million) and the European Union (EUR 80 million). A Multi-Donor Trust Fund, managed by the International Finance Corporation, has been established to manage these external resources. The Fund's spending plan for 2018 envisaged investments to the tune of about EUR 52 million.

63. The main beneficiaries of the Fund's support will be Associations of Homeowners primarily in multi-storeyed buildings. The Fund will provide support for thermal modernisation, installation of highly efficient heating and/or cooling systems and equipment as well as the replacement of existing systems with more efficient ones. The Fund will provide grants only and will work closely with selected private and state-owned banks. The Fund will reimburse a certain amount of the cost of EE investments for which project owners have obtained loans from the partnering banks. The Fund and the banks will harmonise their appraisal criteria. The reimbursement of costs will be carried out on the basis of strict criteria (including among others, energy audits of the buildings, verification of actual retrofitting done) and each grant will be financed from both the Fund's domestic and donor resources.

64. Although the Fund's operations are at a very early stage, the legal and institutional set up is well-designed to ensure its operational integrity, political independence and transparency of the use of its resources. This new funding mechanism shows that Ukraine has recognised that country's energy sovereignty depends on significant energy efficiency improvements.

Concluding remarks

65. This brief review of Environmental Funds in the EECCA region illustrates the evolution of these public finance institutions as an instrument of environmental policy-making and implementation. It also demonstrates the diversity of institutional arrangements that governments have chosen for managing their public environmental expenditure. The review shows that there is no “one-size-fits-all” solution. Depending on the economic context, the maturity of finance markets and capacities in the countries, each government selects the institutional set-up and financial instruments that suits it best.

66. The consolidation of traditional Environmental Funds into state budgets has been an on-going process. In the countries where such Funds still exist, environmental authorities may find it more and more difficult to justify the need to maintain them. Reforming such Funds in line with good international practices may be one direction to go.

67. Against this backdrop of declining traditional Funds, new funds are being established. These new Clean Energy Funds are usually much better capitalised, better focused, better governed, use more sophisticated financial products and can support bigger investments. Support by the international development partners, both financial and through technical assistance, may have played a role in this better performance.

68. Institutionally, these new Funds are very different from the traditional ones. They represent a new model which seems to be also better adapted to the needs of the market and more in line with maturing financial markets in some of the countries in the region. Using scarce public resources to create demand and leverage significant private funds for green investments remains the best way to demonstrate the need for public support in meeting national environmental and climate-related goals and priorities.

69. If countries envisage the establishment of new environmentally related Funds, as signalled by Armenia, Georgia or Ukraine, with a possible participation of new external partners and financiers, such as China or the Russian Federation, such Funds need to also undergo public scrutiny and meet the high standards of public finance such as transparency, accountability, and cost-effectiveness. In cases like these, the OECD Good Practices for PEEM may become a useful guiding document and a reference point for establishing sound and healthy public environmental finance institutions.